

Accounting for Provisions and Contingent Liabilities

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Public Sector Accounting and Reporting Program

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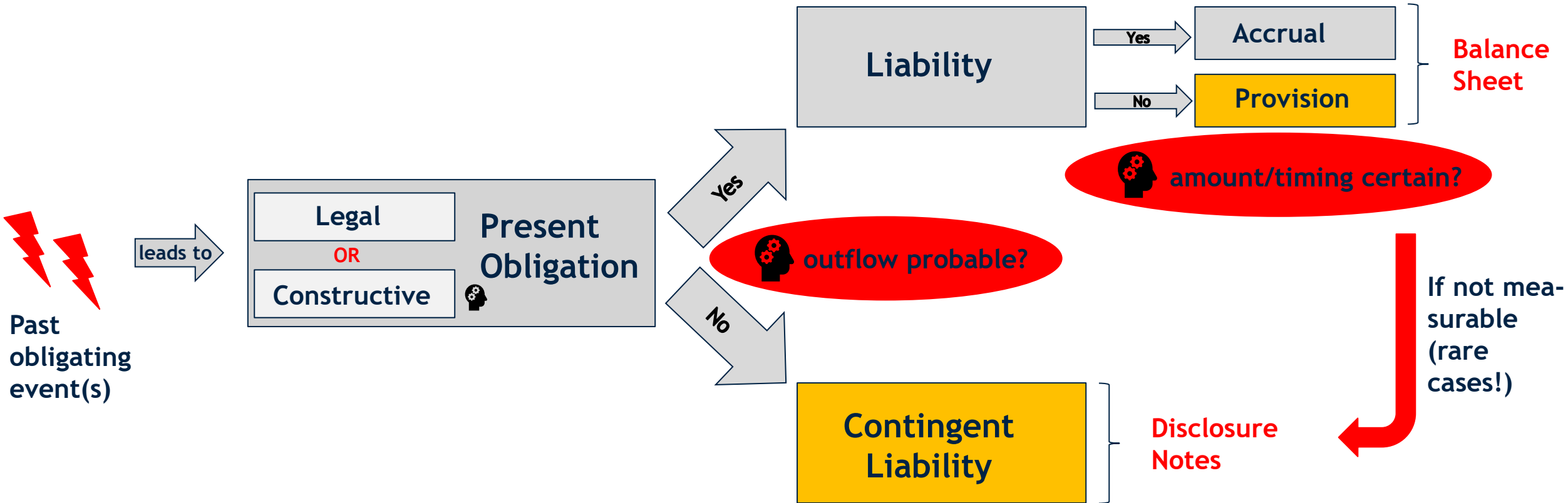
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The scope and flow of IPSAS 19



 = scope of IPSAS 19

 = judgment needed



Judgment: Probability of outflow of resources – Consequential

Action



Present / possible obligation?	Outflow probable?	What to do
Yes	Yes	Recognize liability
Yes	No	Disclose contingent liability
Yes	Remote	-



Judgment: Probability of Outflow of Resources – Different Forms

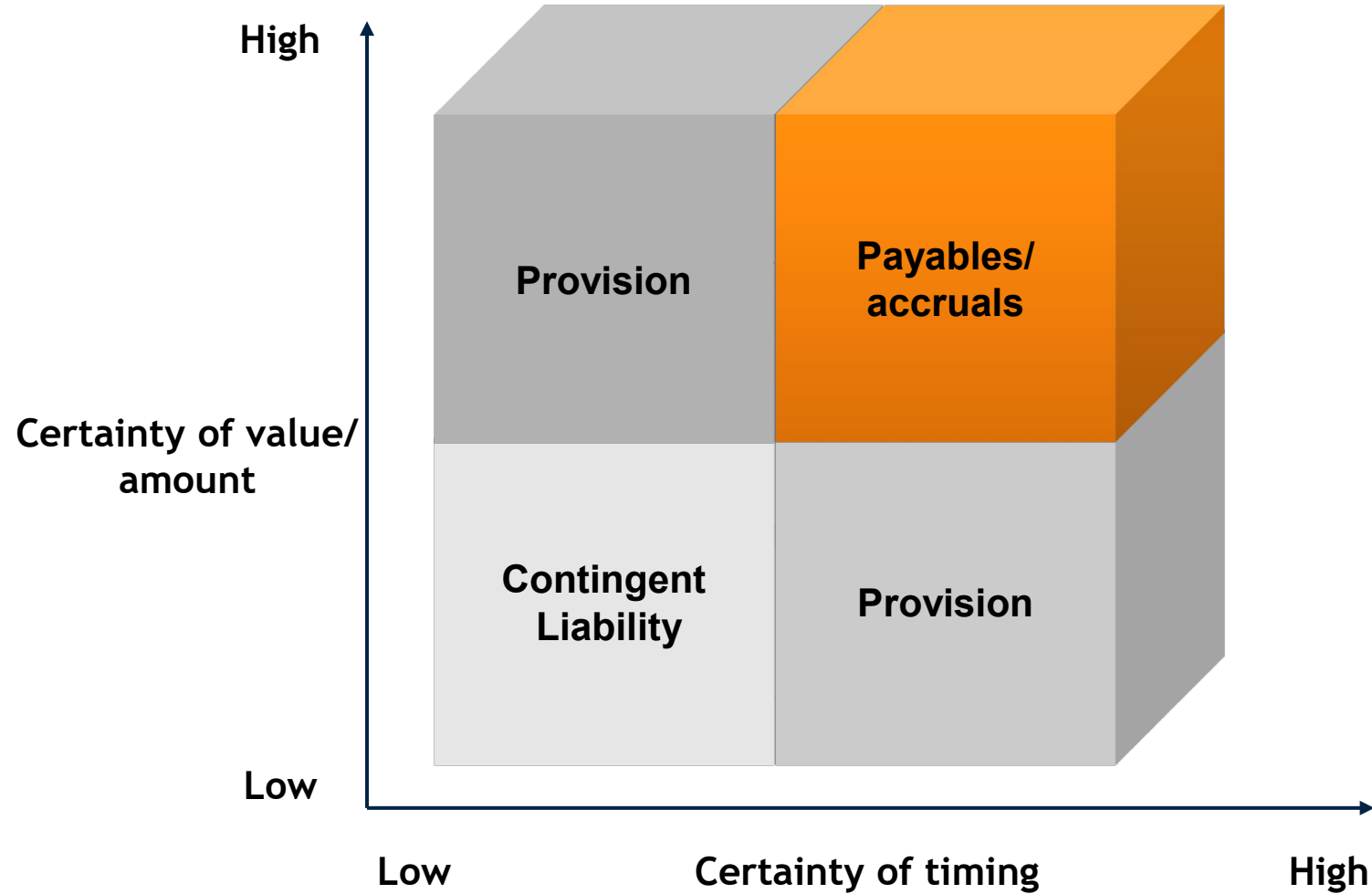


Outflow
/Inflow is
(highly)
probable



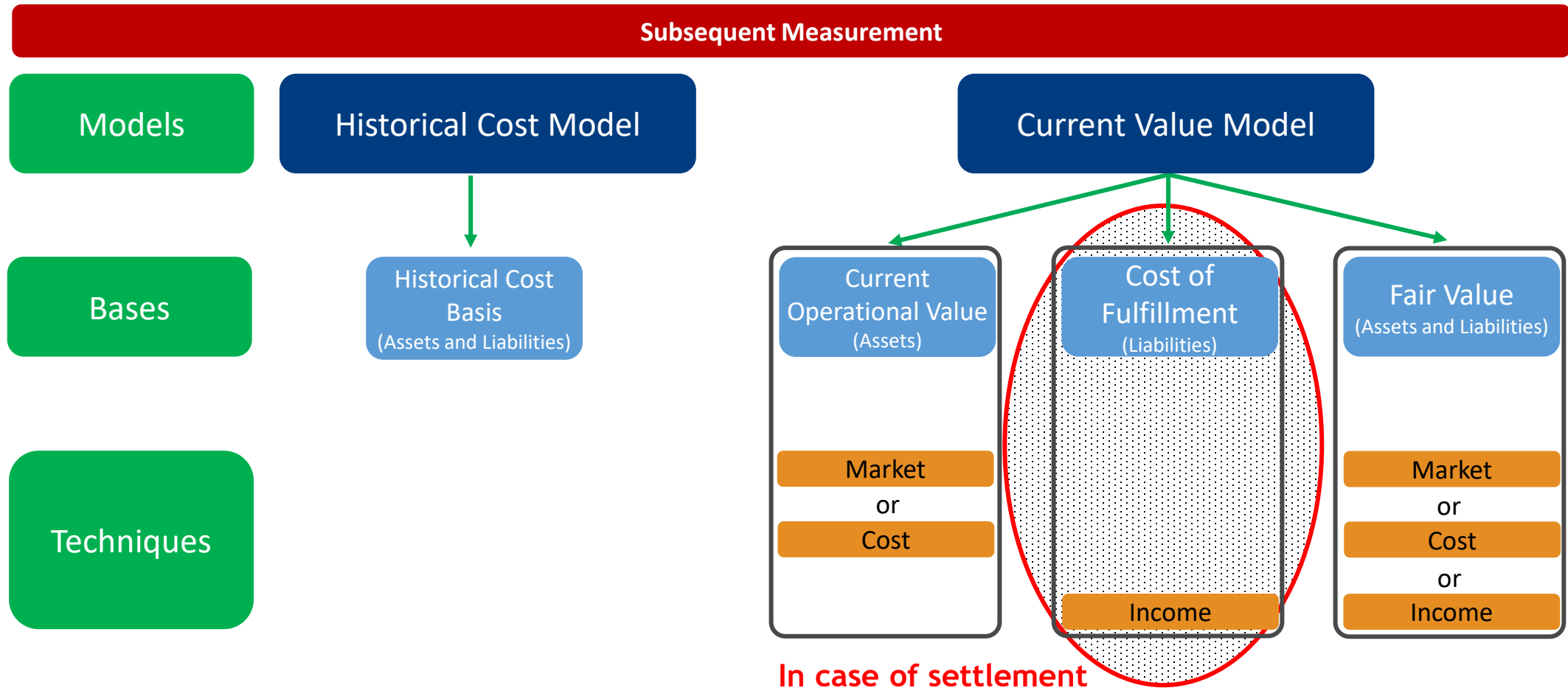
Likelihood of outcome (guidelines)	Contingent Liability/ Provision	
Virtually certain (> 95%)	Accrual recognised	
More likely than not (> 50%)	Provision recognised	
Possible, not probable (5 – 50%)	Contingent Liability disclosed	
Remote (< 5%)	No disclosure	
Contingent liabilities		Contingent assets
<ul style="list-style-type: none"> ▶ Do not recognize in balance sheet ▶ Disclose <u>unless</u> outflow is <u>remote</u> ▶ Needs to be continually assessed 		<ul style="list-style-type: none"> ▶ Do not recognize in balance sheet ▶ Disclose <u>only when</u> inflow is <u>probable</u> ▶ Needs to be continually assessed

Judgment: Certainty of amount and timing



Measurement of Provisions – Measurement Framework

- The subsequent measurement framework of IPSAS 46 *Measurement*:



Measurement of Provisions – Guidance of IPSAS 19



Best Estimate

- Amount recognized shall be the **best estimate of the expenditure required** to settle the present obligation or to transfer it to a third party at the reporting date.
- Different methods, use depends on information available

Present Value

Where the effect of the time value of money is material, the amount of a provision shall be the **present value of the expenditures expected** to be required.

Risks and Uncertainties

- Risks and uncertainties shall be taken into account. Risk describes the variability of outcome.
- Caution is needed in making judgments under uncertainty. A risk adjustment may increase the amount of a liability.
- But: **uncertainty does not justify excessive provisions** or a deliberate overstatement of liabilities.


Thank you!



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Appendix: Definitions and Background Information



Definitions and Background Information – Forms of Obligations

Obligating Event

An event that creates a legal or constructive obligation that results in an entity having **no realistic alternative to settling** that obligation.

Legal Obligation

An obligation that derives from:

- A contract (through its explicit or implicit terms);
- Legislation; or
- Other operation of law

Constructive Obligation

An obligation that derives from the entity's action where:

- (a) by an **established pattern of past practice**, published policies or sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; **and**
- (b) as a result, the entity has created a **valid expectation** on the part of those other parties that it will discharge those responsibilities.

Definitions and Background Information – Contingent Liability



Contingent Liability

- A **possible** obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more **uncertain** future events not wholly within the control of the entity; **or**
- A **present** obligation that arises from past events, but is not recognized because:
 - it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; **or**
 - the amount of the obligation cannot be measured with sufficient reliability

Definitions and Background Information – Measurement Bases



Cost of fulfillment

The costs that the entity will **incur in fulfilling the obligations** represented by the liability, assuming that it does so in the least costly manner.

- ▶ Exit, **entity-specific** cost
- ▶ It cannot be observed directly
- ▶ It is determined using cash-flow based measurement techniques

Fair value

The price that would be received to sell an asset or **paid to transfer a liability** in an orderly transaction between market participants at the measurement date.

- ▶ Exit, **market-based** measurement
- ▶ It reflects changes in the values of assets and liabilities since the previous measurement date
- ▶ It reflects the perspective of market participants

Definitions and Background Information – Measurement Techniques



Market approach

Uses **prices** and other relevant information **generated by market transactions** involving identical or comparable (i.e., similar) assets, liabilities or a group of assets and liabilities.

Cost approach

Reflects the **amount** that would be **required** currently to **replace the service provided** by an asset (often referred to as current replacement cost) through the acquisition, construction, or development of a substitute asset of comparable utility, adjusted for obsolescence.

Income approach

Converts future amounts (e.g., cash flows or revenue and expenses) to a single current (i.e. discounted) amount.