LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

MASB Standard 20

Provisions, Contingent Liabilities and Contingent Assets

Any correspondence regarding this Standard should be addressed to:

The Chairman
Malaysian Accounting Standards Board
Suites 5.01 - 5.03, 5th Floor, Wisma Maran
No. 338, Jalan Tuanku Abdul Rahman
50100 Kuala Lumpur

Tel : 03-4669199
Fax. : 03-4669212

E-mail address : masb@po.jaring.my
Website address : http://www.masb.org.my/

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Introduction

1. MASB 20 prescribes the accounting and disclosure for all provisions, contingent liabilities and contingent assets, except:

   (a) those resulting from financial instruments that are carried at fair value;

   (b) those resulting from executory contracts, except where the contract is onerous. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent;

   (c) those arising in insurance enterprises from contracts with policyholders; or

   (d) those covered by another MASB Standard.

Provisions

2. The Standard defines provisions as liabilities of uncertain timing or amount. A provision should be recognised when, and only when:

   (a) an enterprise has a present obligation (legal or constructive) as a result of a past event;

   (b) it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and

   (c) a reliable estimate can be made of the amount of the obligation. The Standard notes that it is only in extremely rare cases that a reliable estimate will not be possible.

3. The Standard defines a constructive obligation as an obligation that derives from an enterprise's actions where:

   (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities; and

   (b) as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

4. In rare cases, for example in a law suit, it may not be clear whether an enterprise has a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available

evidence, it is more likely than not that a present obligation exists at the balance sheet date. An enterprise recognises a provision for that present obligation if the other recognition criteria described above are met. If it is more likely than not that no present obligation exists, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

5. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date, in other words, the amount that an enterprise would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time.

6. The Standard requires that an enterprise should, in measuring a provision:

   (a) take risks and uncertainties into account. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities;

   (b) discount the provision, where the effect of the time value of money is material, using a pre-tax discount rate (or rates) that reflect(s) current market assessments of the time value of money and those risks specific to the liability that have not been reflected in the best estimate of the expenditure. Where discounting is used, the increase in the provision due to the passage of time is recognised as borrowing costs;

   (c) take future events, such as changes in the law and technological changes, into account where there is sufficient objective evidence that they will occur; and

   (d) not take gains from the expected disposal of assets into account, even if the expected disposal is closely linked to the event giving rise to the provision.

7. An enterprise may expect reimbursement of some or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). An enterprise should:

   (a) recognise a reimbursement when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The amount recognised for the reimbursement should not exceed the amount of the provision; and

(b) recognise the reimbursement as a separate asset. In the income statement, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

8. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

9. A provision should be used only for expenditure for which the provision was originally recognised.

Provisions - Specific Applications

10. The Standard explains how the general recognition and measurement requirements for provisions should be applied in three specific cases: future operating losses; onerous contracts; and restructurings.

11. Provisions should not be recognised for future operating losses. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. In this case, an enterprise tests these assets for impairment under MASB ED 25, Impairment of Assets.

12. If an enterprise has a contract that is onerous, the present obligation under the contract should be recognised and measured as a provision. An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

13. The Standard defines a restructuring as a programme that is planned and controlled by management, and materially changes either:

    (a) the scope of a business undertaken by an enterprise; or

    (b) the manner in which that business is conducted.

14. A provision for restructuring costs is recognised only when the general recognition criteria for provisions are met. In this context, a constructive obligation to restructure arises only when an enterprise:

    (a) has a detailed formal plan for the restructuring identifying at least:

        (i) the business or part of a business concerned;

        (ii) the principal locations affected;

        (iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

(iv) the expenditure that will be undertaken; and

(v) when the plan will be implemented; and

(b) 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.

15. A management or board decision to restructure does not give rise to a constructive obligation at the balance sheet date unless the enterprise has, before the balance sheet date:

(a) started to implement the restructuring plan; or

(b) communicated the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the enterprise will carry out the restructuring.

16. Where a restructuring involves the sale of an operation, no obligation arises for the sale until the enterprise is committed to the sale, i.e. there is a binding sale agreement.

17. A restructuring provision should include only the direct expenditure arising from the restructuring, which are those that are both:

(a) necessarily entailed by the restructuring; and

(b) not associated with the ongoing activities of the enterprise. Thus, a restructuring provision does not include such costs as: retraining or relocating continuing staff; marketing; or investment in new systems and distribution networks.

Contingent Liabilities

18. The Standard supersedes the parts of MASB Approved Accounting Standard IAS 10, Contingencies and Events Occurring After the Balance Sheet Date, that deal with contingencies. The Standard defines a contingent liability as:

(a) 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 enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

19. An enterprise should not recognise a contingent liability. An enterprise should disclose a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent Assets

20. The Standard defines a contingent asset as 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 enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.

21. An enterprise should not recognise a contingent asset. A contingent asset should be disclosed where an inflow of economic benefits is probable.

22. When the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

Provisions, Contingent Liabilities and Contingent Assets

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The standards, which have been set in bold type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Foreword to MASB Standards. MASB Standards are not intended to apply to immaterial items.

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

Scope

1. **This Standard should be applied by all enterprises in accounting for provisions, contingent liabilities and contingent assets, except:**

   (a) those resulting from financial instruments that are carried at fair value;

   (b) those resulting from executory contracts, except where the contract is onerous;

   (c) those arising in insurance enterprises from contracts with policyholders; and

   (d) those covered by another MASB Standard.

2. This Standard supersedes the parts of MASB Approved Accounting Standard IAS 10, Contingencies and Events Occurring After the Balance Sheet Date, that deal with contingencies. The parts of that Standard which deal with events after the balance sheet date are superseded by MASB 19, Events After the Balance Sheet Date.

3. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.

4. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.

5. This Standard applies to provisions, contingent liabilities and contingent assets of insurance enterprises other than those arising from contracts with policyholders.

6. Where another MASB Standard deals with a specific type of provision, contingent liability or contingent asset, an enterprise applies that Standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:

   (a) construction contracts (see MASB 7, Construction Contracts);

   (b) income taxes (see MASB Approved Accounting Standard IAS 12, Accounting for Taxes on Income);

   (c) leases (see MASB 10, Leases). However, as MASB 10, Leases, contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases; and

   (d) employee benefits (see MASB Approved Accounting Standard IAS 19, Accounting for Retirement Benefits in the Financial Statements of Employers).

7. Some amounts treated as provisions may relate to the recognition of revenue, for example where an enterprise gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. MASB 9, Revenue, identifies the circumstances in which revenue is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of MASB 9, Revenue.

8. This Standard defines provisions as liabilities of uncertain timing or amount. The term ‘provision’ is also sometimes used in the context of items such as depreciation, impairment of assets and doubtful debts, these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

9. Other MASB Standards specify whether expenditure is treated as an asset or as an expense. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

10. This Standard applies to provisions for restructuring (including discontinuing operations). Where a restructuring meets the definition of a discontinuing operation, additional disclosures may be required by generally accepted accounting practice on discontinuing operations.

Definitions

11. The following terms are used in this Standard with the meanings specified:

A constructive obligation is an obligation that derives from an enterprise's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

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 enterprise.

A contingent liability is:

(a) 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 enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

A legal obligation is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

(b) legislation; or

(c) other operation of law.

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

A provision is a liability of uncertain timing or amount.

A restructuring is a programme that is planned and controlled by management, and materially changes either:

(a) the scope of a business undertaken by an enterprise; or

(b) the manner in which that business is conducted.

An obligating event is an event that creates a legal or constructive obligation that results in an enterprise having no realistic alternative to settling that obligation.

An 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.

Provisions and Other Liabilities

12. Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

(a) 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; and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). 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.

Relationship between Provisions and Contingent Liabilities

13. In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard the term 'contingent' is used for liabilities and assets that are not recognised 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 enterprise. In addition, the term 'contingent liability' is used for liabilities that do not meet the recognition criteria.

14. This Standard distinguishes between:

    (a) provisions - which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations; and

    (b) contingent liabilities - which are not recognised as liabilities because they are either:

        (i) possible obligations, as it has yet to be confirmed whether the enterprise has a present obligation that could lead to an outflow of resources embodying economic benefits; or

        (ii) present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

Recognition

Provisions

15. A provision should be recognised when:

(a) an enterprise has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

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

If these conditions are not met, no provision should be recognised.

Present Obligation

16. In rare cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date.

17. In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a law suit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the balance sheet date.

On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision (if the recognition criteria are met); and

(b) where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 87).

Past Event

18. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

(b) in the case of a constructive obligation, where the event (which may be an action of the enterprise) creates valid expectations in other parties that the enterprise will discharge the obligation.

19. Financial statements deal with the financial position of an enterprise at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date.

20. It is only those obligations arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the enterprise. Similarly, an enterprise recognises a provision for the decommissioning costs of an oil installation to the extent that the enterprise is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an enterprise may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the enterprise can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

21. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed - indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the balance sheet date unless the decision has been communicated before the balance sheet date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the enterprise will discharge its responsibilities.

22. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the enterprise gives rise to a constructive obligation. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the enterprise publicly accepts responsibility for rectification in a way that creates a constructive obligation.

23. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment make it impossible to specify a single event that would make

the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Probable Outflow of Resources Embodying Economic Benefits

24. For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard[*] , an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e. the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an enterprise discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 87).

25. Where there are a number of similar obligations (e.g. product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

Reliable Estimate of the Obligation

26. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other balance sheet items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision.

27. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 87).

[*] The interpretation of ‘probable’ in this Standard as ‘more likely than not’ does not necessarily apply in other MASB Standards.

Contingent Liabilities

28. An enterprise should not recognise a contingent liability.

29. A contingent liability is disclosed, as required by paragraph 87, unless the possibility of an outflow of resources embodying economic benefits is remote.

30. Where an enterprise is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The enterprise recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.

31. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs except in the extremely rare circumstances where no reliable estimate can be made.

Contingent Assets

32. An enterprise should not recognise a contingent asset.

33. Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain.

34. Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

35. A contingent asset is disclosed, as required by paragraph 90, where an inflow of economic benefits is probable.

36. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an enterprise discloses the contingent asset (see paragraph 90).

Measurement

Best Estimate

37. The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

38. The best estimate of the expenditure required to settle the present obligation is the amount that an enterprise would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the balance sheet date. However, the estimate of the amount that an enterprise would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

39. The estimates of outcome and financial effect are determined by the judgement of the management of the enterprise, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the balance sheet date.

40. Uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is 'expected value'. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 per cent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

41. Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the enterprise considers other possible outcomes. 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.

42. The provision is measured before tax, as the tax consequences of the provision, and changes in it, are dealt with under MASB Approved Accounting Standard IAS 12, Accounting for Taxes on Income.

Risks and Uncertainties

43. The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

44. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

45. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 86(b).

Present Value

46. Where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditure expected to be required to settle the obligation.

47. Because of the time value of money, provisions relating to cash outflows that arise soon after the balance sheet date are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

48. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.

Future Events

49. Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

50. Expected future events may be particularly important in measuring provisions. For example, an enterprise may believe that the cost of

cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an enterprise does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

51. The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Expected Disposal of Assets

52. Gains from the expected disposal of assets should not be taken into account in measuring a provision.

53. Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an enterprise recognises gains on expected disposals of assets at the time specified by the MASB Standard dealing with the assets concerned.

Reimbursements

54. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

55. In the income statement, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

56. Sometimes, an enterprise is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the enterprise or pay the amounts directly.

57. In most cases the enterprise will remain liable for the whole of the amount in question so that the enterprise would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it is virtually certain that reimbursement will be received if the enterprise settles the liability.

58. In some cases, the enterprise will not be liable for the costs in question if the third party fails to pay. In such a case the enterprise has no liability for those costs and they are not included in the provision.

59. As noted in paragraph 30, an obligation for which an enterprise is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in Provisions

60. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed.

61. Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing costs.

Use of Provisions

62. A provision should be used only for expenditure for which the provision was originally recognised.

63. Only expenditure that relate to the original provision are set against it. Setting expenditure against a provision that was originally recognised for another purpose would conceal the impact of two different events.

Application of the Recognition and Measurement Rules

Future Operating Losses

64. Provisions should not be recognised for future operating losses.

65. Future operating losses do not meet the definition of a liability in paragraph 11 and the general recognition criteria set out for provisions in paragraph 15.

66. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An enterprise tests these assets for impairment under MASB ED 25, Impairment of Assets.

Onerous Contracts

67. If an enterprise has a contract that is onerous, the present obligation under the contract should be recognised and measured as a provision.

68. Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.

69. This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

70. Before a separate provision for an onerous contract is established, an enterprise recognises any impairment loss that has occurred on assets dedicated to that contract.

Restructuring

71. The following are examples of events that may fall under the definition of restructuring:

(a) sale or termination of a line of business;

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

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

(d) fundamental reorganisations that have a material effect on the nature and focus of the enterprise's operations.

72. A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 15 are met. Paragraphs 73-84 set out how the general recognition criteria apply to a restructuring.

73. A constructive obligation to restructure arises only when an enterprise:

(a) has a detailed formal plan for the restructuring identifying at least:

(i) the business or part of a business concerned;

(ii) the principal locations affected;

(iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

(iv) the expenditure that will be undertaken; and

(v) when the plan will be implemented; and

(b) 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.

74. Evidence that an enterprise has started to implement a restructuring plan would be provided, for example, by dismantling plant or selling assets or by the public announcement of the main features of the plan. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (i.e. setting out the main features of the plan) that it gives rise to valid expectations in other parties such as customers, suppliers and employees (or their representatives) that the enterprise will carry out the restructuring.

75. For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the enterprise is at present committed to restructuring, because the timeframe allows opportunities for the enterprise to change its plans.

76. A management or board decision to restructure taken before the balance sheet date does not give rise to a constructive obligation at the balance sheet date unless the enterprise has, before the balance sheet date:

    (a) started to implement the restructuring plan; or

    (b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the enterprise will carry out the restructuring.

    In some cases, an enterprise starts to implement a restructuring plan, or announces its main features to those affected, only after the balance sheet date. Disclosure may be required under MASB 19, Events After the Balance Sheet Date, if the restructuring is of such importance that its non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

77. Although a constructive obligation is not created solely by a management decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale of an operation, may have been concluded subject only to board approval. Once that approval has been obtained and communicated to the other parties, the enterprise has a constructive obligation to restructure, if the conditions of paragraph 73 are met.

78. In some circumstances, the ultimate authority is vested in a board whose membership includes representatives of interests other than those of management (e.g. employees) or notification to such representatives may be necessary before the board decision is taken. Because a decision by such a board involves communication to these representatives, it may result in a constructive obligation to restructure.

79. No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e. there is a binding sale agreement.

80. Even when an enterprise has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the enterprise will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment, under MASB ED 25, Impairment of Assets. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.

81. A restructuring provision should include only the direct expenditure arising from the restructuring, which are those that are both:

(a) necessarily entailed by the restructuring; and

(b) not associated with the ongoing activities of the enterprise.

82. A restructuring provision does not include such costs as:

(a) retraining or relocating continuing staff;

(b) marketing; or

(c) investment in new systems and distribution networks.

These expenditure relate to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditure are recognised on the same basis as if they arose independently of a restructuring.

83. Identifiable future operating losses up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph 11.

84. As required by paragraph 52, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Disclosure

85. For each class of provision, an enterprise should disclose:

(a) the carrying amount at the beginning and end of the period;

(b) additional provisions made in the period, including increases to existing provisions;

(c) amounts used (i.e. incurred and charged against the provision) during the period;

(d) unused amounts reversed during the period; and

(e) 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.

Comparative information is not required.

86. An enterprise should disclose the following for each class of provision:

(a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

(b) an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 49; and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

87. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect, measured under paragraphs 37 to 53;

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

(c) the possibility of any reimbursement.

88. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs 86(a) and (b) and 87(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.

89. Where a provision and a contingent liability arise from the same set of circumstances, an enterprise makes the disclosures required by paragraphs 85 to 87 in a way that shows the link between the provision and the contingent liability.

90. Where an inflow of economic benefits is probable, an enterprise should disclose a brief description of the nature of the contingent assets at the balance sheet date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 37 to 53.

91. It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of income arising.

92. Where any of the information required by paragraphs 87 and 90 is not disclosed because it is not practicable to do so, that fact should be stated.

93. In extremely rare cases, disclosure of some or all of the information required by paragraphs 85, 86, 87 and 90 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Transitional Provision

94. The effect of adopting this Standard on its effective date (or earlier) should be reported as an adjustment to the opening balance of retained earnings for the period in which the Standard is first adopted. Enterprises are encouraged to adjust the opening balance of retained earnings for the earliest period presented and to restate comparative information. If comparative information is not restated, this fact should be disclosed.

95. The Standard requires a different treatment from MASB 3, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies. MASB 3 requires comparative information to be restated (benchmark treatment) or additional pro forma comparative information on a restated basis to be disclosed (allowed alternative treatment) unless it is impracticable to do so.

Effective Date

96. This MASB Standard becomes operative for financial statements covering periods beginning on or after 1 July 2001. Earlier application is encouraged. If an enterprise applies this Standard for periods beginning before 1 July 2001, it should disclose that fact.

Appendix 1

Compliance with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity in all material respects with International Accounting Standard IAS 37, Provisions, Contingent Liabilities and Contingent Assets.

Appendix 2

Tables-Provisions, Contingent Liabilities, Contingent Assets and Reimbursements

The purpose of this appendix is to summarise the main requirements of the standards. It does not form part of the standards and should be read in the context of the full text of the standards.

Provisions and Contingent Liabilities

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of: (a) a present obligation; or (b) a possible obligation 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 enterprise.		
There is a present obligation that probably requires an outflow of resources.	**There is a possible obligation or a present obligation that may, but probably will not require an outflow of resources.**	**There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.**
A provision is recognised (paragraph 15).	No provision is recognised (paragraph 28).	No provision is recognised (paragraph 28).
Disclosures are required for the provision (paragraphs 85 and 86).	Disclosures are required for the contingent liability (paragraph 87).	No disclosure is required (paragraph 87).

A contingent liability also arises in the extremely rare case where there is a liability that cannot be recognised because it cannot be measured reliably. Disclosures are required for the contingent liability.

Contingent Assets

Where, as a result of past events, there is a possible asset 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 enterprise.		
The inflow of economic benefits is virtually certain.	**The inflow of economic benefits is probable, but not virtually certain.**	**The inflow is not probable.**
The asset is not contingent (paragraph 34).	No asset is recognised (paragraph 32). Disclosures are required (paragraph 90).	No asset is recognised (paragraph 32). No disclosure is required (paragraph 90).

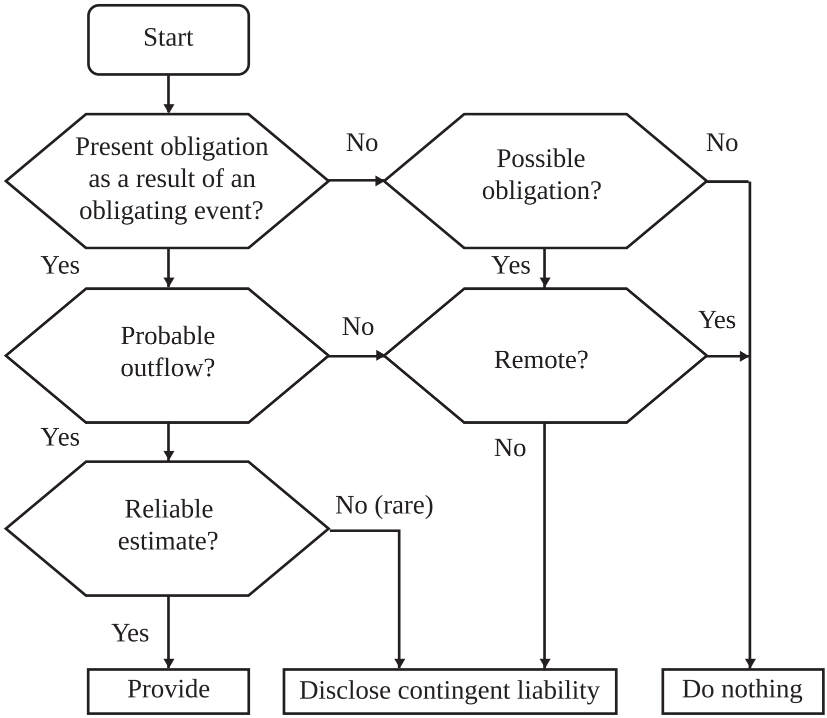
Reimbursements

Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.		
The enterprise has no obligation for the part of the expenditure to be reimbursed by the other party.	**The obligation for the amount expected to be reimbursed remains with the enterprise and it is virtually certain that reimbursement will be received if the enterprise settles the provision.**	**The obligation for the amount expected to be reimbursed remains with the enterprise and the reimbursement is not virtually certain if the enterprise settles the provision.**
The entity has no liability for the amount to be reimbursed (paragraph 58).	The reimbursement is recognised as a separate asset in the balance sheet and may be offset against the expense in the income statement. The amount recognised for the expected reimbursement does not exceed the liability (paragraphs 54 and 55).	The expected reimbursement is not recognised as an asset (paragraph 54).
No disclosure is required.	The reimbursement is disclosed together with the amount recognised for the reimbursement [paragraph 86(c)].	The expected reimbursement is disclosed [paragraph 86(c)].

Appendix 3

Decision Tree

The purpose of the decision tree is to summarise the main recognition requirements of the standards of provisions and contingent liabilities. The decision tree does not form part of the standards and should be read in the context of the full text of the standards.



Note: In rare cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date (paragraph 16 of the Standard).

Appendix 4

Examples: Recognition and Measurement

This appendix illustrates the application of the standards to assist in clarifying their meaning. It does not form part of the standards.

Recognition

All the enterprises in the examples have 31 December year ends. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets - this aspect is not dealt with in the examples.

The cross references provided in the examples indicate paragraphs of the Standard that are particularly relevant. The appendix should be read in the context of the full text of the standards.

References to 'best estimate' are to the present value amount, where the effect of the time value of money is material.

Example 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - Probable for the warranties as a whole (see paragraph 25).

Conclusion - A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date (see paragraphs 15 and 25).

Example 2A: Contaminated Land - Legislation Virtually Certain to be Enacted

An enterprise in the oil industry causes contamination but cleans up only when required to do so under the laws of the particular country in which it operates. One country in which it operates has had no legislation requiring cleaning up, and the enterprise has been contaminating land in that country for several years. At 31 December 2000 it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

Present obligation as a result of a past obligating event - The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the costs of the clean-up (see paragraphs 15 and 23).

Example 2B: Contaminated Land and Constructive Obligation

An enterprise in the oil industry causes contamination and operates in a country where there is no environmental legislation. However, the enterprise has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The enterprise has a record of honouring this published policy.

Present obligation as a result of a past obligating event - The obligating event is the contamination of the land, which gives rise to a constructive obligation because the conduct of the enterprise has created a valid expectation on the part of those affected by it that the enterprise will clean up the contamination.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the costs of clean up [see paragraphs 11 (the definition of a constructive obligation), 15 and 18].

Example 3: Offshore Oilfield

An enterprise operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arises through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

Present obligation as a result of a past obligating event - The construction of the oil rig creates a legal obligation under the terms of the licence to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it (see paragraph 15). These costs are included as part of the cost of the oil rig. The ten per cent of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.

Example 4: 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.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement - Probable, a proportion of goods are returned for refund (see paragraph 25).

Conclusion - A provision is recognised for the best estimate of the costs of refunds [see paragraphs 11 (the definition of a constructive obligation), 15, 18 and 25].

Example 5A: Closure of a Division - No Implementation Before Balance Sheet Date

On 12 December 2000 the board of an enterprise decided to close down a division. Before the balance sheet date (31 December 2000) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event - There has been no obligating event and so there is no obligation.

Conclusion - No provision is recognised (see paragraphs 15 and 73).

Example 5B: Closure of a Division - Communication/ Implementation Before Balance Sheet Date

On 12 December 2000, the board of an enterprise decided to close down a division making a particular product. On 20 December 2000 a detailed plan for closing down the division was agreed by the board; letters were sent to customers warning them to seek an alternative source of supply and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event - The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised at 31 December 2000 for the best estimate of the costs of closing the division (see paragraphs 15 and 73).

Example 6: Legal Requirement to Fit Smoke Filters

Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 June 2000. The enterprise has not fitted the smoke filters.

(a) At the balance sheet date of 31 December 1999

Present obligation as a result of a past obligating event - There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion - No provision is recognised for the cost of fitting the smoke filters (see paragraphs 15 and 18 to 20).

(b) At the balance sheet date of 31 December 2000

Present obligation as a result of a past obligating event - There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement - Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion - No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 15 and 18 to 20).

Example 7: Staff Retraining as a Result of Changes in the Income Tax System

The government introduces a number of changes to the income tax system. As a result of these changes, an enterprise in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date, no retraining of staff has taken place.

Present obligation as a result of a past obligating event - There is no obligation because no obligating event (retraining) has taken place.

Conclusion - No provision is recognised (see paragraphs 15 and 18 to 20).

Example 8: An Onerous Contract

An enterprise operates profitably from a factory that it has leased under an operating lease. During December 2000 the enterprise relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user.

Present obligation as a result of a past obligating event - The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the enterprise accounts for the lease under MASB 10, Leases).

Conclusion - A provision is recognised for the best estimate of the unavoidable lease payments (see paragraphs 6(c), 15 and 67).

Example 9: A Single Guarantee

During 1999, Enterprise A gives a guarantee of certain borrowings of Enterprise B, whose financial condition at that time is sound. During 2000, the financial condition of Enterprise B deteriorates and at 30 June 2000. Enterprise B files for protection from its creditors.

(a) At 31 December 1999

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - No outflow of benefits is probable at 31 December 1999.

Conclusion - No provision is recognised (see paragraphs 15 and 24). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraph 87).

(b) At 31 December 2000

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - At 31 December 2000, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion - A provision is recognised for the best estimate of the obligation (see paragraphs 15 and 24).

Note: This example deals with a single guarantee. If an enterprise has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable (see paragraph 25). Where an enterprise gives guarantees in exchange for a fee, revenue is recognised under MASB 9, Revenue.

Example 10: A Court Case

After a wedding in 2000, ten people died, possibly as a result of food poisoning from products sold by the enterprise. Legal proceedings are started seeking damages from the enterprise but it disputes liability. Up to the date of authorisation of the financial statements for the year to 31 December 2000, the enterprise's lawyers advise that it is probable that the enterprise will not be found liable. However, when the enterprise prepares the financial statements for the year to 31 December 2001, its lawyers advise that, owing to developments in the case, it is probable that the enterprise will be found liable.

(a) At 31 December 2000

Present obligation as a result of a past obligating event - On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion - No provision is recognised (see paragraphs 16 to 17). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraph 87).

(b) At 31 December 2001

Present obligation as a result of a past obligating event - On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the amount to settle the obligation (paragraphs 15 to 17).

Example 11: Repairs and Maintenance

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. MASB 15, Property, Plant and Equipment, gives guidance on allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

Example 11A: Refurbishment Costs - No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event - There is no present obligation.

Conclusion - No provision is recognised (see paragraphs 15 and 18 to 20).

The cost of replacing the lining is not recognised because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions - even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, i.e. it is depreciated over five years. The re-lining costs then incurred are capitalised with the consumption of each new lining shown by depreciation over the subsequent five years.

Example 11B: Refurbishment Costs - Legislative Requirement

An airline is required by law to overhaul its aircraft once every three years.

Present obligation as a result of a past obligating event - There is no present obligation.

Conclusion - No provision is recognised (see paragraphs 15 and 18 to 20).

The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in Example 11A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the enterprise's future actions - the enterprise could avoid the future expenditure by its future actions, for example by selling the aircraft. Instead of a provision being recognised, the depreciation of the aircraft takes account of the future incidence of maintenance costs, i.e. an amount equivalent to the expected maintenance costs is depreciated over three years. (Refer to MASB 15, Property, Plant and Equipment)

Measurement

Example 12: Best Estimate

An enterprise sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of RM 1 million would result. If major defects were detected in all products sold, repair costs of RM 4 million would result. The enterprise's past experience and future expectations indicate that, for the coming year, 75 per cent of the goods sold will have no defects, 20 per cent of the goods sold will have minor defects and 5 per cent of the goods sold will have major defects. The enterprise assesses the probability of an outflow for the warranty obligations as a whole (see paragraph 25)

The expected value of the cost of repairs is:

(75% of nil) + (20% of RM 1m) + (5% of RM 4m) = RM400,000

Appendix 5

Example: Disclosure

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

Two examples of the disclosures required by paragraph 86 are provided below.

Example 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the balance sheet date, a provision of RM60,000 has been recognised. The provision has not been discounted as the effect of discounting is not material. The following information is disclosed:

A provision of RM60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years of the balance sheet date.

Example 2: Decommissioning Costs

In 2000, an enterprise involved in oil exploration recognises a provision for decommissioning costs of RM300 million. The provision is estimated using the assumption that decommissioning will take place in 30-35 years' time. However, there is a possibility that it will not take place until 50-55 years' time, in which case the present value of the costs will be significantly reduced. The following information is disclosed:

A provision of RM300 million has been recognised for decommissioning costs. These costs are expected to be incurred between 2030 and 2035; however, there is a possibility that decommissioning will not take place until 2050-2055. If the costs were measured based upon the expectation that they would not be incurred until 2050-2055 the provision would be reduced to RM136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2 per cent.

An example is given below of the disclosures required by paragraph 93 where some of the information required is not given because it can be expected to prejudice seriously the position of the enterprise.

Example 3: Disclosure Exemption

An enterprise is involved in a dispute with a competitor, who is alleging that the enterprise has infringed patents and is seeking damages of RM100 million. The enterprise recognises a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 85 and 86 of the Standard. The following information is disclosed:

Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of RM 100 million. The information usually required by MASB 20, Provisions, Contingent Liabilities and Contingent Assets, is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the litigation. The directors are of the opinion that the claim can be successfully resisted by the company.