Exposure Draft

Limited revision to Accounting Standard 4

Events Occuring After the Balance Sheet Date

(Last date for Comments: October 10, 2012)

Issued by

Accounting Standards Board

The Institute of Chartered Accountants of India

AS 4 ~~(revised 1995)~~(revised 2012)
Accounting Standard (AS) 4 ~~(revised 1995)~~(Revised 2012)
~~Contingencies and~~ Events Occurring After the Balance Sheet Date
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Accounting Standard (AS) 4[1]
~~(revised 1995)~~(Revised 2012)
~~Contingencies~~[2] ~~and~~ Events Occurring After the Balance Sheet Date[2]

The following is the Exposure Draft of the limited revisions to Accounting Standard (AS) 4, Contingencies and Events Occuring After the Balance Sheet Date. The limited revisions are proposed due to the following reasons:

(i) To harmonise the requirements of AS 4, Contingencies and Events Occuring After the Balance Sheet Date, with the requirements of the revised Schedule VI to the Companies Act, 1956. As the disclosure of provision for proposed dividends is not required in the revised Schedule VI to the Companies Act, 1956, paragraphs 8.5 and 14 have been modified..

(ii) Since the paragraphs dealing with contingencies were already substantially withdrawn by the ICAI when AS 29 became mandatory the provisions dealing with contingencies are deleted from AS 4

(iii) To disclose the non-adjusting events occurring after the balance sheet date in the financial statements instead of in the report of the approving authority with a view to promote transparency in financial statements.

The changes made in the standard are indicated in track-changes mode.

The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than - October 10, 2012. Comments can also be sent by e-mail at edcommentsasb@icai.org *or*

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[1] The Standard was originally issued in November 1982 and subsequently revised in 1995.

~~2 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 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] Revisions in this Standard would come into effect, insofar as companies are concerned, from the date the revised AS 4 is notified by the Government under the Companies Act, 1956.

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*[This Accounting Standard includes paragraphs set in **bold italic** type and 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[3] and the 'Applicability of Accounting Standards to Various Entities'.]*

Introduction

1. This Standard 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 Standard 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.~~ Deleted. (Refer to Annexure A)

Definitions

3. The following terms are used in this Standard 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.***~~ Deleted. (Refer to Annexure A)

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:

(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.

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[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.

[4] ~~See footnote 1.~~

Explanation

~~4~~7. ~~Contingencies~~ Deleted. (Refer to Annexure A)

~~4.1 The term "contingencies" used in this Standard 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. Such events, however, are disclosed in the financial statements.

~~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~~ Deleted. (Refer to Annexure A)~~.~~

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.~~ If dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognised as a liability at the balnce sheet date because no obligation exists at that time. Such dividends are disclosed in the notes.

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.~~ Deleted. (Refer to Annexure A)

9.3 ~~When the~~ The nature of events which are indicative of conditions that arose subsequent to ~~occurring after~~ the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise are disclosed in the ~~report of the approving authority~~financial statements, ~~the information given comprises the nature of the events and an estimate of~~ along with their financial effects or a statement that such an estimate cannot be made.

Main Principles

~~*Contingencies*~~[5]

10-12 Deleted. (Refer to Annexure A)).
~~***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 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.***~~***If an entity declares dividends to shareholders after the balance sheet date, the entity should not recognise those dividends as a liability at the balance sheet date.***

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

~~[5] See also footnote 1.~~

Disclosure

16. ~~***If disclosure of contingencies is required by paragraph 11 of this Standard, 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.***~~ Deleted. (Refer to Annexure A)

17. If disclosure of events occurring after the balance sheet date in the ~~***report of the approving authority***~~***financial statements is required by paragraph 15 of this Standard, 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.

Annexure A

Appendix A

Comparison with Accounting Standard (AS) 4, '*Contingencies and Events Occuring After the Balance Sheet Date (revised 1995)*.

Note: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences between Accounting Standard (AS) 4 (revised 1995), Contingencies and Events Occuring After the Balance Sheet Date and AS 4 (Revised 2012) Events Occuring After the Balance Sheet Date.

1. The paragraphs dealing with contingencies were substantially withdrawn by the ICAI when AS 29 became mandatory. Hence, paragraphs 2, 3.1, 4 to 7, 9.2, 10 to 12 and 16 dealing with contingencies have been deleted from existing AS 4. The paragraph numbering has, however, been retained as there may be reference to the paragraphs of this standard in other Accounting Standards. Further, the provisions relating to contingencies have been deleted from paragraphs 1 and 9.1.

2. AS 4 (revised 1995) permitted proposed dividends being treated as an 'adjusting event'. The provision for proposed dividends is not required to be disclosed in revised Schedule VI to the Companies Act, 1956, Accordingly, to harmonise the requirements of AS 4, with the requirements of the revised Schedule VI to the Companies Act, 1956, paragraphs 8.5 and 14 have been modified.

3. With a view to promote transparency, the non-adjusting events occurring after the balance sheet date, in AS 4 (revised 2012), it is required that the same should be disclosed in the financial statements instead of in the report of the approving authority. Accordingly, paragraphs 9.3, 15 and 17 have been modified and paragraph 8.4 has been deleted.

4. Since the Standard now deals only with the events occuring after the balance sheet date, the title of the Standard has also been changed to '*Events Occuring After the Balance Sheet Date*'.