

**IPSAS 19—PROVISIONS, CONTINGENT LIABILITIES AND  
CONTINGENT ASSETS**

**as adopted by the Maltese Government**

**Issued DD/MM/YY**

**This Standard was issued by the IPSAS Implementation Board pursuant to Part VI, article 38(1) of the Public Finance Management Act No. XXI of 2019**

**DRAFT**

**IPSAS 19— PROVISIONS, CONTINGENT LIABILITIES AND  
CONTINGENT ASSETS  
as adopted by the Maltese Government**

**CONTENTS**

Paragraph

Objective	
Scope .....	1–17
Social Benefits .....	7–11
Other Exclusions from the Scope of the Standard .....	12–17
Definitions .....	18–21
Provisions and Other Liabilities .....	19
Relationship between Provisions and Contingent Liabilities .....	20–21
Recognition .....	22–43
Provisions .....	22–34
Present Obligation .....	23–24
Past Event .....	25–30
Probable Outflow of Resources Embodying Economic Benefits or Service Potential .....	31–32
Reliable Estimate of the Obligation .....	33–34
Contingent Liabilities .....	35–38
Contingent Assets .....	39–43
Measurement .....	44–62
Best Estimate .....	44–49
Risk and Uncertainties .....	50–52
Present Value .....	53–57
Future Events .....	58–60
Expected Disposal of Assets .....	61–62
Reimbursements .....	63–68
Changes in Provisions .....	69–70

Use of Provisions .....	71–72
Application of the Recognition and Measurement Rules .....	73–96
Future Operating Net Deficits .....	73–75
Onerous Contracts .....	76–80
Restructuring .....	81–96
Sale or Transfer of Operations .....	90–92
Restructuring Provisions .....	93–96
Disclosure .....	97–109
Transitional Provision .....	110
Effective Date .....	111–112
Appendix 1: Comparison with IPSAS 19	

DRAFT

International Public Sector Accounting Standard 19, *Provisions, Contingent Liabilities and Contingent Assets as adopted by the Maltese Government*, is set out in the objective and paragraphs 112A. All the paragraphs have equal authority. IPSAS 19<sup>1</sup> should be read in the context of its objective. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

DRAFT

---

<sup>1</sup> References to IPSAS 19 or any other IPSAS shall be taken as meaning ‘as adopted by the Maltese Government.’

## Objective

The objective of this Standard is to (a) define provisions, contingent liabilities, and contingent assets, and (b) identify the circumstances in which provisions should be recognized, how they should be measured, and the disclosures that should be made about them. The Standard also requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements, to enable users to understand their nature, timing, and amount.

## Scope

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for provisions, contingent liabilities, and contingent assets, except:**
  - (a) **Those provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits;**
  - (b) **[Deleted]**
  - (c) **Those resulting from executory contracts, other than where the contract is onerous, subject to other provisions of this paragraph;**
  - (d) **Insurance contracts within the scope of the relevant national accounting standard dealing with insurance contracts;**
  - (e) **Those covered by another IPSAS;**
  - (f) **Those arising in relation to income taxes or income tax equivalents; and**
  - (g) **Those arising from employee benefits, except employee termination benefits that arise as a result of a restructuring, as dealt with in this Standard.**
2. **[Deleted]**
3. **[Deleted]**
4. This Standard does not apply to financial instruments (including guarantees) that are within the scope of IPSAS 29, *Financial Instruments: Recognition and Measurement*.
- 4A. This Standard does not apply to the contingent consideration of an acquirer in a public sector combination which is within the scope of IPSAS 40, *Public Sector Combinations*.
5. **[Deleted]**
6. This Standard applies to provisions for restructuring (including discontinued operations). An entity shall disclose information that enables users of its financial statements to evaluate the financial effects of a restructuring.

## Social Benefits

7. For the purposes of this Standard, “social benefits” refer to goods, services, and other benefits provided in the pursuit of the social policy objectives of a government. These benefits may include:
  - (a) The delivery of health, education, housing, transport, and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services; and
  - (b) Payment of benefits to families, the aged, the disabled, the unemployed, veterans, and others. That is, governments at all levels may provide financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their

income.

8. In many cases, obligations to provide social benefits arise as a consequence of a government's commitment to undertake particular activities on an ongoing basis over the long term in order to provide particular goods and services to the community. The need for, and nature and supply of, goods and services to meet social policy obligations will often depend on a range of demographic and social conditions, and are difficult to predict. These benefits generally fall within the social protection, education, and health classifications under the International Monetary Fund's Government Finance Statistics framework, and often require an actuarial assessment to determine the amount of any liability arising in respect of them.
9. For a provision or contingency arising from a social benefit to be excluded from the scope of this Standard, the Central Government entity providing the benefit will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of the benefit. This exclusion would encompass those circumstances where a charge is levied in respect of the benefit, but there is no direct relationship between the charge and the benefit received. The exclusion of these provisions and contingent liabilities from the scope of this Standard reflects the Committee's view that both (a) the determination of what constitutes the obligating event and (b) the measurement of the liability require further consideration before proposed Standards are exposed. For example, the Committee is aware that there are differing views about whether the obligating event occurs when the individual meets the eligibility criteria for the benefit or at some earlier stage. Similarly, there are differing views about whether the amount of any obligation reflects an estimate of the current period's entitlement, or the present value of all expected future benefits determined on an actuarial basis.
10. Where an entity elects to recognize a provision for such obligations, the entity discloses the basis on which the provisions have been recognized and the measurement basis adopted. The entity also makes other disclosures required by this Standard in respect of those provisions. IPSAS 1, *Presentation of Financial Statements*, provides guidance on dealing with matters not specifically dealt with by another IPSAS. IPSAS 1, *Presentation of Financial Statements*, also includes requirements relating to the selection and disclosure of accounting policies.
11. In some cases, social benefits may give rise to a liability for which there is:
  - (a) Little or no uncertainty as to amount; and
  - (b) The timing of the obligation is not uncertain.

Accordingly, these are not likely to meet the definition of a provision in this Standard. Where such liabilities for social benefits exist, they are recognized where they satisfy the criteria for recognition as liabilities (refer also to paragraph 19). An example would be a period-end accrual for an amount owing to the existing beneficiaries in respect of aged or disability pensions that have been approved for payment consistent with the provisions of a contract or legislation.

#### **Other Exclusions from the Scope of the Standard**

12. This Standard does not apply to executory contracts unless they are onerous. Contracts to provide social benefits entered into with the expectation that the entity will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, are excluded from the scope of this Standard.
13. Where another IPSAS deals with a specific type of provision, contingent liability, or contingent asset, an entity applies that standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:
  - (a) Construction contracts (see IPSAS 11, *Construction Contracts*); and
  - (b) Leases (see IPSAS 13, *Leases*). However, as IPSAS 13 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases.
14. This Standard does not apply to provisions for income taxes or income tax equivalents (guidance on accounting for income taxes is found in IAS 12, *Income Taxes*). Nor does it apply to provisions arising from employee benefits (guidance on accounting for employee benefits is found in IPSAS 39, *Employee Benefits*).

15. Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. IPSAS 9, *Revenue from Exchange Transactions*, identifies the circumstances in which revenue from exchange transactions is recognized, and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of IPSAS 9.
16. This Standard defines provisions as liabilities of uncertain timing or amount. In some countries, the term provision is also used in the context of items such as depreciation, impairment of assets, and doubtful debts; these are adjustments to the carrying amounts of assets and are not addressed in this Standard.
17. Other IPSASs specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalization of the costs recognized when a provision is made.

## Definitions

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

**Central Government entities** means Government Ministries and Departments.

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

- (a) By an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A **contingent asset** is a possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

A **contingent liability** is:

- (a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) A present obligation that arises from past events, but is not recognized because:
  - (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
  - (ii) The amount of the obligation cannot be measured with sufficient reliability.

**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.

A **legal obligation** is an obligation that derives from:

- (a) A contract (through its explicit or implicit terms);
- (b) Legislation; or
- (c) Other operation of law.

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

An **onerous contract** is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic

**benefits or service potential expected to be received under it.**

**A provision is a liability of uncertain timing or amount.**

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

- (a) **The scope of an entity's activities; or**
- (b) **The manner in which those activities are carried out.**

**Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are published separately.**

### **Provisions and Other Liabilities**

19. Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:
- (a) Payables are liabilities to pay for goods or services that have been received or supplied, and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist); and
  - (b) Accruals are liabilities to pay for goods or services that have been received or supplied, but have not been paid, invoiced, or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of accounts payable, whereas provisions are reported separately.

### **Relationship between Provisions and Contingent Liabilities**

20. In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard, the term contingent is used for liabilities and assets that are not recognized because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. In addition, the term contingent liability is used for liabilities that do not meet the recognition criteria.
21. This Standard distinguishes between:
- (a) Provisions—which are recognized as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; and
  - (b) Contingent liabilities—which are not recognized as liabilities because they are either:
    - (i) Possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits or service potential; or
    - (ii) Present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

## Recognition

### Provisions

22. **A provision shall be recognized when:**
- (a) **An entity has a present obligation (legal or constructive) as a result of a past event;**
  - (b) **It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and**
  - (c) **A reliable estimate can be made of the amount of the obligation.**

**If these conditions are not met, no provision shall be recognized.**

### *Present Obligation*

23. **In some cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the reporting date.**
24. In most cases it will be clear whether a past event has given rise to a present obligation. In other cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such cases, an entity determines whether a present obligation exists at the reporting date by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting date. On the basis of such evidence:
- (a) Where it is more likely than not that a present obligation exists at the reporting date, the entity recognizes a provision (if the recognition criteria are met); and
  - (b) Where it is more likely that no present obligation exists at the reporting date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph 100).

### *Past Event*

25. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the 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; or
  - (b) In the case of 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.
26. Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future. The only liabilities recognized in an entity's statement of financial position are those that exist at the reporting date.
27. It is only those obligations arising from past events existing independently of an entity's future actions (that is, the future conduct of its activities) that are recognized as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage imposed by legislation on a Central Government entity. Both of these obligations would lead to an outflow of resources embodying economic benefits or service potential in settlement regardless of the future actions of that Central Government entity. Similarly, a Central Government entity would recognize a provision for the decommissioning costs of a defence installation or a government-owned nuclear power station, to the extent that the Central Government entity is obliged to rectify damage already caused. IPSAS 17, *Property, Plant, and Equipment*, deals with items, including dismantling and site restoring costs, that are included in the cost of an asset. In contrast, because of legal requirements, pressure from constituents, or a desire to demonstrate community leadership, an entity may intend

or need to carry out expenditure to operate in a particular way in the future. An example would be where a Central Government entity decides to fit emission controls on certain of its vehicles, or a government laboratory decides to install extraction units to protect employees from the fumes of certain chemicals. Because the entities can avoid the future expenditure by their future actions – for example, by changing their method of operation – they have no present obligation for that future expenditure, and no provision is recognized.

28. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed – indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a decision by an entity’s management, governing body, or controlling entity does not give rise to a constructive obligation at the reporting date, unless the decision has been 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 will discharge its responsibilities.
29. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused by a Central Government entity, there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified, or when the controlling government or the individual Central Government entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.
30. Where details of a proposed new law have yet to be finalized, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. However, differences in circumstances surrounding enactment often make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases, it is not possible to judge whether a proposed new law is virtually certain to be enacted as drafted, and any decision about the existence of an obligation should await the enactment of the proposed law.

*Probable Outflow of Resources Embodying Economic Benefits or Service Potential*

31. For a liability to qualify for recognition, there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph 100).
32. Where there are a number of similar obligations (for example, a government’s obligation to compensate individuals who have received contaminated blood from a government-owned hospital), the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognized (if the other recognition criteria are met).

*Reliable Estimate of the Obligation*

33. The use of estimates is an essential part of the preparation of financial statements, and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other assets or liabilities. 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 recognizing a provision.
34. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognized. That liability is disclosed as a contingent liability (see paragraph 100).

### Contingent Liabilities

35. **An entity shall not recognize a contingent liability.**
36. A contingent liability is disclosed, as required by paragraph 100, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.
37. Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. For example, in the case of joint arrangement debt, that part of the obligation that is to be met by other joint arrangement participants is treated as a contingent liability. The entity recognizes a provision for the part of the obligation for which an outflow of resources embodying economic benefits or service potential is probable, except in the rare circumstances where no reliable estimate can be made.
38. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognized in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made). For example, a Central Government entity may have breached an environmental law, but it remains unclear whether any damage was caused to the environment. Where, subsequently it becomes clear that damage was caused and remediation will be required, the entity would recognize a provision because an outflow of economic benefits is now probable.

### Contingent Assets

39. **An entity shall not recognize a contingent asset.**
40. Contingent assets usually arise from unplanned or other unexpected events that (a) are not wholly within the control of the entity, and (b) give rise to the possibility of an inflow of economic benefits or service potential to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.
41. Contingent assets are not recognized in financial statements, since this may result in the recognition of revenue that may never be realized. However, when the realization of revenue is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.
42. A contingent asset is disclosed, as required by paragraph 105, where an inflow of economic benefits or service potential is probable.
43. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits or service potential will arise and the asset's value can be measured reliably, the asset and the related revenue are recognized in the financial statements of the period in which the change occurs. If an inflow of economic benefits or service potential has become probable, an entity discloses the contingent asset (see paragraph 105).

### Measurement

#### Best Estimate

44. **The amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the reporting date.**
45. The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the reporting date. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the reporting date.

46. The estimates of outcome and financial effect are determined by the judgment of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting date.

*Example:*

A government medical laboratory provides diagnostic ultrasound scanners to both government-owned and privately owned medical centres and hospitals on a full-cost recovery basis. The equipment is provided with a warranty under which the medical centres and hospitals are covered for the cost of repairs of any defects that become apparent within the first six months after purchase. If minor defects were detected in all equipment provided, repair costs of €1 million would result. If major defects were detected in all equipment provided, repair costs of €4 million would result. The laboratory's past experience and future expectations indicate that, for the coming year, 75% of the equipment will have no defects, 20% of the equipment will have minor defects and 5% of the equipment will have major defects. In accordance with paragraph 32, the laboratory assesses the probability of an outflow for the warranty obligations as a whole.

The expected value of the cost of repairs is:

$$(75\% \text{ of nil}) + (20\% \text{ of } 1\text{m}) + (5\% \text{ of } 4\text{m}) = 400,000$$

47. Uncertainties surrounding the amount to be recognized as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is "expected value." The provision will therefore be different, depending on whether the probability of a loss of a given amount is, for example, 60% or 90%. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the midpoint of the range is used.
48. Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. For example, if a government has to rectify a serious fault in a defence vessel that it has constructed for another government, the individual most likely outcome may be for the repair to succeed at the first attempt at a cost of 100,000 currency units, but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary.
49. The provision is measured before tax or tax equivalents.

### **Risks and Uncertainties**

50. **The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.**
51. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgments under conditions of uncertainty, so that revenue or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent

overstatement of a provision.

52. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 98(b).

#### **Present Value**

53. **Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.**
54. Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting date are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.
- When a provision is discounted over a number of years, the present value of the provision will increase each year as the provision comes closer to the expected time of settlement.
55. Paragraph 97(e) of this Standard requires disclosure of the increase, during the period, in the discounted amount arising from the passage of time.
56. **The discount rate (or rates) shall 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) shall not reflect risks for which future cash flow estimates have been adjusted.**
57. In some jurisdictions, income taxes or income tax equivalents are levied on a public sector entity's surplus for the period. Where such income taxes are levied on public sector entities, the discount rate selected should be a pre- tax rate.

#### **Future Events**

58. **Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.**
59. Expected future events may be particularly important in measuring provisions. For example, certain obligations may be index-linked to compensate recipients for the effects of inflation or other specific price changes. If there is sufficient evidence of likely expected rates of inflation, this should be reflected in the amount of the provision. Another example of future events affecting the amount of a provision is where a government believes that the cost of cleaning up the tar, ash, and other pollutants associated with a gasworks' site at the end of its life will be reduced by future changes in technology. In this case, the amount recognized reflects the cost that technically qualified, objective observers reasonably expect to be incurred, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology, or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an entity does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.
60. The effect of possible new legislation that may affect the amount of an existing obligation of a government or an individual Central Government entity is taken into consideration in measuring that obligation, when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both (a) of what legislation will demand, and (b) of whether it is virtually certain to be enacted and implemented in due course. In many cases, sufficient objective evidence will not exist until the new legislation is enacted.

#### **Expected Disposal of Assets**

61. **Gains from the expected disposal of assets shall not be taken into account in measuring a provision.**
62. Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an

entity recognizes gains on expected disposals of assets at the time specified by the IPSAS dealing with the assets concerned.

## Reimbursements

63. **Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognized for the reimbursement shall not exceed the amount of the provision.**
64. **In the statement of financial performance, the expense relating to a provision may be presented net of the amount recognized for a reimbursement.**
65. Sometimes, an entity is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses, or suppliers' warranties). The other party may either reimburse amounts paid by the entity, or pay the amounts directly. For example, a central government entity may have legal liability to an individual as a result of misleading advice provided by its employees. However, the entity may be able to recover some of the expenditure from professional indemnity insurance.
66. In most cases, the entity will remain liable for the whole of the amount in question, so that the entity would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognized for the full amount of the liability, and a separate asset for the expected reimbursement is recognized when it is virtually certain that reimbursement will be received if the entity settles the liability.
67. In some cases, the entity will not be liable for the costs in question if the third party fails to pay. In such a case, the entity has no liability for those costs, and they are not included in the provision.
68. As noted in paragraph 37, an obligation for which an entity is jointly and severally liable is a contingent liability, to the extent that it is expected that the obligation will be settled by the other parties.

## Changes in Provisions

69. **Provisions shall be reviewed at each reporting date, and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, the provision shall be reversed.**
70. Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognized as an interest expense.

## Use of Provisions

71. **A provision shall be used only for expenditures for which the provision was originally recognized.**
72. Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognized for another purpose would conceal the impact of two different events.

## Application of the Recognition and Measurement Rules

### Future Operating Net Deficits

73. **Provisions shall not be recognized for net deficits from future operating activities.**
74. Net deficits from future operating activities do not meet the definition of liabilities in paragraph 18 and the general recognition criteria set out for provisions in paragraph 22.

75. An expectation of net deficits from future operating activities is an indication that certain assets used in these activities may be impaired. An entity tests these assets for impairment. Guidance on accounting for impairment is found in IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate.

### **Onerous Contracts**

76. **If an entity has a contract that is onerous, the present obligation (net of recoveries) under the contract shall be recognized and measured as a provision.**
77. Paragraph 76 of this Standard applies only to contracts that are onerous. Contracts to provide social benefits entered into with the expectation that the entity does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, are excluded from the scope of this Standard.
78. Many contracts evidencing exchange transactions (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard, and a liability exists that is recognized. Executory contracts that are not onerous fall outside the scope of this Standard.
79. This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it, which includes amounts recoverable. Therefore, it is the present obligation net of recoveries that is recognized as a provision under paragraph 76. 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.
80. Before a separate provision for an onerous contract is established, an entity recognizes any impairment loss that has occurred on assets dedicated to that contract.

### **Restructuring**

81. The following are examples of events that may fall under the definition of restructuring:
- (a) Termination or disposal of an activity or service;
  - (b) The closure of a branch office or termination of activities of a Central Government entity in a specific location or region, or the relocation of activities from one region to another;
  - (c) Changes in management structure, for example, eliminating a layer of management or executive service; and
  - (d) Fundamental reorganizations that have a material effect on the nature and focus of the entity's operations.
82. A provision for restructuring costs is recognized only when the general recognition criteria for provisions set out in paragraph 22 are met. Paragraphs 83–96 set out how the general recognition criteria apply to restructurings.
83. **A constructive obligation to restructure arises only when an entity:**
- (a) **Has a detailed formal plan for the restructuring identifying at least:**
    - (i) **The activity/operating unit or part of an activity/operating unit concerned;**
    - (ii) **The principal locations affected;**
    - (iii) **The location, function, and approximate number of employees who will be compensated for terminating their services;**
    - (iv) **The expenditures that will be undertaken; and**
    - (v) **When the plan will be implemented; and**

- (b) **Has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.**

84. Within the Central Government, restructuring may occur at the whole-of- government, portfolio or ministry, or entity level.
85. Evidence that a government or an individual entity has started to implement a restructuring plan would be provided, for example, by (a) the public announcement of the main features of the plan, (b) the sale or transfer of assets, (c) notification of intention to cancel leases, or (d) the establishment of alternative arrangements for clients of services. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (that is, setting out the main features of the plan) that it gives rise to valid expectations in other parties, such as users of the service, suppliers, and employees (or their representatives) that the government or the entity will carry out the restructuring.
86. For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible, and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins, or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the government or individual entity is at present committed to restructuring, because the timeframe allows opportunities for the government or entity to change its plans.
87. A decision by management or the governing body to restructure, taken before the reporting date, does not give rise to a constructive obligation at the reporting date unless the entity has, before the reporting 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.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting date, disclosure may be required under IPSAS 14, *Events after the Reporting Date*, if the restructuring is material and non-disclosure could influence the economic decisions of users taken on the financial statements.

88. Although a constructive obligation is not created solely by a management or governing body decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale or transfer of an operation, may have been concluded subject only to governing body or board approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure, if the conditions of paragraph 83 are met.
89. In some countries, (a) the ultimate authority for making decisions about a Central Government entity is vested in a governing body or board whose membership includes representatives of interests other than those of management (for example, employees), or (b) notification to these representatives may be necessary before the governing body or board decision is taken. Because a decision by such a governing body or board involves communication to these representatives, it may result in a constructive obligation to restructure.

#### *Sale or Transfer of Operations*

90. **No obligation arises as a consequence of the sale or transfer of an operation until the entity is committed to the sale or transfer, that is, there is a binding agreement.**
91. Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the entity will be able to change its mind, and indeed will have to take another course of action if a purchaser cannot be found on acceptable

terms. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.

92. Restructuring within the public sector often involves the transfer of operations from one controlled entity to another, and may involve the transfer of operations at no or nominal consideration. Such transfers will often take place under a government directive, and will not involve binding agreements as described in paragraph 90. An obligation exists only when there is a binding transfer agreement. Even where proposed transfers do not lead to the recognition of a provision, the planned transaction may require disclosure under other IPSASs, such as IPSAS 14, and IPSAS 20, *Related Party Disclosures*.

#### *Restructuring Provisions*

93. **A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both:**
- (a) **Necessarily entailed by the restructuring; and**
  - (b) **Not associated with the ongoing activities of the entity.**
94. A restructuring provision does not include such costs as:
- (a) Retraining or relocating continuing staff;
  - (b) Marketing; or
  - (c) Investment in new systems and distribution networks.

These expenditures relate to the future conduct of an activity, and are not liabilities for restructuring at the reporting date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring.

95. Identifiable future operating net deficits up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract, as defined in paragraph 18.
96. As required by paragraph 61, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

#### **Disclosure**

97. **For each class of provision, an entity shall disclose:**
- (a) **The carrying amount at the beginning and end of the period;**
  - (b) **Additional provisions made in the period, including increases to existing provisions;**
  - (c) **Amounts used (that is, incurred and charged against the provision) during the period;**
  - (d) **Unused amounts reversed during the period; and**
  - (e) **The increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.**

**Comparative information is not required.**

98. **An entity shall disclose the following for each class of provision:**
- (a) **A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential;**
  - (b) **An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 58; and**

- (c) **The amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.**
99. **Where an entity elects to recognize in its financial statements provisions for social benefits for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, it shall make the disclosures required in paragraphs 97 and 98 in respect of those provisions.**
100. **Unless the possibility of any outflow in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, where practicable:**
- (a) **An estimate of its financial effect, measured under paragraphs 44–62;**
  - (b) **An indication of the uncertainties relating to the amount or timing of any outflow; and**
  - (c) **The possibility of any reimbursement.**
101. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs 98(a) and (b) and 100(a) and (b). Thus, it may be appropriate to treat, as a single class of provision, amounts relating to one type of obligation, but it would not be appropriate to treat, as a single class, amounts relating to environmental restoration costs and amounts that are subject to legal proceedings.
102. Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs 97, 98, and 100 in a way that shows the link between the provision and the contingent liability.
103. An entity may in certain circumstances use external valuation to measure a provision. In such cases, information relating to the valuation can usefully be disclosed.
104. The disclosure requirements in paragraph 100 do not apply to contingent liabilities that arise from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods or services provided, directly in return from the recipients of those benefits (see paragraphs 1(a) and 7–11 for a discussion of the exclusion of social benefits from this Standard).
105. **Where an inflow of economic benefits or service potential is probable, an entity shall disclose a brief description of the nature of the contingent assets at the reporting date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 44–62.**
106. The disclosure requirements in paragraph 105 are only intended to apply to those contingent assets where there is a reasonable expectation that benefits will flow to the entity. That is, there is no requirement to disclose this information about all contingent assets (see paragraphs 39 to 43 for a discussion of contingent assets). It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of revenue arising. For example, a contingent asset would arise from a contract where a Central Government entity allows a private sector company to mine one of its properties in exchange for a royalty based on a set price per ton extracted, and the company has commenced mining. In addition to disclosing the nature of the arrangement, the contingent asset should be quantified, where a reasonable estimate can be made of the quantity of mineral to be extracted and the timing of the expected cash inflows. If there were no proven reserves, or some other circumstances prevailed that indicated that it would be unlikely that any minerals would be extracted, the Central Government entity would not disclose information required by paragraph 105 as there is no probable flow of benefits.
107. The disclosure requirements in paragraph 105 encompass contingent assets from both exchange and non-exchange transactions. Whether a contingent asset exists in relation to taxation revenues rests on the interpretation of what constitutes a taxable event. The determination of the taxable event for taxation revenue and its possible implications for the disclosure of contingent assets related to taxation revenues are to be dealt with as a part of a separate project on non-exchange revenue.

108. **Where any of the information required by paragraphs 100 and 105 is not disclosed because it is not practicable to do so, that fact shall be stated.**
109. **In extremely rare cases, disclosure of some or all of the information required by paragraphs 97–107 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.**

### **Transitional Provision**

110. [Not Used]

### **Effective Date**

111. [Not Used]
- 111A. [Not Used]
112. [Not Used]
- 112A. Central Government entities shall apply this Standard for annual financial statements covering periods beginning or after DD/MM/YY. Earlier application is not permitted.

## **Appendix 1**

### **Comparison with IPSAS 19**

**IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets as adopted by the Maltese Government is drawn from IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets.**

**The following is the main difference between IPSAS 19 as adopted by the Maltese Government and IPSAS 19:**

<b>Section/s</b>	<b>IPSAS 19 (as adopted)</b>	<b>IPSAS 19</b>
9, 27, 29, 38, 60, 65, 81, 84, 89, 106	Reference is made to central government entities.	Reference is made to public sector entities, or government agencies or local government.

DRAFT