ASSURANCE AND ACCOUNTING

ASPE - IFRS: A Comparison

Provisions

In this publication we will examine the key differences between Accounting Standards for Private Enterprises (ASPE) and International Financial Reporting Standards (IFRS) related to provisions, contingent liabilities and contingent assets with a focus on:

- Recognition criteria;
- Measurement principles;
- Recognition and measurement of decommissioning liabilities (i.e. asset retirement obligations);
- Recognition of restructuring obligations; and
- Onerous contracts.

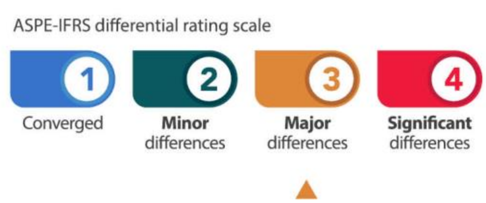
References

ASPE	IFRS
• Section 1000 – *Financial Statement Concepts* • Section 3110 – *Asset Retirement Obligations* • Section 3290 - *Contingencies*	• IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* • IFRIC 1 - *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

Overview of Major Differences

While IFRS and ASPE are similar in some areas there are some differences in the treatment of provisions, contingent liabilities and contingent assets such as:

- IFRS defines the term provision as a liability of uncertain timing or amount, while ASPE does not contain the term provision.
- Under ASPE, an obligation can be legal, equitable or constructive, while under IFRS an obligation can only be either legal or constructive.
- A contingent loss is recognized under ASPE when it is likely that there will be an outflow of resources to settle the obligation. “Likely” is a higher recognition threshold than “probable” (more likely than not), which is the threshold used under IFRS to recognize a provision.
- Under IFRS, onerous contracts are recognized as provisions. ASPE does not contain guidance on onerous contracts.



Scope & Key Definitions

The scope of Section 3290 under ASPE and IAS 37 under IFRS are similar, but there are some differences.

ASPE	IFRS
Section 3290 provides guidance on the treatment of contingent losses and contingent gains including recognition and disclosure. Section 3290 does not apply to allowances for impaired loans and doubtful accounts (see Section 3856, Financial Instruments), non-discretionary vendor rebates, or warranty provisions.	IAS 37 provides guidance on recognition, measurement and disclosure of provisions, contingent liabilities and contingent assets. The standard does not apply to provisions, contingent liabilities and contingent assets arising from non-onerous executory contracts and those covered by another IFRS. It also does not apply to financial instruments (including guarantees) that are within the scope of IAS 39, Financial Instruments, Recognition and Measurement / IFRS 9, Financial Instruments.

The terminology differences between ASPE and IFRS lay the foundation for the differences in the accounting treatment. ASPE addresses the terms liability and contingency. It further breaks down contingency into contingent losses and contingent gains. IFRS addresses the terms liability, provisions, contingent liabilities and contingent assets. Understanding the differences in terminology is the key to understanding how obligations are treated under ASPE as compared to IFRS.

ASPE	IFRS
Liabilities are defined as obligations of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future.	Under IFRS, liabilities are defined as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow of the entity's resources.
ASPE does not specifically define a provision.	IAS 37 defines a provision as a liability of uncertain timing or amount. They are similar to contingent losses, which meet the recognition criteria under ASPE.
Section 3290 defines a contingency as an existing condition or situation involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability. Contingencies can be recognized and unrecognized.	IAS 37 defines a contingent liability as: • A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or • A present obligation that arises from past events but does not meet recognition criteria as it is either not probable that an outflow of resources will be required to settle the obligation OR a sufficiently reliable estimate of the amount cannot be made. Contingent liabilities include only unrecognized obligations. A contingent asset is defined as a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. Contingent assets include only unrecognized assets.

Recognition & Disclosure

Under both ASPE and IFRS, an obligation is recognized depending on the likelihood of the outflow of resources to settle the obligation and on the ability to reasonably determine the amount of the outflow. The decision tree in the Appendix provides a summary of the recognition criteria under IFRS.

ASPE	IFRS
Under ASPE, an obligation can either be legal, equitable or constructive. An equitable obligation is a duty based on ethical or moral considerations. A constructive obligation is one that can be inferred from the facts in a particular situation as opposed to a contractually based obligation. However, there are exceptions to this principle. In the case of an asset retirement obligation, an obligation may be recognized only when there is a legal obligation to settle the obligation.	Under IFRS, an obligation can be either legal or constructive. A legal obligation refers to an obligation from a contract (explicit or implicit terms), legislation or other law. A constructive obligation is an expectation that is created by an established pattern of past practice, published policies or a sufficiently specific current statement the enterprise has indicated to other parties that it will accept certain responsibilities. As a result, the enterprise has created a valid expectation on the part of those other parties that will discharge those responsibilities. Unlike ASPE, there are no exceptions to this principle.
Under ASPE, a contingent loss is recognized when it is likely that there will be an outflow of resources to settle the obligation. "Likely" is a higher recognition threshold than "more likely than not". It should be noted that this is different than the general principles of Section 1000, *Financial Statement Concepts*, where recognition is based on whether it is probable that benefits will be obtained or given up. If an obligation exists but is not recognized, then it should be disclosed. The disclosure should include a description of the nature of the obligation and an estimate of the amount of the obligation or a statement that such an estimate cannot be made. Disclosures should also be made when the likelihood of occurrence of the future event cannot be determined and for any exposure to loss in excess of the amount accrued.	Under IFRS, a provision is recognized when there is a probable outflow of resources to settle the obligation. Probable means more likely than not. Therefore, there is a lower threshold for recognizing such obligations under IFRS than under ASPE. If it is not probable that an obligation will result in an outflow of resources, it should be disclosed as a contingent liability if a reliable estimate of the amount can be made. The disclosure requirements in IAS 37 are more extensive than under ASPE. Some of these disclosures include: movements in the provisions account for each class of provision; a description of the nature of the obligation and an estimate of its financial effect; information about any uncertainty regarding timing and amount of cash flows; and the possibility of any reimbursement.
Under ASPE, the amount of the loss must be reasonably estimable to be accrued.	Under IFRS, the standard takes the view that a sufficiently reliable estimate can always be made. In those very rare circumstances when it cannot be made, it would be disclosed as a contingent liability.
When it is likely that a future event will confirm that an asset had been acquired or a liability reduced at the date of the financial statements, the existence of a contingent gain should be disclosed in notes to the financial statements. The disclosure should include the nature of the contingency and an estimate of the amount or a statement that such an estimate cannot be made.	Under IFRS, a contingent asset should be disclosed if it is probable that the economic benefits will be realized. The disclosure should include the nature of the contingent asset and, where practicable, an estimate of the financial effect or a statement that it is not practicable to disclose this information.

Contingent gains are not recognized until they are realized.	A contingent asset is only recognized if it is virtually certain that it will be realized.
In ASPE, there is no specific recognition guidance provided for recoveries from third parties.	In some circumstances, a third party may reimburse part of the costs required to settle a provision or pay the amounts directly. The entity is usually liable for the whole amount if the third party doesn't settle. Therefore, a provision should be recognized for the whole amount. The reimbursement should only be recognized if realization is virtually certain. Therefore, a liability is often recognized, but the related reimbursement is not. The reimbursement is treated as a separate asset.

Measurement

ASPE requires contingent losses to be based on a reasonable estimate, while IFRS requires provisions to be recognized at the best estimate. Although these sound like similar concepts, they are quite different.

ASPE	IFRS
A reasonable estimate of the amount of a contingent loss to be accrued in the financial statements may be based on information that provides a range of the amount of loss. When a particular amount within such a range appears to be a better estimate than any other, that amount would be accrued; however, when no amount within the range is indicated as a better estimate than any other, the minimum amount in the range would be accrued. Disclosure of any exposure to loss in excess of the amount accrued would be included in the notes to the financial statements.	A provision should be measured at an amount that is the best estimate of the expenditure required to settle the obligation at the balance sheet date. To put it another way, the provision should be measured at the amount an entity would pay to settle the obligation or to transfer it to a third party at the balance sheet date. The two measurement techniques used are expected value and net present value of the outflow. Expected value is used when a large population of items is being measured. A probability is assigned to each value and the sum of the probability weighted values equals the amount to be recognized. Where the effect of the time value of money is material, the amount of the provision should be recorded at the present value of the expenditure required to settle the obligation. This could arise in the case of long term obligations where because of length of the term, the time value of money is material. When using present value techniques, the discount rate used should be pre-tax, and reflect the current market assessments of the time value of money. It should consider the risks specific to the liability.

Application of Key Concepts

The following provides a comparison of the similarities and differences between IFRS and ASPE in accounting for restructuring costs, future operating losses, onerous contracts and asset retirement obligations.

ASPE	IFRS
Restructuring Costs	
Under ASPE, there is no specific standard that provides guidance on accounting for restructuring provisions. Instead, guidance on items that would meet the definition of restructuring costs in IFRS are dealt with in various sections of the ASPE Handbook including Section 3110, *Asset Retirement Obligations*, Section 3462, *Employee Future Benefits*, and Section 3475, *Disposal of Long-lived Assets and Discontinued Operations*.	Under IFRS, a restructuring is a program that is planned and controlled by management, and materially changes either the scope of a business undertaken by an entity or the manner in which that business is conducted. The costs that can be included in the restructuring provision should only include the direct expenditures arising from the restructuring, which are those that are both necessarily entailed by a restructuring and not associated with ongoing activities of the entity. A restructuring obligation is recognized when it becomes a constructive obligation.
Future Operating Losses	
Under ASPE, future operating losses should not be recognized as a liability since they do not result from a past transaction.	Similarly, under IFRS a provision should not be recognized for future operating losses since they are not a present obligation resulting from a past event.
Onerous Contracts	
There is no specific reference to onerous contracts in ASPE. However, if an entity has a situation where the definition of a liability or a contingent liability would be met, the relevant recognition and disclosure requirements should be applied.	Under IFRS, onerous contracts are recognized as provisions. An onerous contract is a contract where the unavoidable costs of meeting the obligations under the contract exceed the benefits expected to be received under it. A provision is recognized based on the net cost to exit the contract. That is, the lower of the cost of fulfilling the contract and any penalties arising from failure to complete it.
Asset Retirement Obligation	
Under ASPE, an asset retirement obligation is recognized when there is a legally enforceable obligation associated with the retirement of a tangible long-lived asset that an entity is required to settle. An asset retirement obligation is recognized in the period in which it is incurred, when a reasonable estimate of the amount of the obligation can be made. Upon initial recognition of a liability for an asset retirement obligation, an entity recognizes an asset retirement cost by increasing the carrying amount of the related long-lived asset by the same amount as the liability. The asset retirement cost is subsequently allocated to expense	Under IFRS, asset retirement obligations are referred to as decommissioning liabilities. A decommissioning liability is essentially a constructive or legal obligation to decommission the asset and / or restore the asset site to minimum required standards. A decommissioning liability should be recognized when the likelihood of outflow of resources is probable and there is a reliable estimate of the amount to settle the obligation. The cost of the related item of property, plant and equipment includes the initial estimate of the costs to dismantle or remove it and restore the site on which it was located.

using a rational and systematic method over its useful life. The asset retirement obligation must be measured at the best estimate of the expenditure required to settle the present obligation at the balance sheet date. Often, a present value technique is used. Changes resulting from the passage of time or revisions to the timing, amount of the original estimate of undiscounted cash flows or the discount rate are recognized as an increase or a decrease in the carrying amount of the liability for the asset retirement obligation and the related asset retirement cost capitalized as part of the carrying amount of the long-lived asset.	The decommissioning liability would be measured at the best estimate of the expenditure required to settle the obligation at the balance sheet date. As per IFRIC 1, changes in the measurement of an existing decommissioning, restoration or similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, are accounted for differently depending on the measurement model that was used for the related asset. If the related asset is measured using the cost model, then the changes in the liability should be added to or deducted from the cost of the related asset in the current period. The amount deducted from the cost of the asset should not exceed its carrying amount. If the related asset is measured using the revaluation model, then the change in the liability alters the revaluation surplus or deficit previously recognized on that asset.

Conclusion

The principles related to provisions and contingencies under ASPE and IFRS have some similarities and some clear differences. In general, more liabilities may be recognized under IFRS than under ASPE. If you require further guidance on accounting for provisions and contingencies under IFRS or ASPE, please contact your local BDO Canada LLP office. If you are considering the adoption of a new standard, learn how our BDO Accounting Advisory Services Team can help you with the transition.

To learn more about the differences between standards, view our ASPE-IFRS: A Comparison Series.

Appendix: Decision Tree on Accounting Treatment for Provisions under IFRS