PROVISIONS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES

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LIABILITIES

- There is no specific standard, definition is given by the Conceptual Framework and by IAS 1 – Presentation of Financial Statement, IAS 37 – Provisions, Contingent Assets and Contingent Liabilities

  = is a present obligation of an entity to transfer economic benefits as a result of past transactions or events.

LIABILITY

- Liability is established as soon as is asset delivered or the irrevocable contract is signed.
- Liability can be established because of building good relationship.
- Termination of liability is connected with outflow of economic benefits.
- Liability can be terminated in case the customer will give up his / her rights.

Classification of Liabilities

1) Time aspect

2) Probability of economic outflow

3) Way of their establishment

Liabilities – time aspect

- Following criteria:

a) Operating cycle
b) Accounting and reporting period
c) Liquidity

a) and b) are defined in IAS 1:

Liability is classified as short-term:

a) It will be repaid during operating cycle
b) It will be repaid during 12 months

a) – liabilities with direct connection to operating cycle

b) – liabilities with indirect connection to operating cycle

US GAAP – criteria liquidity:

- Short-term liability = will be repaid from revenues
- Long-term liability = rest of liabilites

Probability of economic outflows

a) Non-contingent liabilities

b) Contingent Liabilities

a) **CURRENT Liability** is a present obligation of an entity to transfer economic benefits as a result of past transactions or events.

Contingent Liability

Contingent Liabilities:

= is a possible obligation that arises from past events whose outcome is based on uncertain future events or, an obligation that is not probable, or cannot be measured reliably.

- **IAS 10**: Events after balance sheet date
- **IAS 37**: Provisions, contingent assets and contingent liabilities

a) Provisions

b) Contingent Liabilities

PROVISIONS = current liability of uncertain timing or amount.

Differences between provisions and contingent liabilities

- Differences in disclosures requirements:

- **Provisions** are recognised in balance sheet
- **Contingent liabilities** are recognised in notes (why???)

Contingent Liability

= contingent liability should not be recognised in the financial statements, however disclosure should be made unless the possibility of the transfer of economic benefits is remote.

Provisions – IAS 37

- **Provisions:**
- onerous contract,
- Restructuring,
- Harm on environment,
- Tax payment,
- Bonus payment,
- Sale premium,

- Guarantees for product sold,
- Compensation for absence employees,
- Other purposes, if they fulfill the requirements of IAS 37

Provisions of IAS 37 cannot be done:

- Future operating loss,
- Repairment of long-term assets.

Restructuring

- Sale or termination of business activities,
- Business operation closing or their moving,
- Changes in statutorary board,
- Significant restructuring that will significantly change business activities

Provisions´ recording

- Creation of prosion is recorded as an expense, rarely it is activated
- Provisions for restructuring are offset against expenses for restructuring, the rest of them are recorded as operating costs
- Provisions – usually are recorded as operating costs
- Decreasing of provisions is recorded as expenses correction

Liabilities - Probability of economic outflow

a) Non-constructive liability
b) Constructive liability

Non-constructive liability = is an obligation that arises by:

- Contractual right,
- Legal requirements,
- Other requirements;

Constructive liability = **=** is an obligation that results from an entity´s actions where by an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities.

Valuation of Liabilities

In conformity with valuation of entity´s asset:

a) Nominal value,
b) Present Value of future payments,
c) Estimation base.

Nominal value

- Short-term lliability
- Nominal value that was received in exchange for establishing of liability
- In case that for the liability does not exist asset in exchange, then it is valued in the amount of payments for repaying the liability.

Present value

- Long-term liability
- Discounted value of net future expenses that are necessary for its repaying.
- Discounted factor = market interest rate in time of establishing liability

  - Discounted factor
  - Premium factor

Estimation base.

- Very common for provisions
- It is necessary to calculate with al possible risks and uncertainty (legislation changes)
- IAS 37 – not to create provisions excessively.

Provision valuation

- In case of many possible situations – EXPECTED VALUE
- Probability of a given situations

Disclosures Requirements

Disclosures:

a) Certain liability – balance sheet,

b) Provisions – balance sheet,

c) Contingent liability – notes,

d) Remote – no disclosuresJiné závazky, které nelze uznat – se nezveřejňují vůbec.

Disclosures

- Deferred income – liability recognised in balance sheet.
- Payments in advance – short-term and long-term liability.
- According to IAS/IFRS – liabilities must distinguish their short-term and long-term part)

Contingent Assets

- A contingent liability is a possible asset that arises from past events and whose existence will only be confirmed by uncertain future events not wholly within the control of the enterprise.
- They are not recorded in balance sheet but in notes

Liabilities – IFRS for SMEs

- Section: 2, 21 and 22
- Section 2: present obligation to act by a certain way

a) Non-contingent liability

b) Contingent liability

IFRS for SMEs

Provisions, contingent liabilities, contingent assets:

A) Provisions – valuation according to best estimation with discounted factor in case it is significant – present value
B) Contingent asset and liability – recognised only if their probability is not remote

Appendix to Section 21

- Way how to recognise and value provisions
- It gives 9 specific case studies:

a) Future operating loss
b) Onerous contracts
c) Restructuring
d) Guarantee
e) …..

Thank you for your attention