

Case 12-3

Provisions and Contingencies

Scenario 1

Energy Inc. (Energy), which operates in the oil industry, is a U.S. subsidiary of a U.K. entity that prepares its financial statements in accordance with (1) IFRSs in reporting to its parent and (2) U.S. GAAP for reporting to its U.S.-based lender. Energy's operations sometimes result in soil contamination. Energy cleans up this contamination when required to do so under the laws of the particular country in which it operates. One country in which Energy operates has no legislation requiring cleanup, and Energy has inadvertently contaminated land in that country in prior years. As of December 31, 20X1, it is virtually certain that a draft law requiring a cleanup of land already contaminated will be enacted, but not until shortly after the year-end.

Required:

Should Energy recognize a provision as of December 31, 20X1, (1) in reporting to its U.K. parent under IFRSs and (2) in reporting to its U.S.-based lender in accordance with U.S. GAAP?

Scenario 2

FuelSource Co. (FuelSource) is a U.S. subsidiary of a U.K. entity that prepares its financial statements in accordance with (1) IFRSs in reporting to its parent and (2) U.S. GAAP for reporting to its U.S.-based lender. FuelSource also operates in the oil industry and its operations sometimes result in soil contamination. FuelSource operates in Dirty Country where there is no environmental legislation. However, FuelSource has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. FuelSource has a record of honoring this published policy. The U.K. parent also has a widely published environmental policy in which it undertakes to clean up all contamination it causes and has a record of honoring this published policy.

Required:

Should FuelSource recognize a provision for cleanup costs it may incur in Dirty Country (1) in reporting to its U.K. parent under IFRSs and (2) in reporting to its U.S.-based lender in accordance with U.S. GAAP?

Scenario 3

The government introduces a number of changes to the income tax system. As a result of these changes, Energy will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with the new regulations. As of the balance sheet date, no retraining of staff has taken place.

Required:

Should Energy recognize as of the balance sheet date a provision for the expected costs to retrain the staff (1) in reporting to its U.K. parent under IFRSs and (2) in reporting to its U.S.-based lender in accordance with U.S. GAAP?

Scenario 4

Under new legislation, FuelSource is required to install smoke filters in its factories by June 30, 20X2. FuelSource has not yet installed the smoke filters as of December 31, 20X1.

Required:

Should FuelSource recognize a provision as of December 31, 20X1, (1) in reporting to its U.K. parent under IFRSs and (2) in reporting to its U.S.-based lender in accordance with U.S. GAAP?