

42.2 An exercise on comparing provisions and potential assets

A customer sues a food manufacturer, having consumed a contaminated product. The manufacturer is likely to lose the case, but the contamination is traced to an ingredient bought in from another supplier. The food manufacturer sues the supplier, and is likely to win the case.

Should the food manufacturer make a provision for the damages claimed by the customer? Give reasons for your answer.

Response

The manufacturer here has a probable liability to pay compensation to the customer, but also a probable asset in the form of a strong claim against the supplier. It might be argued that the probable asset would cover the probable liability, and thus no provision need be made for the liability.

However, a strict application of the principle of prudence would require the firm to create a provision immediately for the probable liability, while not recognizing the probable asset until the verdict of the court is actually delivered.