



Financial Reporting Council

Thematic Review:

IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'

October 2021

Contents

1.	Executive summary	3
2.	Review scope and sample	5
3.	Scope of IAS 37 and presentation of provisions	6
4.	Disclosures about provisions	8
5.	Disclosures about contingent liabilities and contingent assets	14
6.	Reimbursement assets	18
7.	'Best estimates' and uncertainties	19
8.	Significant judgements and estimates	25
9.	Management commentary	28
10.	Specific types of provision	30
11.	Key disclosure expectations	37
12.	Appendix. Case study: 'best estimate', uncertainties and significant judgements	38

1. Executive Summary

Introduction

The importance of provisions and contingent liabilities in the annual report can be underplayed because their effect is often limited to a short note towards the back of the financial statements and a brief comment in the strategic report. However, even when a provision or a contingent liability is not significant in amount, the circumstances to which it relates can be of great significance to investors owing to the levels of estimation uncertainty and other judgements involved, or to the subject matter of the exposure. Their often long-term nature also means that provisions and contingent liabilities are at the forefront of the financial statement effects of key issues such as climate change and regulatory action.

Issues relating to compliance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' have featured in the FRC's 'top ten' findings for several years.¹ We continue, however, to find room for improvement despite drawing attention in previous publications to matters such as lack of disclosure of the uncertainties about the amount or timing of cash outflows, or the financial effect of contingent liabilities.

This report summarises the key findings of our review of IAS 37 disclosures and related information for a sample of twenty companies. We reviewed their 2020/21 annual reports and accounts and considered how effectively they met the disclosure requirements and provided other relevant information.

We wrote to these companies in December 2020 to inform them that we would be reviewing their disclosure of provisions, contingent liabilities and contingent assets. Consequently, we were pleased to see improvements in these disclosures compared to the prior year in a majority of the sample.



Represents good quality application that we want other companies to consider when preparing their annual reports.



Represents opportunities for improvement by companies to move them towards good practice.



Represents an omission of required disclosure or other issue. We want companies to avoid such issues in their annual reports.

1. See, for example: [Annual Review of Corporate Reporting 2019/20](#), pages 6 and 18; [Annual Review of Corporate Reporting 2018/2019](#), page 10.

1. Executive Summary (continued)

Summary of key observations

We found numerous instances of good practice across each individual aspect of disclosure. However, there was general scope for improvement in several areas including: the disclosure of **quantitative information on expected timing** of future economic outflows, the **key assumptions** used to estimate those outflows, and the **associated uncertainties**. We also identified opportunities to clarify the **nature of the costs** included in certain types of provision, to disclose more **specific accounting policies** and to provide more **quantitative information about contingent liabilities**.

Qualitative information

- Most companies explained provisions and contingencies in a brief paragraph, which was typically proportionate to the amounts concerned.
- Companies with more complex provisions gave more detail to aid the user's understanding.
- In some cases companies included extensive historical information that did not appear necessary for an understanding of the nature of the provision or contingent liability. This made it more difficult to form a clear picture of the potential financial effects and uncertainties.
- Companies could improve the clarity of their description of the underlying obligating event, notably for restructuring, property-related and self-insurance provisions.

Numerical disclosures

- We expect companies to consider the nature of provisions as well as their amounts when grouping them into classes. Classes should carry specific, informative labels.
- We expect companies to provide more information about the anticipated timing of outflows, particularly for longer-term provisions.
- Companies gave more limited quantitative information about contingent liabilities than we would expect.

Uncertainty, estimation and significant judgements

- Where management had been unable to estimate the amount of probable or possible economic outflow, better disclosures explained why and provided 'order of magnitude' information.
- Companies rarely specified the method used to determine the 'best estimate' measurement of a provision or contingent liability. We expect companies to explain their approach – the 'expected value' or 'most likely outcome' method – where the most appropriate choice is not obvious.
- We expect companies to disclose how the discount rate is calculated where the effect of discounting is material.
- A majority of companies identified provisions as a key source of estimation uncertainty. Most of these companies disclosed sensitivity information for changes in key assumptions. For longer-term provisions, this was most commonly provided for changes in the discount rate, which was identified as the factor more likely to materially affect the carrying amount.
- We also expect companies to explain material sensitivity to cash flow forecasting.

Strategic report

- We expect companies to explain significant movements in their provision balances or contingent liability exposures where this is important to provide a fair, balanced and comprehensive review of the development, performance and position of the business.

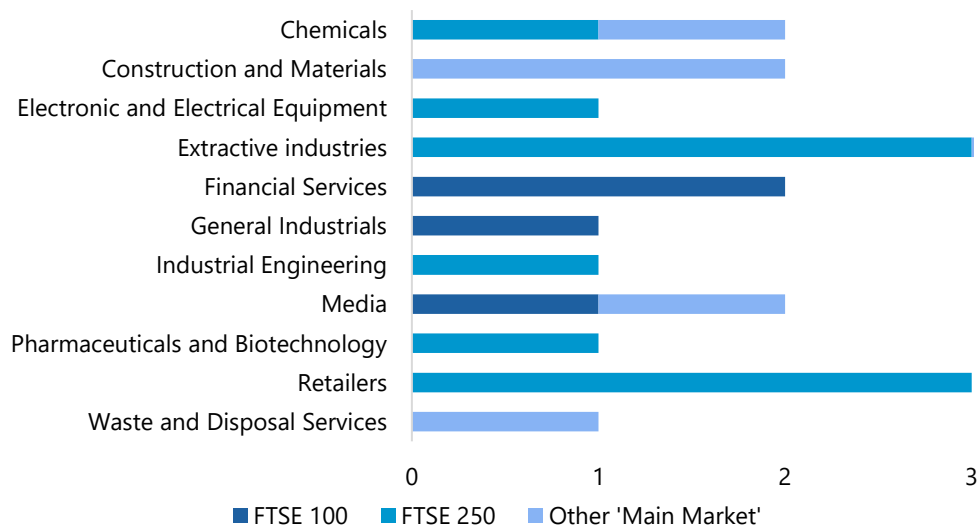
2. Review scope and sample

Our review consisted of a limited scope desktop review of the annual reports and accounts of twenty entities listed on the Main Market of the London Stock Exchange.¹ Most had December 2020 year ends, with one reporting to the end of March 2021 and two to the end of April.

The sample covered a wide range of industry sectors, as shown below. This allowed us to consider the disclosure of sector-specific provision types, as well as those of a more general nature.²

Our report includes extracts from the limited number of reports and accounts included in our sample, and others from our routine monitoring. The examples will not be relevant for all companies or all circumstances, but each demonstrates a characteristic of useful disclosure. Inclusion of a company's disclosure should not be seen as an evaluation of that company's reporting as a whole.

Sample by industry sector and market segment



1. Since the selection, one company has delisted following its acquisition.

2. One company in the sample is an insurance business; we considered only those provisions not arising from its insurance contracts (IAS 37, paragraph 5(e))

Incidence of provisions by type



This analysis is based on companies' provisions as classified in their financial statements and includes items that may be outside the scope of IAS 37, such as obligations for future benefits in the 'employee-related' category. The count of each type of provision includes those identified as a component of a larger balance. 'Not individually described' refers to provisions for which no further details were disclosed, typically because the individual amounts were not material.

3. Scope of IAS 37 and presentation of provisions

Scope

Our questions to companies on IAS 37 in recent routine monitoring have often included matters of scope.

IAS 37 does not apply to provisions or instruments covered by the following standards:

- IFRS 9 'Financial Instruments'
- IAS 12 'Income Taxes'
- IFRS 16 'Leases', unless the lease becomes onerous before the commencement date of the lease, is short-term or over a low-value asset¹
- IAS 19 'Employee Benefits'²
- IFRS 4 'Insurance Contracts', for matters arising from contractual obligations and rights under insurance contracts within its scope
- IFRS 3 'Business Combinations', as regards contingent consideration
- IFRS 15 'Revenue from Contracts with Customers', except as regards contracts that are or have become onerous

This is not an exhaustive list of standards to apply in priority to IAS 37 in respect of provisions.³ We encourage companies to be alert to specific requirements in other areas.

Provisions presented in other line items

Provisions should be presented separately in the statement of financial position, and disaggregated when such presentation is relevant to an understanding of the entity's financial position.⁴

We are aware from our routine reviews that provision balances are, on occasion, misclassified in the statement of financial position. This can lead to the omission of key disclosures required by IAS 37, including information about the associated uncertainties in the timing and amount of probable outflows.

We did not identify any instances of IAS 37 provisions being inappropriately included in other line items, such as accruals or other liabilities, in the sample selected for this thematic. However, one company had restated its comparatives to correct a past mis-classification.

There were some examples of non-IAS 37 obligations, such as contingent consideration or employee benefits (including long-service awards or sabbatical leave), that were presented together with provisions recognised under IAS 37. This approach may have been taken to avoid undue clutter.

Where this approach is adopted, companies should ensure that the disclosure requirements of the more relevant standard are not overlooked. Cross-references may help users find relevant information elsewhere in the financial statements and notes.

1. IFRS 16, paragraph 25, applies IAS 37 to the recognition and measurement of obligations for costs to be incurred by a lessee in dismantling and removing an underlying asset, and/or restoring its condition.
2. IAS 19, paragraphs 153 to 175, address long-term benefits, paragraphs 11 to 24 short-term benefits
3. IAS 37, paragraphs 2 and 5
4. IAS 1 'Presentation of Financial Statements', paragraphs 54 and 55

3. Scope of IAS 37 and presentation of provisions (continued)

Provisions presented in other line items (continued)

It is also important to distinguish between the different recognition criteria and measurement bases, such as fair value measurement for contingent consideration, where that is significant to the carrying amounts of non-IAS 37 obligations.



Two companies aggregated material non-IAS 37 obligations with provisions as a single line item on the face of the statement of financial position. Given the size of these liabilities, we expected those items to be presented on a disaggregated basis in the statement of financial position to meet the requirements of IAS 1.

Material information

Materiality depends on the **nature or magnitude of information**, or both. An entity assesses whether information, **either individually or in combination** with other information, is material in the context of its financial statements as a whole.¹

In determining what to disclose, we expect companies to consider carefully whether the circumstances giving rise to the provision, contingent liability or contingent asset are qualitatively material, even if the potential outflow is not quantitatively material.

1. IAS 1, paragraph 7

4. Disclosures about provisions

Disclosure principles

IAS 37 contains specific disclosure requirements, but these should not be treated as a checklist. As the facts and circumstances can vary widely between companies, even for seemingly similar classes of provisions, judgement must be exercised when assessing what information should be disclosed to meet the overall objective:

The objective of this Standard is to ensure ... that sufficient information is disclosed in the notes to **enable users to understand** [a provision's, contingent liability's or contingent asset's] nature, timing and amount.¹

In the Annual Review of Corporate Reporting 2019/20 (page 7), we drew attention to disclosure objectives in IFRSs and to their importance in ensuring that relevant information is provided effectively.

Disclosures should strike a balance between:

- providing enough detail for users to gain insight into payment profiles, estimation methodologies, discount rates, risk adjustments, and so on; and
- not cluttering the annual report and accounts with duplication, generic statements or information that is not relevant to users.

Accounting policies

All companies disclosed an accounting policy for provisions, although most accounting policies in our sample featured 'boilerplate' language. One company's provisions were so small as not to be separately disclosed, which suggested that the accounting policy might not have been sufficiently significant to warrant disclosure.²



Better examples included more company-specific disclosure of the approach to recognising and measuring different provision classes.

Companies rarely explained whether the 'most likely outcome' or 'expected value' method was used to determine their best estimate of the probable economic outflow. We comment further on improving the disclosure of 'best estimates' in [section 7](#) below.

Accounting policy disclosures relating to discounting rarely stated whether the rate included a risk adjustment and/or own credit risk premium.



Where the effect of discounting is material, we expect companies to clarify their approach to calculating the discount rate.

1. IAS 37, Objective; see also IAS 1, paragraph 9 and Conceptual Framework, paragraphs 2.6 to 2.11

2. IAS 1, paragraph 117; note that 'significant' to be amended to 'material' with effect for periods starting on or after 1 January 2023, with early application permitted.

4. Disclosures about provisions (continued)

Accounting policies (continued)

Site restoration provisions are made in respect of the estimated future costs of closure and restoration, and for environmental rehabilitation costs (which include the dismantling and demolition of infrastructure, removal of residual materials and remediation of disturbed areas) in the accounting period when the related environmental disturbance occurs. The provision is discounted where material and the unwinding of the discount is included in finance costs. Over time, the discounted provision is increased for the change in present value based on the discount rates that reflect current market assessments and the risks specific to the liability. At the time of establishing the provision, a corresponding asset is capitalised where it gives rise to a future benefit and depreciated over the remaining life of the mine to which it relates using a unit of production method. The provision is reviewed on an annual basis for changes in cost estimates, discount rates or life of operations. Any change in restoration costs or assumptions will be recognised as additions or charges to the corresponding asset and provision when they occur. For permanently closed sites, changes to estimated costs are recognised immediately in the income statement.

*KAZ Minerals Limited (formerly KAZ Minerals PLC),
Annual Report And Accounts 2020, p178*

This company disclosed a general accounting policy for provisions, but then provided more specific information about the single class of provisions recognised in the period: the basis for the present obligation, the discount to present value and the recognition of movements that affect a corresponding asset or the income statement.

The provisions note gave additional detail on how these policies were applied.

4. Disclosures about provisions (continued)

Reconciliation from opening to closing balances

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** (i.e. incurred and charged against the provision) during the period;
- (d) **unused amounts reversed** during the period; and
- (e) **the increase** during the period in the discounted amount **arising from the passage of time and the effect of any change in the discount rate**.¹

Most companies disaggregated all classes of provision that were significant based on the relative closing balances.



We expect companies to consider the nature of provisions as well as the amounts when deciding how to aggregate them into classes.

Generally, movements in each class during the period had been (dis)aggregated appropriately. This enabled users to understand the effects of foreign exchange, finance costs on unwinding of discounts, provisions acquired in business combinations or eliminated on disposal of a business and the like, while avoiding undue clutter.



One company included an individually material class in 'other' provisions. Another company included large movements in the 'other' category that were linked to the effects of the Covid-19 pandemic. This was explained in the narrative but not separately identified in the reconciliation. Such aggregation made it more difficult to compare classes with significant closing balances or movements.

We did not identify any material instances of inappropriate netting of movements, such as additions and reversals. However, as explained on [page 11](#), there was divergence in practice as to how companies approached the disclosure of wholly in-year movements.

Half of our sample disclosed comparative figures for their reconciliation, even though this is not required by IAS 37. This information was particularly helpful where those movements reflected material changes in circumstances from year to year, providing context for the narrative explanation.

Some companies supplemented tabular disclosure with narrative explanations. These provided further detail, such as why amounts had been released.

During the year for UK Municipal onerous contracts, strong operational execution and improvements in recycle and offtake outlooks have resulted in a significant reduction in the onerous contract provision for ELWA. On the other hand it has been necessary to increase the Wakefield provision, where the Council has not yet given approval to our proposals to reduce or reconfigure certain operations so as to save money for both parties and to improve the environmental footprint of the South Kirby facility.

*Renewi plc,
Annual Report and Accounts 2021, p175*

This disclosure provided useful commentary on the numerical reconciliation, explaining the movements in the company's second largest class of provisions, particularly the large amount released.

1. IAS 37, paragraph 84

4. Disclosures about provisions (continued)

Amounts charged and utilised or released during the year

There was diversity in the approach companies took to presenting wholly in-year additions to and utilisation and reversals of provisions:

- Several companies included in their reconciliations amounts that were both provided for and utilised or released wholly within the year under review ('gross' presentation).
- Other companies included only the utilisation or release of amounts provided in a prior year, together with a net adjustment for wholly in-year items to bring the provision to the correct closing balance ('net' presentation). There was no indication that wholly in-year movements had been reflected in the reconciliation.



'Gross' presentation will generally provide more useful information about the overall costs incurred in respect of provisions with a large in-year 'churn' or a short lifecycle, such as product-related claims or restructuring costs (notably employee severance). In addition, it will allow for greater linkage with other areas of the annual report, such as the strategic report.



Where material, we expect companies to disclose information about the gross movements in provisions, even when 'net' presentation is adopted in the provisions reconciliation. Where this information is disclosed elsewhere in the accounts, we expect a cross-reference to be included to help users link it to the provision disclosure.

During 2020, XYZ plc paid severance of £9m; £1m for a site closure (announced and provided for in 2019) and £8m for a rationalisation programme announced in October 2020, with total expected severance of £15m.

£1m of the opening provision, also made in relation to the site closure, was released as it was no longer required. The remaining provision is expected to be utilised in the next six months.

	Restructuring Provision £m
At 1 January 2020	2
Additional provisions	15
Release of provisions	(1)
Utilised amounts	(9)
At 31 December 2020	7

This hypothetical disclosure demonstrates the 'gross' presentation, with a wholly 'in-year' addition and utilisation of £8m disclosed within the movements in the year. A 'net' presentation would show a net charge of £7m with utilisation of £1m, excluding the wholly 'in-year' movements. Both presentations would show the release of £1m separately as it relates to a prior year provision.

4. Disclosures about provisions (continued)

Description of the nature of the obligation

An entity shall disclose the following for each class of provision:

(a) a **brief description of the nature** of the obligation...¹

Descriptive disclosures were generally proportionate to the amount and complexity of each class of provision and to significant components within an aggregated class.

Two companies disclosed long historical backgrounds for certain provisions, which were also duplicated in the management commentary. For other companies, disclosure assumed prior knowledge of management's previous communications.



We expect all relevant information to be included in the provision note, or incorporated in it by cross-reference from elsewhere in the annual report and accounts. Duplication of information should be kept to a minimum and reliance should not be placed on information included in other documents or previous annual reports (see also [sections 9 and 10](#)).

Generally, the legal or constructive obligation could be understood from the nature of the provision, such as dilapidation provisions arising from the terms of a lease contract or a constructive obligation arising from previously announced plans to restructure the company's operations. However, in other cases, the nature of the obligating event was less clear.



Specific labelling of provisions often allows for disclosure to be relatively brief while still communicating all material information. However, greater detail may be required for more unusual provisions to explain why there is a constructive or legal obligation.

For certain types of provision, such as acquisition and integration provisions, the disclosure did not always explain the nature of the underlying costs. In these cases, it was not clear whether it was appropriate to include all such costs in the provision under IAS 37. For example, costs should be excluded where they represent future operating losses.

Additionally, where individual provisions had been grouped into classes of obligations, it was not always clear that they all had similar characteristics.² For example, one company appeared to aggregate part of its asset decommissioning obligations with restructuring costs on the basis that the assets were on the site subject to closure. This approach may reduce users' understanding of the company's exposure to obligations with differing characteristics.



We also found the nature of the costs poorly described where a company provided for self-insured liabilities without explaining the underlying obligations or the effect of the self-insurance arrangement on the exposures.

We make further observations on disclosures about the nature of specific types of provision in [section 10 below](#).

1. IAS 37, paragraph 85
2. IAS 37, paragraph 87

4. Disclosures about provisions (continued)

Expected timing of outflows of economic benefit

An entity shall disclose the following for each class of provision:

(a) ... **the expected timing of any resulting outflows** of economic benefits...¹

Most companies disclosed the maximum length of time over which outflows were expected, for example utilisation within a period of years or 'over X years' from the year end. One company disclosed when it expected utilisation to start, but not when it would end.



A minority gave this disclosure for some, but not all, material provisions.

However, details of specific timings of outflows within the maximum period were limited and, at times, unhelpful for understanding the phasing of future outflows, especially for the longer-term provisions. For example property-related provisions were often described as being utilised at or by the end of the lease term, but no indication was given of the duration of those contracts or the expected phasing of the payments.



Where disclosures depend on other information, for example the duration of a related contract term, we expect this to be quantified.



Where the provision is large and covers a number of individual exposures (e.g. remediation at several sites or phases of decommissioning), we expect more granular information about timing to be provided. This is particularly relevant for long-term provisions, as discussed in [section 10](#) below.

Further requirements to disclose an indication of uncertainty in relation to the timing of provisions and contingent liabilities are discussed in [section 7](#) below.

1. IAS 37, paragraph 85
2. IAS 37, paragraphs 91 and 92
3. See also IAS 37 Implementation Guidance, example D3

Disclosure exemption: 'seriously prejudicial'

In **extremely rare cases**, disclosure of some or all of the information required by paragraphs 84 to 89 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**.²

This disclosure exemption may be applied for contingent liabilities and contingent assets as well as provisions. Consistent with the requirements of the standard, we expect the use of this exemption to be extremely rare. Only one company in our sample invoked the exemption, not disclosing the financial effect of a contingent asset.



In routine monitoring, we have seen accounting policies suggesting that the exemption disappplies all disclosure requirements relating to the matter. That is not the case; the exemption applies only to the specific prejudicial information that would otherwise be disclosed under IAS 37.



We expect companies to disclose the general nature of the dispute and the reason for not disclosing more specific information.³

The Group is currently seeking damages from an independent third party following their involvement in anti-competitive behaviour that adversely impacted the Group. Following recent court judgements on similar claims, the Group expects to receive a material amount in settlement. The value of the settlement is not disclosed as it could be prejudicial to the outcome.

Currys plc (formerly Dixons Carphone PLC), Annual Report & Accounts 2020/21, p204

This demonstrates how users can be given specific information about the nature of a dispute and the company's position, while the company also makes clear the extent of information not disclosed.

5. Disclosures about contingent liabilities and contingent assets

Contingent liabilities

Unless the possibility of any outflow in settlement is remote, an entity shall **disclose for each class of contingent liability** at the end of the reporting period a **brief description of the nature** of the contingent liability and, **where practicable**:

- (a) an **estimate of its financial effect**, measured under paragraphs 36–52;
- (b) an **indication of the uncertainties** relating to the amount or timing of any outflow; and
- (c) the **possibility of any reimbursement**.¹

The quality and quantity of disclosure in this area varied. Some companies included brief 'boilerplate' comments that hinted at contingencies but did not clarify the nature and possible amount of the exposure. Other companies gave an extensive history of litigation claims that lacked useful information about their potential financial effect.



Better disclosure quantified the exposure, giving an indication of both the timescale for obtaining greater certainty and the level of confidence that an economic outflow was less than probable but more than remote.

The most extreme 'boilerplate' examples appeared to represent a general caveat or disclaimer that the company may face additional liabilities as a result of past events, rather than highlighting specific contingencies.



Where this is the case, we encourage companies to consider cutting clutter or, where a general statement is judged to be useful, to state explicitly that none of the potential contingencies it alludes to are expected to lead to a material exposure.

Contingent liabilities include obligations with probable outflows for which no reliable estimate can be determined.² These are expected to be extremely rare.³ In most cases it should be possible to disclose at least the order of magnitude of the liability or a range of outcomes, were it to crystallise, even when a single 'best estimate' cannot reliably be made.

Similarly, an order of magnitude, likely maximum exposure or range of outcomes can usually be determined for possible obligations, even though these may be subject to greater uncertainty than those that are probable.

As noted in [section 4](#) above, companies rarely explained the method used to determine the best estimate of a provision; this was also true of contingent liabilities.



Two companies alluded to a potential financial effect but were unclear whether the amounts referred to represented management's best estimate, or had been disclosed to provide an indication of the potential order of magnitude. Where companies are unable to determine a financial effect based on management's best estimate, but can provide an indication of the potential magnitude, we expect this to be clearly explained.

1. IAS 37, paragraphs 86
2. IAS 37, paragraph 10
3. IAS 37, paragraphs 25 and 26

5. Disclosures about contingent liabilities and contingent assets (continued)

Contingent liabilities (continued)

Where any of the information required by paragraphs 86 and 89 is **not disclosed because it is not practicable** to do so, that fact shall be stated.¹

40% of the companies stated that it was not possible or not practical to disclose either the potential financial effect or timing of any outflow (and in some cases both) for at least one contingent liability.

A minority simply stated that an estimate of the potential outflow relating to a contingent liability could not be made.



Better examples explained the reason why it was not practicable.

There is an ongoing criminal investigation into the production of thermally cleaned soil at ATM. This may or may not result in a prosecution and if so, we expect such a process will likely take many years, should it proceed. ATM will defend its conduct strongly in such an event. Given that it is not even clear whether or what charges might be brought in the criminal case and the charge is expected to be lower than €1m we do not consider it appropriate at this stage to provide for this. Given these uncertainties, it cannot be ruled out that the outcome of the criminal investigation or the topic it concerns could result in liability for damages resulting from third party claims in the future.

*Renewi plc,
Annual Report and Accounts 2021, p209*

This disclosure explained why it was not possible to determine the best estimate and the expected timing of any such outflows.

The company disclosed the expected maximum exposure, which indicated the order of magnitude of the matter.

Several companies included contingent liability disclosures as well as recognising provisions for related issues. Where companies explained the interaction between these two disclosures, it was not always easy to follow.



Better disclosure provided cross-references between the notes for contingent liabilities and provisions, or specified the amounts included in provisions for the related contingency disclosed.

On 6 February 2020 the European Commission announced its decision to initiate a formal investigation in which it alleges that the Walloon Region of Belgium provided state aid to the Group in relation to the Cetem landfill. An adverse judgement would require the Walloon Region to seek repayment from the Group and a provision of €15.1m has been recognised in both the current year and the prior year as non-current as timing of any cash flow is expected to be after 12 months from the balance sheet date. The matter remains ongoing and based on legal advice management consider this value to be their best estimate of the potential exposure based on the most likely outcome. Further contingent liability information is provided in note 8.4.

*Renewi plc,
Annual Report and Accounts 2021, p176*

This disclosure (in the provisions note) provided a cross-reference to the information included in the contingent liability note, which in turn cited the amount provided as a component of the maximum possible exposure.

None of the companies in our sample invoked the 'seriously prejudicial' exemption from disclosure of contingent liabilities which, as noted on [page 13](#), would only be used in extremely rare circumstances.

1. IAS 37, paragraph 91. IAS 37 does not define 'not practicable'; by analogy with IAS 8, paragraph 5, disclosure is impracticable when a company cannot provide the information after making every reasonable effort to do so.

5. Disclosures about contingent liabilities and contingent assets (continued)

Contingent liabilities (continued)

One company recognised a provision based on its best estimate for known and unknown legal claims. As the company was unable to determine a potential range of outcomes beyond that recognised as a provision, it disclosed an unquantified contingent liability for further obligations that may arise from the same matter. Such open-ended statements are not generally helpful without explaining why it is not possible to determine the potential range or order of magnitude.

As a provision is based on the 'most likely outcome' or 'expected value', both of which consider the possibility of various outcomes to settle on the best estimate, we expect in most cases that a range of outcomes or order of magnitude could be quantified in the contingent liability disclosures.



Where companies are unable to determine a range of outcomes for possible outflows beyond the provision recognised, we expect companies to explain how the estimate has been determined and why no further estimate of a range or order of magnitude can be determined.

Requirements to disclose an indication of uncertainty in relation to the timing and amount are discussed in [section 7](#) below.

Renewi has provided €15m based on legal advice which represents management's best estimate of the most likely outcome. It is noted that the potential maximum claim is €58m (excluding compound interest currently amounting to €5m), and therefore there is a potential further liability should the Group be wholly unsuccessful in its defence. A ruling from the European Commission is expected during FY22 but no monies would likely become payable until FY23.

*Renewi plc,
Annual Report and Accounts 2021, p209*

This disclosure provided the maximum exposure to the claim, as well as specifying the amount recognised as a provision.
It also explained the expected timeframe for resolution of the uncertainty and when the resulting outflow may occur.

5. Disclosures about contingent liabilities and contingent assets (continued)

Contingent assets

Where an inflow of economic benefits is probable, an entity shall disclose a **brief description of the nature** of the contingent assets at the end of the reporting period, and, **where practicable, an estimate of their financial effect**, measured using the principles set out for provisions in paragraphs 36–52.¹

Companies rarely included an accounting policy for contingent assets. This seemed proportionate as most did not disclose any material contingent assets. Some companies indicated that reimbursement may be available should contingencies crystallise. We make observations about reimbursement assets in [section 6](#) below.

Only one company disclosed a contingent asset and quantified the financial effect. Another company invoked the seriously prejudicial exemption from quantifying the financial effect.²



The inflow of economic benefits must be probable for a contingent asset to be disclosed. Furthermore, any such disclosures should avoid giving misleading indications of the likelihood of income arising.³

At 31 December 2020, the Group identified one contingent asset. This related to insurance claims of £12.1m, relating to losses incurred from events cancelled as a result of COVID-19, which were under negotiation as at year end and as such remained uncertain as to their outcome. In accordance with IAS 37, these amounts have not been recognised in the financial statements of the Group at 31 December 2020. Following the end of year, and before the approval of these financial statements, these amounts were agreed with insurance providers and cash was received, for the full amount of £12.1m.

*Informa PLC,
Annual Report and Accounts 2020, p218*

This disclosure explained the basis for treating the claims as not ‘virtually certain’ at year-end, even though the cash was received before the financial statements had been approved.

1. IAS 37, paragraph 89
2. See [page 13](#)
3. IAS 37, paragraph 90

6. Reimbursement assets

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the **reimbursement shall be recognised 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 recognised for the reimbursement shall not exceed the amount of the provision.

An entity shall **disclose ... the amount of any expected reimbursement**, stating the amount of any asset that has been recognised for that expected reimbursement.

Unless the possibility of any outflow in settlement is remote, an entity shall **disclose for each class of contingent liability ... the possibility of any reimbursement**.¹

Most companies in our sample did not provide a specific accounting policy for reimbursement assets. This appeared proportionate as only a minority referred to the potential for reimbursement.

The few instances of expected reimbursement we identified fell into two categories:

- insurance cover for risks for which a provision had been recognised; and
- contractual arrangements indemnifying the company against exposures in an acquired business.



For one company with a material reimbursement asset, we were unable to identify a corresponding accounting policy.

There were no indications of companies using a right to reimbursement to offset a provision in the current period, instead of presenting it as a separate asset. One company had corrected its prior year treatment, to present the related provision and reimbursement asset separately in accordance with IAS 37.

1. IAS 37, paragraphs 53, 85(c) and 86(c)



Better disclosure explained the link between the relevant provision and the reimbursement asset and identified which line items included that asset.

A few companies with material contingent liabilities disclosed that, were the liability to crystallise, they would be able to mitigate the outflow by claiming on insurance.

US asbestos-related provision	2020 £m	2019 £m
Gross provision	72.7	50.6
Effect of discounting	(8.2)	(6.2)
Discounted US asbestos-related provision	64.5	44.4
Insurance asset	52.4	43.4
Net US asbestos-related liability	12.1	1.0

The net provision and insurance asset are presented in the accounts as follows

	2020 £m	2019 £m
Provisions – current	7.2	7.1
Provisions – non-current	57.3	37.3
Trade & other receivables	7.2	7.0
Long-term receivables	45.2	36.4

The Weir Group PLC,
Annual Report and Financial Statements 2020, p180

This disclosure showed the overall net position of the provision after factoring in the reimbursement asset. It explained that the reimbursement is recognised as a separate asset and identified the specific line items in which it is included.

7. 'Best estimates' and uncertainties

Best estimate

There are several techniques for determining a best estimate from the range of possible outcomes, two of which are described in IAS 37.

Where the provision being measured involves **a large population of items**, the obligation is estimated by **weighting all possible outcomes by their associated probabilities**. ... Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

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.¹

This disclosure put the point estimate in the context of a range, with clear boundaries representing 'reasonably possible' outcomes, and explained how the mean value relates to the best estimate.

Estimation using expected value techniques

IAS 37 suggests this for large populations of items. Expected value could also be appropriate for assessing a single item with many possible outcomes, or selected points on a continuous range, to which probabilities can reasonably be assigned.

Our [Covid-19 Thematic Review](#) noted the 'expected cash flow approach' can be more effective to measure value-in-use than a single estimate.² In times of greater uncertainty, it may become harder to identify a single most likely outcome as the basis for a reliable estimate than to assign a weighting to each of several outcomes.

Companies rarely explained which method ('expected value' or 'most likely outcome') was used to determine their best estimate. In most cases, the nature of the provision gave a reasonable indication but, for some types of provision (e.g. litigation and claims), it was less clear.



Better examples explained the method used and provided qualitative and quantitative information about the inputs used or the assumptions made.

The actuarial model provides a range of potential liability based on levels of probability from 10% to 90%, which, on an undiscounted basis, equates to £53m-£133m. The mean actuarial estimate of £91m represents the expected undiscounted value over the range of reasonably possible outcomes. The provision in the financial statements is based on the mean actuarial estimate which is then adjusted to reflect discounting and restricting our estimate to ten years of future claims.

*The Weir Group PLC,
Annual Report and Financial Statements 2020, p180*

1. IAS 37, paragraphs 39 and 40

2. Review of financial reporting effects of Covid-19, July 2020, page 45; this observation, in the context of impairment, is also pertinent to estimating cash outflows to meet obligations.

7. 'Best estimates' and uncertainties (continued)

Indications of uncertainties

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

The discount rate(s) **shall not reflect risks** for which future **cash flow estimates** have been **adjusted**.¹

Only a minority of companies in our sample specified whether the amount recognised reflected risk through adjusting the cash flow estimates or the discount rate. However, as noted on [page 24](#), discounting did not materially affect the carrying amount of most of the provisions.

Generally, it may be easier to adjust the cash flows for risk rather than the discount rate. When determining the discount rate, care should be taken not to double-count a risk for which cash flows have already been adjusted.



We expect companies to explain the estimation method used, where either method may suit the circumstances and the amount determined would differ significantly depending on the method used, and how risks and uncertainties with material effect have been taken into account.

The disclosure requirements in IAS 37 relating to uncertainty in the amount or timing of an outflow apply to both provisions and contingent liabilities.² Greater emphasis is often given to the disclosures related to provisions due to the direct effect on amounts recognised in the financial statements.

An entity shall disclose ... for each class of provision ... 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 48.

Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability ... where practicable ... **an indication of the uncertainties relating to the amount or timing of any outflow**.

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.³

These disclosure requirements cover a broader set of uncertainties than those in IAS 1, paragraph 125. Under IAS 37, uncertainties should be disclosed regardless of the timescale over which they might materially affect the carrying amount of a provision.



We expect disclosure to help users understand the potential financial effect of additional (or reduced) costs and/or earlier (or later) timing of outflows, rather than simply stating that uncertainty exists.



We encourage companies to consider the types of information suggested in IAS 1, paragraph 129, as examples of useful disclosure, and to think more broadly about how to communicate the specific uncertainties affecting their provisions and contingent liabilities.

See [Section 8](#) for our observations on key sources of estimation uncertainty.

1. IAS 37, paragraphs 42 and 47

2. Subject to the 'not practicable' exemption for contingent liabilities, noted on [page 15](#) above.

3. IAS 37, paragraphs 85(b), 86(b) and 48; see also Implementation Guidance Part D examples 1 and 2

7. 'Best estimates' and uncertainties (continued)

Effective communication of uncertainty

In explaining uncertainty, a company should address outcome uncertainty (probable, possible or remote), as well as the measurement uncertainty.

Management's confidence in its own assessment of these two aspects may diverge, for example:

- It may be probable that leasehold property dilapidations will need to be paid but confidence in the estimated amount might be lower due to past experience of a wide range of costs; conversely,
- the amount of damages arising from a legal claim may be easily determined and largely fixed in quantum but uncertainties might exist about whether the claim can be successfully defended.



We encourage companies to consider how to communicate management's view of uncertainty more effectively, for example by:

- expressing management's confidence in the estimate or range of possible outcomes, as illustrated on [page 19](#); and
- using visual techniques to illustrate central and upside/downside scenarios or to explain the effect of changes in different assumptions.



Characteristics of better disclosure:

- Values were assigned to key assumptions, including the discount rate where the effect of discounting is material.
- Specific values from current experience of settling obligations were disclosed, such as the average actual cost of remediation of one site in a large population.
- Changes in estimation from prior year were quantified and explained.
- Where the provision might materially increase owing to additional obligations, contingent liability disclosures quantified the possible outflow over and above the probable outflow.
- Explanation distinguished between different types of uncertainty.

7. 'Best estimates' and uncertainties (continued)

Uncertainty in the amount of economic outflow

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 items** in the statement of financial position.

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.¹

Two-thirds of the sample provided qualitative and/or quantitative information about uncertainty affecting the amounts of estimated outflows. This was consistent with the proportion identifying provisions and contingent liabilities as a key source of estimation uncertainty (see [section 8](#)).



Quantitative information, for example the values assigned to key assumptions, generally provides a better understanding of the measurement of a provision.

Due to the long time horizons over which costs are anticipated, small changes in recurring annual cash outflows can have a significant cumulative impact on the total provision required.

*Elementis PLC,
Annual Report And Accounts 2020, p132*

This company highlighted the potential significance of changes in cash flow forecasting for its long-term provisions.



Explaining why estimated amounts do not constitute a significant uncertainty may be helpful where this is abnormal for the type of provision or industry sector. However, we do not expect 'negative confirmation' as a matter of course.

An estimation of the provision required for the British Steel DB pension transfer redress was determined based upon calculations performed as part of the skilled person review, which was considered representative of the broader population to form a reasonable estimate. The estimation per case is based upon FCA guidelines and modelling performed, and factors including pension transfer value, date of retirement, discount rate and retail price indexation. The calculations were then extrapolated to the entire population of British Steel DB cases that were advised on by Lighthouse advisers. The proportion of cases to be upheld, and therefore which requires redress payments to be made, was estimated based upon the current position of the review performed by the skilled person of the Lighthouse DB pension transfers

*Quilter plc,
Annual Report 2020, p173*

Better qualitative disclosures described the key factors, the sources of information and/or guidance used and the methodologies applied (e.g. extrapolation from a sample).

This company also provided quantitative information about key assumptions, sensitivities and, as illustrated on [page 23](#) below, ranges of outcome.

1. IAS 37, paragraph 25

7. 'Best estimates' and uncertainties (continued)

Uncertainty in the amount of economic outflow (continued)

A further assumption which has an impact upon the provision is the timing of benefits taken. The uncertainty regarding the timing of benefits taken by each member for the cases not yet determined by the skilled person has a potentially material future impact upon the provision. The range of outcomes for the provision, including anticipated costs, varies from £25 million to £36 million at each extremity of possible timing of benefits taken.

*Quilter plc,
Annual Report 2020, p231*

This disclosure explained that estimated outflow remained materially uncertain, owing to the number of cases not yet determined by the skilled person, and provided a range of possible outcomes.

The presentation distinguished this uncertainty from other factors affecting the estimate of outflows and the present value.

Uncertainty as to timing

We highlight on [page 13](#) opportunities to improve information about the expected timing of future outflows, reflecting management's best estimate of the outcome.

Timing is often subject to uncertainty, with outflows potentially arising sooner or later than originally anticipated. This may have a material effect on:

- the amount payable due to cost inflation;
- the present value of outflows, through discounting as discussed on [page 24](#) below; and
- presentation of the provision (or parts of it) as a current or non-current liability in the statement of financial position.¹



Better disclosure included the source of uncertainty, such as unpredictable timing in a legal process, an indication of the possible variance from the expected timing and quantification of the financial effect.

1. Two companies in our sample presented the statement of financial position using liquidity ranking, as permitted by IAS 1, paragraph 60, with current and non-current maturity information in the provisions note.

7. 'Best estimates' and uncertainties (continued)

Uncertainty in the discount rate

There is no specific requirement to disclose the discount rate used to calculate the present value of estimated future outflows. The IASB's project on discount rates acknowledged that IAS 37 specifies a measurement basis but does not describe it clearly.¹ The IFRS Interpretations Committee also noted that it understood predominant practice was to exclude own credit risk, as a risk of the entity rather than a risk specific to the liability.²



Better disclosure quantified the discount rates and explained how they had been determined, including whether different rates had been used for different parts of the business.

Most companies provided little or no detail as to how discount rates were estimated. However, for the majority, discounting did not materially affect the carrying amount.



We expect companies to disclose the discount rate and how it is calculated where the effect of discounting is material. This disclosure aids comparability from one period to the next and across companies.

... the present value of [restoration] provisions has been calculated using discount rates of between 4.5% and 4.9% in Kazakhstan ... and 6.4% in Kyrgyzstan ... Management estimates the discount rate for its provisions in Kazakhstan based on sovereign bond yields denominated in US dollars adjusted for the differential inflation between the tenge and the US dollar, which is lower in the long term. Management has not calculated its provisions using Kazakhstan sovereign bond yields denominated in tenge, as these bonds have largely been purchased by local institutions and there are limited bonds with maturities which are comparable to the remaining life of each mine.

*KAZ Minerals Limited (formerly KAZ Minerals PLC),
Annual Report And Accounts 2020, p165*



We expect companies to consider whether their disclosure explains each of the following matters, where this is material to understanding the estimation uncertainty:

- how the discount rate has been determined from benchmark rates, and what adjustment (if any) has been applied for cash flow risk, especially where the risk profile (and hence rate adjustment) has changed from the prior period;
- the use of different rates for different provisions and how this relates to the risks inherent in each liability;
- use of a real discount rate where projected cash flows have not been increased for inflation or a nominal rate where inflation has been applied in forecasting; and
- why an adjustment (if made) for own credit risk is justified in the specific context of the liability.

This company's disclosure explained how the estimation of the discount rate was affected by the key currencies in which the company transacted. The company went on to explain by how much the provision would change if a discount rate based on tenge-denominated bonds were used.

1. Project Summary published in February 2019 as 'Discount rates in IFRS Standards', at <https://www.ifrs.org/content/dam/ifrs/project/discount-rates/project-summary.pdf>. The project summary also noted that IAS 37 is not clear on which inputs, in particular an adjustment for the company's own credit risk, should be included in the discount rates used to measure provisions.
2. IFRIC Agenda Decision, March 2011, at <https://www.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/ias-37-inclusion-of-own-credit-risk-in-discount-rate-march-2011.pdf>

8. Significant judgements and estimates

Key sources of estimation uncertainty

An entity shall **disclose information about the assumptions it makes about the future**, and other major sources of estimation uncertainty at the end of the reporting period, that have a **significant risk** of resulting in a **material adjustment** to the carrying amounts of assets and liabilities **within the next financial year**.¹

In cases where there is significant risk of a material adjustment to the carrying amount of a provision in the following financial year, the more specific requirements of IAS 1, which focus on the short-term effects of uncertainty, complement those in IAS 37 discussed in [section 7](#). Companies can often deal appropriately with these two aspects of uncertainty disclosures in a single note. It is important, however, that undue emphasis is not given to only one of the aspects where this approach is taken.

IAS 1, paragraph 129, sets out the kinds of information that enable users to understand management's assumptions and the effect of estimation uncertainty as follows:

- (a) the **nature** of the assumption or other estimation uncertainty;
- (b) the **sensitivity** of carrying amounts to the methods, assumptions and estimates underlying their calculation, **including the reasons for the sensitivity**;
- (c) the expected resolution of an uncertainty and the **range of reasonably possible outcomes** within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
- (d) an **explanation of changes made to past assumptions** concerning those assets and liabilities, if the uncertainty remains unresolved.



Companies should take care not to omit relevant disclosure about estimation uncertainty when reporting the significant judgements made in preparing their financial statements.

Management's judgements about provisions, contingent liabilities and contingent assets frequently involved estimation of probabilities, amounts and timing. Almost two-thirds of the companies in our sample identified at least one provision or contingent liability as a key source of estimation uncertainty.



Better disclosure provided:

- specific descriptions of the assumptions made by management;
- quantitative information about the point estimates and the ranges considered for sensitivity or alternative scenarios; and
- linkage between levels of short and long-term uncertainty.

Most companies with large long-term provisions disclosed sensitivity information for changes to the discount rate (see [page 26](#) for an example).

One company disclosed provisions generally as a key source of estimation uncertainty but did not explain the specific risk of material adjustment. Another company disclosed uncertainties related to provisions as 'critical' but included sensitivity information that indicated that a reasonable possible change in the key assumptions would not result in a material adjustment to the carrying amount.



We do not discourage the disclosure of additional information where management believe that it is relevant to users of the accounts. However, we do expect a clear distinction to be made between such information and disclosures required under IAS 1, paragraph 125, where there is a significant risk of material adjustment to carrying amounts within the next financial year.



One company cross-referred to a note which duplicated the disclosure and provided no further information about the provision.

1. IAS 1, paragraph 125; recognising a provision in the following year, instead of disclosing a contingent liability (with nil carrying amount), may be regarded as a significant adjustment.

8. Significant judgements and estimates (continued)

Key sources of estimation uncertainty (continued)

Provisions for restoration and decommissioning obligations are made based on the best estimate of the likely committed cash outflow. Management seek specialist input from third party experts to estimate the cost to perform necessary remediation work at the reporting date. These experts undertake site visits in years where scoping identifies there is a change in operations in the year which could suggest a change in these estimates, or at sites that have not been visited recently. Desktop reviews are undertaken to inform the estimates for other sites. If the cost estimates increased by 10% the value of provisions could change by c.£1.2m. The useful lives of quarrying sites are based on the estimated mineral reserve remaining and manufacturing facilities linked to the useful life of site property, plant and equipment. Changes to these useful lives do not have a significant impact on the provision.

The estimation of inflation and discount rates is also considered to be judgemental and can have a significant impact on net present value. Management reference information from the Bank of England when making such estimates. If the discount or inflation rate were changed and the spread between them increased by 1% the value of provisions could change by c.£2.5m.

Forterra PLC,
Annual Report and Accounts 2020, p142

This company clearly set out its methodology for estimating the outflow, using current costs as determined by third party experts from site visits where there is likely to be greater uncertainty owing to changes in operations or passage of time.

Sensitivity disclosure addressed changes in estimated costs and the spread between the discount rate and inflation.

The comment on useful lives of quarrying sites and of property, plant and equipment at manufacturing facilities is informative even though changes to these lives do not have a significant effect. The disclosure provides a reasonable indication that the expected timing of outflows, estimated from current costs, is not a critical source of uncertainty compared to the absolute amounts estimated or the rate at which future outflows are discounted to present value.

This disclosure noted the source for the 'time value of money' (risk-free) component of the discount rate. The accounting policy for provisions explained that the discount rate is adjusted for risks specific to the liability.



Where a significant risk of a material adjustment to the carrying amount of a provision exists, but the sensitivities to single variables are not individually material, we expect companies to explain the effect of reasonably possible changes in combination. This is especially relevant where different variables are not independent.

8. Significant judgements and estimates (continued)

Key sources of estimation uncertainty (continued)



Companies provide better information about longer-term sources of uncertainty, such as climate change, when they link them to specific items, as illustrated below.¹

Environmental restoration and decommissioning provisions

The recognition and measurement of environmental restoration and decommissioning provisions requires judgement and is based on assumptions and estimates, including the required closure and rehabilitation costs, the timing of future cash flows, and the discount rates applied. The Group considers that no reasonably possible change to a single assumption would have a material impact on the provisions, however a combination of changes in multiple assumptions may.

The Group considers the impact of climate change on environmental restoration and decommissioning provisions, specifically the timing of future cash flows, and has concluded that it does not currently represent a key source of estimation uncertainty. Changes to legislation, including in relation to climate change, are factored into the provisions when the legislation becomes enacted.

*Anglo American plc,
Integrated Annual Report 2020, p181
(routine monitoring)*

This disclosure explained management's view of sensitivity to reasonably possible changes in assumptions under current conditions, in the context of short-term adjustments. Climate change and legislation introduced to address it (among other issues) are flagged as sources of uncertainty that may become key in the longer-term. Changes that become reasonably possible over that timeframe may have a material impact.

Significant judgements

An entity shall disclose, along with its significant accounting policies or other notes, **the judgements**, apart from those involving estimations (see paragraph 125), that **management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised** in the financial statements.²

Examples of non-estimation judgements that may significantly affect the recognition and measurement of provisions include:

- whether the most likely outcome or an expected value calculation gives a more reliable best estimate for the projected costs;
- whether the amount can reliably be estimated at all; and
- whether an estimated probability of outflow is 'remote' or 'possible'.³

Determining whether an exemption from disclosure is applicable and, if so, what information should still be disclosed, may also require significant judgement.



Disclosure that repeats or paraphrases the accounting policy for recognising or measuring provisions does not satisfy the requirements of IAS 1.

A case study in the Appendix uses a hypothetical legal claim to illustrate the main considerations in disclosing the significant judgement applied to the circumstances and the uncertainty as to the amount of potential outflow across the range of possible outcomes.

1. See also the [FRC's Climate Thematic November 2020](#)

2. IAS 1, paragraph 122

3. See also IAS 37, Implementation Guidance B

9. Management commentary

Strategic report commentary

Section 414C of the Companies Act 2006 requires companies to present a strategic report. The Companies Act requires the strategic report to provide a **fair, balanced and comprehensive review** of the company's development, performance and position, and a description of the **principal risks and uncertainties** facing the company.

We considered the consistency of management commentary in the strategic report¹ with disclosures in the financial statements and notes, taking account of other references to provisions, contingent liabilities and contingent assets in the annual report.

Discussion of major changes in provision balances, where present, tended to form part of the commentary on the related charges to profit or loss as exceptional or adjusting items.



One company provided no commentary on a significant increase in a major long-term provision.

Another company attributed its movement in working capital liabilities to changes in timing of payments and delivery, which would mainly affect trade payables. The increase in provisions appeared to account for most of the movement but this was not mentioned in the narrative.



Companies should consider the adequacy of commentary, particularly where provisions warrant comment in other parts of the annual report, or where movements are larger than other amounts discussed in the strategic report.



Better disclosure summarised the nature of material provisions and contingent liabilities, providing commentary on key movements in the period, together with cross-references to the relevant note.



Where management commentary provides a more in-depth explanation of obligations and costs, for example for restructuring projects, it may be helpful to cross-reference it in the financial statement notes.

One company referred to a legal claim in the strategic report but did not disclose it in the financial statements. We do not expect companies to give negative confirmation where the probability is clearly considered remote. However, disclosure in the notes may help users to understand the company's position where other information indicates that the risk may be greater, for example where the company had previously disclosed a contingent liability.



Two companies disclosed information about the discount rate in the narrative reporting but did not include it in the financial statements. As noted on [page 12](#), we encourage greater use of cross-referencing to reduce duplication. However, in the first instance, we expect companies to present information that is relevant to meeting the disclosure requirements of IAS 37 in the financial statement notes.

1. Equivalent report for two non-UK incorporated companies in the sample

9. Management commentary (continued)

Principal risks and uncertainties

Disclosure of provisions and contingent liabilities may overlap with those included for principal risks and uncertainties (PRUs). For example, companies in extractive industries or highly regulated sectors often included the risk of more stringent regulation and uncertainty over the lifetime of operations. We found no examples in the sample of PRU disclosure that suggested failure to disclose a material contingent liability.

There were opportunities to explain differences between PRUs and provisions, as well as similarities. For example, risks (or opportunities) of future changes in technology or legislation may be referenced in both the PRU disclosures and the disclosures on uncertainties (see [section 7](#)) but to different extents. They would be factored into the measurement of a provision only when supported by sufficient objective evidence,¹ whereas PRU disclosures would typically take a broader view.

Where companies identify risks related to climate change, we expect these to be disclosed as uncertainties in the potential timing and amount of outflows required to satisfy relevant present obligations. This is especially pertinent where physical or transitional risks tend to increase or accelerate outflows. For example, the effects of climate change may increase the uncertainty over timing of already-projected decommissioning costs; we would expect the IAS 37 disclosures to take account of this when material.²

1. See further commentary on long-term provisions on [pages 30 and 31](#).
2. See also the [FRC's Climate Thematic November 2020](#)

10. Specific types of provision

Certain types of provision present specific challenges for effective reporting. Some of the issues touched on in earlier sections are particularly relevant to specific types of provision. This section draws them together, noting that our points may also be applicable to other types of provision.

Long-term provisions

Some obligations crystallise over decades, rather than years. These include, for example, asset decommissioning requirements in the power generation sector, or remediation, restoration and environmental aftercare obligations commonly found in extractive and landfill businesses. Almost half of the companies in our sample included a long-term provision.

Companies with decommissioning liabilities explained that the change in estimate (reflecting changes in the expected outflow and discount rate) was either included in the corresponding asset or expensed where the asset was impaired or no longer in use.¹

Future events such as **changes in law or advances in technology** should only be reflected in the measurement of a provision **when there is sufficient objective evidence that they will occur**. Changes in law must be virtually certain to be enacted.

Cost reductions would be included for increased experience in applying existing technology or through applying existing technology to larger or more complex operations. However, the **anticipation of completely new technology cannot be reflected in measuring the provision unless there is sufficient evidence** that it will be available and effective.²

Companies with remediation, restoration and aftercare obligations generally explained that their estimation of costs was based on existing technology, and as required by currently enacted legislation. One company explained that the obligation was based on current costs, with inflation built in, and another's disclosure about the discount rate suggested the same approach. Others were less clear about how they addressed cost inflation.

1. IFRIC 1 'Changes in Existing Decommissioning, Restoration and Similar Liabilities', paragraphs 5 to 7

2. IAS 37, paragraphs 48 to 50; as noted on [page 29](#) above, less certain developments in technology or law may warrant disclosure in the strategic report's commentary on PRUs facing the company.



One company provided a maturity analysis to show when outflows were forecast to occur.



By contrast, several others disclosed only an approximate maximum or minimum timeframe. We expect companies with a number of different assets with varying periods of use to provide more granular detail in respect of timeframes. This would enable users to better understand the phasing of the outflows.

Future costs are expected to be incurred over the useful life of the sites, which is a period of up to 83 years.

The following table shows the timeline in which undiscounted costs in relation to the restoration and decommissioning provision are expected to become current:

2020	Current £m	1 - 20 years £m	21 - 40 years £m	40 years plus £m	Total £m
Restoration and decommissioning	3.2	2.0	5.1	2.9	13.2

*Forterra plc,
Annual Report and Accounts 2020, p158*

This disclosure shows the expected timing of outflows using aging categories to help demonstrate the expected phasing of future costs over the 83 years.

10. Specific types of provision (continued)

Long-term provisions (continued)

Discounting should be clearly explained, as the effect of changes in timing or rate can be very significant in this type of provision. See also [page 24](#) for opportunities to improve discount rate disclosures.

In most cases, companies with long-term provisions provided sensitivity information for changes in the discount rate. However, it was rarely included for changes in the projected costs or timing of outflows.



Two companies indicated that a future change in the assessment of the useful life of the asset to be decommissioned might affect the provision but provided no sensitivity for changes in the timing.



Good disclosure quantified the movement arising from changes in the underlying assumptions during the period, including that arising from changes in the discount rate or expected outflows. One company went on to explain the basis for the change in the assumptions from the prior year-end.

Climate change may be expected to have a more significant effect on certain classes of long-term provisions, for example asset retirement obligations. Consequently, greater transparency in reporting key assumptions such as timing and estimated costs will be important.

b. At 31 December 2020, the Group performed normal revisions to its asset retirement obligations which resulted in a \$110,464 adjustment, of which \$102,686 relates to macroeconomic factors stemming largely from the Covid-19 pandemic that reduced bond yields and resulted in a lower discount rate applied to our asset retirement obligations liability. The remaining \$7,778 relates to pricing-related adjustments based on historical costs incurred to plug and abandon wells.

c. At 31 December 2019, the Group performed normal revisions to its asset retirement obligations which resulted in a \$46,736 adjustment, of which \$42,650 relates to macroeconomic factors that reduced bond yields and resulted in a lower discount rate applied to our asset retirement obligations liability. The remaining \$4,086 relates to pricing-related adjustments based on historical costs incurred to plug and abandon

*Diversified Energy Company PLC (formerly Diversified Gas & Oil PLC),
Annual Report 2020, p186*

This company's disclosure explained the movement in the estimate as a result of the change to the discount rate and the expected costs, which included an explanation for the lower discount rate applied. The equivalent disclosure was also provided for the comparative period.

10. Specific types of provision (continued)

Litigation and claims

The level of detail was significantly greater in disclosures describing provisions and contingent liabilities for litigation claims and regulatory issues than for other types. In some cases, this reflected the complexity of the situation. In other cases, however, we would have expected greater focus on clear and concise communication of the information relevant to users' decisions.

IAS 1, paragraph 30A, explains that material information should not be obscured by immaterial information.



Some companies included extensive information about the history of legal proceedings. Often this information did not appear relevant to an understanding of the nature of the provision and the potential financial effects and uncertainties.



Where companies are required to provide this level of detail to meet regulatory or legal requirements, we encourage companies to disclose the financial effect and related uncertainties in a format that enables a user to more easily locate and understand the relevant information for the purposes of IAS 37.



Companies rarely specified the method (i.e. 'expected value' or the 'most likely amount') used to determine their best estimate. Where it is unclear which method may be more appropriate for the circumstances, we expect companies to explain the method used.

Better disclosure tended to be provided for those matters that used a formulaic or statistical method to determine the expected outflow for the associated claims.



Characteristics of good disclosure:

- A succinct background that can be read on a standalone basis
- An update on the position from prior periods (where relevant) and how this affected the provisions recognised or contingent liabilities disclosed
- Key assumptions and inputs used in measuring the amount, with better examples quantifying assumptions applied
- Where applicable, explanation of the extent to which external specialists were used in determining the expected outflow and whether specific models or guidance had been applied in the provision's calculation
- A range of possible outcomes or sensitivity information for changes in key assumptions

10. Specific types of provision (continued)

Restructuring and redundancy

Generally, we found disclosures explaining what costs (other than severance) a company anticipated from its restructuring project(s) to be limited.

Similarly, some companies included provisions to close or decommission sites within this category; however, limited information about the nature of the underlying costs was provided.



Additional background was sometimes included as part of the management commentary or disclosures covering exceptional or adjusting items. Where such information is relevant to understanding the nature of the obligation, we expect companies to include a cross-reference to where that information is provided.

IAS 37 prohibits the recognition of provisions for future operating losses and certain costs that may be associated with restructuring, including retraining and relocating continuing staff, marketing or investment in new systems and distribution networks which relate to the future operation of the business.¹



Better examples explained that most of the provision related to severance costs and identified other cost categories, with some explicitly stating that provisions excluded future operating losses.

In contrast, some companies with provisions relating to acquisitions or integration projects disclosed limited information in respect of the underlying costs included.



For wider rationalisation and integration programmes, we expect companies to clearly explain the nature of the underlying costs included in the restructuring provision. We expect companies, when commenting on the total expenditure for such projects, to distinguish between those outflows that can be recognised as a provision and those that are part of the ongoing activities of the business.

1. IAS 37, paragraphs 63 and 81

Exceptional rationalisation

The exceptional rationalisation provision relates to exceptional charges included within note 5 where the cost is based on a reliable estimate of the obligation.

The opening balance of £12.8m relates to restructuring costs booked in prior periods. The utilised balance includes £8.7m of cash settlements in 2020 and £1.5m of non-cash settlements, with £0.7m unutilised relating to Oil & Gas restructuring costs. The closing balance includes £1.9m for onerous contract provisions in Minerals with £0.8m classified as non-current.

Additions in the year, related to continuing operations, total £19.8m. This includes £9.7m in Minerals for Covid-19 restructuring and other costs, plus legal and consultancy fees related to the Black Economic Empowerment transaction in South Africa. In respect of ESCO, additions of £4.2m relate to Covid-19 restructuring and other costs along with final integration charges. The remaining balance includes £1.8m related to Central restructuring and £4.1m for Oil & Gas disposal costs where work streams were committed. In the year £13.1m was cash settled, with the closing balance of £6.6m related to severance costs in Minerals and Oil & Gas disposal costs.

Discontinued operations included additions in the year of £7.8m relating to restructuring and other costs, onerous purchase contracts and Covid-19 incremental charges, with £3.4m being cash settled in the year. The closing balance, which is expected to settle within 12 months, was transferred to liabilities held for sale and included provisions for onerous purchase contracts and final restructuring and rationalisation costs.

*The Weir Group PLC,
Annual Report and Financial Statements 2020, p181*

This disclosure provided an informative analysis of the provision by operating segment, by type of costs (e.g. onerous contracts, severance, incremental Covid-19-related charges), and by cash and non-cash movements. It also helps users understand the relationship between movements in the overall provision balance and the amounts held for sale at year end.

10. Specific types of provision (continued)

Self-insurance and captive insurance

Three companies in the sample disclosed provisions relating to self-insurance. The disclosures lacked clarity as to the arrangements, the extent of third party cover, and did not always explain the underlying obligation. We note that passing the risk to a captive insurance company within the group does not change the consolidated reporting entity's exposure to the underlying obligation, such as product warranty claims, public liability or disputes over contractual performance.



One company did not explain which aspects of its contracts were involved in claims falling within 'self-insurance' or how significant any non-contractual liabilities in this class might be.



Another explained that its self-insurance related to retained risks. However, it did not clarify the nature of those liabilities or to what extent it had separately provided for externally insured risks that the company was liable for in the first instance but for which reimbursement was expected.¹



Given the variety of self-insurance and captive insurance arrangements in use, users may find it hard to understand the exposure.² We expect companies to explain clearly the nature and extent of the risk associated with the underlying obligations.

Onerous contracts

None of the companies with onerous contracts in our sample specified whether the costs to fulfil the contracts included an allocation of other costs that relate directly to fulfilling the contracts (the 'full cost' approach) or only the incremental costs (the 'incremental cost' approach). The incremental cost approach remains an option until amendments to IAS 37, which are intended to address diversity in practice, come into effect for periods beginning on or after 1 January 2022.³

Property provisions

Provisions relating to leased property have reduced following adoption of IFRS 16. Circumstances that previously led to an onerous lease provision now first affect the carrying amount of a right of use (RoU) asset, with a provision being recognised only when that carrying amount has been reduced to nil.

Dilapidation and reinstatement provisions may still be necessary for leasehold properties. IFRS 16, paragraphs 24(d) and 25, require that an estimate of the costs of restoring the underlying asset to the condition required by the lease should generally be included in the cost of the RoU asset, with the obligations recognised and measured in accordance with IAS 37.⁴

Companies rarely explained the nature of the costs included in property provisions. For example, it was unclear whether they related to dilapidations or unavoidable costs of onerous leases that had not been included in the lease liability, such as service costs.

1. IAS 37, paragraph 55 to 57 and 85(c)
2. Arrangements range from captive insurance with a reserve fund and/or third party reinsurance to, in effect, no insurance.
3. 'Onerous Contracts — Cost of Fulfilling a Contract', inserting paragraph 68A and amending paragraph 69 of IAS 37. Early adoption is permitted; restatement of comparatives is not required.
4. Costs incurred to produce inventories are dealt with in IAS 2 'Inventories' in accordance with IFRS 16, paragraph 25.

10. Specific types of provision (continued)

Property provisions (continued)



We expect companies to explain the nature of the underlying outflows for property related provisions, particularly following the adoption of IFRS 16.



Better disclosure explained why there was an obligation, when the recognition threshold was met and the interaction with IFRS 16.



Several companies referred to the lease term to describe the expected timing of outflows, without quantification. We expect companies to disclose the expected timing of outflows for property-related provisions.

For provisions relating to long leasehold properties, our comments on the timing of outflows and discounting of long-term provisions on [pages 30 and 31](#) are also relevant.

This disclosure also explained why there was an obligation, the point at which the recognition criteria had been reached and the interaction with the impairment review of the related assets, including the ROU assets.

This company disclosed the nature of the unavoidable costs included in the provision for closure costs and explained that these were explicitly excluded from the measurement of the lease liabilities.

Property

Following the previously announced store closure programmes, the Group has a number of present obligations related to its property portfolio that are explicitly excluded from the measurement of lease liabilities in accordance with IFRS 16. As such, the Group has onerous contracts for unavoidable store closure costs including service fees, legal costs and dilapidations of £32m primarily relating to the Currys PCWorld 3-in-1 programme and Carphone Warehouse UK store closures at the reporting date.

Provisions for the costs described above are only recognised where there is a definitive business decision to exit a leased property, it is believed the unavoidable cost of meeting or exiting the obligations exceed the expected benefit to be received and after any impairment being recorded over right-of-use and store related assets in accordance with IAS 36. The amounts of future expenditures for store closure costs are reviewed throughout the year and are based on readily available information at the reporting date as well as management's historical experience of similar transactions.

Of the £32m related to closure programmes announced in prior periods, utilisation is to be incurred in conjunction with the profile of the leases to which they relate. The longest lease will unwind over the next nine years.

*Currys plc (formerly Dixons Carphone PLC),
Annual Report & Accounts 2020/21, p183 and p184*

10. Specific types of provision (continued)

Product warranties

The expected value approach tends to suit product warranties with large numbers of individually small claims, for estimating the costs of repair or replacement of faulty products. There was no explicit reference to this in the one company in our sample with a material warranty provision, which also did not explain the estimation method for any of its classes of provision.



Disclosing a maturity profile for a population, especially for warranties with a longer than typical life cycle, can provide useful insight.

Provisions

The Group provides product warranties on all new vehicle sales. Warranty provisions are recognised when vehicles are sold or when new warranty programs are initiated. Based on historical warranty claim experience, assumptions are made on the type and extent of future warranty claims including non-contractual warranty claims as well as on possible recall campaigns. These assessments are based on the frequency and extent of vehicle faults and defects in the past. In addition, the estimates include assumptions on the potential repair costs per vehicle and the effects of possible time or mileage limits. The provisions are regularly adjusted to reflect new information.

*Aston Martin Lagonda Global Holdings PLC,
2020 Annual Report, p106
(routine monitoring)*

The accounting policy disclosed by the company (not part of the sample of twenty) was specific to the provisions recognised. This policy specified when the warranty provision was recognised and explained the assumptions made in determining the estimate.

Additional provisions relating to Covid-19 pandemic issues

We found some indications of increases in provisions prompted by companies' responses to Covid-19 pandemic issues; these included:

- some additional provision for redundancy and/or other closure costs within restructuring provisions;
- an addition to and utilisation of 'other provisions' in respect of cancellation costs for events and hired venues; and
- provision against a contract for property development, also aggregated within 'other provisions'.

Given users' interest in reporting of the effects of the pandemic, we would have expected provisions arising from its effect in one company to be more prominent than a component of 'other provisions'. However, the associated narrative disclosures were satisfactory.

We also observed some indirect effects from the Covid-19 pandemic, with one company explaining that a lower discount rate had been applied to its provision in response to a reduction in bond yields that largely stemmed from the pandemic.

11. Key disclosure expectations

As highlighted throughout this report, there is scope for improvement in disclosure. We encourage companies to consider our findings when drafting their future annual reports and accounts.

Our expectations for good disclosure of provisions, contingent liabilities and contingent assets

Good disclosure should include the following, wherever the matters are material and of relevance to the company's financial reporting:

Concise and entity-specific descriptions of the significant accounting policies adopted in respect of provisions and contingencies

Clear and specific descriptions of the nature of each material exposure, the timeframe over which it is expected to crystallise and the basis for determining the best estimate of the probable or possible outflow

Quantitative information about expected or maximum exposures to contingent liabilities, or a clear and justified statement that it is not practicable to provide an estimate of the financial effect; negative confirmation can be helpful where users may otherwise expect the company to report an exposure

'Indications of uncertainty' in timing and/or amount that help users understand the potential financial effect (which may arise beyond the next financial year) of additional or reduced costs and/or earlier or later timing of outflows

Explanation of significant judgement exercised by management in determining the recognition and measurement of provisions, setting out the rationale for management's conclusion and the effect on the financial statements of taking an alternative view

Quantitative and qualitative information about critical estimation uncertainty affecting the next financial year, including disclosure of key assumptions and sensitivities

Management commentary on significant year-end balances and unrecognised exposures, and on significant movements recognised during the period (whether additions, new provisions, utilisations or reversals)

12. Appendix. Case study: ‘best estimate’, uncertainties and significant judgements

Scenario

A regulator in XYZ plc’s largest market has challenged the company’s business practices. Precedents from similar actions suggest that the regulator is more likely than not to impose a large fine (material to XYZ plc). An appeal process may result in a fine smaller or larger than that originally proposed.

Legal advisors to XYZ plc believe that the outcome, if adverse, will follow a set of precedent cases with no discernible bias towards a high or low value in that range. The appeal court may give weight to other factors leading to a materially higher or lower fine, for example: XYZ plc’s conduct during the case, changes in business practices and emerging public interest issues. It is only remotely likely that the penalty will be either nominal or punitive.

Interim hearings in the next twelve months are expected to provide stronger indications of the court’s attitude. A final decision will take up to four years.

Management has assessed the likelihood of an adverse outcome to be close to 50/50. A critical factor is the weight given to new legal arguments in XYZ plc’s favour. Management judges that a provision is required, on the critical assumption that the court is more likely than not to reject these arguments.

There is significant risk that as a result of the interim hearings:

- either the best estimate for the provision will move to the top or bottom of the current ‘probable’ range, requiring a material adjustment; or
- management’s judgement will change to regard the adverse outcome as only possible, leading to release of the entire provision (i.e. a material adjustment) and disclosure of a contingent liability.

The diagram below indicates the main considerations in disclosing the significant judgement applied to the circumstances and the uncertainty as to the amount of potential outflow across the range of possible outcomes.

Significant judgement (IAS 1, paragraph 122)	Exercised in assessing whether there is a probable present obligation: were management to prefer the alternative view on new legal arguments, the obligation to pay anything would be considered only possible and no provision would be recognised.				
Range of outcomes, across entire spectrum of probability	Nominal penalty only remotely likely	Smaller payout possible, taking account of mitigating factors	Probable payout range based on precedent cases, assumed to carry equal weight across the range	Larger payout possible	Punitive fine only remotely likely
Recognition	No provision	No provision	Provision recognised	No additional provision	No provision
Measurement	N/A	Estimate of minimum ‘possible’ payout, relevant for indication of uncertainty	‘Best estimate’ amount, in this case at mid-point within probable payout range	Estimate of maximum ‘possible’ payout, relevant for indication of uncertainty	N/A
Disclosure about uncertainty (IAS 37, paragraph 85)	No disclosure	‘Indication of uncertainty’ addresses the range of possible outcomes of an adverse decision, looking beyond the probable range and considering the overall timeframe for resolution of the matter			No disclosure
Key source of estimation uncertainty (IAS 1, paragraph 125)			Key estimation uncertainty (outcome of interim hearings) affecting following financial year		



Financial Reporting Council

**Financial
Reporting Council**
8th Floor
125 London Wall
London EC2Y 5AS

+44 (0)20 7492 2300
www.frc.org.uk