

Chapter 5

IAS 37 – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

1. Definitions

A **provision** is a liability where the timing or the amount is uncertain.

A **contingent liability** is a liability that may result, but depends (or is contingent) on the outcome of uncertain events.

For example, the company may have been taken to court, but the outcome of the case is not yet known. If they lose the case then they may have to pay a fine. There is therefore a potential liability, but it is not certain. The question is as to whether or not we show the potential liability in the accounts.

A **contingent asset** is where there may be an asset resulting for the company, but, again, it is not certain.

2. The requirements of IAS 37:

Provisions:

If the payment is **probable** (i.e. more than 50% likely) then the liability should be recognised in the financial statements.

If the payment is **possible** (i.e. between 5% and 50% likely) then the liability is not recognised in the financial statements, but should be disclosed by way of a note.

If the payment is **remote** (i.e. less than 5% likely) then it is not recognised in the financial statements and nor is it disclosed by way of a note.

Contingent liabilities:

These are disclosed as notes to the statements (but not accrued) unless the likelihood of payment is **remote** (less than 5%) in which case there is no disclosure required.

But, if a past event has given rise to the possible obligation (for example, a lawsuit) then it is treated as a provision and if the payment is **probable** (i.e. more than 50% likely) then it should be recognised in the financial statements.



Contingent assets:

If **virtually certain** (i.e. more than 95% likely) then it is not a contingent asset and should be recognised.

If **probable** (i.e. more than 50% likely) then it should be disclosed by way of a note to the financial statements.

(If the likelihood is only either **possible** or **remote** (i.e. less than 50%) then no recognition and no disclosure by way of note.)

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