Notes on AS 4 Contingencies and events occurring after the balance sheet date

Overview:

AS 4 covers the accounting treatment for

- Contingencies and
- Events occurring after the Balance sheet date

Note: Pursuant to AS 29 " Provisions, Contingent Liabilities and Contingent Assets" all paragraphs of this standard that deal with contingencies stand withdrawn **except** to the extent they deal with Impairment of (Financial) Assets (like receivables) not covered by other Indian Accounting Standards. For example, provision for doubtful debts dealt under AS 4

Definitions:

Contingencies- **Withdrawn**

Events occurring after the balance sheet:
Para 3, Standard defines events occurring after 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 case of Companies and by corresponding approving authority in case of other entities

In this context two types of events can be identified:

i) Those events that provide further evidence of the conditions that existed at the balance sheet date,
ii) Those which are indicative of the conditions that arose subsequent to the balance sheet date

How the events occurring after the Balance sheet date are **reported**:

i) Making appropriate adjustments in the Financial statements (Adjusting events)
ii) Through report of the approving authority i.e., Directors report in case of companies and report of the corresponding approving authority in case of other entities (Non adjusting events)

Adjusting Events: Para 13, An event after the balance sheet date may require adjustment of the reported values of assets, liabilities, expenses, income and equity for the accounting period, if the event is such as to provide further evidence of the conditions that existed at the balance sheet date

Disclosure requirements:

i) Disclosure is required in case of those contingencies and events which affect the financial position to a material extent
ii) If a contingent loss is not provided for, its nature and an estimate of its financial effect are generally disclosed by way of notes unless the possibility of a loss is remote. If a reliable estimate of financial effect cannot be made, this fact should be disclosed
iii) When the events occurring after the balance sheet date are disclosed in the notes of the approving authority, the information given comprises the nature of the events and an estimate of their financial effect or a statement that such an estimate cannot be made

Example for Adjusting event: A Ltd., whose accounting year ends on 31/03/2011, agreed in principle to sell a plot of land on 18/03/2011 at a price to be determined by independent valuers. Pending the agreement for sale and due to non-receipt of valuers report, the sale of the land could not be completed up to 31/03/2011. The company received the report on April 7, 2011 and the agreement was signed on April 10, 2011. The financial statements for 2010-11 were approved by the board on May 12, 2011. (SM)
The sale of land is an event occurring after the balance sheet date. Also, the condition, which led to the sell, existed on the balance sheet date. The signing of the agreement provides further evidence as to the condition that existed on the balance sheet date. The sale of land after the balance sheet date is therefore an adjusting event, which means the sale transaction should be recorded in the books of A Ltd. for the purpose of its financial statements for 2010-11

Non-Adjusting events: Events after balance sheet date may result from conditions arising subsequent to the balance sheet date. Such events do not justify change in the reported values of assets, liabilities, expenses, income or equity

Disclosure requirements:

i) Such events, if they represent material changes and commitments affecting financial position of the enterprise, should be disclosed in the report of approving authority i.e., Director's report in case of companies and report of the corresponding approving authority in case of other entities.

ii) Para 17, In reporting the Non adjusting events, the directors (or the approving authority as the case may be) should state the nature of the event along with their estimate of financial effect or a statement that such an estimate cannot be made

Example to Non Adjusting event: An earthquake destroyed a major warehouse of C Ltd. on April 20, 2011. The last accounting year of the company ended on 31/03/2011 and the financial statements for the year were approved on May 8, 2011. The destruction of warehouse is a significant event occurring after the balance sheet date, but since the earthquake did not exist on the balance sheet date, the destruction by earthquake is a non-adjusting event. The value of property lost by earthquake therefore need not be recognised in financial statements of 2010-11.
The Report of the Directors for 2010-11 should disclose the fact of earthquake together with an estimate of loss on earthquake. If no loss can be made, the report should state that loss on earthquake could not be estimated.

Important practical point: A Company follows April-March as its financial year. The company recognizes cheques dated 31st March or before, received from the customers after the balance sheet date but before approval of financial statement by debiting cheques in hand A/c and crediting the Debtors A/c. The Cheques in hand is shown in balance sheet as an item of cash and cash equivalents. All cheques in hand are presented to bank in the month of April and are also realised in the same month in normal course after deposit in the bank. State with reasons, whether the collection of cheques bearing date 31st March or before, but received after balance sheet date is an adjusting event and how this fact is to be disclosed by the company **(M10 IPCC 2M)**
Even if the cheques bear the date 31st March or before, the cheques received after 31st March do not represent any condition existing on 31st March. Thus the collection of cheques after balance sheet date is not an adjusting event. Recognition of cheques in hand is therefore not consistent with requirements of AS 4. Moreover, the collection of cheques after balance sheet date does not represent any material change or commitments affecting the financial position of the enterprise, and so no disclosure of such collections in the Directors' Report is necessary.

Exception to the rule:

1) Going concern concept: **Para 13**, An event occurring after the balance sheet date shall be an adjusting event even if it does not reflect any condition existing on the balance sheet date if the event is such as to indicate that the fundamental accounting assumption of Going Concern is no longer appropriate.

Suppose a fire occurred in the factory and office premises of an enterprise after 31/03/11 but before the approval of financial statements of 2010-11. The loss of fire is of such a magnitude that it is not reasonable to expect the enterprise to start operations again. Since the fire occurred after 31/03/11, the loss on fire is not a result of any condition existing on 31/03/2011. Yet, the loss should be recognised in the statement of profit and loss for 2010-11 and the assets lost should be written off from the balance sheet dated 31/03/2011, because the fundamental assumption of going concern is under question.

2) Proposed Dividend: **Para 14**
   i) Directors propose dividends after the balance sheet date because no dividend should be proposed till the year is over and profit is ascertained.
   ii) Dividends do not reflect any condition existing on the balance sheet date still it should be treated as adjusting event and should be incorporated in the financial statements

In X Co. Ltd theft of cash of Rs. 5 Lakhs by the cashier in Jan 2011 was detected only in May, 2011. The accounts of the company were not yet approved by the Board of Directors of the company.
Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31.03.2011. Decide **(M07 2M)**

As per Para 13 of AS 4 (revised) 'Contingencies and events occurring after the balance sheet date', an event occurring after the balance sheet date may require adjustment to the reported values of assets, liabilities, expenses or incomes. If fraud of the accounting period is detected after the balance sheet date but before approval of the financial statements, it is necessary to recognize the loss amounting Rs. 5 Lakhs and adjust the accounts of the company for the year ended 31st March, 2011

An earthquake destroyed a major warehouse of ACO Ltd. on 20.05.2009. The accounting year of the company ended on 31.03.2009. The accounts were approved on 30.06.2009.The loss from earthquake is estimated at Rs.30 Lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company **(N09 2M)**
Para 8.3 of AS 4 "Contingencies and event occurring after the balance sheet date", states that adjustment 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. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.03.2009. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2008-09

However, according to para 8.6 of the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon. Hence, the fact of earthquake together with an estimated loss of Rs.30 Lakhs should be disclosed in the Report of the Directors for the financial year 2008-09.

Practical questions (previously asked questions)

1) A major fire has damaged assets in a factory of X Co Ltd on 8.4.2011, 8 days after the year end closing of accounts. The loss is estimated to be Rs. 16 crores (after estimating the recoverable amount of Rs. 24 crores from the Insurance Company).
If the company has no insurance cover the loss due to fire would be Rs. 40 crores.
Explain, how the loss should be treated in the Final accounts of the year ended 31.03.2011. **(Pe 2 M05 4M)**
The present event does not relate to conditions existing at the balance sheet date. Hence, no specific adjustment is required in the financial statements for the year ending on 31.03.2011. But if the event occurring after balance sheet date gives an indication that the enterprise may cease to be a going concern, then the assets and liabilities are required to be adjusted for the financial year ended 31st March 2011. AS 4 (Revised) requires disclosure in respect of events occurring after the balance sheet date representing unusual changes affecting the existence or substratum of the enterprise after the date of the balance sheet. In the present event, the loss of assets in a factory can be considered to be an event affecting the substratum of the enterprise. Hence, an appropriate disclosure should be made in the report of the approving authority.

2) ABC Ltd could not recover Rs. 10 Lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company were finalized for the year ended 31.03.2011 by making a provision @ 20% of the amount due from the said debtor.
The debtor became bankrupt in April, 2011 and nothing is recoverable from him
Do you advice the company to provide for the entire loss of Rs. 10 lakhs in the books of account for the year ended 31st march 2011? **(Pe 2 N05 4M)**
As per AS 4 "Contingencies and events occurring after the balance sheet date', 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
In the given case, bankruptcy of the debtor in April 2011 and consequent non-recovery of debt is an event occurring after the balance sheet date which materially affects the determination of profits for the year ended 31.03.2011. Therefore, the company should be advised for the entire amount of Rs. 10 Lakhs according to para 8 of AS 4.

3) A major fire has damaged the assets in a factory of a limited company on 5th April – five days after the year end and closure of accounts. The loss is estimated at Rs. 10 crores out of which 7 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final account for the previous year. **(Pe 2 M09 5M)**
The loss due to break out of fire is an example of event occurring after the balance sheet date. The event does not relate to conditions existing at the balance sheet date. It has not affected the financial position as on the balance sheet date and therefore required no specific adjustments in the financial statements. However, para 8.6 of AS 4 states that disclosure is

generally made of events occurring after balance sheet date i.e. in subsequent periods that represent unusual changes affecting the existence or substratum of the enterprise after the balance sheet date. In the given case, the amount of loss of assets in a factory is material and may be considered as an event affecting the substratum of the enterprise. Hence, as recommended in para 15 of AS 4, disclosure of the event should be made in the report of the approving authority

4) A company entered into an agreement to sell its immovable property to another company for Rs. 35 Lakhs. The property was shown in the Balance sheet at Rs. 7 Lakhs. The agreement to sell was concluded on 15th February 2011 and sale deed was registered on 30th April 2011. The financial statements for the year 2010-11 were approved by the Board of Directors on 12th May 2011. You are required to state with reason how this event would be dealt with in the financial statements for the year ended 31st March 2011? **(Pe 2 N09 5M) (Model test paper IPCC N12 4M)**

According to para 13 of AS 4 “Contingencies and events occurring after balance sheet date”, assets and liabilities should be adjusted for events occurring after the balance sheet date that provides additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date

In the given case, sale of immovable property was carried out before the closure of the books of accounts. This clearly an event occurring after the balance sheet date but agreement to sell was effected on 15th Feb 2011 i.e. before the balance sheet date. Registration of the sale deed on 30th April, 2011, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of immovable property is necessary in the financial statements for the year ended 31st March 2011.

5) In Raj Co Ltd, theft of cash of Rs. 2 Lakhs by the cashier in January 2011 was detected in May 2011. The accounts of the company were not yet approved by the Board of Directors of the company

Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31. 03. 2011. Decide **(M10 PCC 2M)**

AS per para 13 of AS 4 (revised), ‘Contingencies and events occurring after balance sheet date’ 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

Thought the theft, by the cashier Rs. 2 Lakhs was detected after the balance sheet date (before approval of financial statements) but it is additional information materially affecting the determination of the cash amount relating to conditions existing at the balance sheet date. Therefore, it is necessary to make the necessary adjustments in the financial statements of the company for the year ended 31st March 2011 for recognition of loss amounting to Rs. 2 Lakhs

6) While preparing its final accounts for the year ended 31st March 2010, a company made a provision for bad debts @ 4 % of its total debtors (as per trend follows from the previous years). In the first week of March 2010, a debtor for Rs. 3 Lakhs had suffered heavy loss due to an earthquake; the loss was not covered by any insurance policy. In April 2010 the debtor became a bankrupt. Can the company provide for full loss arising out of insolvency of the debtor in the final accounts for the year ended 31st March 2010 **(N10 IPCC 5M)**

As per para 8 of AS 4 ‘Contingencies and events occurring after balance sheet date’, adjustment 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.

A debtor for Rs. 3 Lakhs suffered heavy loss due to earthquake in the first week of March, 2010 and he became bankrupt in April 2010 (after the balance sheet date). The loss was also not covered by any insurance policy. Accordingly full provision for bad debts amounting Rs. 3 Lakhs should be made, to cover the loss arising due to the insolvency of a debtor, in the final accounts for the year ended 31st March 2010.