



# Intensive Refresher Course on Practical Aspects of Accounting Standards

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AS 18 Related Party Disclosures

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AS 20 EPS

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AS 24 Discontinuing Operations

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AS 25 Interim Financial Reporting

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AS 29 Provisions, Contingent Liabilities  
and Contingent Assets

Standards

# Applicability of Accounting Standards

- Company
  - AS 20 : DEPS may not be disclosed for SMCs
  - AS 29 : Para 66 and 67 relating to disclosures may not be complied
- Non Company Entities (NCE)
  - AS 18 Related Party Disclosures and AS 24 Discontinuing Operations: Not Applicable to Levels 3 & 4
  - AS 20 Earnings Per Share and AS 25 Interim Financial Reporting : Not applicable to Levels 2, 3 & 4
  - AS 29 – Recognition and Measurement principles applicable, only certain disclosure exemptions applicable to Level 2, 3 and 4

# AS 29 Provisions, Contingent Liabilities and Contingent Assets

## Question 1

A constructive obligation to restructure arises only when an entity has:

Select one or more options and click **Submit**.

- a detailed formal plan for the restructuring.
- a detailed informal plan for the restructuring.
- raised a valid expectation with management that restructuring will be carried out.
- raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

# Q1

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- raised a valid expectation with management that restructuring will be carried out.
- raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.
- raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

## Question 2

Just before the end of the reporting period an employer announced their intention to terminate the employment of a number of employees. The employer met with the trade union and presented the details of the terminations planned. However, the trade union indicated that they were unhappy with the terms and unlikely to agree to them. How should this event be accounted for in the employer's financial statements?

Select one option and click **Submit**.

- The employer has a detailed plan for the terminations and has created a constructive obligation through announcement of it and discussions with the trade union. Therefore, a provision should be recognised.
- As the employees through the trade union have not indicated acceptance of the plan, no constructive obligation exists, and no provision should be made
- A contingent liability should be disclosed, as the amount of the provision will be confirmed by acceptance of the terms by the employees and their trade union.

## Q2

Just before the end of the reporting period an employer announced their intention to terminate the employment of a number of employees. The employer met with the trade union and presented the details of the terminations planned. However, the trade union indicated that they were unhappy with the terms and unlikely to agree to them. How should this event be accounted for in the employer's financial statements?

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- A contingent liability should be disclosed, as the amount of the provision will be confirmed by acceptance of the terms by the employees and their trade union.



### Question 3

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of €1 million would result. If major defects were detected in all products sold, repair costs of €4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75 % of the goods sold will have no defects, 20 % of the goods sold will have minor defects and 5 % of the goods sold will have major defects.

The expected value of the cost of repairs is:

Select one option and click **Submit**.

- €400,000
- €1 million
- €4 million
- €2,5million

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# Q3

An entity sells goods with a warranty under which customers are covered for the cost of repairs of any manufacturing defects that become apparent within the first six months after purchase. If minor defects were detected in all products sold, repair costs of €1 million would result. If major defects were detected in all products sold, repair costs of €4 million would result. The entity's past experience and future expectations indicate that, for the coming year, 75 % of the goods sold will have no defects, 20 % of the goods sold will have minor defects and 5 % of the goods sold will have major defects.

The expected value of the cost of repairs is:

Select one option and click **Submit**.

- €400,000
- €1 million
- €4 million
- €2,5million

## Question 4

An entity has recognised a warranty provision in its statement of financial position. It has also taken out an insurance policy against returns from customers under the terms of the warranty offered. Proceeds from this insurance policy can be offset in the statement of comprehensive income against the warranty provision expense.

Is this statement true or false?

Select one option and click **Submit**.

True

False

# Q4

An entity has recognised a warranty provision in its statement of financial position. It has also taken out an insurance policy against returns from customers under the terms of the warranty offered. Proceeds from this insurance policy can be offset in the statement of comprehensive income against the warranty provision expense.

Is this statement true or false?

Select one option and click **Submit**.

- True
- False

## Question 5

Select the true statements with respect to contingent assets.

Contingent assets are:

Select one or more options and click **Submit**.

- not recognised in financial statements.
- recognised in the financial statements.
- disclosed in the financial statements if inflow is probable.
- never recognised in the financial statements.

# Q5

Select the true statements with respect to contingent assets.

Contingent assets are:

Select one or more options and click **Submit**.

- not recognised in financial statements.
- recognised in the financial statements.
- disclosed in the financial statements if inflow is probable.
- never recognised in the financial statements.

## Question 6

Which of the following statements is true?

Select one option and click **Submit**.

- A contingent asset can only be recognised if the inflow of economic benefits is virtually certain.
- Future operating losses meet definition of a liability if they can be measured reliably.
- An entity estimates a liability to be at least €5000 (90% chance) and €10,000 at most (10% chance). It should recognise a liability of €10,000.

# Q6

Which of the following statements is true?

Select one option and click **Submit**.

- A contingent asset can only be recognised if the inflow of economic benefits is virtually certain.
- Future operating losses meet definition of a liability if they can be measured reliably.
- An entity estimates a liability to be at least €5000 (90% chance) and €10,000 at most (10% chance). It should recognise a liability of €10,000.



## Question 7

Which statements need to be satisfied in order for a provision to be recognised?

Select one or more options and click **Submit**.

- An entity has a present obligation (legal or constructive) as a result of a past event
- An entity has a past obligation (legal or constructive) as a result of a past event
- It is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation
- A reliable estimate can be made of the amount of the obligation
- The amount of the obligation of the obligation is known

# Q7

Which statements need to be satisfied in order for a provision to be recognised?

Select one or more options and click **Submit**.

- An entity has a present obligation (legal or constructive) as a result of a past event
- An entity has a past obligation (legal or constructive) as a result of a past event
- It is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation
- A reliable estimate can be made of the amount of the obligation
- The amount of the obligation of the obligation is known

## Question 8

An entity is planning to install smoke filters as a result of new legislation, which was announced at the end of the reporting period. Which of the following statements are correct?

Select one or more options and click **Submit**.

- As a result of the new legislation, the entity has a constructive obligation. Therefore, a provision should be recognised.
- This is a future event, therefore there is no obligating event and no liability should be recognised
- This is a liability that will be confirmed by the occurrence of a future event. Therefore, a contingent liability should be disclosed.
- Any penalties arising because the entity fails to install the smoke filters or are late in installing the filters shall be provided for at the date that legislation is passed.

# Q8

An entity is planning to install smoke filters as a result of new legislation, which was announced at the end of the reporting period. Which of the following statements are correct?

Select one or more options and click **Submit**.

- As a result of the new legislation, the entity has a constructive obligation. Therefore, a provision should be recognised.
- This is a future event, therefore there is no obligating event and no liability should be recognised
- This is a liability that will be confirmed by the occurrence of a future event. Therefore, a contingent liability should be disclosed.
- Any penalties arising because the entity fails to install the smoke filters or are late in installing the filters shall be provided for at the date that legislation is passed.

## Question 9

A mining entity has damaged the environment through its past operations. At the end of the reporting period, legislation is passed requiring the entity to repair the damage. Is it appropriate for the entity to recognise a provision?

Select one or more options and click **Submit**.

- Yes, because the legislation creates a legal obligation
- Yes, because the legislation was passed at the end of the reporting period, and therefore there is a past event
- Yes, because the damage occurred in past, and hence there is a present obligation to repair the damage

## Q9

A mining entity has damaged the environment through its past operations. At the end of the reporting period, legislation is passed requiring the entity to repair the damage. Is it appropriate for the entity to recognise a provision?

Select one or more options and click **Submit**.

- Yes, because the legislation creates a legal obligation
- Yes, because the legislation was passed at the end of the reporting period, and therefore there is a past event
- Yes, because the damage occurred in past, and hence there is a present obligation to repair the damage

## Question 10

Which of the following statements are false?

Select one or more options and click **Submit**.

- An entity rents a property for its business operation. The property is rented over a period of ten years. The operation predicts it will be making losses for the first five years, but the overall contract is estimated to be profitable. This meets the definition of an onerous contract.
- An entity has abandoned a property that it was renting. It must continue to pay rent for the next three years due to the terms of the rental agreement, but there will be no economic benefits generated by the property. This meets the definition of an onerous contract.
- An entity that takes out insurance against a liability must set the asset off against the liability.

# Q10

Which of the following statements are false?

Select one or more options and click **Submit**.

- An entity rents a property for its business operation. The property is rented over a period of ten years. The operation predicts it will be making losses for the first five years, but the overall contract is estimated to be profitable. This meets the definition of an onerous contract.
- An entity has abandoned a property that it was renting. It must continue to pay rent for the next three years due to the terms of the rental agreement, but there will be no economic benefits generated by the property. This meets the definition of an onerous contract.
- An entity that takes out insurance against a liability must set the asset off against the liability.



# 1. LIABILITY WITH PAYMENT LINKED TO FUTURE SALES

## Background

Entity A faces a claim for an alleged infringement of intellectual property (IP) rights. On 31 December 20X1, in settlement of the claim, Entity A agrees to pay the claimant a fixed sum plus a variable amount calculated as 1 per cent of any revenue generated by Entity A over the next five years from sales of a specified product.

## ***Question***

At 31 December 20X1, should Entity A recognise a liability for the obligation to pay a variable amount on the basis of future sales?

# 1. LIABILITY WITH PAYMENT LINKED TO FUTURE SALES

## *Answer*

It depends whether the variable amount to be paid based on future sales represents a settlement for use of the IP in the past or compensation for the future use by Entity A of the underlying IP:

- if the sales-linked feature is a **mechanism for determining the amount due for past use by Entity A of the IP** (plus any compensatory or punitive element), Entity A should recognise a liability; and
- if the sales-linked payments relate to **future use by Entity A of the IP**, the obligation arises as new sales are realised and represents an executory contract under AS 29. In such circumstances, Entity A should not recognise a liability for the variable amount to be paid based on future sales at 31 December 20X1, unless the executory contract is determined to be onerous.
- In practice, situations in which entities would recognise immediately a liability for the variable amount to be paid on the basis of future sales are expected to be rare.

## 2. LATE DELIVERY PENALTIES

### Background

- In some circumstances, a late delivery penalty may be incurred when goods are not supplied by a specified delivery date. At the end of its reporting period, an entity may know that it will not be able to meet the delivery date for goods to be supplied in the next year.

### ***Question***

- Should the entity recognise a provision for the penalty that will be payable when, as is expected, the goods are delivered late?

## 2. LATE DELIVERY PENALTIES

### *Answer*

- No. There is no past event because the late delivery of goods has not yet occurred. Consequently, there is neither a legal nor a constructive obligation to pay the penalty at the end of the current reporting period and no basis for recognising a provision for the penalty.
- However, if the remaining part of the contract has, as a whole, become onerous as a result of the penalty clause, a provision should be made for any overall loss expected to result.

### 3. LATE DELIVERY PENALTIES — EXAMPLE

- Entity A (which has a December year end) signed a firm sales contract with one of its major clients on 1 February 20X1. This contract specifies that 100 units of a product must be delivered before 1 February 20X2 at a fixed price of CU10 per unit. The costs of production are CU9 per unit. If the products are delivered more than 10 days late, the client will be given a discount of 50 per cent on each delayed product.
- When Entity A signed the contract, it had the ability and the intention to produce the 100 units on time. However, at the end of 20X1, it has only been able to deliver 80 units, and expects to deliver only 10 more before 1 February 20X2 due to manufacturing constraints. Therefore, at the end of the reporting period, Entity A expects to deliver 10 of the remaining 20 units at the discounted price of CU5 per unit.
- Total revenue from this contract will be CU950  $[(90 \times 10) + (10 \times 5)]$ . Total costs will be CU900  $(100 \times 9)$ . Therefore, the overall contract is profitable. However, the situation at the end of the 20X1 reporting period is as follows:
  - Entity A has recognised CU800 revenue and CU720 costs (i.e. profit of CU80) in 20X1;
  - Entity A expects to deliver 10 units on time at a profit of CU10  $[(10 \times 10) - (10 \times 9)]$ ; and
  - Entity A expects to deliver 10 units after the deadline at a loss of CU40  $[(10 \times 5) - (10 \times 9)]$ .

### 3. LATE DELIVERY PENALTIES — EXAMPLE

- The remaining part of the contract is therefore onerous and a provision of CU30 should be recognised to cover the potential loss arising from the outstanding obligations under the contract. If Entity A is able and expects to mitigate damages by purchasing suitable replacement products and delivering them prior to 1 February, the provision should be adjusted to reflect the expected economic loss anticipated to be incurred by Entity A.
- If Entity A had entered into this contract knowing that it would not be able to deliver on time, this would have been dealt with under the revenue recognition criteria. If, from the outset, Entity A expected to sell 100 units at an average price of CU9.50 ( $CU950 \div 100$ ) per unit, then revenue of only CU9.50 would have been recognised for each unit sold (both in 20X1 and 20X2) and there would have been no need to consider a separate provision.

## 4. EMPLOYMENT DISPUTES

### Background

- An entity employs three professional seamen. Maritime law prescribes that registered professionals are paid a premium over unregistered professionals. The entity subsequently discovers that the professionals are not registered, and therefore, have been overpaid. The entity consequently reduces the salaries of these professionals who then take the matter to court. One employee wins the case and is awarded a CU70,000 retrenchment package. The other two lose on a technicality, but will appeal the decision. Lawyers are certain that the appeal will be successful.

### ***Question***

- What provision should be recognised?

## 4. EMPLOYMENT DISPUTES

### *Answer*

- A provision should be recognised for the best estimate of the costs to settle the appeal. The past event is the underpayment of the employees (after it was thought they were overpaid) which occurred during the year. As a result of the court proceedings, a legal obligation to compensate the one employee exists in the current year (for CU70,000). With regard to the other two seamen, the past event is the constructive dismissal (i.e. the reduction in salaries) that occurred during the year. Because it is probable (more likely than not) that the entity will be found liable, a present obligation exists. It is probable that economic benefits will flow from the entity.



# 5. RECOGNITION OF CONSTRUCTIVE OBLIGATIONS ASSOCIATED WITH A CONSTRUCTION CONTRACT

## Background

- Entity X is in the construction industry. It stores plant and machinery at its site, Site A, and transports certain plant and machinery (e.g. cranes) to a construction site (Site B), where it is in the process of constructing a hotel. At the end of construction, Entity X will be required to remove the crane from Site B and transport it back to Site A, or to a site of another contract.

## ***Question***

- Should a liability be recognised for the transporting of the crane back to site A?

## 5. RECOGNITION OF CONSTRUCTIVE OBLIGATIONS ASSOCIATED WITH A CONSTRUCTION CONTRACT

### ***Answer***

- Yes. A liability should be recognised for transporting the crane back to Site A. AS 7 Construction Contracts does not deal specifically with this type of provision, and so it falls within the scope of AS 29.
- It is only those obligations arising from past events existing independently of an entity's future actions (i.e. the future conduct of its business) that are recognised as provisions.
- Because the crane cannot be left at Site B, Entity X has a constructive obligation to remove the crane. Therefore, Entity X should recognise a liability for the removal of the crane once it is installed on site B and measure that liability at the best estimate of the cost of transporting the crane back to Site A (or the next site at which it is required).

# 6. OBLIGATION TO RESTORE LEASED PROPERTY

## Background

- Entity A is a lessee in a lease contract. As a condition of the lease and prior to return of the property to the lessor, Entity A is required to:
  - remove any leasehold improvements, such as additional internal walls or partitioning fitted by the lessee; and
  - repair the fabric of the building so that it is restored to its original condition at the date of inception of the lease, i.e. to make good any dilapidations.

## ***Question***

- When should Entity A recognise any provision in relation to restoration of the leased property?

## 6. OBLIGATION TO RESTORE LEASED PROPERTY

### *Answer*

- If a lease agreement requires an item to be replaced if its standard falls below a specified level, no provision should be recognised until the point at which it is no longer possible for the entity to avoid replacing the item.
- Generally, it will not be appropriate to recognise a provision for restoring leased property on a straight-line basis over the lease term, because typically the obligation will not arise on a straight-line basis. For example, if a lease agreement requires carpets to be replaced or walls to be repainted at the end of the lease period, full provision for the associated cost will be required from the outset, because the outflow cannot be avoided.
- Typically, a provision will be recognised on a straight-line basis only when the associated costs are directly proportional to the length of time for which the associated asset has been used. This may be true for some elements of restoration relating to, for example, oil wells and landfill sites, but it is less common for property leases.
- Accordingly, Entity A should recognise a provision for the cost of removing leasehold improvements when those leasehold improvements are first made (e.g. when additional internal walls and partitioning are fitted). Entity A should only provide for repairs to the fabric of the building once it is no longer possible for Entity A to avoid making those repairs.

# 7. VOUCHERS ISSUED FOR NO CONSIDERATION

## Background

- A reporting entity may, for no consideration, distribute vouchers that can be used, sometimes within a set period, to obtain discounts on the entity's products and/or a third party's products.

## *Question*

- Should the entity recognise a provision in respect of the vouchers distributed?

# 7. VOUCHERS ISSUED FOR NO CONSIDERATION

## ***Answer***

Applying AS 29's recognition criteria, the questions to consider are as follows.

- Is there a present obligation? Generally, the answer will be yes. However, if the reporting entity reserves the right to terminate the scheme at any time, thus invalidating existing vouchers, then there may or may not be a constructive obligation. In the absence of evidence that schemes have been terminated (and existing vouchers invalidated) in the past, it should be presumed that an obligation exists.
- Is it probable that economic benefits will be transferred? If, after vouchers are deducted, the entity's products are still being sold at a profit, the answer will be no — in which case no provision should be recognised. To the extent that products will be sold at a loss, however, or that a third party will be reimbursed for discounts, there will be a transfer of economic benefits.
- Can a reliable estimate be made? The answer here should be presumed to be yes, but in making the estimate the entity should consider how many vouchers are expected to be used.
- In summary, if the criteria are met, a provision should be recognised for the best estimate of the cost to the entity (which may not be the face value of the discounts). The entity will need to form a view as to how many vouchers are expected to be used and should also consider whether discounting is appropriate.

## 8. OBLIGATION FOR FUTURE COSTS — MAJOR REFIT AND REPAIR COSTS

### *Question*

- Ships and aircraft are required to undergo major work at regular intervals due to maritime and aviation law. Should an entity, which recognises these ships and aircraft as assets, accrue an obligation for these future costs?

### *Answer*

- No. There is no present obligation created by the legal requirement to do the major work until the requisite number of hours or days have been completed. The cost of the major work is not recognised because, at the end of the reporting period, no obligation to undergo such major work exists independently of the entity's future actions — the entity could avoid the future expenditure by its future actions, for example by selling the ship or aircraft.

## 9. LEASE OF AIRCRAFT — EXAMPLE

- Under some operating leases, the lessee is required to incur periodic charges for maintenance of the leased asset or to make good dilapidations or other damage occurring during the rental period. Because the lease is a legal contract, it may give rise to legal obligations. Accordingly, the principles of AS 29, which generally preclude the recognition of provisions for repairs and maintenance, do not preclude the recognition of such liabilities in a lease once the event giving rise to the obligation under the lease has occurred.
- For example, an entity leases an aircraft under an operating lease. The aircraft has to undergo an expensive 'C check' after every 2,400 flying hours.
- The requirement to perform a 'C check' does not give rise to a present obligation at the time the lease is signed because, until 2,400 hours have been flown, no obligation exists independently of the entity's future actions. Even the intention to incur the cost of a 'C check' depends on the entity deciding to continue flying the aircraft. Therefore, no provision should be recognised for a future 'C check'. The cost of each successive 'C check' will instead be capitalised when it is incurred and amortised over the period to the next 'C check'.



## 9. LEASE OF AIRCRAFT — EXAMPLE

- This leaves the question of the condition in which the aircraft must be returned to the lessor at the end of the lease and of whether this creates a present obligation, and thus the requirement for a provision, at the time the lease is signed. The answer depends on what the lease terms state will happen when the aircraft is returned at the end of the lease. If no final 'C check' is required (i.e. in the final period, the client can use the aircraft for up to 2,399 flying hours and then return it without bearing any cost), no provision should be recognised because there is no legal obligation.
- If a 'C check' is required at the end of the lease, irrespective of how many hours have been flown, full provision for the cost should be recognised at the start of the lease. The costs should be carried forward and written off over the shorter of the next 2,400 flying hours and the number of flying hours to the end of the lease — and similarly each time a 'C check' is carried out.
- If, on returning the aircraft, the entity must make a payment towards the 'C check' which is in proportion to the number of hours flown (e.g. 75 per cent of the cost of a 'C check' for 1,800 hours flown), then an obligation is created as the aircraft is used. It will be appropriate to build up a provision based on the number of hours flown.

# 10. RECOGNITION OF REIMBURSEMENT EXPECTED FROM INSURANCE COMPANY

## Background

- An entity has a high probability of losing a lawsuit in which it is the defendant. The entity's insurance company is expected to cover any loss incurred.

## ***Question***

- What amounts, if any, should the entity recognise in its statement of financial position in respect of the anticipated loss and reimbursement?

# 10. RECOGNITION OF REIMBURSEMENT EXPECTED FROM INSURANCE COMPANY

## ***Answer***

- The outflow of resources expected on the loss of the lawsuit and the amounts expected to be recovered from the insurance company arise from the same past event.
- When the conditions of AS 29 are met, the entity should recognise a liability for the expected outflow of resources, measured at the best estimate of the expenditure required to settle the obligation at the end of the reporting period as stated in AS 29.
- In respect of the expected recovery from the insurance company, the entity should assess the effectiveness of its insurance policy. Under AS 29, it should recognise the amount expected to be reimbursed (as a separate asset) when, and only when, it is virtually certain that the claim will be received (i.e. unless there is doubt regarding the insurance claim).
- The amount recognised for the reimbursement should not exceed the amount of the provision.

# 11A. RECOGNITION AND MEASUREMENT OF ONEROUS CONTRACTS

## Background

- Entity A has entered into a contract with Entity B to supply goods for a fixed price of CU100. Because of price inflation, Entity A's expenditure to meet its obligations under the contract is expected to be CU120. No other benefits are expected under the contract. Therefore, the contract is considered to be onerous, and a provision should be recognised. Entity A estimates that any compensation or penalties arising from failure to fulfill the contract are equal to the cost of fulfilling the contract (i.e. CU120).

## ***Question 1***

- Should the provision recognised by Entity A be the entire cost of fulfilling the contract (CU120) or only the expected loss (CU20)?

# 11A. RECOGNITION AND MEASUREMENT OF ONEROUS CONTRACTS

## *Answer 1*

- Entity A should recognise a provision for the onerous contract equal to the expected loss of CU20.
- AS 29 defines an onerous contract as “a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it”. AS 29 further states that “[t]he unavoidable costs under a contract reflect the **least net cost** of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it” (emphasis added).
- Because AS 29 refers to the net cost rather than the gross cost associated with the contract, the provision for the onerous contract should reflect the costs required to fulfill the contract net of any income that the entity will receive as a consequence of fulfilling the contract.

# 11B. RECOGNITION AND MEASUREMENT OF ONEROUS CONTRACTS

## Background

- Entity A has entered into a contract with Entity B to supply goods for a fixed price of CU100. Because of price inflation, Entity A's expenditure to meet its obligations under the contract is expected to be CU120. No other benefits are expected under the contract. Therefore, the contract is considered to be onerous, and a provision should be recognised. Entity A estimates that any compensation or penalties arising from failure to fulfill the contract are equal to the cost of fulfilling the contract (i.e. CU120).

## ***Question 2***

At the end of the reporting period, Entity A has commenced negotiations with Entity B with a view to increasing the price at which the goods are supplied under the contract. Entity A expects that Entity B will be willing to agree to such a price increase so as to avoid Entity A ceasing to trade as a result of the losses incurred under the contract (and, consequently, cutting off the source of supply of goods necessary for Entity B's own business).

- Should the potential renegotiation of the supply contract between Entity A and Entity B be reflected in the amount of provision recognised for the onerous contract?

# 11B. RECOGNITION AND MEASUREMENT OF ONEROUS CONTRACTS

## ***Answer 2***

- No. The onerous contract should be measured based on the contractual terms in existence at the end of the reporting period because that is Entity A's 'present obligation' required to be recognised and measured in accordance with AS 29. Any future amendment to the terms of the contract would be a change in the obligation resulting in remeasurement of the provision when the amendment occurs.
- AS 29 states that "future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur". However, this reference to future events is not to changes in the underlying obligation, but to those future events that are factors in estimating the costs of meeting a present obligation (e.g. developments in the technology used to clean up a site [AS 29]) or in assessing the extent to which a present contractual obligation is onerous (e.g. an expectation of subleasing a vacant property).

# 12. LEASE TERMINATION

## Background

- An entity has developed a detailed formal plan for restructuring a business, and has announced the key features of the restructuring to all affected by it in a manner that meets the criteria of AS 29. As part of the restructuring, the entity has entered into an oral agreement (i.e. a commitment has been established) with the landlord to terminate a lease and pay a settlement fee of CU1 million to the landlord. The settlement fee represents a direct cost resulting from the restructuring. The entity does not expect to be able to sublet the property; therefore, the CU1 million represents the minimum expected obligation.

## ***Question***

- Should a provision be recognised for the settlement fee to the landlord?



## 12. LEASE TERMINATION

### Answer

- Yes. A provision should be recognised for the CU1 million settlement fee for the lease because a valid expectation has been created between the lessor and lessee that the lease will be terminated.
- The entity has a constructive restructuring obligation because it has publicly announced the plan to restructure. Such an announcement gives rise to valid expectations in other parties (e.g. the lessor) that the entity will carry out the restructuring, which includes the termination of the lease.

# 13. IDENTIFICATION OF EMPLOYEES TO BE TERMINATED UNDER A RESTRUCTURING PLAN

## Background

- Under AS 29, the two principal requirements for the recognition of a provision for a restructuring are that the entity (a) "has a detailed formal plan" and (b) "has raised a valid expectation in those affected [that the plan will be carried out,] by starting to implement that plan or announcing its main features to those affected by it".

## ***Question***

- To meet the criteria for recognition as a provision, is it necessary that a plan for restructuring specifically identify which individual employees will be terminated under the plan?

# 13. IDENTIFICATION OF EMPLOYEES TO BE TERMINATED UNDER A RESTRUCTURING PLAN

## *Answer*

- No. AS 29 requires that the detailed formal plan must identify the location, function and approximate number of employees who will be compensated for terminating their services. Generally, it is not necessary for the plan to be so detailed that it identifies which individual employees will be leaving. However, it must be sufficiently detailed that those employees in the employee groups affected by the restructuring plan have a valid expectation that either they or their colleagues in the group will be affected.

# 14. VACANT PROPERTY

## Background

- Company X entered into an operating lease over a property several years ago. The property is now surplus to requirements and Company X has vacated it. The lease has three years to run with an associated expense of CU10,000 per year.
- Company X believes it may be able to find a tenant to take a sublease of the property, but that it might only receive CU8,000 per year from the sublease. Alternatively, the landlord is prepared to terminate the lease and forgive the future rentals of CU30,000, if Company X makes a termination payment of CU5,500.

## ***Question***

- What, if any, provision should Company X recognise in relation to the operating lease?

# 14. VACANT PROPERTY

## *Answer*

- Because the property has been vacated, and the continuing rentals are not expected to be recoverable from subleasing the property, a provision should be recognised. The provision should represent the best estimate of the expenditure required to settle the obligation at the end of the reporting period. If Company X subleases the property, it expects to pay CU30,000 in lease rentals and receive CU24,000 in sublease rentals, which would leave a deficit of CU6,000 to be provided. However, in this case, the amount the landlord would accept to terminate the lease is CU5,500, which is lower. Accordingly, Entity X should recognise an onerous lease provision of CU5,500, irrespective of whether it intends to terminate the lease or enter into a sublease.



# AS 18 Related Party Disclosures

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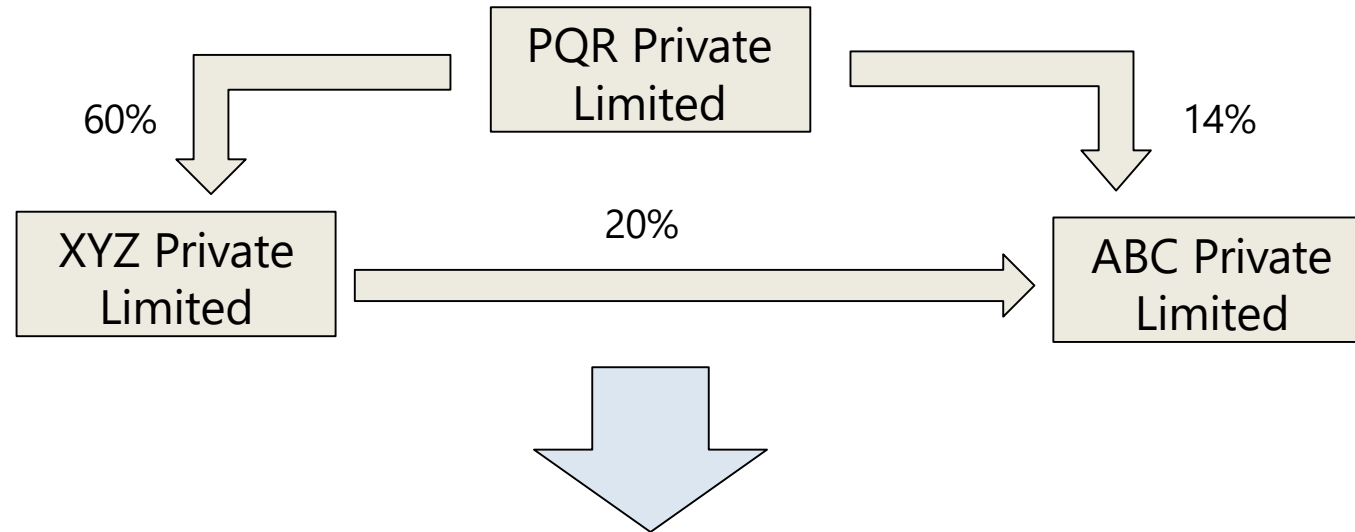
SA 550 on Related Parties r.w. SA 240 (fraud), 315 (risks) and 330 (auditor responses to assessed risk)

Companies Act 2013 -185, 186, 188, CARO, Schedule III

SEBI (LODR) also focus on regulating RP and RPT (now half yearly disclosures are required to be published)

Income tax – Transaction on arm's length basis – reporting in tax audit and transfer pricing audit

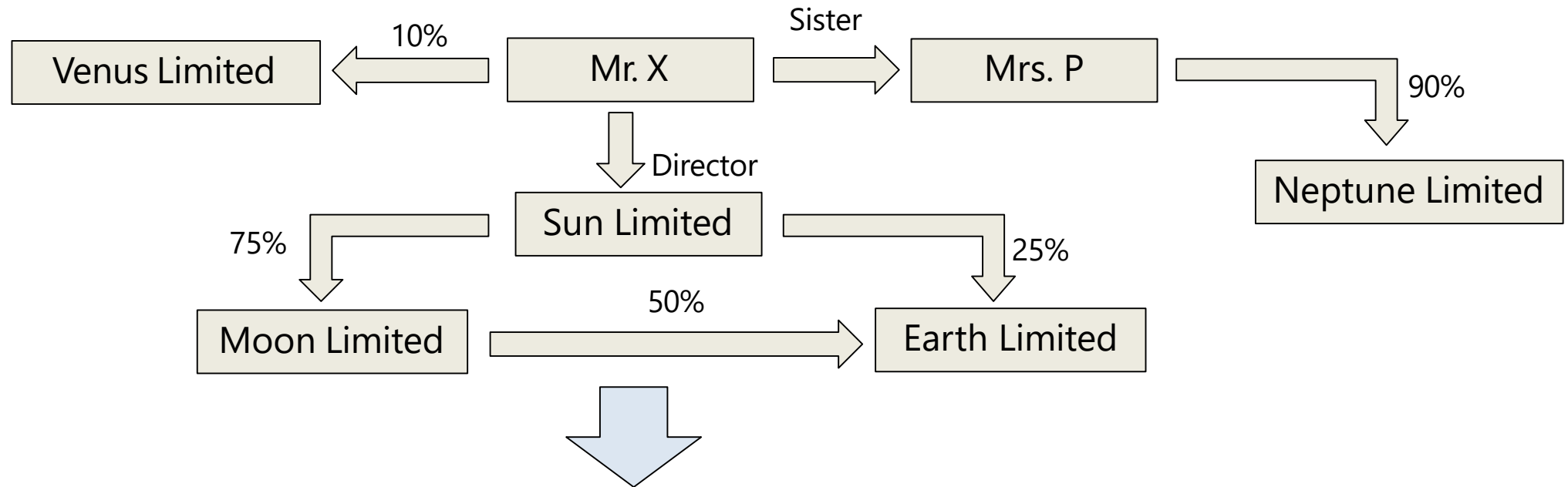
# Case A (i) – Identifying related party relationship



- PQR Private Limited has 60% voting rights in XYZ Private Limited and hence it **controls** XYZ Private Limited [para 3(a) and para 10.3]
- PQR Private Limited directly and through XYZ Private Limited holds 26% [14% + 12% (60% of 20%)] in ABC Private Limited and hence PQR Private Limited has **significant influence** in ABC Private Limited [para 3(b) and para 10.4]

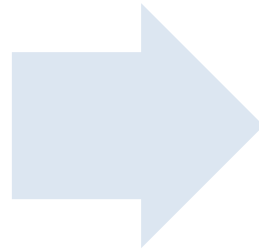


# Case A (ii) – Identifying related party relationship



Sun Limited holds 75% shares in Moon Limited and hence, it controls Moon Limited  
Sun Limited holds 62.5% shares in Earth Limited [25% directly and 37.5% through Moon Limited (75% of 50%)] and hence, it also controls Earth Limited  
Mr. X is KMP of Sun Limited as per para 3(d) and para 10.8  
Mrs. P is related to Sun Limited (relative of KMP) as per para 3(d) and para 10.9  
Neptune Limited is related to Sun Limited as per para 3(e)

X Private Limited sells goods to its associate company on regular basis. After Q1, the relationship ceased to exist. However, goods were supplied to it like any other customer. Whether transactions for entire year is required to be disclosed under AS 18?

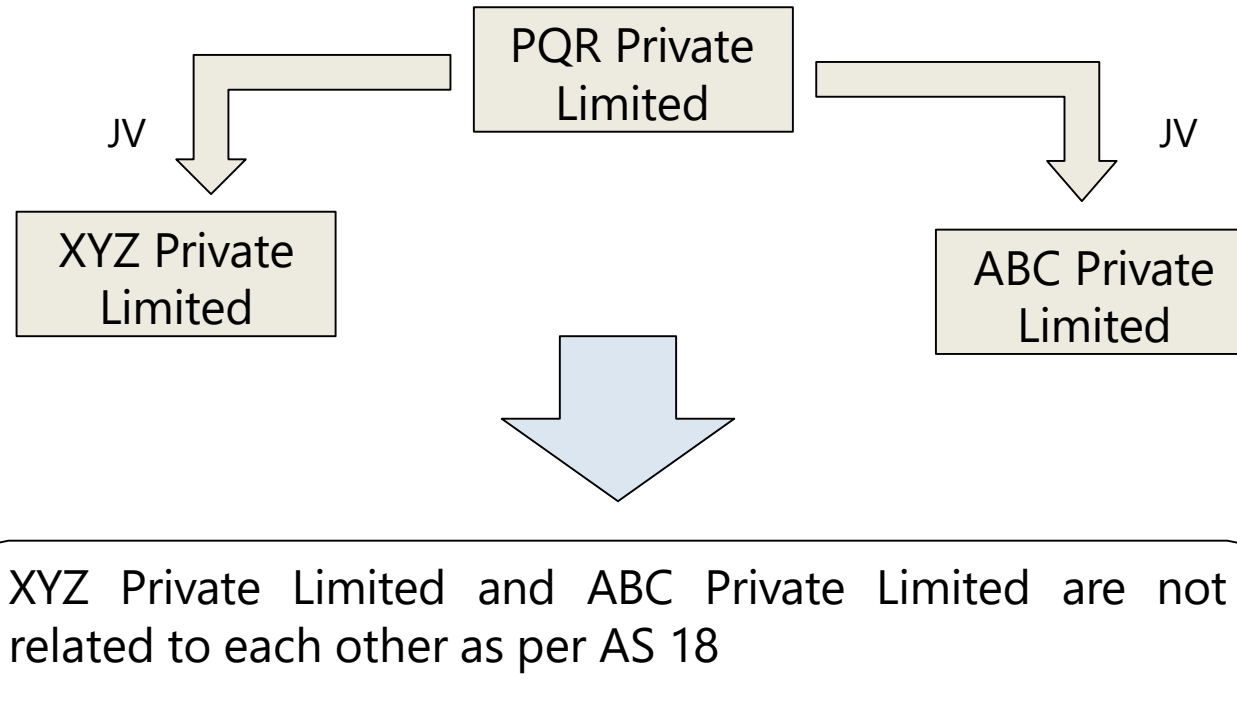


As per para 23 of AS 18 - Related party disclosures, **transactions for Q1 are required to be disclosed** as related party transactions. Transactions for the period in which related party relationship did not exist is not required to be disclosed

### **Ind AS regime:**

Same treatment under Ind AS 24 – Related party transactions

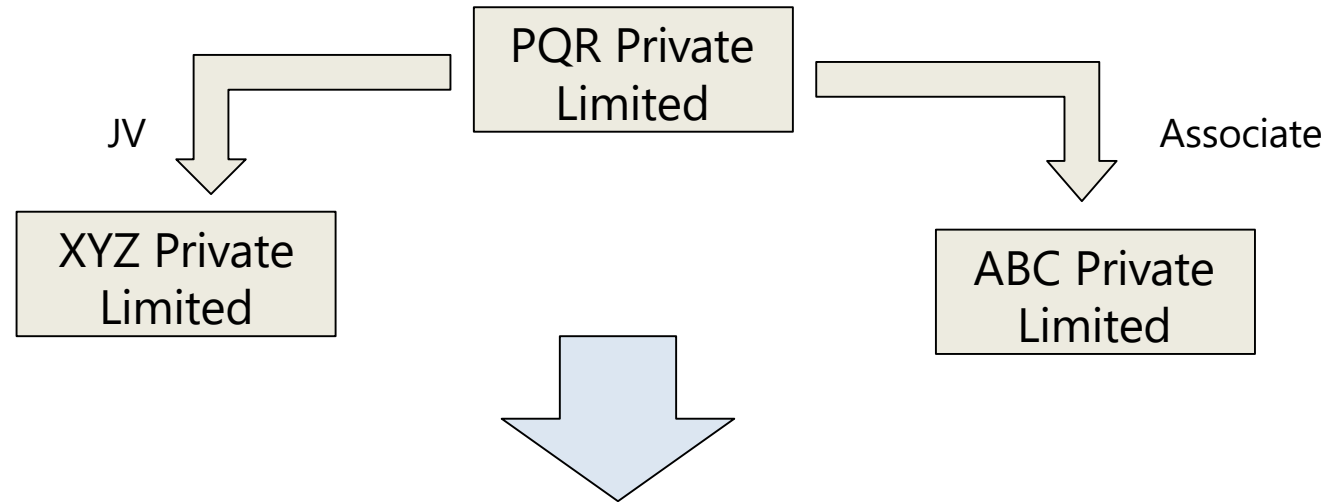
# Case C – Fellow joint venture



## **Ind AS regime:**

XYZ Private Limited and ABC Private Limited are related parties as per Ind AS 24 - Related party disclosure

# Case D – Associates & Joint Venture of same party



XYZ Private Limited and ABC Private Limited are not related to each other as per AS 18

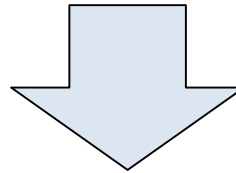
## **Ind AS regime:**

XYZ Private Limited and ABC Private Limited are related parties as per Ind AS 24 - Related party disclosure

# Case E – Post employment benefit plan

PQR Private Limited

PQR Gratuity Trust (post-employment benefit plan for employees of PQR Private Limited)



PQR Private Limited and PQR Gratuity trust are not related to each other as per AS 18

## **Ind AS regime:**

PQR Private Limited and PQR Gratuity trust are related parties as per Ind AS 24 - Related party disclosure

# Key takeaways

When in doubt -- disclose

Ensure completeness (refer MBP 1, last year tax audit report, register of contracts, shareholders agreement, minutes of meeting, etc.)

Discuss with Board and audit committee

Letter of representation

# Non-compliances observed by ICAI and QRB

Non-disclosure of previous year figures



Non-disclosure of related party name and transaction till the date of existence of relationship



Non-disclosure of volume of transaction (either as amount or as a proportion) in case of KMP



Non-executive directors have been disclosed as KMP in contravention of Para 14 of AS-18

AS 24 Discontinuing  
Operations / AS 20 EPS / AS  
25 IFR



# Resources Referred

#	Particulars	Reference
1	Guidance Note on Related Party Transactions, ICSI, March 2019	<a href="https://www.icsi.edu/media/webmodules/Guidance_Note_on_RPTs_4-4-2019.pdf">https://www.icsi.edu/media/webmodules/Guidance Note on RPTs 4-4-2019.pdf</a> <a href="https://www.icsi.edu/ssb/home/">https://www.icsi.edu/ssb/home/</a>
2	Accounting Standards for Non Company Entities, WIRC ICAI	<a href="http://flipbook.finesse.co.in/books/swiz/mobile/index.html">http://flipbook.finesse.co.in/books/swiz/mobile/index.html</a>
3	Accounting Standards – Applicable for Accounting Period on or After 01.04.2021, MCA	<a href="https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/accounting-standards.html#">https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/accounting-standards.html#</a>
4	Companies (Accounting Standards) Rules, 2021, MCA	<a href="https://www.mca.gov.in/bin/ebook/dms/getdocument?doc=MjA0NzM=&amp;docCategory=Notifications&amp;type=open">https://www.mca.gov.in/bin/ebook/dms/getdocument?doc=MjA0NzM=&amp;docCategory=Notifications&amp;type=open</a> <a href="https://egazette.nic.in/WriteReadData/2021/227890.pdf">https://egazette.nic.in/WriteReadData/2021/227890.pdf</a>

# Resources Referred

#	Particulars	Reference
5	Technical Guides and Other Materials, ICAI	<a href="https://www.icai.org/post/technical-guides-and-other-materials">https://www.icai.org/post/technical-guides-and-other-materials</a>
6	Accounting Standards: Quick Referencer (as on April 01,2019), ICAI	<a href="https://resource.cdn.icai.org/55939asb45327.pdf">https://resource.cdn.icai.org/55939asb45327.pdf</a>
7	Accounting Standards Quick Referencer for Micro Non-company entities	<a href="https://resource.cdn.icai.org/64842asb52105.pdf">https://resource.cdn.icai.org/64842asb52105.pdf</a>
8	Applicability of Acct. Stds. to Various Entities, ICAI	<a href="https://resource.cdn.icai.org/66488bos53751-accp-2.pdf">https://resource.cdn.icai.org/66488bos53751-accp-2.pdf</a>
9	Referencer for Quick Revision (BOS, ICAI)	<a href="https://resource.cdn.icai.org/60360bos49180.pdf">https://resource.cdn.icai.org/60360bos49180.pdf</a>