

SREERAM COACHING POINT

ACCOUNTING STANDARD - 29

Provisions, Contingent Liabilities and Contingent Assets

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Note: 1

The provision which are in the nature of adjustment to carrying amounts of assets are not addressed in AS 29 Example: Depreciation, Impairment, Doubtful debts etc.

Note: 2

Provisions are distinguished from trade payables and accruals. Because for provision, estimation is important. Sometimes, with respect to accruals, estimation is made. But the degree of estimation is generally much less than that for provisions.

Note: 3

Financial statements deal with financial position of an enterprise at the end of its reporting period. It is not for possible position in future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future [i.e. future operating losses]

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When to Recognise Provision?

The following conditions should be satisfied

1. There is a present obligation
2. Such obligation arise as a result of past event
3. There is no realistic alternative exists in settling that obligation
4. It is probable that outflow of resources embodying economic benefits will be required to settle the obligation
5. A reliable estimate can be made of the amount of obligation

The amount of provision should not be discounted to its present value

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Obligation

- It means duty or responsibility
- It may be
- Legally enforceable as a consequence of a binding contract or statutory requirement or
- Arise from normal course of business practice, custom etc.

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Definition: Present obligation

- Based on the evidence available, its existence on the balance sheet date is considered probable.
- Probable means “more likely than not”

Obligation – Example

LEGAL OBLIGATION

- Warranty given at time of sale to repair or replace faulty goods
- legal requirement to clean up environmental damage caused by entity

CONSTRUCTIVE OBLIGATION

- policy to return price paid on undamaged goods returned by customer
- published entity policy to clean up environmental damage caused by entity

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Note:

1. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources will be required to settle the obligation, the provision should be reserved

2. A provision should be used only for expenditures for which the provision was originally recognised

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Sale with Warranty

- Present obligation
- Past event
- Outflow of economic benefits

- Legal obligation under contract to repair or replace faulty goods
- Sale of goods subject to warranty
- Cost of repair or replacement goods

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Environmental Damage

- Present obligation
 - Past event
 - Outflow of economic benefits
- Legal obligation under law to repair damage caused to environment
 - Damage to environment
 - Expenditure incurred to repair damage

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- Entity A guarantees a borrowing by entity B
- A has an obligation as a result of giving the guarantee

If B *has* defaulted on debt

- Settlement of obligation *is* probable
- Recognise *provision* on balance sheet

If B has *not* defaulted on debt

- Settlement of obligation is *not* probable
- Disclose *contingent liability* in notes to financial statements

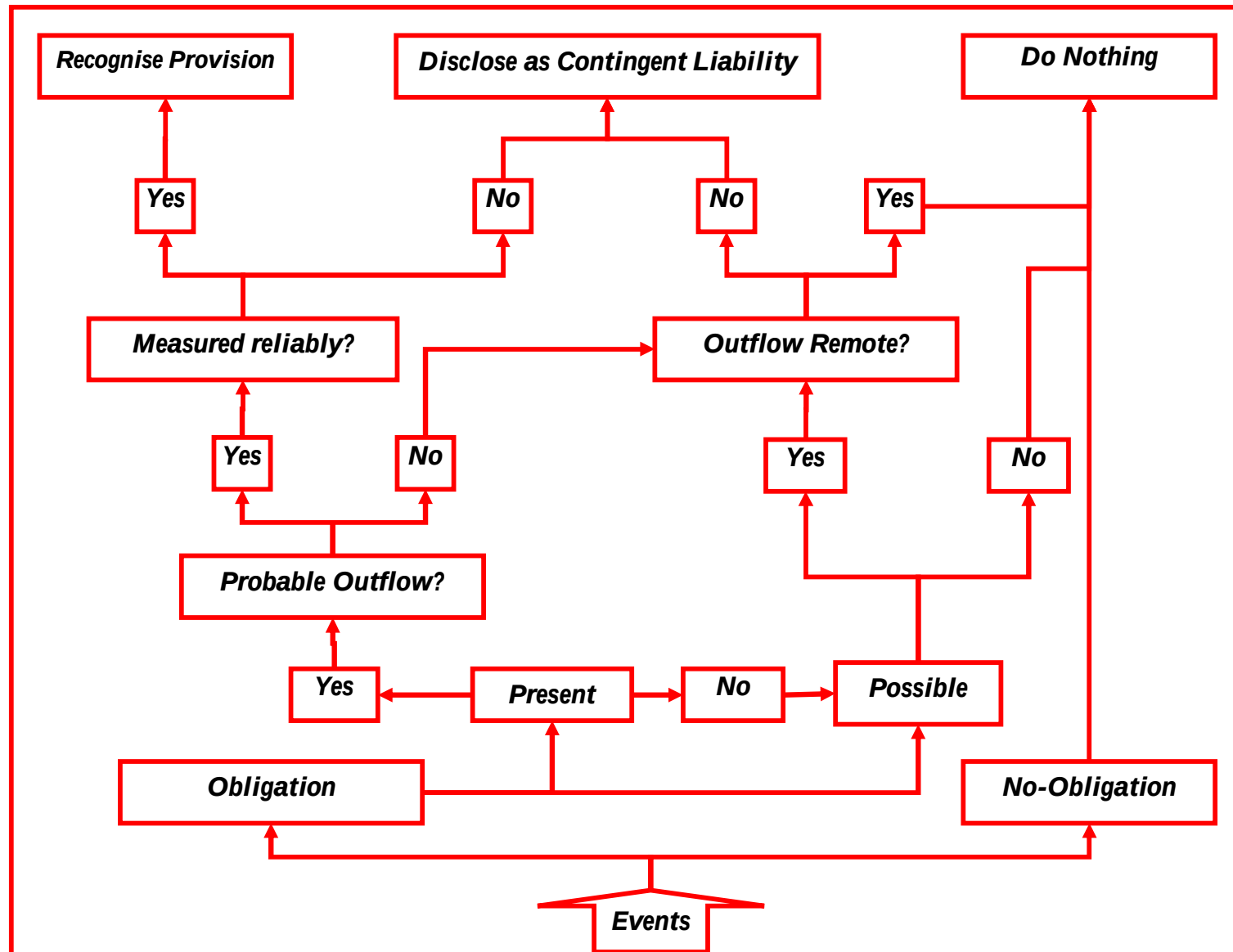
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Para: 46 Reimbursements

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation.

The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision

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Contingent Assets

1. Contingent assets are not recognised in financial statements.
2. They are not disclosed in financial statements
3. They are usually disclosed in the report of approving authority [Example: in case of company “ Directors Report”]
4. Where the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate`

Restructuring

Restructuring Costs – Example

The following are examples of events that may fall under the definition of restructuring

- a. Sale or termination of a line of business;
- b. The closure of business locations in a country or region etc.

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A provision for restructuring costs is recognised only when the recognition criteria for provisions are met

No obligation arises for the sale of an operation until the enterprise is committed to the sale, i.e., there is a binding sale agreement

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Note:

The following cost cannot be regarded as restructuring provision

1. Retraining or relocating continuing staff
2. Marketing
3. Investment in new systems and distribution networks

Reason: These expenditures relate to the future conduct of the business are not liabilities for restructuring at the B/S date.