Accounting Standard **AASB 1044**
October 2001

Provisions, Contingent Liabilities and Contingent Assets

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Defined words are *italicised* each time they appear. The definitions are in Section 16. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The Standard:

(a) defines “provisions” and, with certain exceptions, specifies the criteria for their recognition in the statement of financial position;

(b) specifies recognition criteria and presentation requirements for recoveries receivable from third parties in respect of provisions;

(c) defines “contingent liabilities” and “contingent assets” as particular items that are not recognised in the statement of financial position and requires their disclosure;

(d) specifies measurement requirements for provisions, recoveries receivable, contingent liabilities and contingent assets;

(e) requires estimated cash flows used to measure provisions, recoveries receivable, contingent liabilities and contingent assets to be discounted to their present value;

(f) requires the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability (to the extent risks are not reflected in the future cash flow estimates) to be used in determining the present value of provisions;

(g) prohibits providing for future operating losses (deficits);

(h) requires provisions to be recognised for the net amount of the estimated loss (deficit) expected to arise under onerous contracts;

(i) specifies the conditions under which provisions for restructurings (including restructurings occurring as a consequence of an acquisition of an entity or operation) are recognised and the costs that are included in such provisions. The requirements in relation to the recognition of provisions for restructurings recognised as a part of an acquisition of an entity or operation, including the “relief” provided by paragraph 12.3(b) (the so-called three-month window), will be reviewed when International Accounting Standard IAS 22 “Business Combinations” is reviewed by the International Accounting Standards Board;

(j) requires liabilities to be recognised for the entire amount of declared, determined or publicly recommended dividends that remain undistributed at the reporting date, regardless of the extent to which they are expected to be paid in cash;

(k) prohibits the recognition of dividends as liabilities where they were not declared, determined or publicly recommended on or before the reporting date; and

(l) requires various disclosures about provisions, recoveries receivable, contingent liabilities and contingent assets.

ACCOUNTING STANDARD AASB 1044

The Australian Accounting Standards Board makes Accounting Standard AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets" under section 334 of the *Corporations Act 2001*.

	F. K. Alfredson
Dated 25 October 2001	Chair – AASB

ACCOUNTING STANDARD

AASB 1044 "PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS"

GENERAL

1 Application

1.1 This Standard applies to:

> **(a) each *entity* that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a *reporting entity*;**
>
> **(b) *general purpose financial reports* of each other *reporting entity*; and**
>
> **(c) financial reports that are, or are held out to be, *general purpose financial reports.***

1.2 Subject to paragraph 1.3, this Standard applies to all *provisions,* recoveries receivable from third parties in relation to *provisions, contingent liabilities* and *contingent assets*.

1.3 This Standard does not apply to:

> **(a) *financial liabilities* carried at *fair value,* other than *derivatives*;**

(b) ***derivatives* other than financial guarantee contracts (including letters of credit) that provide for payments to be made if the debtor fails to make payment when due;**

(c) ***provisions* associated with the retirement or disposal of long-lived *assets*;**

(d) ***employee benefits*, except for disclosures required by paragraphs 14.3 to 14.5; and**

(e) ***agreements equally proportionately unperformed*, except where the agreement is an *onerous contract*.**

1.3.1 The standards specified in this Standard apply to the financial report where information resulting from their application is material in accordance with Accounting Standard AASB 1031 and Australian Accounting Standard AAS 5 "Materiality".

1.3.2 This Standard addresses the *recognition*, measurement and disclosure of *provisions*, which are defined as a subset of *liabilities*. The term "provision" has been used elsewhere to refer to items such as depreciation and doubtful debts; these are adjustments to the *carrying amounts* of *assets* and are not addressed in this Standard.

1.3.3 For general insurers and life insurers, this Standard applies to *provisions*, *contingent liabilities* and *contingent assets* that do not result from insurance contracts and are not covered by another Accounting Standard or an Australian Accounting Standard. This Standard also applies to *provisions*, *contingent liabilities* and *contingent assets* arising from uninsured events.

1.3.4 This Standard applies to *provisions* for *restructuring* (including *restructurings* resulting from the acquisition of an *entity* or operation, and from discontinuing operations), unless they fall within any of the exclusions in paragraph 1.3.

1.3.5 With the exception of paragraphs 14.3 to 14.5, this Standard does not apply to *provisions* that are in the nature of *employee benefits*, irrespective of whether those *employee benefits* are required to be *recognised* in accordance with Accounting Standard AASB 1028 "Employee Benefits". Accordingly, this Standard does not apply to *provisions* for *employee benefits* that are not required to be *recognised* under AASB 1028, including post-employment benefits that are superannuation or medical benefits and equity compensation benefits.

1.3.6 Other Accounting Standards or Australian Accounting Standards specify whether sacrifices of economic benefits that have been incurred are *recognised* as giving rise to increases in *assets* or *recognised* as *expenses*. These issues are not addressed in this Standard, and accordingly in general this Standard does not specify whether the costs *recognised* when a *provision* is made are to be *recognised* as an *asset* in particular circumstances. However, this Standard does address the circumstances in which *provisions* relate to an expected recovery from a third party, and whether such recoveries are reported as separate *assets*.

1.3.7 Examples of *provisions* excluded from this Standard's scope under paragraph 1.3(c) are *provisions* for the costs of removing oil rigs or restoring mine sites or contaminated land.

1.3.8 This Standard does not require the *recognition* of *liabilities* and related *assets* arising from *agreements equally proportionately unperformed* (for example, contracts for the supply of materials or equipment) unless they arise from *onerous contracts.* The requirements for "onerous contracts" (which are defined in paragraph 16.1) are set out in section 11 of this Standard.

1.3.9 In practice, *liabilities* arising from *agreements equally proportionately unperformed* that would satisfy the *recognition* criteria for *liabilities* that are set out in this Standard in respect of *provisions* have usually been *recognised* only in respect of particular types of agreements. For many other agreements, significant uncertainty may exist as to whether the definition of, and *recognition* criteria for, *liabilities* would be satisfied. Substantial difficulties may arise in determining a *reliable* and appropriate measure for *liabilities* which may arise from these agreements. In addition, *recognition* of all *liabilities* which arise from *agreements equally proportionately unperformed* and satisfy the criteria for *recognition* would represent a fundamental change to existing reporting practices in Australia and in overseas jurisdictions.

2 Operative Date

2.1 This Standard applies to *annual reporting periods* beginning on or after 1 July 2002.

2.2 This Standard may be applied to *annual reporting periods* beginning before 1 July 2002. An *entity* that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act may apply this Standard to *annual reporting*

***periods* beginning before 1 July 2002, where an election has been made in accordance with subsection 334(5) of the Corporations Act.**

2.2.1 Notice of this Standard was published in the *Commonwealth of Australia Gazette* on 26 October 2001.

3 Purpose of Standard

3.1 The purpose of this Standard is to prescribe requirements for:

(a) the *recognition*, measurement, presentation and disclosure of *provisions* and recoveries receivable to assist users to assess their nature and amount; and

(b) the disclosure of *contingent liabilities* and *contingent assets* to assist users to assess their nature and amount and the uncertainties expected to affect their ultimate outcome.

Liabilities and Provisions

3.1.1 *Liabilities* are defined in this Standard as future sacrifices of economic benefits that the *entity* is presently obliged to make to other *entities* as a result of past transactions or other past events. *Provisions* are a subset of *liabilities.* They are defined in paragraph 16.1 as "*liabilities* for which the amount or timing of the future sacrifice of economic benefits that will be made is uncertain".

Distinction between Provisions and Other Liabilities

3.1.2 Most *liabilities* involve a degree of uncertainty as to the amount or timing of the future sacrifice of economic benefits that will be required to settle them. For *liabilities* other than *provisions* (for example, borrowings, trade creditors and accruals) this uncertainty normally is insignificant and accordingly does not give rise to significant issues concerning measurement and hence *recognition*. In particular:

(a) borrowings are *liabilities* for which the amount (or terms for calculating the amount) and timing of the payments to settle the obligation are specified in the borrowing agreement;

(b) trade creditors are *liabilities* to pay for goods or services that have been received and have been invoiced or formally agreed with the supplier; and

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

3.1.3 In rare cases, the degree of uncertainty regarding the amount or timing of the future sacrifice of economic benefits to settle a *provision* is so great as to prevent *reliable* measurement (and hence *recognition*), in which case the *provision* is classified under this Standard as a *contingent liability*, and not *recognised* in the statement of financial position. The nature of *contingent liabilities* is discussed in paragraphs 3.1.4 to 3.1.7.

Contingent Liabilities

3.1.4 For the purpose of this Standard, *contingent liabilities* are:

(a) possible *liabilities* that arise from past events the existence of which 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

(b) *provisions* that fail either or both of the criteria for *recognition* as *liabilities.* These are:

(i) *provisions* for which it is not *probable* that the future sacrifice of economic benefits will be required; and

(ii) *provisions* the amount of which cannot be measured *reliably* (that is, the degree of uncertainty regarding the amount or timing of the future sacrifice of economic benefits is so great as to prevent *reliable* measurement of the amount of the obligation).

3.1.5 This Standard adopts a broad concept of *contingent liabilities*. Only those *contingent liabilities* described in paragraph 3.1.4(a) are entirely contingent in nature. However, this Standard adopts the view that it is useful to treat all *provisions* that fail either or both of the criteria for *recognition* as *contingent liabilities.* This enables simpler classification of *provisions* as either requiring *recognition* and disclosure, or requiring disclosure without *recognition* in the same way as the possible *liabilities* described in paragraph 3.1.4(a).

3.1.6 It will normally be clear whether a past event has given rise to a present obligation. In rare cases, for example, in litigation, it may be disputed whether certain past events have occurred or whether those past events resulted in a present obligation. In these cases, to determine whether a present obligation existed at the *reporting date* the *entity* considers all available evidence including, where necessary, the opinions of experts. The evidence considered includes information provided by events occurring between the *reporting date* and the *time of completion* of the financial report. Where, after considering the available evidence, it remains unclear whether a present obligation exists, and the existence of a present obligation 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*, a possible obligation is identified and treated as a *contingent liability.*

3.1.7 *Contingent liabilities* are not *recognised* in the statement of financial position. They are disclosed in notes where the probability of a future sacrifice of economic benefits is higher than remote.

Present Obligation

3.1.8 For a past event to give rise to a present obligation, it is necessary that the *entity* 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 (a legal obligation exists); and/or

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

3.1.9 The most common form of present obligation is a legal obligation: an external party has a present legal right to force the *entity* to pay or perform. Equitable or constructive obligations are based on other sanctions that leave the *entity* with no realistic alternative but to make future sacrifices of economic benefits. An equitable obligation is governed by social or moral sanctions or custom rather than legal sanctions. A constructive obligation is created, inferred or construed from the facts in a particular situation rather than contracted by agreement with another *entity* or imposed by government.

3.1.10 It is only those obligations arising from past events and existing independently of the *entity's* future actions or conduct of its operations that satisfy the definition of *liabilities*. An example of these obligations is a penalty for past unlawful trade practices, since, regardless of the future actions of the *entity*, it requires a future sacrifice of economic benefits in settlement.

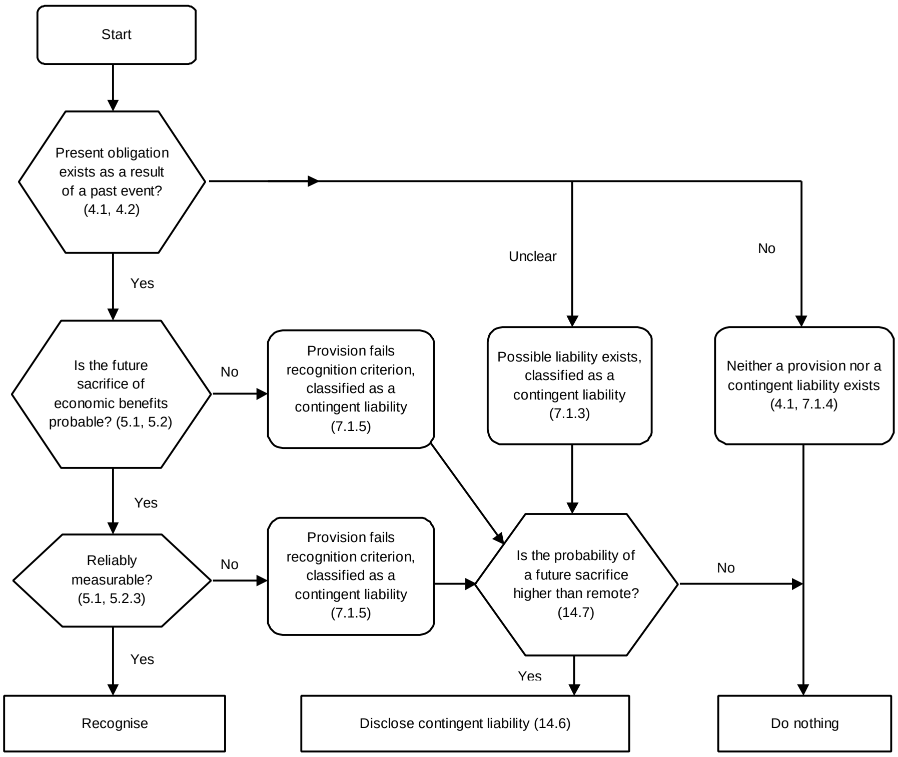
3.1.11 The mere intention to make a future sacrifice of economic benefits is not sufficient to give rise to a present obligation, even if that sacrifice is necessary for the continuation of the *entity's* operations. For example, in order to remain competitive the management or governing body of the *entity* may decide to upgrade equipment in the future. Such a decision does not, of itself, create a present obligation. Another example is where the *entity*, because of commercial pressures or laws governing the manner in which future operations are conducted, intends or needs to sacrifice economic benefits in order to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the *entity* can avoid the future sacrifice of economic benefits by its future actions (for example by changing its method of operation, discontinuing the operation or selling the *assets* concerned), it does not have a present obligation and, therefore, a *liability* does not exist.

3.1.12 An event that does not give rise to an obligation immediately may do so at a later date because changes in the law remove the *entity's* discretion to avoid a future sacrifice of economic benefits (for example, legislation with retrospective effect such as enhanced safety standards that oblige a recall of products previously sold) or because of actions by the *entity* creating a constructive obligation. In situations where it is known at the *reporting date* that a new law is proposed, an obligation only arises if the legislation is virtually certain to be enacted as drafted. There is no universal rule for identifying when it becomes virtually certain that legislation will be enacted as drafted. Depending on the nature of the proposed law, the type of legislative instrument involved and the political environment, the moment when it becomes virtually certain that the legislation will be enacted as drafted can range from when it is announced by the Minister to when it receives Royal Assent. Determining when a particular proposed law becomes virtually certain to be enacted as drafted will be a matter for judgement in the circumstances.

3.1.13 A *liability* always involves another party to whom the obligation is owed by the *entity*, because the *entity* cannot be both the recipient of the economic benefits and the party under the duty to perform. It is not necessary to know the identity of the party to whom the present obligation is owed in order for a present obligation to exist. However, if no other party knows about the matter, the *entity* retains the discretion to avoid making the future sacrifice of economic benefits and a *liability* does not exist. For example, a decision of the *entity's* management or governing body does not, by itself, give rise to a constructive obligation at the *reporting date*, since the *entity* retains the ability to reverse the decision. A present obligation would exist if the decision had been made public or communicated before the *reporting date* to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the *entity* would discharge the obligation.

Decision Flow Chart

The purpose of this decision flow chart is to summarise the main recognition and disclosure requirements of the Standard for provisions and contingent liabilities. Relevant paragraph numbers in the Standard are shown below in parentheses.



Contingent Assets

3.1.14 For the purpose of this Standard, *contingent assets* are:

(a) possible *assets* that arise from past events the existence of which 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

(b) *assets* that fail either or both of the criteria for *recognition* as *assets*. These are:

(i) *assets* for which it is not *probable* that the future economic benefits embodied in them will eventuate; and

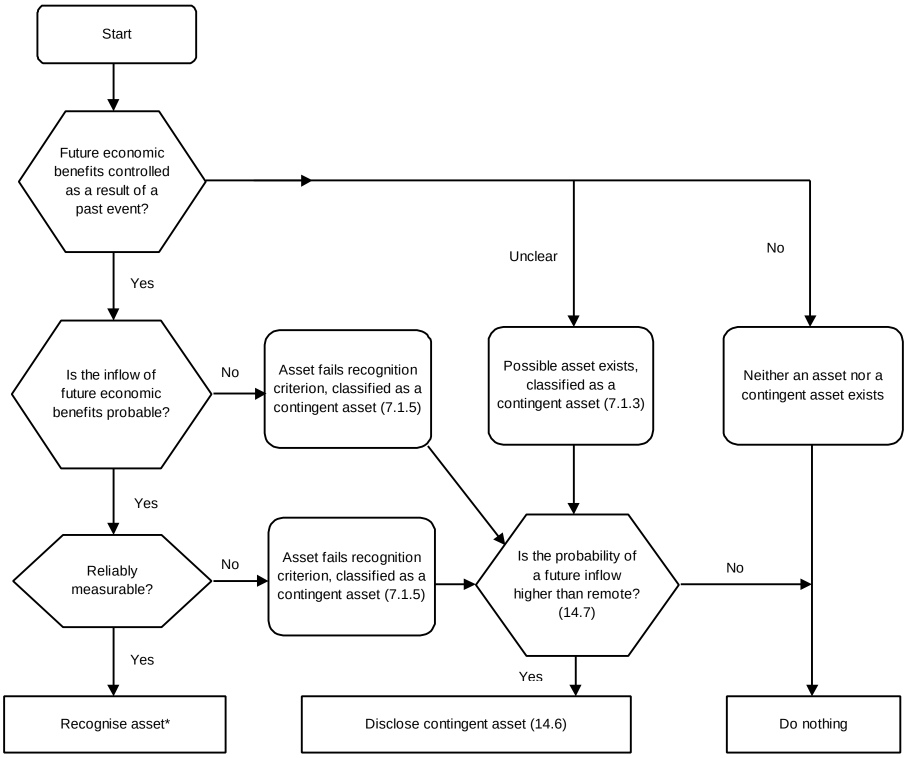
(ii) *assets* that do not possess a cost or other value that can be measured *reliably*.

3.1.15 It will normally be clear whether a past event has given rise to an *asset*. In rare cases, for example, in litigation, it may be disputed whether certain past events have occurred or whether those past events resulted in the *entity* obtaining control of future economic benefits. In these cases, to determine whether an *asset* existed at the *reporting date* the *entity* considers all available evidence including, where necessary, the opinions of experts. The evidence considered includes information provided by events occurring between the *reporting date* and the *time of completion* of the financial report. Where, after considering the available evidence, it remains unclear whether an *asset* exists, and the existence of an *asset* 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*, a possible *asset* is identified and treated as a *contingent asset.*

3.1.16 *Contingent assets* are not *recognised* in the statement of financial position. They are disclosed in notes where the probability of a future inflow of economic benefits is higher than remote.

Decision Flow Chart

The purpose of the decision flow chart is to summarise the main requirements of the Standard for contingent assets. Relevant paragraph numbers in the Standard are shown below in parentheses.



*This Standard does not mandate the recognition of an asset in these circumstances, as assets other than contingent assets are outside the scope of this Standard.

4 Existence of Provisions

4.1 A *provision* exists when, and only when:

(a) the *entity* has a present legal, equitable or constructive obligation to make a future sacrifice of economic benefits to other *entities* as a result of past transactions or other past events; and

(b) the amount or timing of the future sacrifice of economic benefits that will be made to satisfy the present obligation is uncertain.

Present Obligation

4.2 For a present obligation to exist, the *entity* must have no realistic alternative but to make the future sacrifice of economic benefits to settle the obligation.

4.2.1 Examples of *entities* with equitable or constructive obligations that constitute *provisions* are where:

(a) an *entity* has developed a detailed formal plan for a *restructuring* and announced its main features to those affected by the *restructuring* even though it has not entered into any contracts to carry out the *restructuring*. As a result of its actions, the *entity* has no realistic alternative but to proceed with the *restructuring* (specific requirements for the *recognition* of *provisions* for *restructurings* are set out in Section 12); and

(b) an *entity* makes a public announcement that it will match the financial assistance provided by other *entities* to victims of a recent natural disaster and, because of custom and moral considerations, has no realistic alternative but to provide the assistance.

These examples are only intended to indicate when a present obligation exists, and not whether a *provision* would be *recognised* or how it would be measured.

5 Recognition of Provisions

5.1 A *provision* must be *recognised* when, and only when:

(a) **it is *probable* that a future sacrifice of economic benefits will be required; and**

(b) **the amount of the *provision* can be measured *reliably*.**

5.2 It is *probable* that a future sacrifice of economic benefits will be required when it is more likely than less likely that the future sacrifice of economic benefits will be required.

Probable Future Sacrifice of Economic Benefits

5.2.1 Where there are a number of similar obligations (for example, product warranties or similar contracts) the probability that settlement will be required is determined by considering the class of obligations as a whole. Although the probability for any one item may be small, or unascertainable, it may be *probable* that a future sacrifice of economic benefits will be required to settle the class of obligations as a whole. If that is the case, and the amount can be measured *reliably*, a *provision* is *recognised*.

Reliable Measurement

5.2.2 The amount of a *provision* can be measured *reliably* when it can be justified as representing faithfully, without bias or undue error, the future sacrifice of economic benefits that will be required.

5.2.3 The use of estimates is an essential part of the preparation of financial reports and does not of itself undermine their *reliability*. This is especially the case with regard to measuring *provisions*. Difficulty in estimating the amount of a *provision* under conditions of significant uncertainty does not justify non-*recognition* of the *provision*. Even when a range of possible outcomes exists and it is possible to measure *reliably* only the minimum amount of the future sacrifice of economic benefits, a *reliable* measure of the *provision* can be determined.

5.2.4 As noted in paragraph 3.1.3, only in rare cases is it impossible to measure *reliably* the amount of a *provision* and therefore inappropriate to *recognise* it (for example, where the *entity* is defending a claim for unspecified damages against it even though professional advice indicates the defence is unlikely to succeed, and no amount of the claim [including its minimum amount] can be measured *reliably* as at the *reporting date* due to the nature of the claim). In these rare circumstances disclosure of the matter is necessary in accordance with paragraph 14.6.

6 Recoveries

6.1 When some or all of the economic benefits required to settle a *provision recognised* in accordance with paragraph 5.1 are expected to be recovered from a third party, the recovery receivable must be *recognised* as an *asset* when, and only when:

(a) it is *probable* that the recovery will be received; and

(b) the amount of the recovery receivable can be measured *reliably.*

6.2 Recoveries receivable *recognised* as *assets* in accordance with paragraph 6.1 must be measured in a manner consistent with the policies set out in paragraphs 8.1 to 9.2.1.

6.3 In the statement of financial performance, the *expense recognised* in respect of the *provision* may be presented net of the recovery.

6.4 When the recovery of some or all of the economic benefits required to settle a *provision* is *recognised* in accordance with paragraph 6.1, the *provision* and the related *asset* must be set off and the net amount *recognised* in the statement of financial position when, and only when, the *entity*:

(a) has a legally recognised right to set off the *asset* and the *provision*; and

(b) intends either to settle on a net basis, or to realise the *asset* and settle the *provision* simultaneously.

6.4.1 Sometimes the *entity* is able to look to another party to provide part or all of the economic benefits required to settle a *provision.* The third party may either reimburse amounts paid by the *entity* or pay the *entity's* creditor directly. In most cases the *entity* will remain liable for the whole of the costs in question so that, if the third party failed to pay for any reason, the *entity* would have to meet the full cost.

6.4.2 In some circumstances, the *entity* would remain liable for the amounts expected to be recovered from a third party, but have a legally recognised right, by contract or otherwise, to apply an amount due from the third party against an amount due to an *entity* in respect of which a *provision* has been *recognised.* When there is an agreement among the three parties that clearly establishes the *entity's* right of set-off and the *entity* intends to exercise its right, or to settle simultaneously, the amounts are set off. The requirements in this Standard for the setting off of *provisions* and expected recoveries are consistent with the corresponding requirements in Accounting Standard AASB 1014 and Australian Accounting Standard AAS 23 "Set-off and Extinguishment of Debt".

7 Contingent Liabilities and Contingent Assets

7.1 *Contingent liabilities* and *contingent assets* must not be *recognised* in the statement of financial position.

7.1.1 The nature of, and criteria for, disclosures of *contingent liabilities* and *contingent assets* are specified in paragraphs 14.6 to 14.8.

7.1.2 There are two types of *contingent liabilities* and *contingent assets*. These are discussed in paragraphs 7.1.3 to 7.1.5.

7.1.3 One type is possible *liabilities* and possible *assets* that arise from past events, the existence of which 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*. Examples of conditions giving rise to this type of *contingent liabilities* and *contingent assets* are:

(a) a tax audit of the *entity* is in progress and the taxation authority has expressed concern about, but not yet disallowed, particular income tax deductions claimed in previous reporting periods. This gives rise to a possible present obligation for additional income taxes, but the *entity* has independent advice that the deductions were claimed correctly and would dispute any disallowance of the deductions; and

(b) the *entity* has made a claim against another *entity* for alleged negligent acts of an *employee* of the other *entity*. At the *reporting date*, it is unclear whether the *entity* has a right (disputed or agreed) to receive compensation from the other *entity*.

7.1.4 It is important to distinguish the conditions illustrated in paragraph 7.1.3 from those where the *entity* is merely exposed to particular risks. For example, neither the mere conduct of a tax audit nor the mere exposure to risk of future losses (deficits) (for example, the holding of an unhedged position in a foreign currency) are conditions arising from past events that give rise to possible *liabilities*.

7.1.5 The other type of *contingent liabilities* and *contingent assets* is the type where existence is not in doubt but the *liabilities* and *assets* fail either or both of the criteria for *recognition*. Examples of circumstances that give rise to *liabilities* and *assets* that do not meet the criteria for *recognition*, and therefore are *contingent liabilities* and *contingent assets*, are:

(a) the *entity* has provided a firm guarantee or indemnity to a financier, for a loan taken out by another *entity*, and at the *reporting date* default on the loan is less than *probable*;

(b) the *entity* has indemnified another *entity* that constructs or operates a facility for it under contract against certain losses from constructing or operating the facility and either or both of the following applies:

(i) at the *reporting date* it is less than *probable* that an indemnified loss will occur; and

(ii) the amount of any indemnified loss that has occurred cannot be measured *reliably* as at the *reporting date* due to the nature of the indemnified risk;

(c) the *entity* is a trustee for a trust or a responsible entity for a registered scheme and has provided a guarantee to meet any deficiency in the funds of the trust or registered scheme, or to remedy any breach of the trust or scheme, and either or both of the following applies:

(i) at the *reporting date* it is less than *probable* that the *entity* will be called upon to meet a deficiency in the funds of the trust or registered scheme, or to remedy a breach of the trust or scheme; and

(ii) the cost of meeting any deficiency in the funds of the trust or registered scheme, or remedying any breach of the trust or scheme cannot be measured *reliably*; and

(d) the *entity* is making or defending a claim for unspecified damages and no amount of the claim (including its minimum amount) can be measured *reliably* as at the *reporting date* due to the nature of the claim.

7.1.6 Where the *entity* is jointly and severally liable to settle an obligation, it discloses (but does not *recognise*) a *contingent liability* for the part of the "joint obligation" for which it is *probable* that the other parties will meet the cost, except that disclosure is not required when the probability of the future sacrifice of economic benefits is remote. If the *entity* has a right to be reimbursed for any economic benefits that it sacrifices to settle a *contingent liability*, that recovery receivable is a *contingent asset* and therefore is not *recognised* as an *asset*.

7.1.7 *Contingent liabilities* may develop in a way not initially expected. Therefore, they are assessed at each *reporting date* to determine whether an event requiring a future sacrifice of economic benefits has occurred. If it becomes *probable* that a future sacrifice of economic benefits will be required for a *liability* previously disclosed as a *contingent liability* (for example, it becomes *probable* that a trustee or responsible *entity* will be called upon to meet a deficiency in the funds of the trust or registered scheme, or to remedy a breach of the trust or scheme), a *provision* is *recognised* (except in the rare circumstances where the *provision* cannot be measured *reliably*).

8 Measurement of Provisions

Best Estimate

8.1 The amount *recognised* as a *provision* must be the best estimate of the consideration required to settle the present obligation as at the *reporting date*, taking into account the risks and uncertainties that surround the events and circumstances that affect the *provision*.

8.1.1 The best estimate of the consideration is the amount which represents as closely as possible the amount the *entity* would rationally pay at the *reporting date* to settle directly the present obligation immediately or to provide consideration to a third party to assume it. Examples of contractual or other market evidence that can be used to estimate the amount needed to settle immediately a *provision*, whether directly or indirectly, include:

(a) the penalty provisions of a contract that has become *onerous*; and

(b) market prices for third party assumptions of similar classes of warranty obligations.

8.1.2 Making the best estimate of the consideration required to settle a *provision* requires the exercise of judgement of the management or governing body of the *entity*, having regard to experience of similar transactions and, where appropriate, advice from independent experts. The evidence considered includes information provided by events occurring between the *reporting date* and the *time of completion* of the financial report.

8.1.3 It will often be impossible or prohibitively expensive to settle or transfer a present obligation at the *reporting date*. However, it is appropriate to measure *provisions* on this basis in order to represent faithfully the burden on the *entity* of its present obligations as at the *reporting date*. Often, observable market evidence of the amount the *entity* would rationally pay at the *reporting date* to settle directly a *provision* immediately or to provide consideration to a third party to assume the present obligation will not exist, and an alternative method of determining the best estimate of the cost of settling the present obligation needs to be used. In these cases, where the *provision* being measured involves a large population of items (for example, a warranty *provision*) the present obligation is estimated by weighting all possible outcomes by their associated probabilities. This has the advantage that the financial statements reflect the difference, for example, between a 60% chance of loss and a 90% chance of loss of the same amount, rather than presenting the two cases as the same.

Simplified example of the use of probabilities

The *entity* sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects which become apparent within the first year after purchase. If minor defects were detected in all products sold, repair costs of $1,000,000 would result. If major defects were detected in all products sold, repair costs of $4,000,000 would result. On the basis of its experience, the *entity* is able to *reliably* estimate that, for the coming year, 75% of the goods sold will have no defects, 20% of the goods sold will have minor defects, and 5% of the goods sold will have major defects. As noted in paragraph 5.2.1, the *entity* assesses the probability of the future sacrifices of economic benefits for the warranty obligations as a single class. The best estimate of the cost of repairs is $400,000, calculated as follows:

(75% x nil) + (20% x $1,000,000) + (5% x $4,000,000) = $400,000.

8.1.4 When the present obligation being measured does not involve a large population of items, there may be insufficient evidence of the possible outcomes and their probabilities to determine *reliably* the calculations described in paragraphs 8.1.3. In these situations, other methods of estimation are used.

8.1.5 Where a single obligation is being measured, and observable market evidence of the amount the *entity* would rationally pay at the *reporting date* to settle directly the obligation immediately or to provide consideration to a third party to assume it does not exist, it is likely to be more difficult to resolve which is the most probable and *reliable* estimate from a range of outcomes. If there is a continuous range of possible outcomes and each point in the range has the same probability as any other, then the mid-point in the range can be used. If one outcome from the range has a higher probability than any other, that outcome can be described as the most likely outcome, but it would not represent the best estimate if there are a number of other possible outcomes such that the balance of probability is that the actual outcome will be substantially higher or lower than the amount of the most likely outcome. The uncertainty as to the amount ultimately payable may give rise to disclosures under paragraph 14.1(a).

Example of measuring a single obligation

If the *entity* has to rectify a serious fault in a major plant that it has constructed for a customer, the most likely outcome may be for the repair to succeed at the first attempt at a cost of $100,000, but a *provision* for a larger amount is *recognised* if there is a significant chance that further attempts will be necessary.

8.1.6 In some cases an open-ended range of possible outcomes exists and it is possible to make a *reliable* estimate only of the minimum amount of the consideration required to settle the present obligation. In these cases, rather than omitting to *recognise* the *provision*, the minimum amount is used to measure the best estimate of the amount of the *provision.*

Present Value

8.2 When a *provision* is measured using the cash flows estimated to be required to settle the present obligation, its *carrying amount* must be the present value at the *reporting date* of those cash flows.

8.2.1 The estimated cash flows used to measure *provisions* are discounted to their present value to reflect the time value of money. Because of the time value of money, for any given amount of cash outflows to settle a *provision*, the later that they need to be made after the *reporting date*, the lower is the present obligation. If the cash flows were not discounted, two *provisions* giving rise to the same cash flows but with different timings would be reported at the same value, although rational economic appraisal would regard them as different.

Discount Rate

8.3 In measuring a *provision* in accordance with paragraph 8.2, the discount rate (or rates) must 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) must not reflect risks for which future cash flow estimates have been adjusted.

8.3.1 In applying paragraph 8.3, pre-tax discount rates are used. Accordingly, the cash flows used in determining the present value of a *provision* are pre-tax cash flows.

8.3.2 The portion of the increase in a *provision* from the previous *reporting date* to the current *reporting date* which is due to discounted obligations not yet settled being one period closer to settlement, conceptually, ought to be classified as interest. However, the view adopted in this Standard is that the cost of distinguishing the interest component of the increase in a *provision* exceeds the benefit that may be gained from reporting it separately. Accordingly, such an increase is not treated as interest.

8.3.3 Where *provision*s have been measured at their present value, users' understanding of the amount of the *provisions recognised* is likely to be enhanced if assumptions adopted in determining the present value were disclosed. Accordingly, this Standard encourages disclosure of:

(a) changes in the estimated timing and amount of future cash outflows to settle *provisions*; and

(b) the discount rate(s) used, and source(s).

8.4 For the purposes of Accounting Standard AASB 1013 and Australian Accounting Standard AAS 18 "Accounting for Goodwill" and Accounting Standard AASB 1015 and Australian Accounting Standard AAS 21 "Acquisitions of Assets", the amounts calculated in accordance with paragraphs 8.1 to 8.3 are deemed to be equal to the fair values of the *provisions*.

Future Events

8.5 Future events expected to affect the consideration required to settle the *entity's* present obligation must be reflected in the amount provided, when there is *reliable* evidence that they will occur.

8.5.1 The expected future events referred to in paragraph 8.5 and the estimated effect of those future events is based on reasonable and supportable assumptions that represent the best estimate by the management or governing body of the economic conditions that will occur over the period to settlement of the *provision*. External evidence is used in preference to internal evidence, and the assumptions are made consistently with the most recent financial budgets or forecasts that have been approved by the *entity's* management or governing body.

8.5.2 When a *provision* is measured using the present value of cash flows estimated to be required to settle the present obligation, for example, when observable market evidence of the amount the *entity* would rationally pay at the *reporting date* to settle directly a *provision* immediately or to provide consideration to a third party to assume the present obligation does not exist, expected future events are taken into account when there is *reliable* evidence that they will occur.

8.5.3 Expected future events may be important in measuring *provisions*. For example, the *entity* may assess that the cost of settling obligations for product warranties outstanding will be reduced by imminent changes in technology. The effect of possible new legislation is taken into consideration in measuring an existing obligation in the same way that it is considered in relation to the existence of a present obligation in paragraph 3.1.12. In many cases *reliable* evidence will not exist until the new legislation is enacted.

Expected Disposal of Assets

8.6 In measuring a *provision*, gains from the expected disposal of *assets* must not be taken into account.

8.6.1 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, the *entity* *recognises* gains on expected disposals of *assets* at the time specified by another Accounting Standard or an Australian Accounting Standard dealing with the *assets* concerned, for example

Accounting Standard AASB 1004 and Australian Accounting Standard AAS 15 "Revenue".

9 Review of Provisions and Adjustments to their Carrying Amounts

9.1 The *carrying amount* of a *provision* must be reviewed as at each *reporting date* and if the best estimate of the consideration required to settle the present obligation as at the *reporting date* has changed, the *carrying amount* must be revised to the best estimate as at the *reporting date.* A *provision* must be reversed to the extent that it is no longer *probable* that a future sacrifice of economic benefits will be required to settle the obligation.

9.1.1 If the sacrifice of economic benefits made to settle a *provision* during the reporting period, or the latest estimate of the sacrifice of economic benefits to be made in the future, is less than the previous *carrying amount* of the *provision*, the *carrying amount* of the *provision* is reduced by the amount of the excess.

9.2 The *carrying amount* of a *provision* must be reduced in respect of a sacrifice of economic benefits made during the reporting period when, and only when, that sacrifice relates to the item for which the *provision* was originally *recognised*.

9.2.1 When sacrifices of economic benefits occur, they are not set against a *provision* that was originally *recognised* for another purpose, as to do so would conceal the impact of two different events. This Standard requires those sacrifices of economic benefits to be treated as arising from a separate event.

SPECIFIC APPLICATIONS

10 Future Operating Losses (Deficits)

10.1 Estimated future operating losses (deficits) are not *liabilities* and must not be *recognised* as *provisions*.

10.1.1 *Provisions* require future sacrifices of economic benefits in settlement and, except where the costs are included in the cost of acquisition of related *assets*, the *recognition* of *provisions* as *liabilities* involves the *recognition* of *expenses* before the reporting periods in which the sacrifices of economic benefits are made. Similarly, *recognising* so-called future operating losses (deficits) involves *recognising expenses* before the reporting periods in which the sacrifices of economic benefits are made. However, unlike for *provisions*, the estimated net sacrifices of economic benefits relating to future operating losses (deficits) are expected to result from future operations for which a present obligation arising from a past event does not exist. As is indicated in paragraph 3.1.11, the mere expectation of future losses (deficits) from operations does not give rise to a present obligation. The *entity's* management or governing body will generally have the ability to avoid incurring future operating losses (deficits) by either disposing of or *restructuring* the operation in question. Accordingly, future operating losses (deficits) do not satisfy the definition of *liabilities*.

10.1.2 The absence of a present obligation is the primary difference between future operating losses (deficits) and items that qualify for *recognition* as *provisions* under this Standard. An expectation of future operating losses (deficits) is an indication that certain *assets* may potentially be impaired. In this case, the *entity* tests these *assets* for impairment to ensure that they are not carried at more than their recoverable amount. Accounting Standard AASB 1010 and Australian Accounting Standard AAS 10 "Recoverable Amount of Non-Current Assets" require that, with limited exceptions, non-current *assets* are to be reviewed regularly as to whether their *carrying amounts* are recoverable from the net cash inflows they are expected to generate.

10.1.3 Where a *provision* exists and it satisfies the criteria for *recognition* as a *liability*, the need to make the future sacrifice of economic benefits is not an impairment of related *assets*. Therefore, the *provision* is not set off against those *assets*. Similarly, to avoid double-counting, the estimated cash outflows for which a *provision* is *recognised* are not included in the calculation of an *asset's* recoverable amount.

11 Onerous Contracts

11.1 If the *entity* has an *onerous contract*, the present obligation under the contract must be *recognised* and measured as a *provision* to the extent that it exceeds the unrecognised *assets*.

11.1.1 If the *entity* is a party to an *onerous contract*, its entry into the contract is a past transaction or other past event that gives rise to a present obligation. The present obligation comprises a *provision* that is *recognised* and measured in accordance with paragraphs 5.1 to 5.2.4 and paragraphs 8.1 to 9.2.1.

11.1.2 This Standard defines an *onerous contract* as a contract under which the *entity's* unavoidable costs of meeting its obligations under the contract exceed the economic benefits expected to be received. For example, for the seller in a fixed-price sales contract, the contract will become *onerous* if and when it becomes *probable* that the cost of purchasing the goods and services necessary to honour the sales contract exceeds the contracted sales proceeds. 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 fulfil it. *Onerous contracts* include contracts that give rise to unavoidable costs to the *entity* but are no longer expected to give rise to economic benefits in return.

11.1.3 Before a separate *provision* for an *onerous contract* is established, the *entity recognises* any impairment loss that has occurred on *assets* (for example, property, plant and equipment) dedicated to that contract, in the same manner as discussed in paragraph 10.1.2.

12 Restructuring

Provisions for Restructurings Recognised Other Than as a Part of an Acquisition of an Entity or Operation

12.1 Except for *provisions* for *restructurings* that arise under paragraph 12.3 and qualify for *recognition* under paragraphs 12.4(a)(ii) and 12.4(b), a *provision* for a *restructuring* arises when, and only when, the *entity* has:

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

(i) the *entity* or operation concerned;

(ii) the principal locations affected;

(iii) the location, function, and approximate number of *employees* who will be compensated for terminating their services or changing their terms and conditions of employment;

(iv) the future sacrifices of economic benefits that will be made; and

(v) when the plan will be implemented; and

(b) taken either or both of the following actions:

(i) entered into firm contracts to carry out features of the *restructuring*, the penalty provisions of which leave the *entity* with no realistic alternative but to proceed with the *restructuring*; and

(ii) raised a valid expectation in those affected by the *restructuring* that it will carry out the *restructuring* by:

(A) starting to implement the detailed formal plan for the *restructuring*; or

(B) announcing the main features of the plan to those affected by it (or their representatives),

and, as a consequence, the affected parties can be expected to act in such a manner that the *entity* has no realistic alternative but to proceed with the *restructuring*.

Examples of Restructurings

12.1.1 Examples of events that may fall under the definition of *restructuring* are:

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

(b) the closure of operations in a country or region, or the relocation of operations 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 *entity's* operations.

Recognition of Provisions for Restructurings

12.1.2 A *provision* for *restructuring* costs is *recognised* when, and only when, the essential characteristics of a *provision* set out in paragraphs 4.1 and 4.2 and the general *recognition* criteria for *provisions* set out in paragraph 5.1 are met. Section 12 primarily sets out when an *entity* has a present (legal or constructive) obligation in respect of a *restructuring*. Paragraph 12.1 specifies the criteria for identifying *provisions* for *restructurings* that either:

(a) arise other than as a consequence of an acquisition of an *entity* or operation; or

(b) arise as a consequence of an acquisition of an *entity* or operation and do not qualify under paragraph 12.3 as a *provision* for *restructuring* as at the date of the acquisition, and therefore do not qualify to be taken into account in measuring the fair value of the net assets acquired.

12.1.3 The existence of a detailed formal plan for a *restructuring* is not, of itself, sufficient for *recognition* of a *provision*, although it is a necessary condition. Without a detailed plan, it is unlikely that the necessary commitment to the *restructuring* can exist, since a commitment to something that is essentially vague will not have the effect of causing others to take actions that will effectively remove the discretion of the *entity* to withdraw from the *restructuring*. In addition, a reasonably detailed plan is required in order that the amount and timing of the future sacrifices of economic benefits required to settle the *provision* can be measured *reliably*.

12.1.4 Evidence that the *entity* has raised a valid expectation that it will carry out a *restructuring* would be provided, for example, by dismantling plant, selling *assets*, notifying customers that supplies will be discontinued, or notifying *employees* (or their representatives) that their services will be terminated or their terms and conditions of employment will be changed in a manner giving rise to a right to compensation. A public announcement of a detailed plan to *restructure* by itself constitutes a constructive obligation to *restructure* only if it is made in such a way and in sufficient detail (that is, 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 *entity* will carry out the *restructuring*. The communication would need to have the effect that the *entity* has little or no discretion to withdraw from the *restructuring* because:

(a) of the damage that such withdrawal would cause to relationships with *employees* and the community in which the *entity* operates; or

(b) some *employees* will find other jobs and/or some customers and suppliers will find other sources of supply and other customers for their products.

12.1.5 For a plan to give rise to a present obligation when communicated to those affected by it, its implementation is scheduled 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 *entity* is at present committed to the *restructuring*, because the timeframe allows opportunities for the *entity* to alter its decisions.

12.1.6 A decision of the *entity's* management or governing body to *restructure* made before a particular date does not give rise to a constructive obligation at that date unless the *entity* has, before that 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 *entity* will carry out the *restructuring.*

12.1.7 When the *entity* starts to implement a *restructuring* plan, or announces its main features to those affected, between the *reporting date* and the *time of completion* of the financial report, disclosure of this event may be required under Accounting Standard AASB 1002 and Australian Accounting Standard AAS 8 "Events Occurring After Reporting Date".

12.1.8 Although a constructive obligation is not created solely by a management or governing body decision, a present obligation may result from 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 approval by the *entity's* management or governing body. Once that approval has been obtained and communicated to the other parties, the *entity* has a constructive obligation to *restructure*, if the conditions in paragraph 12.1 are met.

12.1.9 For some *entities*, the ultimate authority is held by a supervisory board the membership of which includes representatives of external parties (for example, *employees*). Because a decision by such a board involves communication to these representatives, it may result in a constructive obligation to *restructure*. However, if further consultations or major modifications to the plan are likely to be subsequently required, it is unlikely that the *entity* has a present obligation. If significant changes are possible, for example, as a result of the outcome of further negotiations, the *entity* does not have a constructive obligation in respect of a specific *restructuring* plan.

Costs Included in Provisions for Restructurings

12.2 A *provision* for a *restructuring* must include only those future sacrifices of economic benefits that are:

(a) directly and necessarily caused by the *restructuring*;

(b) not associated with the ongoing activities of the *entity*; and

(c) not *termination benefits*.

12.2.1 Examples of future sacrifices of economic benefits that are included within a *provision* for a *restructuring* are the costs of:

(a) terminating leases and other contracts as a direct result of the *restructuring*;

(b) operations conducted in effecting the *restructuring*, for example *employees'* remuneration while they are engaged in such tasks as dismantling plant, disposing of surplus stocks and fulfilling contractual obligations; and

(c) making *employees* redundant, other than costs of *termination benefits* incurred as a result of the *restructuring*.

The costs of *termination benefits* incurred as a result of a *restructuring* are accounted for under Accounting Standard AASB 1028 "Employee Benefits", which prescribes requirements for the *recognition* and measurement of *termination benefit* obligations arising from *restructurings*. Although these costs are excluded from the scope, and therefore *recognition* requirements, of this Standard, actions giving rise to an obligation to provide *termination benefits* often give rise to a present obligation for other *restructuring* costs (such as those described in paragraph 12.2.1(a) to (c)), which are subject to the *recognition* requirements of this Standard. In addition, *liabilities* for *termination benefits* arising in respect of certain acquisitions of *entities* or operations are disclosed jointly with *provisions* for *restructurings* under paragraphs 14.3 and 14.4.

12.2.2 Examples of costs excluded from *provisions* for *restructurings* are costs of:

(a) retraining or relocating continuing staff;

(b) marketing; or

(c) investment in new systems and distribution networks.

These future sacrifices of economic benefits relate to the future conduct of the *entity* or operation and do not relate to present obligations.

12.2.3 Consistent with paragraph 10.1, estimated future operating losses (deficits) up to the time of performing a *restructuring* are not included in a *provision.*

12.2.4 As required by paragraph 8.6, gains on the expected disposal of *assets* are not taken into account in measuring a *provision* for a *restructuring,* even if the sale of *assets* is envisaged as part of the *restructuring.*

Provisions for Restructurings Recognised as a Part of an Acquisition of an Entity or Operation

12.3 For a *restructuring* of an acquired *entity* or operation that arises as a consequence of the acquisition, a *provision* for the *restructuring* exists as at the date of acquisition when, and only when, the acquirer has:

(a) at, or before, the date of the acquisition, developed the main features of a plan that involves *restructuring* the activities of the acquiree and relates to:

(i) closing facilities of the acquiree;

(ii) eliminating product or service lines of the acquiree; or

(iii) terminating contracts of the acquiree that have become onerous because the acquirer has communicated to the other party or parties at, or before, the date of the acquisition that the contract will be terminated;

(b) by the earlier of:

(i) three months after the date of the acquisition; and

(ii) the *time of completion* of the annual financial report;

developed the main features of the plan described in paragraph 12.3(a) into a detailed formal plan that identifies at least the items set out in paragraph 12.1(a); and

(c) at, or before, the date of the acquisition, taken either or both of the actions set out in paragraph 12.1(b).

12.4 A *provision* for a *restructuring* must be *recognised* by the acquiree as at the date of the acquisition of an *entity* or operation, and taken into account by the acquirer in measuring the fair value of the net assets acquired, when, and only when:

(a) either of the following applies:

(i) the acquiree has satisfied the conditions specified in paragraph 12.1 for the existence of a *provision* for a *restructuring* at, or before, the date of the acquisition; or

(ii) the acquirer has satisfied the conditions specified in paragraph 12.3; and

(b) the *provision* satisfies the *recognition* criteria for a *provision* that are specified in paragraph 5.1.

12.5 *Provisions* for *restructurings recognised* under paragraph 12.4 must include only the costs incurred in *restructuring* the activities of the acquiree that are set out in paragraph 12.3(a).

12.5.1 Paragraph 12.3 specifies the same criteria for identifying the existence and composition of a *provision* for a *restructuring* that occurs as a consequence of an acquisition of an *entity* or operation as those specified for other *provisions* for *restructurings* in paragraph 12.1, except that:

(a) if the main features of the plan for the *restructuring* are developed by the date of the acquisition, a detailed formal plan need not be developed until the earlier of three months after the date of the acquisition and the *time of completion* of the annual financial report; and

(b) unlike paragraph 12.1, it specifies particular actions in respect of which the related costs qualify for inclusion in the *provision.*

12.5.2 The criteria for the *recognition* of *provisions* for *restructurings recognised* as a part of an acquisition of an *entity* or operation, set out in paragraph 12.4, include additional criteria to the *recognition* criteria for other *provisions* for *restructurings*, which are the general criteria for the *recognition* of *provisions* as set out in paragraph 5.1.

12.5.3 *Provisions* for *restructurings* that failed the criteria for *recognition* as at the date of acquisition are excluded from the determination of the fair value of the net assets acquired (and accordingly any goodwill or discount on acquisition). In addition, *provisions* do not exist for future operating losses (deficits) or other costs estimated to be incurred as a result of the acquisition, whether they relate to the acquirer or the acquiree. Applying these policies is pertinent to applying Accounting Standard AASB 1013 and Australian Accounting Standard AAS 18 "Accounting for Goodwill" and Accounting Standard AASB 1015 and Australian Accounting Standard AAS 21 "Acquisitions of Assets". However, *provisions* for *restructurings* can subsequently qualify for *recognition* because they meet the tests in paragraph 12.1, even though they fail to qualify to be taken into account in measuring the fair value of the net assets acquired. This is illustrated in Example 2.2B in Appendix 2.

12.6 The outstanding balance, or any part thereof, of a *provision* for a *restructuring recognised* under paragraphs 12.4(a)(ii) and 12.4(b) must be reversed when, and only when:

(a) settlement is no longer *probable*; or

(b) the detailed formal plan, developed in accordance with paragraph 12.3(b), is not implemented:

(i) in the manner set out in the detailed formal plan; or

(ii) within the timeframe established in the detailed formal plan.

Where the acquisition gave rise to goodwill or discount on acquisition (or could have so given rise), the reversal must be *recognised* directly as an adjustment to goodwill or discount on acquisition (and outside equity interest, where applicable). If the adjustment is a decrease in goodwill, the adjusted *carrying amount* of goodwill must be amortised prospectively in accordance with Accounting Standard AASB 1013 and Australian Accounting Standard AAS 18 "Accounting for Goodwill" from the date as at which the reversal is *recognised*. If the adjustment is an increase in discount on acquisition, a corresponding proportionate reduction must be made to the remaining *carrying amounts* of the non-monetary *assets* acquired until the discount is eliminated. Where a discount balance remains after reducing to zero the recorded amounts of the non-monetary *assets* acquired, the discount balance must be *recognised* immediately as *revenue*. Following any adjustment to the *carrying amounts* of the non-monetary *assets* acquired, the remaining *carrying amounts* of those *assets* must be depreciated prospectively in accordance with Accounting Standard AASB 1021 and Australian Accounting Standard AAS 4 "Depreciation".

12.6.1 A reversal normally is not necessary in respect of *provisions* for *restructurings recognised* under paragraphs 12.4(a)(ii) and 12.4(b) because the detailed formal plan is required to identify the nature and amounts of future sacrifices of economic benefits that will occur. Where such sacrifices of economic benefits do not occur in the planned manner, in the planned timeframe, or are no longer *probable*, the *entity* reverses the *carrying amount* (to the extent the plan is not likely to be implemented or settlement is no longer *probable*), immediately prior to reversal, of those *provisions* for *restructurings*, with a corresponding adjustment to the amount of goodwill or discount on acquisition (and outside equity interests, where applicable). Where a reversal made in accordance with paragraph 12.6 reduces the *carrying amount* of goodwill, no adjustment is *recognised* to compensate for the fact that past amortisation was based on a higher *carrying amount* prior to the reversal. Similarly, where a reversal increases the amount of discount on acquisition, no adjustment is *recognised* to compensate for the fact that past depreciation of the acquired non-monetary *assets* was based on higher *carrying amounts* for those *assets* prior to the reversal. If subsequently a provision for a *restructuring* arises under paragraph 12.1 that is required to be *recognised*, the *entity* *recognises* a corresponding *expense*.

12.6.2 In certain circumstances under Australian Accounting Standard AAS 21 “Acquisitions of Assets”, AAS 27 “Financial Reporting by Local Governments”, or AAS 29 “Financial Reporting by Government Departments”, acquisitions can be accounted for in a way that does not give rise to goodwill or discount on acquisition. An example is the acquisition by a government department of the net assets of another government department for nominal consideration as a result of a *restructuring* of administrative arrangements. In those circumstances, the reversal required by paragraph 12.6 is *recognised* as *revenue* in the reporting period in which the reversal is invoked.

13 Dividends

13.1 Dividends declared, determined or publicly recommended:

(a) on or before the *reporting date* must be *recognised* as a *liability* for the entire amount that remained undistributed at that date, regardless of the extent to which they are expected to be paid in cash; and

(b) by the *time of completion* of the financial report but not on or before the *reporting date*:

(i) must not be *recognised* as a *liability* as at the *reporting date*, but

(ii) must be disclosed (in aggregate) in the financial report.

13.1.1 An *entity's* constitution or enabling legislation may empower the governing body to declare dividends, that is, make a binding decision. In addition, in the public sector, a Minister or the owner may determine a dividend. Alternatively, a governing body may have the power to recommend a dividend and final approval of that recommendation rests with another group, such as shareholders. Even in the case where final approval is required for a recommended dividend the public announcement of that recommendation gives rise to a valid expectation in those affected.

13.1.2 Disclosure of dividends under paragraph 13.1(b) may be made in either or both of the statement of financial position (as a separate component of *equity*) and the notes.

DISCLOSURES

14 Disclosures

Provisions

14.1 Subject to paragraph 14.8, for each *class of provisions,* the following must be disclosed:

(a) a brief description of the nature of the present obligation and of any significant uncertainty about the amount of the future sacrifice of economic benefits (including *relevant* major assumptions about future events); and

(b) the amount of any related estimated recovery, stating the amount of any *asset recognised* for that expected recovery.

14.2 Subject to paragraph 14.8, movements during the reporting period for each *class of provisions* must be disclosed, showing separately:

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

(b) additional *provisions recognised* during the reporting period, including increases to existing *provisions*;

(c) reductions in the *carrying amounts* of *provisions* that result from payments or other sacrifices of economic benefits made during the reporting period; and

(d) reductions in the *carrying amounts* of *provisions* resulting from remeasurement of the estimated future sacrifice of economic benefits or from settlement of the *provisions* without cost to the *entity*.

Provisions for Certain Restructurings and Liabilities for Certain Termination Benefits

14.3 For the purposes of making the disclosures specified in paragraphs 14.1 and 14.2, the sum of items (a) and (b) below must be treated as a separate *class of provisions*:

(a) ***provisions* for *restructurings* occurring as a consequence of acquisitions of *entities* or operations that are *recognised* under paragraphs 12.4 and 12.5; and**

(b) ***liabilities* for *termination benefits recognised* in respect of the same acquisitions under Accounting Standard AASB 1028 "Employee Benefits".**

14.3.1 *Liabilities* for *termination benefits* arising from *restructurings* occurring as a consequence of an acquisition of an *entity* or operation are excluded from the definition and *recognition* requirements of this Standard because those requirements are set out in AASB 1028. However, these *liabilities* are disclosed jointly with *provisions* for *restructurings recognised* under paragraphs 12.4 and 12.5, because they arise from the same event.

14.4 For the items treated as a *class of provisions* as identified in paragraph 14.3, the *carrying amount* as at the *reporting date* must be disclosed separately for each acquisition.

14.5 Comparative information is not required for the disclosures set out in paragraphs 14.1 to 14.4.

Contingent Liabilities and Contingent Assets

14.6 Subject to paragraphs 14.7 and 14.8, the following information for each *class of contingent liabilities* and *class of contingent assets* must be disclosed:

(a) **a brief description of the nature of the *class of contingent liabilities* or *class of contingent assets*;**

(b) **an indication of the uncertainties relating to the amount or timing of any future sacrifice or inflow of economic benefits;**

(c) **an estimate of the potential financial effect, measured in a manner consistent with the policies in paragraphs 8.1 to 9.2.1, or a statement that it is not practicable to make such an estimate when that is the case; and**

(d) **for each *class of contingent liabilities*, the existence and amount of any possible recovery.**

14.6.1 In determining which *provisions*, *contingent liabilities* or *contingent assets* are to be aggregated to form a class, consideration is given to whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs 14.1 and 14.6. For example, it may be appropriate to treat as a single *class of provisions* amounts relating to warranties of different products, but it would be inappropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.

14.6.2 Where a set of circumstances gives rise to the need to *recognise* a *provision* and also gives rise to a *contingent liability* that qualifies for disclosure, the *entity* makes the disclosures required by paragraphs 14.1 to 14.6 in a way that shows the link between the *provision* and the *contingent liability*.

14.7 The disclosures set out in paragraph 14.6 are not required:

(a) in respect of *contingent liabilities*, when the probability of a future sacrifice of economic benefits is remote;

(b) in respect of *contingent assets*, when the probability of a future inflow of economic benefits is remote; and

(c) for the following types of *contingent assets*:

(i) internally generated goodwill;

(ii) identifiable intangible *assets*; and

(iii) *assets* unique to extractive industry operations.

14.7.1 Paragraph 14.7 exempts certain *contingent assets* from the disclosures in paragraph 14.6. Examples of identifiable intangible *contingent assets* exempted from disclosure are intangible unrecognised *assets* arising directly from research and development activities, unrecognised internally developed software and unrecognised customer lists. The exemptions from disclosure in paragraph 14.7 relate mainly to intangible *assets*, as relatively few tangible *assets* would fail the criteria for *recognition* and be classified as *contingent assets*.

Disclosure Exemption

14.8 In extremely rare cases, disclosure of some or all of the information required by paragraphs 14.1, 14.2 or 14.6 would be expected to seriously prejudice the position of the *entity* in a dispute with other parties on the subject matter of the *provision*, recovery receivable, *contingent liability* or *contingent asset*. In such cases, the information need not be disclosed. However, the

general nature of the dispute, together with the fact, and reason why, that information has not been disclosed must be stated.

14.8.1 This exemption from disclosure is applied only in extremely rare cases, for example when only one material *provision* exists and it concerns a dispute with another party that exhibits the characteristics of legal claims that qualify for exemption. Regardless of how sensitive certain information about *provisions* may be, this exemption from disclosure does not affect the requirement to *recognise provisions* that satisfy the criteria for *recognition* set out in paragraph 5.1. When a *class of provisions* exists it is unlikely that disclosure of information regarding the *class of provisions* as a whole will seriously prejudice the position of the *entity* in respect of disputed legal claims.

OTHER REQUIREMENTS

15 Transitional Arrangements

15.1 Except for the *accounting policies* required by paragraphs 12.3 to 12.6, the *accounting policies* required by this Standard must be applied as at the beginning of the reporting period to which this Standard is first applied. Where this, or the voluntary application of paragraphs 12.3 to 12.6 to *liabilities* or *assets* as at the beginning of that reporting period, gives rise to initial adjustments which would otherwise be *recognised* in *net profit or loss/result,* the net amount of those adjustments, including any adjustments to deferred income tax balances, must be adjusted directly against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

15.1.1 The exception in paragraph 15.1 to the application of paragraphs 12.3 to 12.6 allows the *entity* to continue to apply its existing *accounting policies* to any acquisition of an *entity* or operation that occurs before the reporting period to which this Standard is first applied. Paragraphs 12.3 to 12.6 are applied for any acquisition that occurs on or after the beginning of the reporting period to which this Standard is first applied. Those paragraphs may also be applied to acquisitions that occur before that date.

16 Definitions

16.1 In this Standard:

***accounting policies* means the specific accounting principles, bases or rules adopted in preparing and presenting the financial report;**

***agreements equally proportionately unperformed* means agreements under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent;**

***annual reporting period* means the financial year or similar period to which an annual financial report relates;**

***assets* means future economic benefits controlled by the *entity* as a result of past transactions or other past events;**

***carrying amount* means, in relation to an *asset* or a *liability*, the amount at which the *asset* or *liability* is recorded in the accounting records as at a particular date;**

***class of provisions, class of contingent liabilities,* and *class of contingent assets* each means a category of items having a similar nature or function in the operations of the *entity*, which category, for the purpose of disclosure in the financial report, is shown as a single item without supplementary dissection;**

***contingent asset* means:**

(a) a possible *asset* that arises from past events the existence of which 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

(b) an *asset* that is not *recognised* because:

(i) it is not *probable* that the future economic benefits embodied in the *asset* will eventuate; or

(ii) the *asset* does not possess a cost or other value that can be measured *reliably*;

***contingent liability* means:**

(a) **a possible *liability* that arises from past events the existence of which 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**

(b) **a *liability* that is not *recognised* because:**

   (i) **it is not *probable* that a future sacrifice of economic benefits will be required; or**

   (ii) **the amount of the *liability* cannot be measured *reliably*;**

***derivative* means a *financial instrument*:**

(a) **whose value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or similar variable (sometimes called the "underlying");**

(b) **that requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions; and**

(c) **that is settled at a future date;**

***disclosing entity* is defined in the Corporations Act;**

***economic entity* means a group of *entities* comprising the *parent entity* and each of its *subsidiaries*;**

***employee* means a natural person (including a director) appointed or engaged under a contract for services who is subject to the direction of an *employer* in respect of the manner of execution of those services, whether on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, in respect of public sector *entities* that are required to prepare *general purpose financial reports* in accordance with Australian Accounting Standard AAS 27 "Financial Reporting by Local Governments" or AAS 31 "Financial Reporting by**

Governments", all elected representatives are deemed to be *employees*;

employee benefits* means all forms of consideration given by an *entity* in exchange for services rendered by *employees;

***employer* means an *entity*, including an *economic entity*, which consumes the services of *employees* in exchange for providing *employee benefits*;**

***entity* means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives;**

***equity* means the residual interest in the *assets* of the *entity* after deduction of its *liabilities*;**

***expenses* means consumptions or losses of future economic benefits in the form of reductions in *assets* or increases in *liabilities* of the *entity*, other than those relating to distributions to owners, that result in a decrease in *equity* during the reporting period;**

***fair value* means the amount for which an *asset* could be exchanged, or a *liability* settled, between knowledgeable, willing parties in an arm's length transaction;**

***financial asset* means any *asset* that is:**

(a) cash; or

(b) a contractual right to receive cash or another *financial asset* from another *entity*; or

(c) a contractual right to exchange *financial instruments* with another *entity* under conditions that are potentially favourable; or

(d) an equity instrument of another *entity*;

***financial instrument* means any contract that gives rise to both a *financial asset* of one *entity* and a *financial liability* or equity instrument of another *entity*;**

***financial liability* means any *liability* that is a contractual obligation:**

(a) to deliver cash or another *financial asset* to another *entity*; or

(b) to exchange *financial instruments* with another *entity* under conditions that are potentially unfavourable;

***general purpose financial report* means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs;**

***liabilities* means future sacrifices of economic benefits that the *entity* is presently obliged to make to other *entities* as a result of past transactions or other past events;**

***net profit or loss/result* means:**

(a) in the case of an *entity* that is not an *economic entity*, profit or loss/result after income tax expense (income tax revenue) from ordinary activities and extraordinary items; and

(b) in the case of an *entity* that is an *economic entity*, profit or loss/result after income tax expense (income tax revenue) from ordinary activities and extraordinary items, before adjustment for that portion that can be attributed to outside equity interest;

***onerous contract* means a contract under which the *entity's* unavoidable costs of meeting its obligations under the contract exceed the economic benefits estimated to be received;**

***parent entity* means an *entity* which controls another *entity*;**

***probable* means, in relation to a future event, that it is more likely than less likely that the event will occur;**

***provisions* means *liabilities* for which the amount or timing of the future sacrifice of economic benefits that will be made is uncertain;**

***recognised* means reported on, or incorporated in amounts reported on, the face of the statement of financial**

performance or the statement of financial position (whether or not further disclosure of the item is made in the notes);

relevance **means that quality of financial information which exists when that information influences decisions by users about the allocation of scarce resources by:**

(a) **helping them form predictions about the outcomes of past, present or future events; or**

(b) **confirming or correcting their past evaluations;**

and which enables users to assess the discharge of accountability by the management or governing body of the ***entity*****;**

reliability **means that quality of financial information which exists when that information can be depended upon to represent faithfully, and without bias or undue error, the transactions or other events that either it purports to represent or could reasonably be expected to represent;**

reporting date **means the end of the reporting period to which the financial report relates;**

reporting entity **means an** ***entity*** **(including an** ***economic entity*****) in respect of which it is reasonable to expect the existence of users dependent on** ***general purpose financial reports*** **for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources, and includes but is not limited to the following:**

(a) **a** ***disclosing entity*****; and**

(b) **a company which is not a** ***subsidiary*** **of a holding company incorporated in Australia and which is a** ***subsidiary*** **of a foreign company where that foreign company has its securities listed for quotation on a stock market or those securities are traded on a stock market;**

restructuring **means a program that is planned and controlled by the** ***entity's*** **management or governing body, and materially changes either:**

(a) **the scope of an activity undertaken by the** ***entity*****; or**

(b) **the manner in which that activity is conducted;**

revenues **means the inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in *assets* or reductions in *liabilities* of the *entity*, other than those relating to contributions by owners, that result in an increase in *equity* during the reporting period;**

subsidiary **means an *entity* which is controlled by a *parent entity*;**

termination benefits **means *employee benefits* payable as a result of either:**

(a) **an *entity's* decision to terminate an *employee's* employment before the normal retirement date; or**

(b) **an *employee's* decision to accept voluntary redundancy in exchange for those benefits; and**

time of completion **means:**

(a) **in the case of *entities* required to produce a financial report in accordance with the Corporations Act - the date of the Directors' Declaration; and**

(b) **in the case of other *entities* - the date of final approval of the financial report by the management or governing body of the *entity*, whichever is applicable.**

Annual Reporting Period

16.1.1 The definition of *annual reporting period* refers to financial year or similar period and will normally be a twelve-month period. The *annual reporting period* will differ from twelve months in circumstances such as:

(a) the *entity* being established on a date other than a date exactly twelve months before the *reporting date*; and

(b) the *entity* changing its *reporting date.*

APPENDIX 1

SUMMARY OF MAIN REQUIREMENTS

This Appendix forms part of the commentary and is provided only as a summary of the main requirements of this Standard. It should be read in the context of the full text of this Standard.

Table 1.1 Provisions and Contingent Liabilities

<table>
<tr><td colspan="3">Where, as a result of past events, there might be a future sacrifice of economic benefits in settlement of (a) a present obligation; or (b) a possible obligation the existence of which 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:</td></tr>
<tr><td>There is a present obligation that probably will require a future sacrifice of economic benefits and its amount can be measured reliably:</td><td>There is a possible obligation or a present obligation for which the probability of a future sacrifice of economic benefits is higher than remote but less than probable:</td><td>There is a possible obligation or a present obligation for which the probability of a future sacrifice of economic benefits is remote:</td></tr>
<tr><td>A provision is recognised (paragraph 5.1).

Disclosures are required for the provision (paragraphs 14.1 – 14.4).</td><td>No provision is recognised (paragraph 5.1).

Disclosures are required for the contingent liability (paragraph 14.6).</td><td>No provision is recognised (paragraph 5.1).

No disclosure is required for the contingent liability (paragraph 14.7).</td></tr>
</table>

A *contingent liability* also exists in the rare cases where there is a present obligation for which a future sacrifice of economic benefits will probably be required but its amount cannot be measured *reliably*. Disclosures are required for this form of *contingent liability* (paragraph 14.6).

Table 1.2 Contingent Assets

Where, as a result of past events, future economic benefits might eventuate from (a) an *asset*; or (b) a possible *asset* the existence of which 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*:		
There is an *asset* for which it is *probable* that future economic benefits will eventuate and the amount of this *asset* can be measured *reliably*:	There is a possible *asset* or an *asset* for which the probability that future economic benefits will eventuate is higher than remote but less than *probable*:	There is a possible *asset* or an *asset* for which the probability that future economic benefits will eventuate is remote:
The *asset* is not contingent (paragraph 3.1.14). *Assets* that are not contingent are outside the scope of this Standard.	No *asset* is *recognised* (paragraph 7.1). Disclosures are required for the *contingent asset* (paragraph 14.6).	No *asset* is *recognised* (paragraph 7.1). No disclosure is required for the *contingent asset* (paragraph 14.7).

Table 1.3 Recoveries

Some or all of the future sacrifice of economic benefits required to settle a ***provision*** are expected to be met by or recovered from a third party:		
The obligation for the amount expected to be recovered remains with the *entity*, it is *probable* that the recovery will be received, and the amount of the recovery receivable can be measured *reliably*:	The obligation for the amount expected to be recovered remains with the *entity* and the recovery receivable is either less than *probable* to be received or cannot be measured *reliably*:	The *entity* has neither a present obligation for, nor a right in respect of, the part of the future sacrifice of economic benefits to be met by the third party:
The recovery is *recognised* as an *asset* (paragraph 6.1) and, if the conditions for set-off in paragraph 6.4 are satisfied, set-off against the *provision*. Disclosures are required for the recovery receivable (paragraph 14.1(b))	The recovery receivable is not *recognised* as an *asset* (paragraph 6.1). Disclosures are required for the recovery receivable (paragraph 14.1(b)).	There is no *liability* or *asset* to *recognise*, nor does a possible *liability* or possible *asset* (*contingent liability* or *contingent asset*) exist. No disclosure is required.

APPENDIX 2

EXAMPLES OF APPLYING THE CRITERIA FOR THE RECOGNITION OF PROVISIONS

This Appendix forms part of the commentary and is provided to illustrate the application of this Standard's criteria for the *recognition* of *provisions*.

The *entities* in the examples have 30 June *reporting dates* and *annual reporting periods*, except where indicated otherwise. In all cases, it is assumed that a *reliable* estimate can be made of any future sacrifice of economic benefits. In some examples the circumstances described may have resulted in impairment of an *asset* – this aspect is not dealt with in the examples.

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

References to "best estimate" are to the present value amount, where the effect of the time value of money and risks specific to the *liability* is material. When the term "past event" is used, it should be taken to mean a past event that gives rise to a *liability*, as explained in this Standard.

Example 2.1: 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 remedy, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. Based on experience, it is *probable* (that is, more likely than less likely) that there will be claims under the warranties.

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

Future sacrifice of economic benefits – *Probable* for the warranties as a whole (see paragraph 5.2.1).

Conclusion – A *provision* is *recognised* for the best estimate of the costs of making good under warranty those products sold on or before the *reporting date* (see paragraphs 5.1 and 8.1).

[For illustrative disclosures, see Appendix 3, Example 3.1]

Example 2.2A: Restructuring Other Than as a Consequence of an Acquisition of an Entity

Example 2.2A(i) Closure of a Division – No Implementation Before the Reporting Date

On 12 June 2003, the management of an *entity* decided to close down a division. Before the *reporting date* (30 June 2003) 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 event – There has been no past event that gives rise to a present obligation.

Conclusion – No *provision* is *recognised* (see paragraphs 4.1 and 12.1).

Example 2.2A(ii) Closure of a Division – Communication/Implementation Before the Reporting Date

On 12 June 2003, the management of an *entity* decided to close down a division making a particular product. On 20 June 2003 a detailed plan for closing down the division was developed by the management; letters were sent to customers warning them to seek an alternative source of supply, and redundancy notices were sent to the *employees* of the division.

Present obligation as a result of a past event – The past 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.

Future sacrifice of economic benefits – *Probable*.

Conclusion – A *provision* is *recognised* as at 30 June 2003 for the best estimate of the costs of closing the division (see paragraphs 4.1, 5.1 and 12.1). The *liability* relating to *termination benefits* is *recognised* under Accounting Standard AASB 1028 “Employee Benefits”.

Example 2.2B: Restructuring Occurring as a Consequence of an Acquisition of an Entity

Entity A acquires Entity B (a diversified industrial *entity*) on 3 May 2003. In connection with the acquisition, Entity A intends to incur costs to discontinue certain of its own engineering operations and certain engineering operations of Entity B. Furthermore, in order to combine the engineering operations of the two *entities*, Entity A plans to incur integration costs, such as training

Entity B staff, relocating *employees* of Entity A and Entity B, upgrading Entity B's computer system, consolidating and *restructuring* certain functions, and *termination benefits* relating to *employees* performing duplicative functions. Entity A's plans to consolidate and *restructure* certain functions are expected to give rise to costs of terminating leases and engaging *employees* in dismantling plant and selling *assets*.

Entity A (the acquirer) developed the main features of a plan for the *restructuring* of the engineering operations of both *entities* before 3 May 2003, and made a public announcement to the *employees* and customers of both *entities* on 3 May 2003. A detailed formal plan for the *restructuring* was finalised by both *entities* on 31 July 2003. The *time of completion* of the annual financial reports of Entity A, and the *economic entity* of which Entity A is the *parent entity*, for the *annual reporting period* ended on 30 June 2003 was 7 August 2003.

Prior to being acquired by Entity A, Entity B had developed a detailed formal plan for the *restructuring* of its battery products division and made a public announcement to its *employees* and customers, with the effect that it was demonstrably committed to the *restructuring.* The acquisition of Entity B by Entity A did not affect the existence of Entity B's obligation to carry out the *restructuring.*

2.2B(i) At the acquisition date: 3 May 2003

Present obligation as a result of a past event – A present obligation does not arise for either *entity* from a *restructuring* in respect of costs of training or relocating *employees*, and upgrading computer systems, because these are costs of future operations that each *entity* has the discretion to avoid (paragraph 12.2).

As at the acquisition date, a *provision* in respect of the costs of terminating leases and engaging *employees* in dismantling plant and selling *assets* in relation to the *restructuring* of Entity B's engineering operations arises under paragraph 12.3. In addition, at the acquisition date, Entity B had a present obligation for the *restructuring* of its battery products division under paragraph 12.1. These *provisions* would be *recognised* in both Entity B's financial statements and the consolidated financial statements of the *economic entity* of which Entity A is the *parent entity*. However, as at the acquisition date, a *provision* is not identified in respect of any costs relating to the *restructuring* of the engineering operations of Entity A (the acquirer) under paragraph 12.3 (nor under paragraph 12.1).

Future sacrifice of economic benefits – *Probable* in respect of the costs to *restructure* Entity B's engineering operations and battery products division.

Conclusion – Entity B *recognises* a *provision* for the best estimate of the amount to settle its present obligation for the *restructuring* of its engineering operations (see paragraphs 12.3 and 12.4) and battery products division (see paragraphs 12.1 and 12.4). The fair value of this *provision* at the date of the acquisition will be taken into account in determining the amount of any goodwill or discount arising upon the acquisition of Entity B, in accordance with Accounting Standard AASB 1013 and Australian Accounting Standard AAS 18 "Accounting for Goodwill". The *liability* relating to *termination benefits* is *recognised* under Accounting Standard AASB 1028 "Employee Benefits". A *provision* is not *recognised* in respect of the *restructuring* of the engineering operations of Entity A, because the costs of *restructuring* the operations of an acquirer fall outside paragraphs 12.3 and 12.4 (and because the conditions in paragraph 12.1 have not been satisfied).

2.2B(ii) At the First Reporting Date After the Acquisition: 30 June 2003

Present obligation as a result of a past event – A present obligation does not arise for either *entity* from a *restructuring* in respect of costs of training or relocating *employees*, and upgrading computer systems, to the extent that these are costs of future operations that each *entity* has the discretion to avoid (paragraph 12.2). At 30 June 2003, Entity B had a present obligation for the other costs relating to the *restructuring* of its engineering operations. In addition, Entity B had a present obligation for any unsettled costs of *restructuring* its battery products division. Because the detailed formal plan for the *restructuring* of the engineering operations of Entity A was not finalised until 31 July 2003, a present obligation for that *restructuring* did not exist at 30 June 2003 (see paragraph 12.1).

Future sacrifice of economic benefits – *Probable* in respect of the costs to *restructure* Entity B's engineering operations and battery products division.

Conclusion – A *provision* is *recognised* for the best estimate of the amount to settle Entity B's present obligations for the *restructuring* of its engineering operations (see paragraphs 12.3 and 12.4) and battery products division (see paragraphs 12.1 and 12.4). The *liability* relating to *termination benefits* is *recognised* under AASB 1028.

2.2B(iii) At the Following Reporting Date: 31 December 2003

Present obligation as a result of a past event – As for 3 May 2003 and 30 June 2003, a present obligation does not arise for either *entity* from a *restructuring* in respect of costs of training or relocating *employees*, and upgrading computer systems to the extent that these are costs of future operations (see paragraph 12.2.2). At 31 December 2003, both Entity A and Entity B had a present obligation for the unsettled component of the costs of terminating leases and engaging *employees* in dismantling plant and selling *assets* in relation to the *restructuring* of their engineering operations. In addition, Entity B had a present obligation for any unsettled costs of *restructuring* its battery products division.

Future sacrifice of economic benefits – *Probable* in respect of both *entities'* present obligations for *restructuring*.

Conclusion – A *provision* is *recognised* for the best estimate of the amount to settle Entity A's and Entity B's present obligations for the *restructuring* of the engineering operations and battery products division. The *liability* relating to *termination benefits* is *recognised* under AASB 1028.

Example 2.3: Legal Requirement to Fit Smoke Filters

Under new legislation, an *entity* is required to fit smoke filters to its factories by 31 December 2003 and *entities* that do not comply will be fined or required to pay penalties. The *entity* has not fitted the smoke filters.

2.3A At the Reporting Date: 30 June 2003

Present obligation as a result of a past event – There is no present obligation because there is no past event either for the costs of fitting smoke filters or for fines under the legislation. The *entity* can avoid the costs of fitting smoke filters by its future actions (for example by changing its method of operation, discontinuing the operation or selling the *assets* concerned). For the same reason, the *entity* can avoid the costs of fines under legislation that comes into force after the *reporting date*.

Conclusion – No *provision* is *recognised* for the cost of fitting the smoke filters (see paragraphs 3.1.11, 4.1 and 5.1).

2.3B At the Reporting Date: 30 June 2004

Present obligation as a result of a past event – There is still no present obligation for the costs of fitting smoke filters because a past event committing the *entity* to fitting the filters has not occurred. The *entity* can still avoid the costs of fitting smoke filters by its future actions (for example, by changing its method of operation, discontinuing the operation or selling the *assets* concerned). However, the *entity* has failed to observe the legislation in force and this failure represents a past event giving rise to an obligation that may be imposed to pay fines or penalties under the legislation.

Future sacrifice of economic benefits – Assessment of probability of fines and penalties being imposed for 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 *probable* (see paragraphs 3.1.11, 4.1 and 5.1).

Example 2.4: 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 *entity* will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with regulations governing operations in the *entity's* industry. At the *reporting date*, no retraining of staff has taken place.

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

Conclusion – No *provision* is *recognised* (see paragraphs 3.1.11, 4.1 and 5.1).

Example 2.5: A Single Guarantee

In February 2003, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 2004, the financial condition of Entity B deteriorates, and at 30 June 2004, Entity B voluntarily appoints an administrator.

2.5A At the Reporting Date: 30 June 2003

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

Future sacrifice of economic benefits – Less than *probable* at 30 June 2003.

Conclusion – No *provision* is *recognised* (see paragraphs 4.1 and 5.1). The guarantee is disclosed as a *contingent liability* (see paragraphs 7.1.5 and 14.6).

2.5B At the Reporting Date: 30 June 2004

Present obligation as a result of a past event – The past event remains the signing of the guarantee, which has not been revoked and still gives rise to a legal obligation.

Future sacrifice of economic benefits – At 30 June 2004, it is *probable* that a future sacrifice of economic benefits will be required to settle the obligation.

Conclusion – A *provision* is *recognised* for the best estimate of the obligation (see paragraphs 4.1 and 5.1).

Note: This example deals with a single guarantee. If an *entity* has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether any future sacrifice of economic benefits is *probable* (see paragraph 5.2.1).

Example 2.6: A Court Case

After a wedding in January 2003, ten people became ill, possibly as a result of food poisoning from food provided by a caterer. Legal proceedings were started seeking damages from the caterer, but it disputes liability. Up to the *time of completion* of the financial report for the year to 30 June 2003, the caterer's lawyers advised that it was *probable* that the *entity* would not be found liable. However, when the caterer prepared the financial report for the year to 30 June 2004, its lawyers advised that, owing to developments in the case, it was *probable* that it would be found liable. The caterer is insured against damages for the effects of food it provides to customers, and its lawyers advise that the insurance policy covers the caterer for the full amount of the damages claimed.

2.6A At the Reporting Date: 30 June 2003

Present obligation as a result of a past event – On the basis of the evidence available at the *time of completion* of the financial report, a possible obligation exists.

Conclusion – A *provision* is not *recognised* (see paragraphs 7.1 and 7.1.3). The possible *liability* and possible *asset* (being the amount claimable from the *entity's* insurer) are disclosed as a *contingent liability* and *contingent asset* if the possibility of a future sacrifice and inflow of economic benefits is higher than remote (see paragraphs 14.6 and 14.7).

2.6B At the Reporting Date: 30 June 2004

Present obligation and *asset* (recovery) as a result of a past event – On the basis of the evidence available, there is a present obligation and a related *asset* in the form of a guarantee from the insurer that it will provide a recovery of the damages paid.

Future sacrifice and inflow of economic benefits – *Probable*.

Conclusion – A *provision* is *recognised* for the best estimate of the amount to settle the obligation, and an *asset* is *recognised* for the best estimate of the recovery from the insurer (see paragraphs 5.1, 6.1, 6.2 and 7.1.7).

Example 2.7: Repairs and Maintenance

Some *assets* require, in addition to routine maintenance, substantial sacrifices of economic benefits every few years for major refits or refurbishment and the replacement of major components. Subsequent expenditure on an *asset* should be allocated to its component parts where these components have different useful lives. Where the expenditure improves the condition of the *asset* beyond its originally assessed standard of performance, it is added to the *carrying amount* of the *asset* (refer to Accounting Standard AASB 1021 and Australian Accounting Standard AAS 4 "Depreciation", paragraphs 5.7 to 5.7.3).

2.7A Refurbishment Costs – No Legislative Requirement

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

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

Conclusion – No *provision* is *recognised* (see paragraphs 3.1.8, 3.1.11 and 4.1).

The cost of replacing the lining is not *recognised* because, at the *reporting date*, no obligation to replace the lining exists. The need to replace the lining is dependent on the *entity's* future actions. Even the intention to replace the lining depends on the *entity* deciding to continue operating the furnace. Instead of a *provision* being *recognised*, the depreciation of the lining takes account of its consumption, that is, it is depreciated over five years. Re-lining costs when incurred are capitalised and the consumption of each new lining is *recognised* as depreciation over the subsequent five years.

2.7B 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 event – There is no present obligation.

Conclusion – No *provision* is *recognised* (see paragraphs 3.1.8, 3.1.11 and 4.1)

The costs of overhauling aircraft are not *recognised* as a *provision*, for the same reasons that a *provision* is not *recognised* for the cost of replacing the lining in Example 2.7A. Even a legal requirement to overhaul an *asset* does not make the costs of overhaul a *liability*, because no obligation exists to overhaul the *asset*. The need to overhaul its aircraft is dependent on the *entity's* future actions. The *entity* could avoid the future sacrifice of economic benefits by its future actions, for example by selling the aircraft.

The treatment of cyclical maintenance is covered by AASB 1021 and AAS 4. Accordingly, instead of a *provision* being *recognised*, the depreciation of the aircraft takes account of the timing of replacement of component parts. However, overhaul costs other than costs of replacing components of an *asset* are *recognised* as an *expense* in the reporting period in which the overhaul occurs, because those costs do not qualify for *recognition* as an *asset*.

Example 2.8: Self-Insurance

An *entity* that operates a chain of retail outlets has reviewed its insurance arrangements for its *liability* in respect of accidents sustained by its customers. It establishes that, based on its experience, the cost of these accidents is $100,000 a year. Instead of continuing its policy with an insurance provider, it decides to "self insure": that is, to retain the risk of these losses.

Present obligation as a result of a past event – A present obligation for the cost of uninsured accidents arises when the accidents occur. Therefore, when uninsured accidents occur on or before the *reporting date*, including those for which the customer has yet to make a claim, the past events giving rise to a present obligation to settle the claims have occurred. However, so-called *provisions* for self-insurance do not involve a present obligation where uninsured accidents have not occurred on or before the *reporting date*.

The claims *expense* incurred by the *entity* may be more volatile than the pattern of premium *expense* that would have been reported had the *entity* insured its risks. Such increased volatility would faithfully represent the consequences of retaining the risk of claims for accidents.

Future sacrifice of economic benefits – To assess whether it is *probable* that a future sacrifice of economic benefits will be required in respect of accidents that have occurred before the *reporting date*, the *entity* will examine claims reported but not settled by the *reporting date* and consider its experience with claims incurred but not reported by previous *reporting dates*.

Conclusion – If it is *probable* that a future sacrifice of economic benefits will be required in respect of accidents that have occurred before the *reporting date*, a *provision* is *recognised* for the best estimate of the amount to settle the present obligation for those accidents (see paragraphs 4.1, 5.1 and 8.1).

APPENDIX 3

ILLUSTRATIONS OF DISCLOSURES

This Appendix forms part of the commentary and is provided to illustrate this Standard's disclosure requirements. It does not illustrate every possible disclosure that may be appropriate to the circumstances of *entities* with similar *provisions.*

Example 3.1 illustrates the disclosures required by paragraphs 14.1 and 14.2. Examples 3.2A and 3.2B illustrate disclosures made under paragraph 14.8.

Example 3.1 Warranties

As in Example 2.1 of Appendix 2, a manufacturer gives warranties at the time of sale to purchasers of its products. Under the terms of the contract of sale, the manufacturer warrants to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. At the *reporting date* of 30 June 2003, a *provision* of $60,000 was *recognised* as the best estimate of the costs of meeting the obligation. The *provision* was not discounted to its present value as the effect of discounting was not material.

During the year ending 30 June 2004, the manufacturer paid $50,000 for repairs under warranty and sales increased by 20%, by including sales of new product lines (carrying the same warranty). At the end of the year, the best estimate of the costs of meeting the warranty obligation was $70,000.

Disclosures at the reporting date of 30 June 2004

(See paragraph 14.1 of this Standard)

"A provision of $70,000 has been recognised for estimated warranty claims in respect of products sold during the last three financial years."

(See paragraph 14.2 of this Standard)

Provision for Warranty Claims	*at 1 July 2003*	*$60,000*
Claims settled during the year		*(50,000)*
Claims incurred during the year [including estimates]		*60,000*
Provision for Warranty Claims	*at 30 June 2004*	*$70,000*

Example 3.2 Disclosure Exemption

Example 3.2A Negligence Claim

In the circumstances described in Example 2.6 of Appendix 2, litigation against a caterer was commenced early in the year 2003. In contrast with the facts noted in Example 2.6, the insurance policy does not cover the caterer for any claims of damages. In addition to the other advice noted in Example 2.6, the advice from the lawyers in June 2003 was that any disclosure could seriously affect the position of the *entity* in court. In June 2004, the lawyers again advised that disclosure could affect the court proceedings yet to be heard. Based on paragraph 14.8 and the conclusions in Example 2.6A and 2.6B, the caterer could make the following disclosures:

Disclosures as at the reporting dates of 30 June 2003 and 30 June 2004

The entity is being sued for unspecified and uninsured damages in relation to an incident in 2003 in which 10 people claim they became ill after eating food provided by the entity. The entity is involved in litigation denying the allegations. Details of the case are sub judice. In accordance with Accounting Standard AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets", the information usually required by that Standard is not disclosed on the grounds that it may seriously prejudice the outcome of this case.

Example 3.2B Infringement of Patents Claim

An *entity* is involved in a dispute with a competitor, who is alleging that the *entity* has infringed patents and is seeking damages of $100 million that the directors believe can be successfully resisted. The *entity recognises* a *provision* for its best estimate of the obligation, but discloses none of the information required by paragraphs 14.1 and 14.2 of this Standard. The following information is disclosed:

Litigation is in process against the entity relating to a dispute with a competitor who alleges that the entity has infringed patents and is seeking damages of $100 million. The information usually required by Accounting Standard AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets" is not disclosed on the grounds that it can be expected to seriously prejudice the outcome of the litigation. The directors are of the opinion that the claim can be successfully resisted by the entity.

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards issued by the International Accounting Standards Board

IAS 37 "Provisions, Contingent Liabilities and Contingent Assets"

At the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" except in the following areas.

Derivatives

The scope of this Standard excludes derivatives that are not financial guarantees. IAS 37 does not explicitly exclude provisions arising from such instruments from its scope. However, they are implicitly excluded because the primary International Accounting Standard relating to these instruments is International Accounting Standard IAS 39 "Financial Instruments: Recognition and Measurement". There is no Standard in Australia that is equivalent to IAS 39.

Costs of Disposal or Retirement of Long-Lived Assets

The scope of this Standard excludes provisions in respect of the costs of disposal or retirement of long-lived assets, such as the costs of removing oil rigs or restoring mine sites or contaminated land. IAS 37 does not exclude these provisions from its scope. The Board believes that it would be inappropriate to prescribe requirements for the recognition of these provisions without specifying whether the related costs (and changes in estimates of those costs) should be recognised as increases in assets or as expenses. Consistent with IAS 37, this Standard does not address the classification of costs relating to provisions. The Board will undertake a separate project on provisions in respect of the costs of disposal or retirement of long-lived assets.

Criteria for the Recognition and Set-off of Expected Recoveries of Costs relating to Provisions

Consistent with the asset recognition criteria in Statement of Accounting Concepts SAC 4 "Definition and Recognition of the Elements of Financial Statements", this Standard specifies that expected recoveries of costs relating to provisions are recognised when it is probable that they will be received. IAS 37 specifies that expected recoveries are recognised as assets when it is virtually certain that they will be received if the related obligation is settled. In addition, expected recoveries recognised in accordance with paragraph 6.1 of this Standard must be set off against the related provision when they satisfy the set-off criteria in Accounting Standard AASB 1014 and Australian Accounting Standard AAS 23 "Set-off and Extinguishment of Debt". IAS 37 prohibits the setting off of provisions and expected recoveries.

Sale of an Operation

IAS 37 specifies that, where an operation is to be sold, a demonstrable commitment for a restructuring arises when there is a binding sale agreement. This Standard accepts that where an operation is to be sold, a demonstrable commitment can arise before a binding sale agreement exists, provided that the entity has a detailed formal plan for the restructuring and is without a realistic possibility of withdrawal (see paragraph 12.1).

Provisions for Restructurings

This Standard specifies that in order to create a constructive obligation for a restructuring, it is necessary that the commencement of implementation or public announcement of the restructuring plan can be expected to cause the affected parties to act in such a manner that the entity has no realistic alternative but to proceed with the restructuring (see paragraph 12.1(b)(ii)). IAS 37 does not include this test of a constructive obligation.

Disclosures

For each class of provisions, IAS 37 requires disclosure of the expected timing and uncertainty about timing of the future sacrifices of economic benefits to settle the provisions. In addition, IAS 37 requires separate disclosure of the increase in the carrying amount of a class of discounted provisions which is due to the passage of time and the effect of any change in the discount rate and, separately, unused amounts reversed during the period. This Standard does not require these disclosures, adopting the view that the cost of making them is likely to exceed the resulting benefits. Instead, this Standard requires separate disclosure of reductions in the carrying amounts of provisions resulting from remeasurement of the estimated future sacrifice of economic benefits or from settlement of the provisions without cost to the entity, without disaggregation.

Unlike IAS 37, this Standard specifically exempts the following contingent assets from specified disclosures: internally generated goodwill, identifiable intangible assets and assets unique to extractive industry operations. This exemption is provided because they require further specific consideration by the AASB.

IAS 22 "Business Combinations"

Provisions for Restructurings Arising Upon an Acquisition of an Entity or Operation

At the date of issue of this Standard, compliance with this Standard will ensure conformity with the treatment of provisions for restructurings arising upon an acquisition of a business as set out in International Accounting Standard IAS 22 "Business Combinations" except in relation to the following matter.

IAS 22 requires an acquirer (but not an acquiree) to recognise a provision for a restructuring that was not a liability of an acquiree at the date of acquisition if the acquirer has, among other things, by the earlier of three months after the date of acquisition and the time of completion of the annual financial report, developed the main features of a plan for restructuring the activities of the acquiree into a detailed formal plan. In contrast, this Standard requires, under similar circumstances, the acquiree to recognise a provision for a restructuring on its acquisition by the acquirer, and the acquirer to take it into account in allocating the cost of acquisition and in determining the amount of goodwill or discount on acquisition (see paragraphs 12.3 and 12.4). Therefore, this Standard requires the acquiree to recognise a provision for a restructuring on acquisition, whilst IAS 22 requires only the acquirer to recognise a provision for a restructuring on acquisition in its consolidated financial statements.

IAS 10 "Events After the Balance Sheet Date"

Dividends Declared, Determined or Publicly Recommended

This Standard requires the recognition of a liability for dividends when dividends are declared, determined or publicly recommended. International Accounting Standards do not explicitly prescribe when a liability for dividends is required to be recognised. At the date of issue of this Standard, compliance with this Standard will ensure conformity with the treatment of dividends that are declared or proposed after the reporting date, as set out in International Accounting Standard IAS 10 "Events After the Balance Sheet Date".

Conformity with International Public Sector Accounting Standards issued by the Public Sector Committee of the International Federation of Accountants

At the date of issue, this Standard has no corresponding International Public Sector Accounting Standard.

Conformity with New Zealand Accounting Standards

FRS-15 "Provisions, Contingent Liabilities and Contingent Assets"

At the date of issue of this Standard, compliance with this Standard will ensure conformity with New Zealand Financial Reporting Standard FRS-15 "Provisions, Contingent Liabilities and Contingent Assets" except in the following areas.

Costs of Disposal or Retirement of Long-Lived Assets

The scope of this Standard excludes provisions in respect of the costs of disposal or retirement of long-lived assets, such as the costs of removing oil rigs or restoring mine sites or contaminated land. Consistent with IAS 37, FRS-15 does not exclude these provisions from its scope.

Treatment of Recoveries

Consistent with IAS 37, this Standard allows the expense recognised in respect of a provision to be presented net of any recoveries in the statement of financial performance (see paragraph 6.3). In contrast, FRS-15 requires the expense and any recoveries relating to a provision to be presented separately.

Expected recoveries recognised in accordance with paragraph 6.1 of this Standard must be set off against the related provision when they satisfy the set-off criteria in Accounting Standard AASB 1014 and Australian Accounting Standard AAS 23 "Set-off and Extinguishment of Debt". FRS-15 prohibits the setting off of provisions and expected recoveries.

Sale of an Operation

Consistent with IAS 37, FRS-15 specifies that, where an operation is to be sold, a demonstrable commitment for a restructuring arises when there is a binding sale agreement. This Standard accepts that where an operation is to be sold, a demonstrable commitment can arise before a binding sale agreement exists, provided that the entity has a detailed formal plan for the restructuring and is without a realistic possibility of withdrawal (see paragraph 12.1).

Provisions for Restructurings

This Standard specifies that in order to create a constructive obligation for a restructuring, it is necessary that the commencement of implementation or public announcement of the restructuring plan can be expected to cause the affected parties to act in such a manner that the entity has no realistic alternative but to proceed with the restructuring (see paragraph 12.1(b)(ii)). Like IAS 37, FRS-15 does not include this test of a constructive obligation.

Provisions for Restructurings Arising Upon an Acquisition of an Entity or Operation

This Standard and IAS 22 specify conditions additional to those required by FRS-15 that need to exist before a provision for restructuring arising from the acquisition of an entity or operation can be recognised. In contrast to this Standard and IAS 22, New Zealand Financial Reporting Standards are silent regarding a condition in this Standard and IAS 22 that a detailed formal restructuring plan must be developed within the earlier of three months after the date of the acquisition and the time of completion of the annual financial report before a provision can be recognised as at the date of acquisition (see paragraph 12.3(b)), and whether the acquirer (consistent with IAS 22) or the acquiree (consistent with this Standard) recognises the provision.

Disclosures

FRS-15 specifies the following disclosures that are not required by this Standard:

(a) the expected timing of any future sacrifices of economic benefits, for each class of provisions (however, Accounting Standard AASB 1040 and Australian Accounting Standard AAS 36 "Statement of Financial Position" require that, except where categorisation of assets and liabilities on a liquidity basis provides more relevant and reliable information, provisions are to be categorised between their current and non-current portions);

(b) the increase in the carrying amount of a discounted provision which is due to the provision being closer to settlement or to a change in the discount rate, and, separately, unused amounts reversed during the period, for each class of provisions. Instead, this Standard requires separate disclosure of reductions in the carrying amounts of provisions resulting from remeasurement of the estimated future sacrifice of economic benefits or from settlement of the provisions without cost to the entity, without disaggregation;

(c) contingent assets that are unique to extractive industry operations; and

(d) contingent assets and liabilities that are remote, if knowledge of the transaction or event is necessary to achieve the objectives of general purpose financial reporting.

FRS-5 "Accounting for Events Occurring After Balance Date"

Dividends Declared, Determined or Publicly Recommended

This Standard requires the recognition of a liability for dividends when dividends are declared, determined or publicly recommended. New Zealand Financial Reporting Standards do not explicitly prescribe when a liability for dividends is required to be recognised. At the date of issue of this Standard, compliance with this Standard will ensure conformity with the treatment of dividends that are declared or proposed after the reporting date, as set out in New Zealand Financial Reporting Standard FRS-5 "Accounting for Events Occurring After Balance Date".

DEVELOPMENT OF THE STANDARD

This section does not form part of the Standard. It is a summary of the development of the Standard.

1 The issue of the Standard is part of a program commenced by the former Australian Accounting Standards Board and the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation (the Boards) to achieve greater harmony between Australian accounting standards and those of the International Accounting Standards Committee (IASC). The reconstituted Australian Accounting Standards Board (AASB) is continuing this program and has issued the Standard as part of a single series of Standards rather than in the former two series of Standards, that is, the Accounting Standard series and the Australian Accounting Standard series.

2 The issue of the Standard follows consideration of the responses received on Exposure Draft ED 88 "Provisions and Contingencies" (which was prepared by the Boards and released in December 1997), and Invitation to Comment "Provisions and Contingencies: Restructuring Upon Acquisitions, and Transitional Provisions" (which was prepared by the Boards and released in February 1999).

3 ED 88 contained proposals aimed at harmonising Australian accounting standards with the proposed standards in IASC Exposure Draft E59 "Provisions, Contingent Liabilities and Contingent Assets" (which was finalised and issued by the IASC in 1998 as International Accounting Standard IAS 37 "Provisions, Contingent Liabilities and Contingent Assets").

4 The Invitation to Comment contained proposals on whether to harmonise with the part of International Accounting Standard IAS 22 "Business Combinations" dealing with the recognition of provisions for restructuring occurring as a consequence of an acquisition of an entity or operation.

5 The Standard also deals with whether liabilities should be recognised for dividends declared, determined or publicly recommended after the reporting date. International Accounting Standard IAS 10 "Events After the Balance Sheet Date", which was amended in March 1999, contains requirements in respect of this issue.

Noteworthy Differences from ED 88

6 The Standard retains most of the content of ED 88, which in turn was based mainly on the IASC's E59.

7 As a consequence of comments received from constituents and other considerations, the Standard differs from the proposals in ED 88 in a number of respects. In particular, the Standard:

(a) excludes provisions in respect of obligations associated with the retirement or disposal of long-lived assets from its scope, to address concerns that it is also necessary to specify whether related costs and changes in estimates of those costs should be recognised as increases in assets or as expenses;

(b) restricts the definition of contingent liabilities to possible liabilities and liabilities that fail the criteria for recognition (this change, and the corresponding change noted below regarding contingent assets, conforms with IAS 37 and helps simplify the treatment of contingent liabilities and contingent assets);

(c) restricts the definition of contingent assets to possible assets and assets that fail the criteria for recognition;

(d) specifies that to identify a provision for a restructuring that occurs as a consequence of an acquisition of an entity or operation, if the main features of the plan for the restructuring are developed by the date of the acquisition, a detailed formal plan need not be developed until the earlier of three months after the date of the acquisition and the time of completion of the annual financial report. This change conforms with IAS 22. It is notable that the criteria for recognising a provision for a restructuring arising as a consequence of an acquisition of an entity or operation are more stringent than those set out in Urgent Issues Group Abstract 8 "Accounting for Acquisitions – Recognition of Restructuring Costs as Liabilities". The requirements in relation to the recognition of provisions for restructurings recognised as a part of an acquisition of an entity or operation, including the "relief" provided by paragraph 12.3(b) (the so-called three-month window), will be reviewed when IAS 22 is reviewed by the IASB;

(e) specifically exempts the following contingent assets from the disclosure requirements for contingent assets: internally generated goodwill, identifiable intangible assets and assets unique to extractive industry operations. These exemptions are provided because they require further specific consideration by the AASB;

(f) specifies that the discount rate for provisions is the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability (where those risks are not reflected in the future cash flow estimates). This change is consistent with IAS 37;

(g) prohibits, rather than requires, deducting from provisions for restructurings the gains estimated to result from the future disposal of assets. This change conforms with IAS 37;

(h) prohibits, rather than requires, the recognition of liabilities for dividends that were not declared, determined or publicly recommended on or before the reporting date. This change conforms with an amendment to IAS 10 in March 1999;

(i) clarifies that liabilities for dividends are to be recognised for the entire amount of declared, determined or publicly recommended dividends that remain undistributed at the reporting date, regardless of the extent to which they are expected to be paid in cash or otherwise, for example, in shares as part of a dividend reinvestment plan. This policy is based on the principle that the entity's present obligation at the reporting date is for the entire amount of the undistributed dividends;

(j) omits the proposed requirement to disclose separately the increase in the carrying amount of provisions due to the accrual of interest. The Board believes that the cost of distinguishing that component of the increase in provisions exceeds the benefits from its separate disclosure as interest; and

(k) includes transitional provisions requiring, with a limited exception, the adjustment of opening balances of assets and liabilities upon initial adoption of the Standard, with a corresponding adjustment made directly to the opening balance of retained profits (surplus) or accumulated losses (deficiency).