Accounting standard no 29
Provisions, contingent liabilities, contingent assets

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Comparative international standards and highlights

- IAS 37
- Deals with
  - Distinction between liabilities, provisions and contingent liabilities
  - When to make provision for a liability, when to book a contingent liability, when to take no action at all
  - Gives several illustrations of situations about provisioning, contingent liability recognition
- Significant differences between IAS 37 and the present form of the AS
  - For future liabilities, no present valuation is required under AS 29
  - Required under IAS 37

Scope

- Those resulting from financial instruments carried at fair value
  - Original text of the AS said, the AS applies to liabilities arising out of financial instruments too
  - With AS 30, there is a separate statement dealing with financial instruments
  - Hence, this standard does NOT now apply to financial instruments
- Some guarantees are covered by AS 30
  - The statement does not apply to such guarantees too
- The standard does not apply to liabilities under executory contracts
  - Meaning of executory contract – performance pending on the part of a party to a contract – for example, obligation of a landlord to maintain a building
  - That is, pending performance under a contract does not come as a liability or contingent liability
    - However, in case of onerous executory contracts, provision may be required
    - Onerous executory contract is one which exposes one party to a clear liability
- Does not apply to
  - Liability of insurers under insurance contracts
  - Liabilities dealt with by other standards
    - For example construction contracts
    - Tax provisions
    - Retirement benefits, etc

Important definitions

- **Provision – a liability that can be measured using *a substantial degree of estimation***
- **Liability - present obligation for past events, expected to result into an outflow**
- **Contingent liability**
  - **Possible obligation from past events, existence of which will be confirmed only on occurrence or non occurrence of future events not within the control of the enterprise**
  - **Present obligation from past events, not recognised as liability because**
    - **It is not probable that an outflow will be required to settle the obligation or**
    - **Reliable estimate of the amount of obligation cannot be made**
- **Contingent asset**
  - **Possible asset that arises from past events, existence of which will be confirmed only on occurrence or non occurrence of future events not within the control of the enterprise**
- **Present versus probable**
  - **More likely than not – it is present**

Distinction between liabilities, provisions and contingent liability

- Liability is liability to make future payments
  - For goods/services already received or obligations already created
  - Or accruals – whole or part of the expense pertains to the current period
- Provision
  - the liability is not an existing liability
  - Substantial Degree of estimation is required
    - Where degree of estimation required is less, we create a liability
- Contingent
  - Things are to happen in future whereby a liability may arise
  - It is conditional, contingent upon such things happening or not happening
  - Hence the liability is notrecognised as such

Recognition

- provision should be made with these THREE conditions are satisfied
  - Entity has a present obligation as a result of past event
    - Obligation is present - that is, more likely than not
    - It pertains to or arises out of a past event, not out of an event to happen in future
  - It is probable that an outflow will take place to settle the obligation
  - A reliable estimate can be made of the obligation
- Note the difference between liability and provision discussed earlier
  - The degree of estimation required
    - If the amount of liability is almost ascertainable and does not require significant estimation, we create a liability
    - If estimation required is significant, we make a provision
    - If reliable estimate cannot be made, or other conditions for provisioning are not satisfied, we create a contingent liability

Evidence required for provisioning

- Provisions are based on an estimated liability for events that have already happened, that is, obligating event
- The probability of incurrence of such obligations is tested based on evidence
  - Evidence may include evidence available after the balance sheet date
  - That is to say, provision may be created on the balance sheet date
    - If the event, due to which liability arises, has happened upto balance sheet date
    - Though the evidence of such obligation arises after balance sheet date

Obligating event

- **Obligating events that exist on the balance sheet date only lead to provisions**
  - **We cannot be looking at what expenditure will have to be incurred in future: only to the extent of liabilities already created**
- **Second condition is the obligating event pertains to things that have happened**
  - **For example, penalty for infraction of a law that has happened**
- **For an obligation to exist, it is not necessary to identify the counterparty, that is the recipient**

Contingent liabilities and contingent assets

- Contingent liabilities are not recognised
  - They are only disclosed
- When the liability satisfies the features to create a provision, or becomes a certain liability, it is recognised as such
- Contingent assets are neither recognised nor disclosed

Estimation of liability to make provision

- Estimation is done applying best estimate
- Gains from future disposal of assets are not captured in estimating the amount of the liability
- Reimbursements from third parties are not incorporated unless it is reasonably certain of receipt
- Provisions should be reviewed every period
- A provision should be used only for the expenditure for which it was intended

Restructuring provision

- **Meaning of restructuring**
  - Sale or termination of a line of business
  - Closure of business locations
  - Management restructuring, e.g., Eliminating a layer of management
  - Fundamental reorganisations having material impact on nature or focus of the enterprise
- **If the entity announces restructuring, restructuring provision should be made if**
  - Expenses necessarily associated with restrcturing
  - Not associated with the ongoing activities of the enterprise

Main recognition requirements of the Accounting Standard for provisions and contingent liabilities

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