

IFRS Accounting Standards discussion fora: Provisions, contingent liabilities and contingent assets

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Applicable version of IFRS Accounting Standards

Unless specified otherwise, the accounting requirements that are the subject matter of this discussion forum are IFRS Accounting Standards as issued by the International Accounting Standards Board that are applicable for annual period beginning on or after 1 January 2023 without early applying new and amended IFRS Accounting Standards that have a later mandatory application date.

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Aims

- » Develop a more cohesive understanding in Ethiopia of IFRS accounting and reporting for Provisions, contingent liabilities and contingent assets.
- » Enhance capacity in Ethiopia to apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* more consistently.

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Index of issues

» Provisions and contingent liabilities

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- » Issue 1: how to classify, measure and disclose an asset (or possible asset) arising from our company being the claimant in a lawsuit?

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Provisions and contingent liabilities

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Issue 1: how to classify, measure and disclose a liability for product warranty

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Classifying, measuring and disclosing a product warranty liability

What do you think?

The accounting for product warranties is specified in two IFRS Accounting Standards:

- (i) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- (ii) IFRS 15 *Revenue from Contracts with Customers*.

How to determine whether IAS 37 or IFRS 15 applies to a particular product warranty?

How to measure a product warranty liability?

Which disclosures apply to product warranties?

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Classifying a product warranty liability

Summary of discussion

How to determine whether IAS 37 or IFRS 15 applies to a particular product warranty?

Discussants' consensus view =

- » IFRS 15 *Revenue from Contracts with Customers* applies when a customer has the option to purchase the warranty separately because the warranty is a distinct service in addition to the product functionality described in the contract. (IFRS 15.B29)
- » IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* typically applies when a customer does not have the option to purchase a warranty separately.
 - » However, IFRS 15 would apply to such a compulsory warranty (or the part of the promised warranty) that provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. (IFRS 15.B30)

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Measuring a product warranty liability

Summary of discussion

How to measure a product warranty liability? Discussants' consensus view =

- » Service-type warranties are performance obligations in the scope of IFRS 15, measured on the basis of an allocation of the contract price in accordance with IFRS 15 (IFRS 15.B29).
 - » If the entity's promises include both an assurance-type warranty and a service-type warranty and management cannot reasonably account for them separately, the entity accounts for both warranties together as a single performance obligation (IFRS 15.B32).
- » Assurance-type warranties are provisions in the scope of IAS 37, measured at the best estimate of the amount the entity would rationally pay to settle the liability or transfer it to another party, at the reporting date (IAS 37.36 and .37).
 - » If the product warranties relate to a large population of items (as typically is the case), best estimate is measured using a present valued risk-adjusted expected value model (IAS 37.39).
 - » If the product warrant is a single obligation (for example, if entity has constructed only one large hydro-power station), best estimate is measured at the present value of the risk-adjusted single most likely outcome, adjusted for considering other possible outcomes (IAS 37.40).

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Disclosing a product warranty liability

Summary of discussion

Which disclosures apply to product warranties? Discussants' consensus view =

- » Disclosures about warranties in the scope of IFRS 15 must include sufficient qualitative and entity-specific quantitative information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers; and significant judgements, and changes in the judgements, made in accounting for revenue (IFRS 15.110).
- » Disclosures about warranties in the scope of IAS 37 include:
 - » A rollforward of the carrying amount of the provision for the year (comparative information is not required);
 - » a brief description of the nature of the obligation;
 - » the expected timing of any expected benefit outflows (and uncertainties in the timing or amount and any discernible major assumptions made concerning future events); and
 - » the amount of any expected reimbursement (identifying separately the amount of any related reimbursement asset recognised) (IAS 37.84 and .85).

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Issue 2: how to classify, measure and disclose a liability (or possible liability) arising from our company being the defendant in a lawsuit

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Classifying, measuring and disclosing a liability (or possible liability) arising from being the defendant in a lawsuit

What do you think?

The accounting and reporting for a liability (or possible liability) arising from being the defendant in a lawsuit is specified in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

How to classify a liability (or possible liability) arising from being the defendant in a lawsuit?

How to measure a liability arising from being the defendant in a lawsuit?

Which disclosures apply to a liability (or possible liability) arising from being the defendant in a lawsuit?

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Classifying a liability (or possible liability) arising from being the defendant in a lawsuit

Summary of discussion

How to determine whether a liability (or possible liability) arising from being the defendant in a lawsuit is a provision or a contingent liability?

Discussants' consensus view =

- » For present obligations (and deemed present obligations) of uncertain timing or amount IAS 37 specifies two provision (liability) recognition criteria:
 - » it is more likely than not 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. (IAS 37.14–.16)
- » When either of the provision (liability) recognition criteria above are not satisfied, and in cases of possible obligations (rather than present obligations), the entity discloses a contingent liability in the notes instead of recognising a provision (liability), unless the possibility of an outflow is determined to be remote (IAS 37.28).

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Measuring a liability arising from being the defendant in a lawsuit

Summary of discussion

How to measure a provision (liability) arising from being the defendant in a lawsuit?

- » Discussants' consensus view = for a single obligation (like most court cases), best estimate of the provision (liability) is measured at the present value of the risk-adjusted single most likely outcome, adjusted for considering other possible outcomes because "Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount." (IAS 37.40).

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Disclosing a liability (or possible liability) arising from being the defendant in a lawsuit

Summary of discussion

Which disclosures apply to a liability (or possible liability) arising from being the defendant in a lawsuit? Discussants' consensus view:

- » If a provision (liability), disclosures include: (i) a roll-forward of the carrying amount of the provision for the year (comparative information is not required); (ii) a brief description of the nature of the obligation; (iii) the expected timing of any expected benefit outflows (and uncertainties in the timing or amount and any discernible major assumptions made concerning future events; and (iv) the amount of any expected reimbursement (identifying separately the amount of any related reimbursement asset recognised) (IAS 37.84 and .85).
- » If a contingent liabilities, disclosures include: (i) a brief description of the nature of the contingent liability; and where practicable, (ii) the best estimate of its financial effect, an indication of uncertainties in the expected timing or amount, and the possibility of any reimbursement (IAS 37.86).
- » Note: alternative disclosures apply in the extremely rare cases in which the disclosure above can reasonably be expected to prejudice seriously the position of the reporting entity in a dispute with other parties (IAS 37.92).

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Contingent assets

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» Issue 1: how to classify, measure and disclose an asset (or possible asset) arising from our company being the claimant in a lawsuit

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Issue 1: how to classify, measure and disclose an asset (or possible asset) arising from our company being the claimant in a lawsuit

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Classifying, measuring and disclosing an asset (or possible asset) arising from being the claimant in a lawsuit

What do you think?

The accounting and reporting for an asset (or possible asset) arising from being the claimant in a lawsuit is specified in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

How to classify an asset (or possible asset) arising from being the claimant in a lawsuit?

How to measure an asset arising from being the claimant in a lawsuit?

Which disclosures apply to a possible asset arising from being the claimant in a lawsuit?

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Classifying an asset (or possible asset) arising from being the claimant in a lawsuit

Summary of discussion

How to classify an asset (or possible asset) arising from being the claimant in a lawsuit? Discussants' consensus view =

- » In accordance with IAS 37, the related asset is recognised only when the realisation of income from the court case becomes virtually certain (IAS 37.33).
- » Before then, recognition of the contingent asset is prohibited (IAS 37.31–.33). Instead of recognising the asset, the entity is required to disclose the contingent asset in the notes when the realisation of income from the court case is more likely than not (IAS 37.34).

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Measuring an asset arising from being the defendant in a lawsuit

Summary of discussion

How to measure an asset arising from being the claimant in a lawsuit?

Discussants' consensus view = because an asset is recognized only when, the realisation of income from the court case becomes virtually certain (IAS 37.33), there is unlikely to be significant uncertainties in measuring its best estimate.

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Disclosing a possible asset arising from being the claimant in a lawsuit

Summary of discussion

Which disclosures apply to a possible asset arising from being the claimant in a lawsuit? Discussants' consensus view:

- » from when the realisation of income from the court case becomes more likely than not (IAS 37.34) but remains less than virtually certain, the required disclosures about the contingent asset include: (i) a brief description of the nature of the contingent asset; and (ii) the best estimate of its financial effect (IAS 37.89).
- » Note: alternative disclosures apply in the extremely rare cases in which the disclosure above can reasonably be expected to prejudice seriously the position of the reporting entity in a dispute with other parties (IAS 37.92).

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