

AS-29

Provisions, Contingent Liabilities and Contingent Assets

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Objective of the Standard

- ✉ 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
- ✉ Laying down appropriate accounting for contingent assets

Scope of the Standard

- ✉ **Standard should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets**
- ✉ **Statement does not apply to provisions, contingent liabilities and contingent assets:**
 - ← **Resulting from financial instruments that are carried at fair value**
 - ← **Resulting from executory contracts unless they become onerous contracts**
 - ← **Arising in insurance enterprises from contracts with policy holders and**
 - ← **Covered by another accounting standard**

Scope of the Standard (contd...)

✉ **Executory contracts (unless they are onerous) are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent**

✉ **Examples of provisions dealt with by another standard are:**

← **AS 7 construction contracts**

← **AS 22 accounting for taxes on income**

← **AS 19 leases**

← **AS 15 accounting for retirement benefits in the financial statements of employers**

Scope of the Standard (contd...)

✉ **This statement does not address recognition of revenue i.e. it does not change the requirements of AS 9 revenue recognition**

✉ **The term provision (as used in this standard) does not include depreciation, impairment loss and doubtful debts**

Definitions explained

✉ **A Provision is:**

← A liability

← Which can be measured only by using a substantial degree of estimation

✉ **A Liability is:**

← Present obligation arising from past events

← Settlement of which is expected to result in outflow of resources embodying economic benefits

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Definitions explained (contd...)

✉ **An Obligating Event is:**

← An event that creates an obligation

← That results in an enterprise having no realistic alternative to settling that obligation

✉ **A Possible Obligation is an obligation the existence of which (based on the evidence available) at the balance sheet date is considered not probable.**

Definitions explained (contd...)

✉ **A Present Obligation is an obligation the existence of which (based on the evidence available) at the balance sheet date is considered probable i.e. more likely than not**

✉ **A Contingent Asset is:**

← **A possible asset that arises from past events**

← **The existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise**

Definitions explained (contd...)

A Contingent Liability is:

← A possible obligation

 that arises from past events

 the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise

← A present obligation that arises from past events but is not recognised because:

 It is not probable that an outflow of economic resources will be required to settle the obligation or

 A reliable estimate of the amount of the obligation cannot be made

Definitions explained (contd...)

✉ **A Restructuring Programme is a programme:**

← **that is planned and controlled by management
and**

← **that materially changes either:**

⌚ **the scope of a business undertaken by an
enterprise**

⌚ **the manner in which that business is conducted**

Recognition criteria - Provisions

✉ **Para 14 of AS states that a Provision should be recognised when:**

← **an enterprise has a present obligation as a result of a past event**

← **it is probable that an outflow of economic resources embodying economic benefits will be required to settle the obligation and**

← **a reliable estimate can be made of the amount of the obligation**

Observations/other points - Provisions

✉ On the basis of evidence available on the balance sheet date and after considering additional evidence provided by events occurring after the balance sheet date:

← where it is more likely than not that a present obligation exists at the balance sheet date, the enterprise recognises a provision if:

- ⌚ the settlement of obligation will result in outflow of economic resources and
- ⌚ a reliable estimate of the amount can be made

Observations/other points - Provisions (contd...)

← where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability, unless the possibility of an outflow of economic resources is remote

✉ Only present obligations arising out of past events should be considered

✉ No provision should be recognised for costs that need to be incurred to operate in future

Observations/other points - Provisions (contd...)

✉ **An obligation always involves another party to whom obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed**

✉ **An outflow of economic resources or other event is regarded as probable if the probability that the event will occur is greater than the probability that it will not**

Observations/other points - Provisions (contd...)

- ✉ **Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make a reliable estimate of the amount of provision**
- ✉ **In extremely rare cases where it is not possible to make a reliable estimate, no provision is recognised and the liability is disclosed as contingent liability**

Recognition criteria - Contingencies

✉ **As per para 26 of AS an enterprise should not
recognise a contingent liability**

✉ **As per para 30 of AS an enterprise should not
recognise a contingent asset**

Observations / other points - Contingencies

✉ **Where an enterprise is jointly and severally liable
for an obligation:**

← **provision (if the recognition criteria is met) should
be made of the part of the obligation which has
to be met by the enterprise**

← **the part of the obligation that is expected to be
met by other parties is treated as contingent
liability**

Observations/other points - Contingencies (contd...)

- ✉ **Contingent Liabilities should be assessed continually to determine whether outflow of economic resources has become probable or not**
- ✉ **The moment the outflow of economic resource becomes probable provision should be recognised if other recognition criteria is met**

Observations/other points - Contingencies (contd...)

- ✉ **When the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate**
- ✉ **A contingent asset is not disclosed in the financial statements**
- ✉ **Contingent assets are assessed continually and the moment the inflow of economic resource becomes virtually certain, the asset and related income should be recognised**

Measurement of Provisions

Best Estimate:

- ← **The amount recognised as a provision should be the best estimate of the expenditure**
- ← **It should not be discounted to its present value**
- ← **It should be based on evidence available not only on the balance sheet date but also from the events occurring after the balance sheet date**
- ← **The provision is measured before tax - tax consequences should be dealt in accordance with AS 22 Accounting for Taxes on Income**

Measurement of Provisions (contd...)

Risks and Uncertainties:

← **Risks and uncertainties that surround events and circumstances should be taken into account in reaching the best estimate**

← **Uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities**

Measurement of Provisions (contd...)

Future Events:

← **Future events affecting the amount required to settle an obligation should be reflected in the amount of a provision if and only if there is sufficient objective evidence that they will occur**

Expected Disposal of Assets:

← **Gains from the expected disposal of assets should not be taken into account in measuring a provision**

Measurement of Provisions (contd...)

Reimbursements:

- ← When the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised
- ← It should be recognised only if it is virtually certain that reimbursement will be received
- ← Reimbursement should be treated as a separate asset
- ← The amount of reimbursement should not exceed the amount of provision

Measurement of Provisions (contd...)

Changes in and Use of Provisions:

- ← Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate**
- ← If after review it is identified that it does not meet the recognition criteria it should be reversed**
- ← Provision should be used only for expenditure for which the provision was originally recognised**

Other points

✉ Future Operating Losses:

- ← Provisions should not be recognised for future operating losses
- ← 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

Other points (contd...)

Restructuring:

← Provision for restructuring costs is recognised only when the recognition criteria for provisions are met

← A restructuring provision should include only the direct expenditure arising from the restructuring and which are:

⌚ necessarily entailed by the restructuring and

⌚ not associated with the ongoing activities of the enterprise

Other points (contd...)

✉ Restructuring (contd...) :

← Examples of restructuring are:

- ⌚ sale or termination of a line of business
- ⌚ the closure of business locations in a country or region
- ⌚ relocation of business activities
- ⌚ changes in management structure
- ⌚ fundamental re-organisations that have a material effect on the operations

Other points (contd...)

Restructuring (contd...) :

← **Restructuring provision does not include such costs as:**

 **retraining or relocating continuing staff**

 **marketing or**

 **investment in new systems and distribution networks**

Disclosure

✉ **For each class of provision, the following should be disclosed (para 66 of the AS) :**

← **carrying amount at beginning and end of the period**

← **additional provisions made in the period**

← **amount used during the period**

← **unused amounts reversed during the period**

Disclosure (contd...)

✉ **For each class of provision, the following should be disclosed (para 67 of the AS) :**

- ← **brief description of the nature of the obligation and expected timing of any resulting outflow of economic resources**
- ← **an indication of the uncertainties about those outflows and major assumptions concerning future events**
- ← **the amount of expected reimbursement, stating the amount recognised as an asset for expected reimbursement**

Disclosure (contd...)

✉ **Unless the possibility of outflow of economic resources is remote, for each class of contingent liability, the following should be disclosed (para 68 of the AS) :**

- ← **brief description of the nature of contingent liability**
- ← **an estimate of financial effect**
- ← **an indication of the uncertainties relating to any outflow**
- ← **the possibility of any reimbursement**

Disclosure (contd...)

✉ **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 are 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**

Disclosure (contd...)

- ✉ If as per above, the enterprise does not disclose the information, it is required to disclose
- ← the general nature of the dispute
 - ← reason why the information has not been disclosed

Comparison with AS 4 Contingencies and Events Occurring After the Balance Sheet Date

AS 29	AS 4
Definition of Contingent Liability and Contingent Asset separated	Contingent Liability and Contingent Asset included in the definition of 'Contingency'
The term 'Provision' clearly distinguished from 'Contingent Liability' and thus both the terms have been elaborated	No express segregation of the term 'Provision' from the term of 'Contingent Liability'

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Comparison with AS 4 Contingencies and Events Occurring After the Balance Sheet Date (contd...)

AS 29	AS 4
Only if there is a present obligation and there will be outflow of economic resources (to settle it) which can be reliably estimated, provision should be made	If it is probable that contingency will result in a loss (an asset impaired or liability incurred), provision should be made
Provision once made should be reviewed at each Balance Sheet date to see whether it still meets the recognition criteria	No such express requirement mentioned

Comparison with AS 4 Contingencies and Events Occurring After the Balance Sheet Date (contd...)

AS 29	AS 4
Measurement of amount of provision should be: • Based on best estimate • After considering risks and uncertainties • After considering future events • Made without considering expected disposal of assets • After taking into account reimbursements	No such detailed measurement principles laid down

Comparison with AS 4 Contingencies and Events Occurring After the Balance Sheet Date (contd...)

AS 29	AS 4
Provision can be made for Restructuring activities if it meets the recognition criteria	No such specific activity included in the Standard
Provision should be used only for expenditure for which the provision was originally recognised	No such express requirement mentioned in the Standard
Detailed disclosure requirement for the Provisions made	No disclosure requirement for contingent liability for which provision is made

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**Comparison with AS 4 Contingencies and Events
 Occurring After the Balance Sheet Date (contd...)**

AS 29	AS 4
If the disclosure of information will prejudicially affect the interest of the enterprise (in a dispute with third party) the same may not be disclosed. However, general nature of dispute and the reason for non-disclosure should be mentioned	No such concession given by the Standard

Decision Table - Position Summarized

Situation 1	Situation 2	Situation 3
There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation.	There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.	There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.
Action 1	Action 2	Action 3
A provision is recognised (para 14). Disclosures are required for the provision (paras 66 and 67)	No provision is recognised (para 26). Disclosures are required for the contingent liability (para 68). Sreeram Coaching Point	No provision is recognised (para 26). No disclosure is required (para 68).

Comparison with International Accounting Standard (contd...)

IAS 37

AS 29

Constructive Obligation

IAS deals with 'constructive obligation' in the context of creation of provision. For example, in case of a restructuring, a constructive obligation arises when an enterprise has a detailed formal plan for restructuring. Thus, in this case provision is recognised at an early stage

Requirement of recognising constructive obligation has been omitted by AS 29.

THANK YOU