PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (AS 29)

PRESENTATION BY :

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IAS 37 Applicability

The requirements of AS 29are applicable to recognition & measurement of all provisions, contingent liabilities, and appropriate accounting for contingent assets *except*

(a) Fin Instruments that are carried at FV

(b) Those resulting from executory contracts except where the contract is onerous contracts

(c) Insurance companies

(b) Those covered by other Standards

Exclusion

- Construction contracts (AS 7)
- Income taxes (As 22)
- Leases (onerous leases are covered by AS 29.)
- Employee benefits AS 15)
- Insurance contracts (However, AS 29 still applies to other than those arising from its contractual obligations
  and rights under insurance contracts covered)
- Financial instruments (including guarantees) , if not carried at FV

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Executory Contract

Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

This Standard does not apply to executory contracts unless they are onerous.

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Provision

liabilities that can be measured only by using a substantial degree of estimation"provisions"

Whether following are provisions :
- Provision for Depreciation
- Provision for Bad Debts
- Provision for O/S Expenses
- Provision for Bonus
- Creditors

None of the above are provisions

Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

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Provision- Conditions

IFF all conditions are fulfilled : -

a) An entity has a *present obligation resulting from a past (obligating) event;*

(b) It is *probable that an outflow of resources embodying economic benefits would be required* to settle the obligation; *and*

(c) A *reliable estimate can be made of the amount of the obligation.*

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Obligation –

An *obligating event* **is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation. Based on evidence available on the BS date and that it is probable i.e. more likely than not.**

Legal or Normal Business Practice Obligation

Legal Obligation : is an obligation that could

(a) Be contractual; *or*

(b) Arise due to a legislation; *or*

(c) Result from other operation of law.

Case Study – Past events & Obligating Events

- Clean- Up costs
- Decommissioning Costs
- Future Losses
- Law Suits
- Identity Not known
- Warranties
- Due to proposed law, that have yet to be finalised

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Measurement of Provision

best estimate of the expenditure required to settle the present obligation at the balance sheet date

If not possible to obtain a reliable estimate then it is to be disclosed as Contingent Liab .

- ✓*Best Estimate based on past experience*
- ✓*If group of items > Expected Value*
- ✓*If single item > Most likely outcome*

Measurement of Provision

The entity's past experience with warranty claims is

- 60% of cars sold in a year have zero defects.
- 25% of cars sold in a year have normal defects.
- 15% of cars sold in a year have significant defects.
- The cost of rectifying a "normal defect" in a car is Rs.10,000 and for a "significant defect"in a car is Rs.30,000.

Find the Provision Reqd.

- **(60% × 0) + (25% × 10,000) + (15% × 30,000)**
  Provision Reqd = Rs. 7,000.

Measurement of Provision

- Remeasure at each B/S Date
- No provision for the future operating losses
  (However, impairment may be reqd)

Provision for an **onerous contract** where the unavoidable costs exceed the benefits expected (The excess unavoidable costs should be provided for at the time the contract becomes onerous)

Reimbursement

- Reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received
- Reimbursement be treated as separate asset
- The amount recognised for the reimbursement should not exceed the amount of the provision.
- Expense relating to a provision may be presented net of the reimbursement.
- Sometimes, full amt as liability and r'ble as asset, depending upon whose liability is it.

Restructuring - Examples

- Sale or termination of a line of business
- Closure of business locations in a region or relocation of business activities from one locationto another
- Changes in management structure, such as elimination of a layer of management
- Fundamental reorganization of the entity such that it has a material and a significant impact on its operations.

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Obligation - Restructuring

- No obligation arises for the sale of an operation until the enterprise is committed to the sale,
  - Binding Sale Agreement is a pre-requisite
  - To include only direct expenditure arising n restructuring (a) Only due to restructuring; and (b) not associated with ongoing activities.
  - Does not include: Retraining and Relocation of staff, marketing, invst in new systand dist network

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Contingent Liability

A contingent liability is a *possible obligation arising from past events, the outcome of* which will be confirmed only on the occurrence or nonoccurrence of one or more uncertain future events. A contingent liability is also a *present bligation that is not recognized, either because it is* not probable that an outflow of resources will be required to settle an bligation or the amount of the obligation cannot be measured with sufficient reliability

- Jointly and Severally liable for an obligation

Contingent Assets

Contingent assets are *possible assets that arise from a past event and whose existence is confirmed* only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the entity.

Virtual Certainty required

EXAMPLES

- Warranties
- Reimbursements
- Refund Policy
- Legal Requirement to fit Smoke Filters
- Staff Retraining as a result of changes in Tax
- Guarantees
- Onerous Contracts
- Refurbishment cost – Legal Requirements

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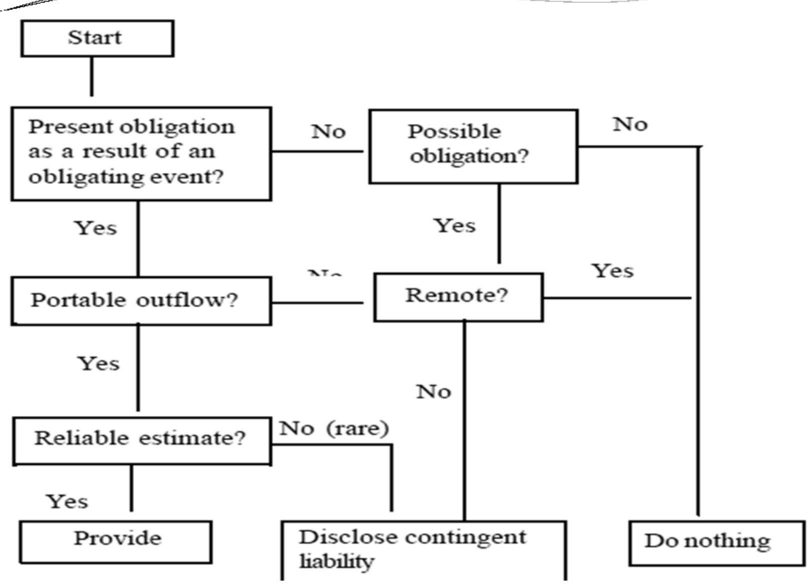

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Asset	Virtually certain (>=90%)	Recognize
Contingent Asset	Probable (> = 50%) Possible (< = 50%) Remote (< = 10%)	Disclose No Disclosure No Disclosure
Liability	Virtually Certain Probable (reliably measurable)	Recognize Recognize
Contingent Liability	Probable Possible Remote	disclose disclose do not disclose

Questions ?????

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