IND AS 37 - Provisions, Contingent Liabilities and Contingent Assets

Liability

Liability is a

- Present Obligation arising from Past Events
  - It can be
    - Legal Obligation that derives from a Contract or Legislation
    - OR
    - Constructive Obligation that derives from Past Practice or Commitment of the Entity
- and
- Settlement of Obligation will result in outflow of resources

Provisions

(1) Meaning of Provision :-

Provision is a Liability of Uncertain Amount or Timing , i.e.

- Present Obligation arising from Past Events
- and
- Outflow of Resources is Probable [50% or More]
- and
- Amount can be estimated reliably

(2) Recognition of Provision :-

- Provision shall be recognised as a Liability in financial Statements.
- Amount of Provision:
  - → It should be measured as follows [Best Estimate of Expenditure to be incurred]:
    - If there are many possible outcomes, then calculate Expected Value by using the Probability of each outcome
    - If there is only 1 Possible outcome, then consider such amount directly
  - → If Expenditure is to be incurred after 1 Year, then Provision should be recognised at Present Value by discounting the expenditure using Pre Tax Discounting Rate

    and

    Charge Interest Expense (Finance Cost) on such Provision to unwind the discount over the period in P&L at discounting rate.
  - → If there is Risk that Actual Outflow would be more than the Expected Present Value of Outflow, then Risk Adjustment is done by adding it to the Expected Present Value of Outflow as follows

Expected Present Value of Outflow	xxx
(+) Risk Adjustment @ Risk factor %	xxx
Provision Amount	xxx

→ Journal Entries

(i) P&L A/c
  To Provision A/c

(ii) Interest Expense A/c (Finance Cost)
  To Provision A/c

[Opening Balance of Provision × Discounting Rate]

- Provision should be Reviewed at each Balance Sheet Date & adjusted to reflect the current best estimate. If it is no longer required, then it should be reversed.

Note:- If Entity can avoid any expenditure by its future actions, then No Provision is recognised for such expenditure.
Example: future Operating Costs like Overhauling or Inspection of Ships, Future Operating Losses, etc.

(3) Special Points:-

- Onerous Contract:

→ It is a Contract in which unavoidable costs of meeting the obligation exceeds economic benefits to be received under it.

→ Provision is recognised on Onerous Contract at Lower of

Loss on fulfilling the Onerous Contract

OR

Penalty for Non Performance of the Contract [i.e. Exiting from the Contract]

- Restructuring:

→ It is a plan to change the scope of business or manner of conducting business.
Example: Discontinuing a Line of business or Closure of Operations in an Area.

→ Provision for Restructuring Costs is recognised when Constructive Obligation to Restructure arises, i.e.

Entity has a detailed Formal Plan

AND

Entity has raised a valid expectation for restructuring by announcing the Plan

→ Amount of Provision for Restructuring Costs include only direct expenditures arising from Restructuring i.e. Staff Termination / Redundancy Costs, Compensation to Customer, Lease Termination Cost, etc.

[Relocation / Retraining Cost for employees remained in Company & Impairment on Assets are not considered in Provision Amount for Restructuring]

- Reimbursements:

→ If Expenditure required to settle a obligation is expected to be reimbursed by other party & it is virtually certain [More than 95% Chance] that reimbursement will be received

- Reimbursement shall be recognised as a Separate Asset in Balance Sheet
- Provision Expense & Reimbursement Income can be presented by Netting off in P&L
- Reimbursement shall not exceed Provision Amount

→ If Reimbursement is not virtually certain, then Disclose in Notes to Financial Statements.

Contingent Liabilities

(1.) Meaning of Contingent Liability :-

- Possible Obligation arising from Past Events that will be confirmed only on occurrence or non occurrence of uncertain future events

OR

- Present Obligation arising from Past Events and
  - Outflow of Resources is Not Probable [Less than 50%]

    OR
  - Amount cannot be estimated reliably

(2.) Recognition of Contingent Liability :-

- Contingent Liability shall not be recognised But It should be disclosed in Notes in Financial Statements.
- However, If Possibility of Outflow is Remote [Less than 5%], then Disclosure is also not required.

Contingent Assets

(1.) Meaning of Contingent Assets :-

Possible Asset arising from Past Events that will be confirmed only on occurrence or non occurrence of uncertain future events.

(2.) Recognition of Contingent Assets :-

- If Inflow of Resources is Virtually Certain [More than 95%]

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  It is no more a Contingent Asset. It becomes an Asset. So, Recognise the Asset.
- If Inflow of Resources is Probable But Not Virtually Certain [50% or More]

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  Contingent Asset shall not be recognised But It should be disclosed in Notes in Financial Statements
- If Inflow of Resources is Not Probable [Less than 50%]

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  Contingent Asset shall neither be recognised nor disclosed