LIABILITIES

- There is no specific standard, definition is given by the Conceptual Framework and by IAS 1 – Presentation of Financial Statement, IAS 37 – Provisions, Contingent Assets and Contingent Liabilities

    = is a present obligation of an entity to transfer economic benefits as a result of past transactions or events.
LIABILITY

- Liability is established as soon as is asset delivered or the irrevocable contract is signed.
- Liability can be established because of building good relationship.
- Termination of liability is connected with outflow of economic benefits.
- Liability can be terminated in case the customer will give up his / her rights.
Classification of Liabilities

1) Time aspect
2) Probability of economic outflow
3) Way of their establishment
Liabilities – time aspect

- Following criteria:
  a) Operating cycle
  b) Accounting and reporting period
  c) Liquidity

a) and b) are defined in IAS 1:

Liability is classified as short-term:

a) It will be repaid during operating cycle
b) It will be repaid during 12 months
a) – liabilities with direct connection to operating cycle
b) – liabilities with indirect connection to operating cycle

**US GAAP – criteria liquidity:**
- Short-term liability = will be repaid from revenues
- Long-term liability = rest of liabilities
Probability of economic outflows

a) Non-contingent liabilities
b) Contingent Liabilities

a) CURRENT Liability is a present obligation of an entity to transfer economic benefits as a result of past transactions or events.
Contingent Liability

Contingent Liabilities:

= is a possible obligation that arises from past events whose outcome is based on uncertain future events or, an obligation that is not probable, or cannot be measured reliably.

- **IAS 10**: Events after balance sheet date
- **IAS 37**: Provisions, contingent assets and contingent liabilities
a) Provisions

b) Contingent Liabilities

**PROVISIONS** = current liability of uncertain timing or amount.
Differences between provisions and contingent liabilities

- Differences in disclosures requirements:
  - **Provisions** are recognised in balance sheet
  - **Contingent liabilities** are recognised in notes
    (why???)
Contingent Liability

= contingent liability should not be recognised in the financial statements, however disclosure should be made unless the possibility of the transfer of economic benefits is remote.
Provisions – IAS 37

- Provisions:
  - onerous contract,
  - Restructuring,
  - Harm on environment,
  - Tax payment,
  - Bonus payment,
  - Sale premium,
- Guarantees for product sold,
- Compensation for absence employees,
- Other purposes, if they fulfill the requirements of IAS 37

Provisions of IAS 37 cannot be done:
- Future operating loss,
- Repairment of long-term assets.
Restructuring

- Sale or termination of business activities,
- Business operation closing or their moving,
- Changes in statutorary board,
- Significant restructuring that will significantly change business activities
Provisions´ recording

- Creation of provision is recorded as an expense, rarely it is activated
- Provisions for restructuring are offset against expenses for restructuring, the rest of them are recorded as operating costs
- Provisions – usually are recorded as operating costs
- Decreasing of provisions is recorded as expenses correction
Liabilities - Probability of economic outflow

a) Non-constructive liability
b) Constructive liability

**Non-constructive liability** = is an obligation that arises by:
- Contractual right,
- Legal requirements,
- Other requirements;

**Constructive liability** = is an obligation that results from an entity’s actions where by an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities.
Valuation of Liabilities

In conformity with valuation of entity’s asset:

a) Nominal value,

b) Present Value of future payments,

c) Estimation base.
Nominal value

- Short-term liability
- Nominal value that was received in exchange for establishing of liability
- In case that for the liability does not exist asset in exchange, then it is valued in the amount of payments for repaying the liability.
Present value

- Long-term liability
- Discounted value of net future expenses that are necessary for its repaying.
- Discounted factor = market interest rate in time of establishing liability
  - Discounted factor
  - Premium factor
Estimation base.

- Very common for provisions
- It is necessary to calculate with all possible risks and uncertainty (legislation changes)
- IAS 37 – not to create provisions excessively.
Provision valuation

- In case of many possible situations – EXPECTED VALUE

- Probability of a given situations
Disclosures Requirements

Disclosures:

a) Certain liability – balance sheet,
b) Provisions – balance sheet,
c) Contingent liability – notes,
d) Remote – no disclosures

Jiné závazky, které nelze uznat – se nezveřejňují vůbec.
Disclosures

- Deferred income – liability recognised in balance sheet.
- Payments in advance – short-term and long-term liability.
- According to IAS/IFRS – liabilities must distinguish their short-term and long-term part)
Contingent Assets

- A contingent liability is a possible asset that arises from past events and whose existence will only be confirmed by uncertain future events not wholly within the control of the enterprise.
- They are not recorded in balance sheet but in notes.
Liabilities – IFRS for SMEs

- Section: 2, 21 and 22
- Section 2: present obligation to act by a certain way
  a) Non-contingent liability
  b) Contingent liability
IFRS for SMEs

Provisions, contingent liabilities, contingent assets:

A) Provisions – valuation according to best estimation with discounted factor in case it is significant – present value

B) Contingent asset and liability – recognised only if their probability is not remote
Appendix to Section 21

- Way how to recognise and value provisions
- It gives 9 specific case studies:
  a) Future operating loss
  b) Onerous contracts
  c) Restructuring
  d) Guarantee
  e) .....
Thank you for your attention