Provisions, Contingent Assets and Contingent Liabilities – AS29

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Theme and Objective

- **Supersedes AS 4 in respect of contingencies**
- **Basic theme same as that of AS 4, but there are some significant differences**
- **Ensuring that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities**
- **Incorporation of sufficient information in financial statements to enable users to understand the nature, timing and amount of provisions and contingent liabilities**

Not Applicable

- **Executory contracts** - These are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. These are excluded from the scope of AS 29 unless they are onerous.
- Financial Instruments that are carried at Fair Value (Would be covered by AS-30 once mandatory).
- Items covered by other Accounting Standard.
- Arising in insurance enterprises from contracts with policy holders

Scope

- **This statement does not address recognition of revenue i.e. it does not change the requirements of AS 9 on Revenue recognition**
- **The term provision (as used in this standard) does not include depreciation, impairment loss and doubtful debts**
- **Examples of provisions dealt with by another standard are:**

  ←AS 22 Accounting for taxes on income

  ←AS 19 Leases

  ←AS 15 Accounting for retirement benefits

Provisions and Contingent Liabilities

- Provision is required for probable outflow on account of obligations existing on the balance sheet date, provided the amount of the outflow can be estimated reliably.
- If the outflow is not probable or if it cannot be estimated reliably, disclosure of relevant information is required, unless the possibility of outflow is remote.

Provision

- Present obligation as a result of a past event – At the Balance Sheet date. Independent of enterprise future actions.
- Probable outflow of resources.
- Reliable estimate of obligation.

Past Event

- Penalties or clean-up costs for environmental damage already done
- Smoke filters to be fitted in factory in future year -- does not result in present obligation unless liable for penalties on the date of the balance sheet
- No provision should be recognized for costs that need to be incurred to operate in future

Probable Outflow of Resources

- More likely than not to occur
- A chance of more than 50 per cent

Reliable Estimates

- Extremely rare case that reliable estimate can not be made.

Examples

- Provisions for expected clean up costs when virtually certain that a law requiring cleaning-up of land already contaminated will be enacted
- An offshore oilfield where its licensing agreement requires removal of the oil rig at end of production and restore seabed
- Policy of refunding purchases by dissatisfied customers

Contd.

Examples *(Contd.)*

- Costs under the warranty – class of obligations.
- Guarantee of borrowings
  - Financial condition of guaranteed party sound
  - Party in Liquidation – provision required
- Furnace lining that needs to be replaced every five years

Measurement of Provisions

- Best estimate of expenditure
- Should not be discounted to present value
- Uncertainty does not justify creation of excessive provisions or deliberate overstatement of liabilities

Contingent Liabilities

- Present obligation
  - Resource outflow not probable or
  - Rare situation where reliable estimate cannot be made – unless possibility of outflow remote
- Possible obligation from past events and existence will be confirmed only by occurrence or non-occurrence of one or more uncertain future events not wholly within control of the enterprise.
- To be assessed at each closing.

Contingent Assets

- Asset that arises from past events, existence of which will be confirmed only by occurrence or non-occurrence of uncertain future events not wholly within control of the enterprise.
- Contingent Assets not to be recognized unless income is virtually certain.

Expected Disposal of Assets

- Gains from expected disposal should not be taken into account
- Recognized only as per the time specified in accounting standard dealing with the relevant asset.

Reimbursements

- Reimbursement recognized only when virtually certain
- Treated as a separate asset
- Reimbursement recognized not to exceed provision made.
- Expense may be presented as net.
- Even when reimbursement is recognized, the same should be reflected as contingent liability.

Changes in Provisions

- Reviewed at each balance sheet date and adjusted.
- Only expenditures that relate to the original provision are adjusted against it.

Future Operating Losses

- Provisions should not be recognised
- Future operating losses do not meet the definition of liability
- Expectation of future operating losses is an indication that certain assets may be impaired and thus, these assets should be tested under AS 28 Impairment of Assets

Disclosures – Para 66

- Carrying amount at beginning and end of period
- Additional provisions made during the period
- Amounts used against the provision
- Unused amounts reversed during the period

Disclosures – Para 67 Provisions

- Brief description of the nature of the obligation and expected timing of resulting outflows.
- Indication of uncertainties of these outflows. Assumptions made concerning future events.
- Expected reimbursement and amount recognized against the same.

Disclosures – Para 68

- **Contingent Liabilities**
- Where any of the information required by para 68 is not disclosed because it is not practicable to do so, that fact should be stated
- If the disclosure of information as required in the Standard, is expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision or contingent liability, enterprise need not disclose the information. General nature of dispute and reason for non disclosure to be disclosed.

Problem Areas

- Prohibition on discounting of long-term provisions – Allowed in IAS.
- Recognition of reimbursements
- Constructive obligations – As per IAS provision is required to be made for the same resulting in early recognition. Restructuring exercise.
- Onerous Contracts

What is an Onerous Contract

- A contract is onerous if the unavoidable costs of meeting the obligation under the contract exceed the benefits expected under it.
- Unavoidable cost of meeting the obligations under a contract is the lower of –
  - Net cost of fulfilling the contract, and
  - Cost of terminating it.

Example

- 5 year operating lease at Rs 20 lakh per annum
- Can be cancelled by the lessee after 2 years by paying a penalty of Rs 15 lakh
- The lessee has no use of the leased asset.

Thanks

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