

# What Are Provisions and Contingent Liabilities?

## Worksheet

A provision is recognized when an outflow of resources is probable and can be reliably estimated; if not, it's only disclosed as a contingent liability.

## Questions

1. Which condition is NOT required to recognize a provision?
  - A) Present obligation from a past event
  - B) Probable outflow of resources
  - C) The amount can be reliably estimated
  - D) Shareholder approval of the amount
2. A lawsuit has a 20% chance of loss. How should it be treated?
  - A) Recognize a provision
  - B) Disclose as a contingent liability
  - C) Ignore it entirely
  - D) Record it as an asset
3. Where are contingent liabilities reported?
  - A) On the balance sheet as a liability
  - B) In the notes to the financial statements
  - C) As a reduction of equity
  - D) They are not reported at all
4. What accounting standard covers provisions?
  - A) IAS 16
  - B) IAS 37
  - C) IAS 40
  - D) IFRS 15
5. A company is being sued and lawyers estimate an 80% chance of losing, with a probable payout of \$200,000. How should this be treated?
6. A company faces a lawsuit with only a 15% chance of loss, estimated at \$500,000.
7. A firm has a warranty obligation: 60% probability of claims totaling \$50,000.
8. Define: What is a provision?
9. Define: What is a contingent liability?
10. Define: Three recognition criteria for a provision?

## Answer Key

1. D) Shareholder approval of the amount - Provisions need a present obligation, probable outflow, and a reliable estimate - not shareholder approval.
2. B) Disclose as a contingent liability - At only 20% likelihood, the outflow isn't probable, so it's disclosed as a contingent liability, not recognized.
3. B) In the notes to the financial statements - Contingent liabilities are disclosed in the notes unless the possibility of outflow is remote.
4. B) IAS 37 - IAS 37 governs provisions, contingent liabilities and contingent assets.
5. Outflow is probable (80% chance) and the amount is reliably estimated Recognize a provision of \$200,000 Disclose the nature of the obligation in the notes
6. Outflow is not probable (15% < 50%) Do not recognize a provision Disclose as a contingent liability in the notes (unless remote)
7. Probability Amount = 0.60 \$50,000 = \$30,000 Recognize a provision of \$30,000 as the best estimate
8. A liability of uncertain timing or amount, recognized when an obligation is probable and reliably estimable.
9. A possible obligation that's too uncertain to recognize - disclosed in the notes instead of recorded.
10. Present obligation from a past event, probable outflow of resources, and a reliable estimate of the amount.

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