



HM TREASURY

Financial Reporting Advisory Board Paper

Implementation of IAS 37 and IFRIC 5 in an IAS/IFRS based FReM

Issue:	Implementation in the IAS/IFRS-based FReM in due course of: <ul style="list-style-type: none">○ IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i>○ IFRIC 5 <i>Rights to Interests Arising from Decommissioning, Restoration and Environmental Funds</i>
Impact on guidance:	The proposed text in Annex A would form the basis of an IAS/IFRS-based FReM.
UK GAAP adaptation?	No, to IAS 37; yes, to IFRIC 5.
IAS/IFRS compliant?	Yes, to IAS 37; no, adaptation to IFRIC 5
IPSAS compliant?	Some differences would exist as IPSAS 19 modifies IAS 37
Impact on budgetary regime?	No
Recommendation:	Adopt IAS 37 in full and IFRIC 5 as adapted.
Timing:	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

DETAIL

Background

IAS 37

1. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* was developed at the same time as FRS 12 *Provisions, Contingent Liabilities and Contingent Assets*. There was close cooperation between the two boards. There are no significant differences between the two standards.

2. FRS 12 includes more guidance than IAS 37 on the discount rate to be used in determining the present value of a provision. Otherwise the main difference is that FRS 12 deals with the circumstances in which an obligation recognised as a provision results in the recognition of an asset.

IAS 37 does not deal with this in the standard, but there is an illustrative example that is consistent with the FRS 12 guidance.

3. Because IAS 37 is so similar to FRS 12, the proposal here is that the former would be implemented in the IAS/IFRS based FReM on the same basis as the latter, and so the FReM's current interpretations of FRS 12 would be maintained.

4. Related to IAS 37 is IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* which covers how changes in capitalised provisions should be accounted for. There is no equivalent UITF Abstract. IFRIC 1 has different requirements depending on whether an entity applies the cost or revaluation model under IAS 16 *Property, Plant and Equipment* to the relevant asset. Proposals on the adoption of IFRIC 1 in an IAS/IFRIC based FReM will be presented to the Board when it considers those for IAS 16.

5. The IASB proposed substantial amendments to IAS 37 in June 2005, which we have discussed with the Board. The IASB is continuing its lengthy consideration of the responses it received to its consultation. An amended IAS 37 would not be effective before 1 January 2009. We will bring proposals to the Board in due course on the amended IAS's implementation in the IAS/IFRS-based FReM.

IFRC 5

6. IFRIC 5 *Rights to Interests Arising from Decommissioning, Restoration and Environmental Funds* covers how entities should account for their interests in funds established to reimburse the decommissioning, restoration or rehabilitation costs when they are incurred. The issues addressed in IFRIC 5 are:

- How should a contributor account for its interest in a fund?
- When a contributor has an obligation to make additional contributions, how should that obligation be accounted for?

7. Entities falling directly or indirectly within the scope of the FReM do not, as far as we are aware, have any interests in funds that would be required to be accounted for under IFRIC 5. There is no UITF Abstract equivalent to the IFRIC, and there is no related text otherwise in the current FReM.

IAS/IFRS compliance

8. The proposals would implement IAS 37 fully and give an adaptation of IFRIC 5.

9. The IFRIC's various requirements include one that the contributor to a fund shall determine whether it has control, joint control or significant influence over the fund by reference to IAS 27 *Consolidation*, IAS 28 *Equity Method*, IAS 31 *Joint Ventures*, and SIC 12 *Special Purpose Entities*. If it does, the contributor shall account for its interest in the fund in accordance with those Standards. The FReM, however, has adaptations of the equivalent UK standards in respect of the departmental boundary. A similar adaptation of IFRIC 5 is proposed to ensure consistency of accounting.

IPSAS compliance

10. IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* is drawn primarily from IAS 37. But there are some differences between the two. For example, the IPSAS clarifies that it does

not apply generally to social benefit obligations, and it modifies IAS 37 to require that for onerous contracts it is the present obligation net of recoveries that is recognised as a provision. These differences would also exist between IPSAS 19 and an IAS/IFRS based FReM as reflected in these proposals.

Proposed text for the Government Financial Reporting Manual

11. See Annex A for the proposed text for the IAS/IFRS-based FReM.

Impact on the budgetary regime

12. There should be no significant impact on the budgetary regime.

Impact on Department Yellow

13. There should be no significant impact on Department Yellow.

Summary and recommendation

14. The FRAB is invited to approve the adoption in full of IAS 37, with the interpretations currently given for FRS 12, and of IFRIC 5 subject an adaptation in respect of the departmental boundary.

Financial Reporting Policy team
19 March 2007

PROPOSED TEXT FOR THE IAS/IFRS BASED FRaM

Provisions and Contingencies

The following accounting standard deals with provisions and contingencies:

IAS 37 Provisions, contingent liabilities and contingent assets

IAS 37 Provisions, contingent liabilities and contingent assets

Applicability

IAS 37 applies in full, as interpreted, to the entities covered by this Manual.

Objectives of IAS 37

The objective of IAS 37 is to ensure that provisions, contingent liabilities and contingent assets are appropriately recognised and measured and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

A provision should be recognised when an entity has a present obligation (legal or constructive) as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision. Unless these conditions are met, no provision should be recognised although it may be necessary to disclose a contingent liability.

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

Interpretation of IAS 37 for the public sector context

Where the cash flows to be discounted are expressed in current prices, entities should use the real discount rate set by HM Treasury.

Separate disclosure of information about a particular contingency need not be made if that information has a protective marking. Guidance on protective markings is issued from time to time by the Cabinet Office or the [relevant authority](#). If the potential effect of the contingency is required to be disclosed under IAS 37, the relevant amount should still be included in the aggregate figure for such contingencies.

Departments may disclose, by way of note, significant liabilities of the non-departmental public body, which will be funded by the department if they crystallise, where they relate to other than the routine business of the body. Departments should not recognise the liabilities of non-departmental public bodies,

nor disclose any contingent liabilities of a non-departmental public body that arise in the normal course of business.

Other requirements

In making major changes to the method of calculation of a provision, entities should confer with the [relevant authorities](#) (through sponsoring bodies where appropriate) to establish whether there is a significant impact on expenditure control.

Provision of information to Parliament

Where the [guidance on the handling of public funds](#) requires certain financial but remote obligations that fall outside the scope of IAS 37 to be reported to [Parliament](#), entities should include in their financial statements a note detailing those obligations.

IFRIC 5 Rights to Interests Arising from Decommissioning, Restoration and Environmental Funds

Applicability

IFRIC 5 applies as adapted in paragraph xx to the entities covered by this Manual.

IFRIC consensus

The consensus of the IFRIC includes that the contributor shall recognise its obligation to pay decommissioning costs as a liability and recognise its interest in a decommissioning fund separately unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay. It also includes that the contributor shall determine whether it has control, joint control or significant influence over the fund by reference to IAS 27, IAS 28, IAS 31 and SIC-12. If it does, the contributor shall account for its interest in the fund in accordance with those Standards.

Adaptation of IFRIC 5 for the public sector context

In applying IFRIC 5, entities covered by this Manual shall comply with the adaptations that are made by this Manual to IAS 27, IAS 28, IAS 31 and SIC-12 in respect of the departmental boundary.