



VIRTUAL IFRS SEMINAR

DATE : 8th DECEMBER 2021 – 9th DECEMBER 2021

Session III : IAS 37 Provisions, Contingent Liabilities and Assets

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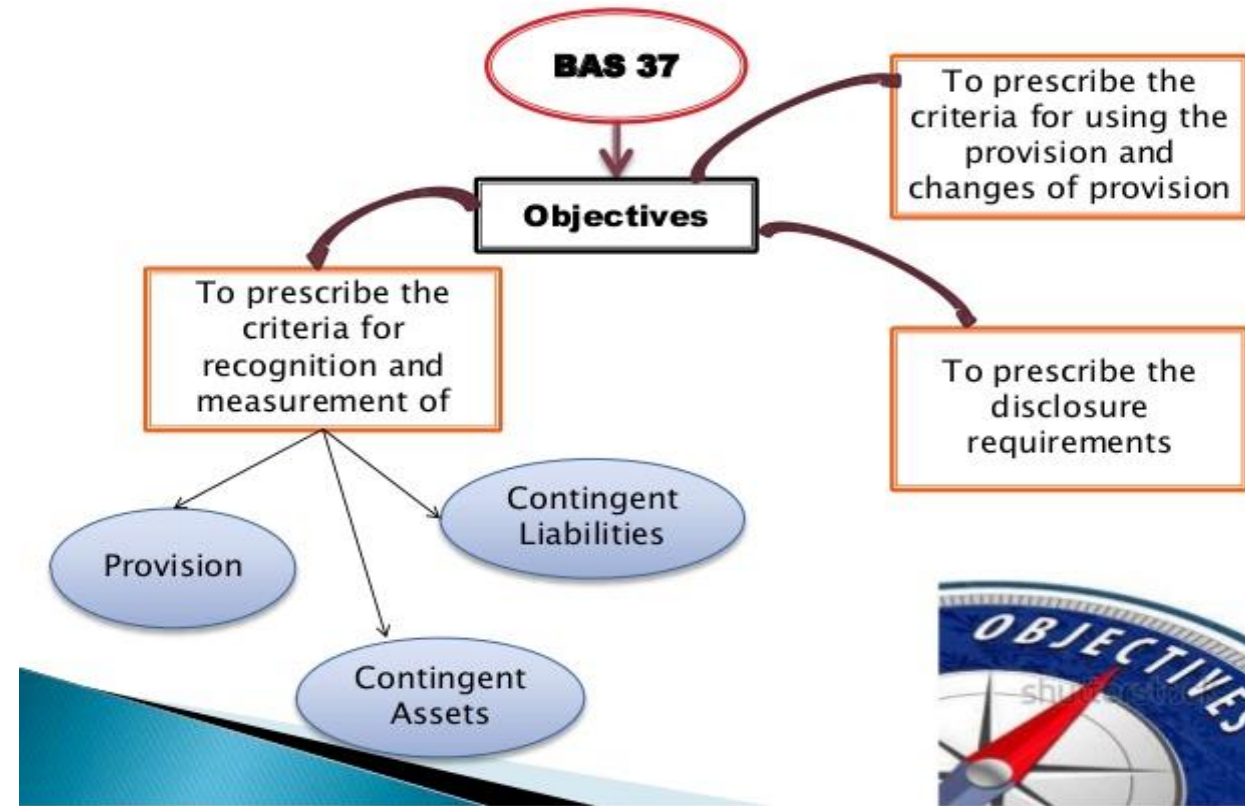
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1. Introduction



IAS 37 Prescribes clear-cut rules and guidance in respect of the recognition and measurement of provisions, contingent liabilities, and contingent assets. It also makes certain disclosures mandatory for companies.

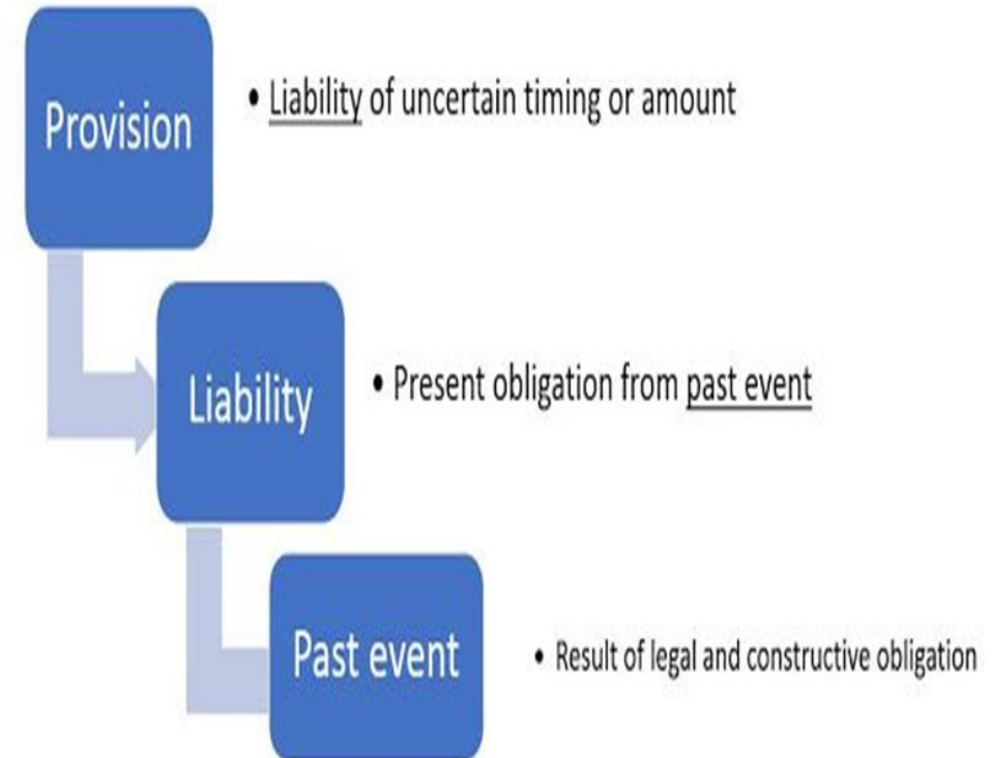
One objective of IAS 37 is to make it difficult for an entity to manipulate the financial reports with the help of provisions i.e. high provisions when performance is good, but low provisions or reversal of provisions when performance is poor.

2. Provisions



Definition

A provision is a liability of uncertain timing or amount. Remember a liability is a present obligation of the entity to transfer an economic resource as a result of past events. An obligation is a duty or responsibility that the entity has no practical ability to avoid (The Framework)



2. Provisions



Definition Provisions can be distinguished from other liabilities such as trade payables and accruals because, for provisions there is uncertainty about the *timing* or *amount* of the future expenditure required in settlement. By contrast, trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier.

Previous definition of a liability

A Present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of the resources embodying economic benefits



Revised definition of a liability

A Present obligation of the entity to transfer an economic resource as a result of past events. An obligation is a duty or responsibility that the entity has no practical ability to avoid

2. Provisions



Definition

Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid for, invoiced or formally agreed with the supplier. Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions. Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.

2. Provisions



Accounts Payable

Provisions

Accruals

Contingent Liability

Certainty Continuum

Recognize Liability

Recognize Liability

Recognize Liability

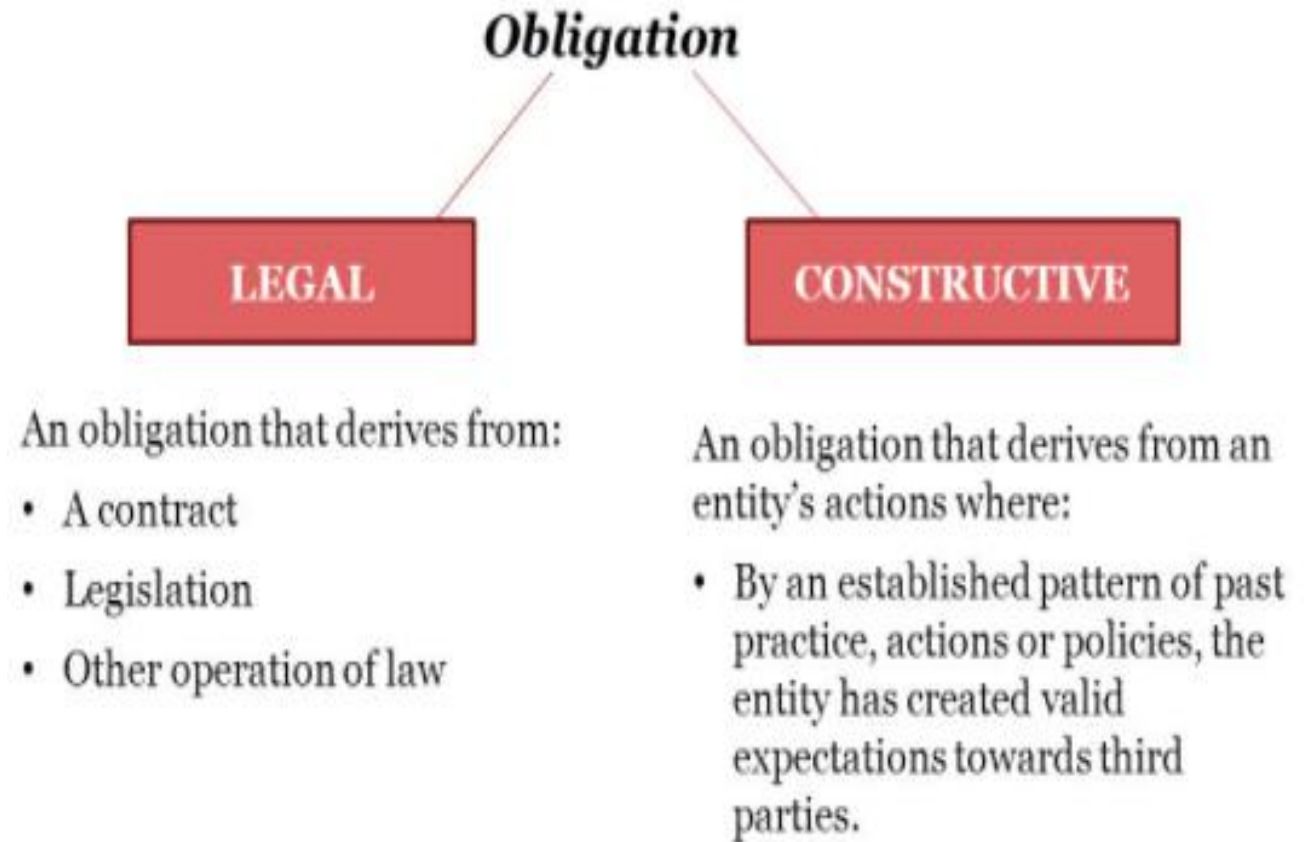
Disclose

2.1. Provisions - Recognition



A provision shall only be recognized when:

(a) An entity has a **present obligation** (legal or constructive) as a result of a past event; for example, there is a court case (legal) or the firm has made promises that can be enforced (constructive).



2.1. Provisions - Recognition



A provision shall only be recognized when:

(b) It is probable that an **outflow of resources** embodying economic benefits will be required to settle the obligation i.e. more than 50% chance that a payment would be made (based on expert advice or past experience).

Outcome	Probability
Virtually certain	At least 90%
Probable (more likely than not)	51-89% probable
Possible but not probable	5-50%
Remote	Less than 5%

2.1. Provisions - Recognition



(c) A **reliable estimate** can be made of the amount of the obligation. Provisions are measured at the best estimate of the expenditure required to settle the present obligation at reporting date. Where the provision being measured involves a large population of items (i.e. goods' warranties), the obligation is estimated by weighting all possible outcomes by their associated probabilities.

2.1. Provisions - Recognition



(c) A **reliable estimate** can be made of the amount of the obligation.

Provision relating to	Methodology
Large number of items	Expected value method—assess all outcomes and assign probabilities to each outcome.
Large number of items with a continuous range of possible outcomes, each as likely as the other	Use the midpoint of the range.
Single item	Use the most likely outcome but take into account the probability of possible outcomes to refine if the information is available. ⁹

2.1. Provisions – Recognition: Examples



1. Future operating losses

Provisions shall not be recognized for future operating losses/deficits. Future operating losses/deficits do not meet the definition of a liability and the general recognition criteria set out for provisions. There is no past event and even though there maybe some probability of making losses given company/entity and market conditions, it may not be possible to come up with a reasonable estimate of the amount.

2.1. Provisions – Recognition: Examples



2. *Onerous contract*

Is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. If an entity has a contract that is onerous, the present obligation under the contract shall be recognized and measured as a provision.

For onerous contract, the provision is recognized and measured at the lower of:

- The cost of fulfilling the contract
- The costs/penalties incurred in cancelling the contract.

2.1. Provisions – Recognition: Examples



NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

46. Provisions and other payables

	Group		Company	
	2020	2019	2020	2019
	Shs'000	Shs'000	Shs'000	Shs'000
Accrued expenses	1,041,387	914,040	156,532	52,495
Premiums paid in advance	213,506	254,041	-	-
Accrued dividends payable	24,078	26,774	23,528	26,224
Trade payables	385,411	103,700	-	-
Government taxes & statutory deductions	562,356	399,030	41,912	23,037
Other liabilities	1,544,824	1,188,590	-	12,603
Provision for investment losses	5,206,685	-	5,206,685	-
Total provisions and other payables	8,978,247	2,886,175	5,428,657	114,359

There are no individually significant items under other liabilities category. Other payables are classified as current liabilities.

The Holding Company has made a provision of Shs 5.2 billion, which is the estimated present obligation of the financial support to resolve an asset-liability mismatch in the Wealth Management Fund LLP, occasioned from the Fund's operations. Wealth Management Fund LLP is a Fund managed by Britam Asset Managers which is a fully owned subsidiary of Britam Holdings PLC.

The Holdings Company is committed to support the Fund to fulfil its obligations as they fall due through management oversight of the Fund's operations and the agreed recovery plan.

2.1. Provisions – Recognition: Examples



3. Restructuring costs

A restructuring is a programme that is planned and controlled by management, and materially changes either the scope of an entity undertaken by an entity or the manner in which operations are conducted.

Examples of events that may fall under the definition of restructuring:

(a) Sale or termination of a line of the organization,

2.1. Provisions – Recognition: Examples



3. Restructuring costs

(b) The closure of locations in a country or region or the relocation of activities from one country or region to another.

(c) Changes in management structure, for example, eliminating a layer of management and

(d) Fundamental reorganizations that have a material effect on the nature and focus of the entity's operations and may lead to redundancy costs.

2.1. Provisions – Recognition: Examples



3. Restructuring costs

A provision for restructuring should only be made when an entity has a detailed formal plan for the restructuring and the entity has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Restructuring Cost



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2.1. Provisions – Recognition: Examples



4. Warranties

A dealer gives warranties at the time of sale to purchasers of its product where the terms of the contract require the dealer to make good, by repair or replacement defects that become apparent within a given period from the date of sale. A provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period.

2.1. Provisions – Recognition: Examples



4. Warranties: Update from IFRS 15 revenue from contract with customers

With the introduction of IFRS 15, the treatment of sales warranties starts in IFRS 15, to end in certain circumstance in IAS 37.

Retails goods are frequently sold with a warranty (or guarantee) that they will operate satisfactorily for a specified period of time. The accounting treatment depends on:

2.1. Provisions – Recognition: Examples

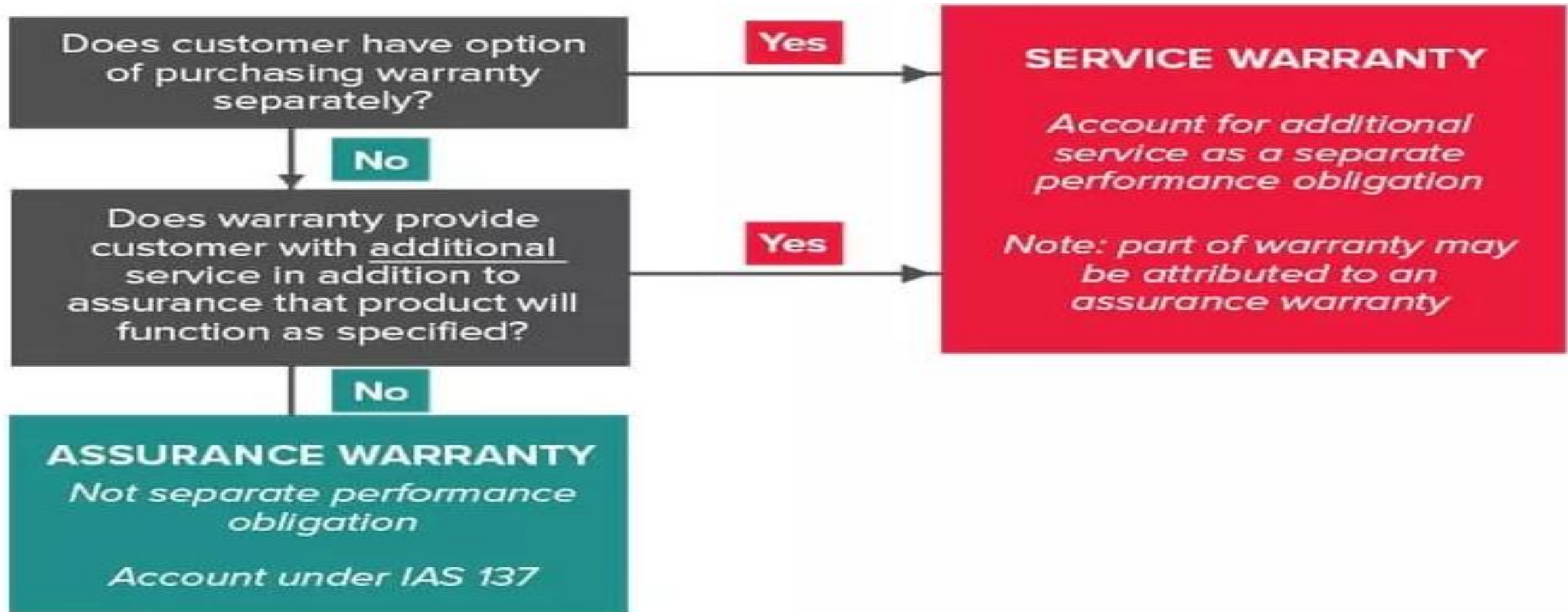


4. Warranties:

Update from IFRS 15 revenue from contract with customers

1. Whether customers have an option to purchase the warranty separately, and
2. Whether the warranty is part of the overall package of goods sold to the customer (Assurance type warranty)

2.1. Provisions – Recognition: Examples



2.1. Provisions – Recognition: Examples



Example – Providing a free extended warranty as per IFRS 15

XYZ has a special promotion for refrigerators, selling at \$1,000 per unit. Customers get a free 2-year extended warranty, in addition to the 6-month standard warranty. Without the promotion, the 2-year extended warranty is usually sold to customers for \$200. How should the free warranty offer be reported by XYZ?

Contract components	Standalone selling price	Revenue
Washing machine	\$1,000	\$833 ($\$1,000 \times (\$1,000 / \$1,200)$)
Extended warranty	\$200	\$167 ($\$1,000 \times (\$200 / \$1,200)$)
	\$1,200	\$1,000

XYZ will report revenue \$833 upon sale. \$167 is deferred until the warranty obligation is satisfied.

Before IFRS 15 XYZ would have reported \$1,000 as revenue, and a provision under IAS 37.

2.1. Provisions – Recognition: Examples



Example – Measuring warranty expense under IAS 37

Meta sold goods for CU1,000,000 in 2020. Experience shows that 90% of goods do not require warranty repairs; 6% require minor repairs costing 30% of the sale price; and 4% of products sold require major repairs costing 70% of sale price. The expenditures for warranty repairs and replacements for products sold in 2020 are expected to be made 60% in 2021, 30% in 2022, and 10% in 2023, at the end of the period. Compute the 2020 Warranty...assuming the discount rates for 6% for 1 year and 7% for years 2 and 3.

Year	Warranty probability %		Warranty costs CU	=	Warranty cash outflow expectation CU	Discount rate %	Present value calculation	Present value CU
1	60	X	46.000	=	27.600	6	=27.600/((1+0,06)^1)	26.038
2	30	X	46.000	=	13.800	7	=13.800/((1+0,07)^2)	12.053
3	10	X	46.000	=	4.600	7	=4.600/((1+0,07)^3)	3.755
								41.846

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2.1. Provisions – Recognition: Examples



5. Contaminated Land

An entity in the oil industry causes contamination and operates in a country where there is either environmental legislation or has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. A provision is recognized for the best estimate of the costs of clean-up.



2.1. Provisions – Recognition: Examples



6. Refunds Policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known. A provision is recognized for the best estimate of the costs of refunds.



2.1. Provisions – Recognition: Examples



7. A court Case

A firm is being sued by a former employee for wrongful termination. The former employee is seeking damages from the entity but the entity disputes liability. Up to the date of authorization of the financial statements for issue, the entity's lawyers advise that it is probable (more than 50% chance) that the entity will not be found liable. No provision is recognized. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote in which it need not be disclosed.



3. Contingent Liabilities



A contingent liability is:

(i) 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,

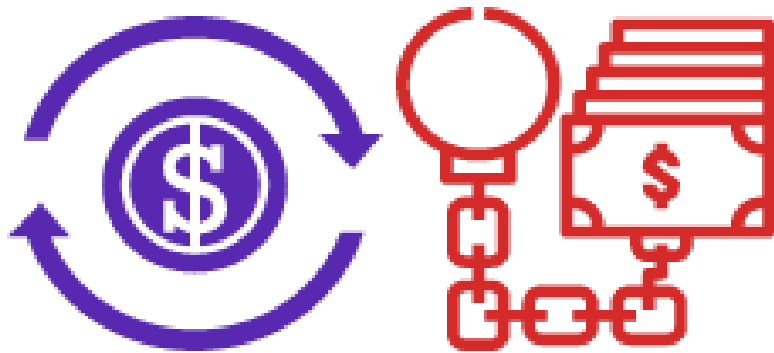
(ii) A present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient

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3. Contingent Liabilities



What Are Contingent Liabilities



In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, under IAS 37 term 'contingent' is used for liabilities and assets that are not recognized because their 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.

3. Contingent Liabilities



In addition, the term 'contingent liability' is used for liabilities that do not meet the recognition criteria. Remember Provisions are due to past events, while contingent liabilities are waiting for future events.

Therefore, an entity shall not recognize a contingent liability. A contingent liability is disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

3. Contingent Liabilities



32 Contingent liabilities

The Group has contingent liabilities in respect of legal claims arising in the ordinary course of business. At 31 March 2021, a guarantee of KShs 25 million (2020: KShs 25 million) had been given to Citibank NA against credit cards for the use by senior staff during travel and a guarantee of KShs 398.8 million (2020: KShs 244.4 million) to various suppliers of goods and services regularly provided by the Company.

The Company has outstanding matters with Kenya Revenue Authority (KRA) and various ongoing legal cases from trade and contractual disputes arising from normal course of business.

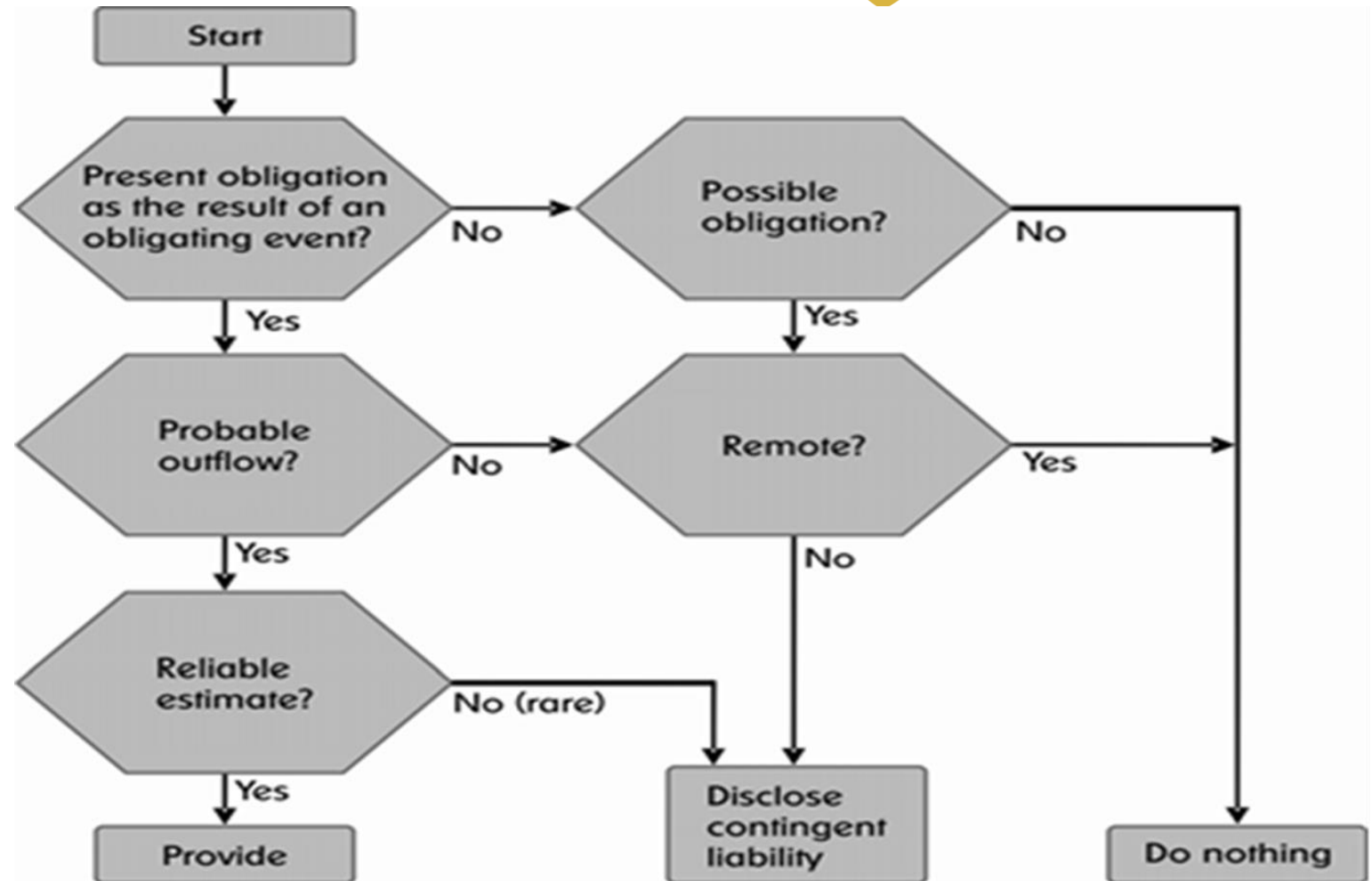
The Directors have assessed the status of the contingent liabilities and as a result do not anticipate any additional material liabilities that may have a significant impact on these financial statements.

Legal contingencies

The Group is currently involved in various legal disputes and has, in consultation with its legal advisors, assessed the possible outcomes in these cases and has determined that adequate provision has been made in respect of all these cases as at 31 March 2021.

Due to the nature and uncertainty of the outcomes of the various litigation cases management exercises judgement to determine the quantum and adequacy of the provision carried. Settlement only happens when a case is closed either through court rulings or out of court between parties involved. The impact of discounting on the provision is not considered to be material.

3. Contingent Liabilities



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3. Contingent Assets

A contingent asset is a possible asset 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.

An entity shall not recognize a contingent asset. Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity.

Contingent Asset

- **Virtually certain** – recognise as **asset** on SFP
- **Probable** – disclose a **note** in the FS

3. Contingent Assets



4. Disclosures



1. For each class of provision, the carrying amount at the beginning and end of the period; additional provisions made in the period, including increases to existing provisions; amounts used (ie incurred and charged against the provision); unused amounts reversed during the period; and the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

4. Disclosures



(b) Provisions for liabilities

	GROUP	
	2021 KShs'm	2020 KShs'm
At 1 April	4,462.3	3,893.6
Charge for the year	363.4	1,428.9
Addition ARO provision	2,207.4	–
Payments and release for the year	(1,320.2)	(860.2)
At 31 March	5,712.9	4,462.3
Current portion	2,561.5	4,462.3
Non-current portion	3,151.4	–
	5,712.9	4,462.3

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4. Disclosures



29 PROVISION FOR LIABILITIES (a) Group

Year ended 31 December 2020	Return condition provision Kshs Millions	Redundancy provision Kshs Millions	Asset retirement obligation Kshs Millions	Other provisions Kshs Millions	Total provisions Kshs Millions
At start of year	7,591	447	14	1,127	9,179
Charged to profit or loss	955	129	-	69	1,153
Utilised in the year	(3,671)	(133)	-	(11)	(3,815)
Unwinding of discount	100	-	-	-	100
Effect of currency translation	406	-	-	-	406
At end of year	5,381	443	14	1,185	7,023
Split as follows:					
Current	2,573	443	-	1,185	4,201
Non-current	2,808	-	14	-	2,822
At 31 December 2020	5,381	443	14	1,185	7,023

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4. Disclosures



(iii) Return condition provisions

Return condition provision relates to a provision for an unavoidable contractual obligation to return the aircraft in certain conditions at the date of return. In order to fulfil these return conditions, major overhauls are required to be conducted on a regular basis. Accordingly, estimated costs of major overhauls for aircraft and engines under leases are accrued and charged to the profit or loss over the estimated period between overhauls using the ratios of actual flying hours/cycles and estimated flying hours/cycles between overhauls. Differences between the estimated costs and the actual costs of overhauls are included in the profit or loss in the period of overhaul. The return condition provision is calculated using a model which incorporates several assumption which include the past and expected future utilisation and maintenance patterns of the aircraft and engines, expected cost of maintenance at the time it is estimated to occur and discount rate applied to calculate the present value of the future liability.

4. Disclosures



(iv) Redundancy provisions

The Group implemented a staff restructuring program in the year 2012 aimed at improving operational efficiency. The program affected 599 employees and as at 31 December 2020 a provision of KShs 443 million (2019: KShs 447 million) is held to cover the redundancy payments arising from the accompanying litigation. The unionisable staff had moved to the Industrial Court to block the restructuring and the Court ruled in their favour, ordering the reinstatement of affected employees. The Group appealed against the decision and on 11 July 2014, the Court of Appeal ruled that the Group was justified in declaring the redundancy but had failed to meet the statutory threshold procedural fairness. The employees challenged the decision further at the Supreme Court.

(i) Asset retirement obligations

Under the terms of certain property lease arrangements, the Group and Company has a contractual obligation to restore the property in a certain condition at the end of the lease term.

(ii) Other provisions

Other provisions relate to various legal cases brought against the Group and Company which are pending determination by the courts. Provisions are recognised when the Group has determined that it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Management has made appropriate provisions in respect of certain cases.



4. Disclosures



2. An entity shall disclose the following for each class of provision:

- a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
- an indication of the uncertainties about the amount or timing of those outflows.

Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.

4. Disclosures



3. Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the reporting

(a) period a brief description of the nature of the contingent liability and, where practicable: an estimate of its financial effect, measured under;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement.

4. Disclosures



36. CONTINGENT LIABILITIES

There are certain pending legal claims brought against the Group and Company at 30 September 2019 and 2018. In particular, litigations relating to Collective Bargaining Agreement for one of the subsidiaries for the years 2014 and 2015 is pending determination at the Court of Appeal. In the opinion of the directors and after taking appropriate legal advice the outcome of the legal claims will not give rise to any significant loss beyond the amounts provided for in these financial statements.



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4. Disclosures



In extremely rare cases, disclosure of some or all of the information required can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

END



The quality of your
life is in direct
proportion to the
amount of uncertainty
you can comfortably
deal with.
- Tony Robbins

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