Accounting Standard (AS) 4
(revised 1995)

Contingencies and Events Occurring After the Balance Sheet Date

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Accounting Standard (AS) 4*

(revised 1995)

Contingencies[1] and Events Occurring After the Balance Sheet Date

(This Accounting Standard includes paragraphs 10-17 set in ***bold italic*** *type and paragraphs 1-9 set in plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of the Preface to the Statements of Accounting Standards[2].)*

The following is the text of the revised Accounting Standard (AS) 4, 'Contingencies and Events Occurring After the Balance Sheet Date', issued by the Council of the Institute of Chartered Accountants of India.

This revised standard comes into effect in respect of accounting periods commencing on or after 1.4.1995 and is mandatory in nature.[3] It is clarified

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*The Standard was originally issued in November 1982.

[1] Pursuant to AS 29, Provisions, Contingent Liabilities and Contingent Assets, becoming mandatory in respect of accounting periods commencing on or after 1-4-2004, all paragraphs of this Standard that deal with contingencies (viz. paragraphs 1(a), 2, 3.1, 4 (4.1 to 4.4), 5 (5.1 to 5.6), 6, 7 (7.1 to 7.3), 9.1 (relevant portion), 9.2, 10, 11, 12 and 16) stand withdrawn except to the extent they deal with impairment of assets not covered by other Indian Accounting Standards. For example, impairment of receivables (commonly referred to as the provision for bad and doubtful debts), would continue to be covered by AS 4. (See Announcement on 'Applicability of AS 4 to impairment of assets not covered by present Indian Accounting Standards' (published in 'The Chartered Accountant', April 2004, pp. 1151)). This Announcement is reproduced under the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium.

[2] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

[3] Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard.

that in respect of accounting periods commencing on a date prior to 1.4.1995, Accounting Standard 4 as originally issued in November 1982 (and subsequently made mandatory) applies.

Introduction

1. This Statement deals with the treatment in financial statements of

(a) contingencies[4], and

(b) events occurring after the balance sheet date.

2. The following subjects, which may result in contingencies, are excluded from the scope of this Statement in view of special considerations applicable to them:

(a) liabilities of life assurance and general insurance enterprises arising from policies issued;

(b) obligations under retirement benefit plans; and

(c) commitments arising from long-term lease contracts.

Definitions

3. The following terms are used in this Statement with the meanings specified:

3.1 A *contingency* is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

3.2 *Events occurring after the balance sheet date* are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.

Two types of events can be identified:

[4] See footnote 1.

(a) those which provide further evidence of conditions that existed at the balance sheet date; and

(b) those which are indicative of conditions that arose subsequent to the balance sheet date.

Explanation

4. Contingencies

4.1 The term "contingencies" used in this Statement is restricted to conditions or situations at the balance sheet date, the financial effect of which is to be determined by future events which may or may not occur.

4.2 Estimates are required for determining the amounts to be stated in the financial statements for many on-going and recurring activities of an enterprise. One must, however, distinguish between an event which is certain and one which is uncertain. The fact that an estimate is involved does not, of itself, create the type of uncertainty which characterises a contingency. For example, the fact that estimates of useful life are used to determine depreciation, does not make depreciation a contingency; the eventual expiry of the useful life of the asset is not uncertain. Also, amounts owed for services received are not contingencies as defined in paragraph 3.1, even though the amounts may have been estimated, as there is nothing uncertain about the fact that these obligations have been incurred.

4.3 The uncertainty relating to future events can be expressed by a range of outcomes. This range may be presented as quantified probabilities, but in most circumstances, this suggests a level of precision that is not supported by the available information. The possible outcomes can, therefore, usually be generally described except where reasonable quantification is practicable.

4.4 The estimates of the outcome and of the financial effect of contingencies are determined by the judgement of the management of the enterprise. This judgement is based on consideration of information available up to the date on which the financial statements are approved and will include a review of events occurring after the balance sheet date, supplemented by experience of similar transactions and, in some cases, reports from independent experts.

5. Accounting Treatment of Contingent Losses

5.1 The accounting treatment of a contingent loss is determined by the expected outcome of the contingency. If it is likely that a contingency will result in a loss to the enterprise, then it is prudent to provide for that loss in the financial statements.

5.2 The estimation of the amount of a contingent loss to be provided for in the financial statements may be based on information referred to in paragraph 4.4.

5.3 If there is conflicting or insufficient evidence for estimating the amount of a contingent loss, then disclosure is made of the existence and nature of the contingency.

5.4 A potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. Suitable disclosure regarding the nature and gross amount of the contingent liability is also made.

5.5 The existence and amount of guarantees, obligations arising from discounted bills of exchange and similar obligations undertaken by an enterprise are generally disclosed in financial statements by way of note, even though the possibility that a loss to the enterprise will occur, is remote.

5.6 Provisions for contingencies are not made in respect of general or unspecified business risks since they do not relate to conditions or situations existing at the balance sheet date.

6. Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realised. However, when the realisation of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

7. Determination of the Amounts at which Contingencies are included in Financial Statements

7.1 The amount at which a contingency is stated in the financial statements is based on the information which is available at the date on which the financial statements are approved. Events occurring after the balance sheet date that indicate that an asset may have been impaired, or that a liability may have existed, at the balance sheet date are, therefore, taken into account in identifying contingencies and in determining the amounts at which such contingencies are included in financial statements.

7.2 In some cases, each contingency can be separately identified, and the special circumstances of each situation considered in the determination of the amount of the contingency. A substantial legal claim against the enterprise may represent such a contingency. Among the factors taken into account by management in evaluating such a contingency are the progress of the claim
at the date on which the financial statements are approved, the opinions, wherever necessary, of legal experts or other advisers, the experience of the enterprise in similar cases and the experience of other enterprises in similar situations.

7.3 If the uncertainties which created a contingency in respect of an individual transaction are common to a large number of similar transactions, then the amount of the contingency need not be individually determined, but may be based on the group of similar transactions. An example of such contingencies may be the estimated uncollectable portion of accounts receivable. Another example of such contingencies may be the warranties for products sold. These costs are usually incurred frequently and experience provides a means by which the amount of the liability or loss can be estimated with reasonable precision although the particular transactions that may result in a liability or a loss are not identified. Provision for these costs results in their recognition in the same accounting period in which the related transactions took place.

8. Events Occurring after the Balance Sheet Date

8.1 Events which occur between the balance sheet date and the date on which the financial statements are approved, may indicate the need for adjustments to assets and liabilities as at the balance sheet date or may require disclosure.

8.2 Adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date. For example, an adjustment may be made for a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

8.3 Adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. An example is the decline in market value of investments between the balance sheet date and the date on which the financial statements are approved. Ordinary fluctuations in market values do not normally relate to the condition of the investments at the balance sheet date, but reflect circumstances which have occurred in the following period.

8.4 Events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

8.5 There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements.

8.6 Events occurring after the balance sheet date may indicate that the enterprise ceases to be a going concern. A deterioration in operating results and financial position, or unusual changes affecting the existence or substratum of the enterprise after the balance sheet date (e.g., destruction of a major production plant by a fire after the balance sheet date) may indicate a need to consider whether it is proper to use the fundamental accounting assumption of going concern in the preparation of the financial statements.

9. Disclosure

9.1 The disclosure requirements herein referred to apply only in respect of those contingencies or events which affect the financial position to a material extent.

9.2 If a contingent loss is not provided for, its nature and an estimate of its financial effect are generally disclosed by way of note unless the possibility of a loss is remote (other than the circumstances mentioned in paragraph 5.5). If a reliable estimate of the financial effect cannot be made, this fact is disclosed.

9.3 When the events occurring after the balance sheet date are disclosed in the report of the approving authority, the information given comprises the nature of the events and an estimate of their financial effects or a statement that such an estimate cannot be made.

Accounting Standard

Contingencies[5]

10. The amount of a contingent loss should be provided for by a charge in the statement of profit and loss if:

(a) it is probable that future events will confirm that, after taking into account any related probable recovery, an asset has been impaired or a liability has been incurred as at the balance sheet date, and

(b) a reasonable estimate of the amount of the resulting loss can be made.

11. The existence of a contingent loss should be disclosed in the financial statements if either of the conditions in paragraph 10 is not met, unless the possibility of a loss is remote.

12. Contingent gains should not be recognised in the financial statements.

Events Occurring after the Balance Sheet Date

13. Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of

[5] See also footnote 1.

going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate.

14. Dividends stated to be in respect of the period covered by the financial statements, which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted.

15. Disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

Disclosure

16. If disclosure of contingencies is required by paragraph 11 of this Statement, the following information should be provided:

(a) the nature of the contingency;

(b) the uncertainties which may affect the future outcome;

(c) an estimate of the financial effect, or a statement that such an estimate cannot be made.

17. If disclosure of events occurring after the balance sheet date in the report of the approving authority is required by paragraph 15 of this Statement, the following information should be provided:

(a) the nature of the event;

(b) an estimate of the financial effect, or a statement that such an estimate cannot be made.