Think Ahead ACCA

Technical factsheet

Provisions and contingencies and breaches of law or regulation

This factsheet has been produced in partnership with Steve Collings FCCA, director of Leavitt Walmsley Associates Ltd Chartered Certified Accountants, lecturer and author of financial reporting publications. You can find the latest publications at stevecollings.co.uk.

Introduction

ACCA has been made aware of third-party consultants contacting members' clients informing them of the potential to reduce tax liabilities (or claim tax back from prior accounting periods) through the recognition of provisions in the financial statements when it is questionable that the recognition criteria for a provision under FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland* or FRS 105, *The Financial Reporting Standard applicable to the Micro-entities Regime* have not been met. It would appear from reports that there is no consideration of UK accounting standards by these third parties. Commissions are payable to these consultants; however, there seems to be no recourse if a provision is disallowed by HMRC.

The purpose of this technical factsheet is to remind members of the recognition criteria contained in UK accounting standards and to carefully scrutinise the facts of each case where a provision has been recognised to ensure the provision is appropriate.

ACCA members should also bear in mind that HMRC would disallow tax relief on a provision if the requirements of UK GAAP are incorrectly applied. Members are also reminded of the importance of correctly interpreting the relevant accounting standard because any misinterpretation can result in the financial statements being incorrect. Any difficult or contentious issues can be discussed with ACCA's Technical Advisory team to mitigate the risk of misstatement in the financial statements. ACCA Technical Advisory can be contacted at advisory@accaglobal.com.

Background

ACCA is aware that third-party consultants are suggesting that members' clients recognise a provision if they suspect that they have breached certain legislation, such as the General Data Protection Regulation (GDPR). These parties are suggesting that tax relief is available where there may be a potential breach, and clients may be misled into incorrectly providing for potential liabilities that may not crystallise. Claims for overpaid tax in respect of provisions are also being made retrospectively by these consultants.

Provisions and contingencies are dealt with in FRS 102, Section 21, *Provisions and Contingencies*. FRS 105 deals with them in Section 16, *Provisions and Contingencies*. Both standards are similar in their recognition and measurement requirements.

Recognition criteria
A 'provision' is defined as a liability of uncertain timing or amount. Provisions can only be recognised when three criteria have been met as follows:

(a) The entity has an obligation at the reporting date as a result of a past event.
(b) It is probable (ie more likely than not) that the entity will be required to transfer economic benefits in settlement.
(c) The amount of the obligation can be estimated reliably.

The same recognition criteria also applies under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

If any one of the above criteria **cannot** be met, the entity cannot recognise a provision but instead may need to disclose a contingent liability (see below).

In some cases, provisions are being included in the financial statements, but are being over-provided and hence impacting on distributable profits.

Disclosure of a contingent liability
If the entity does have a genuine concern that it may have breached law or regulation, and hence may face possible sanctions by an authority but cannot meet the recognition criteria for a provision, the entity may need to disclose a contingent liability in its financial statements, if the entity determines that the contingent liability is material. For clarity, FRS 102, para 21.12 states:

'A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 21.4. An entity shall not recognise a contingent liability as a liability except for provisions for contingent liabilities of an acquiree in a ***business combination*** *(see paragraphs 19.20 and 19.21). Disclosure of a contingent liability is required by paragraph 21.15 unless the possibility of an outflow of resources is remote. When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.'*

Conclusion
Care must be taken by members to ensure that a provision is only recognised in the financial statements when the recognition criteria **under accounting standards** has been met. HMRC will disallow tax relief on provisions (if claimed) where they become aware of an inappropriate provision. Members are also reminded that ACCA does not allow members to have their names associated with financial statements that are misleading, and hence consultation in difficult or contentious matters is always advisable.

Where the entity has its financial statements audited, auditors must ensure sufficient appropriate audit evidence is obtained to justify the provision, ensuring the recognition criteria is appropriately met and relevant disclosures (whether for a provision or contingency liability) are adequate.

August 2022