AS 29 - Provisions, Contingent Liabilities & Contingent Assets

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I. Definitions

- **Liability:**
  - It is a **Present Obligation**
  - Arising out of **Past Events**.
  - Settlement of which is expected to result in **outflow of Resources**.
- **Obligation / Obligating Event:**
  - It is an event that results in an enterprise having **no realistic alternative** to settling the obligation.
  - *Obligation means if we have to settle this, otherwise, there is no other way.*

Obligation / Likelihood of Outflow:

- **Present Obligation:**
  - Means the outflow of resources is **More likely than NOT** (More than 50% chance of paying it).
- **Possible Obligation:**
  - Means the outflow of resources is **Less likely than NOT** (Less than or equal to 50% chance of paying it).
- For an obligation to arise there should be a **past event**.
  - *Example: Loan taken → Past Event is taking loan from a Bank.*
  - *Example: Penalty on government dues or penalty on contamination → Past Event is not paying the government dues or contaminating the river.*

II. Provisions

- **Definition of Provision:**

  - It is a **liability** with **uncertain timing or amount**.

- **Recognition of Provision:**

  - A provision should be recognised when:
    1. An entity has a **present obligation**.
    2. As a result of a **past event**.
    3. It is **probable** that an outflow of resources will be required.
    4. A **reliable estimate** of the amount can be made.

- **Measurement of Provision:**

  - The entity shall apply its **best estimate** to measure the amount of provision.
  - The amount of provision should **NOT be discounted to its Present Value**.
  - **Exception:** In case of Decommissioning / Dismantling / Site Restoration, it is recorded at **Present Value** (As discussed in AS 10).

- **Changes in Provisions:**

  - Provision should be **reviewed at each Balance Sheet date** to reflect the best estimate.
  - If a provision is **no longer required**, then **reverse the provision**.

- **Use of Provision:**

  - Only expenditure that relate to the **original provision** are adjusted against it.

- *Example of Reversing Provision

If Provision for warranty was 15,000 but the actual expense was 12,000, then the remaining 3,000 is reversed:

Provision for Warranty Account Debit 3,000 To Profit and Loss (Reversal) 3,000

III. Special Points related to Provision

1. **Virtually Certain Implementation of Law:**
    - If any law is announced by the government, due to which an obligation to make the payment might arise on the company, then create provision **only when the law is virtually certain to be implemented**.
    - *Example: If a law for penalty on river contamination is announced in parliament, formal signing is pending, the law is virtually certain to be implemented, and a provision for the penalty should be created (YES).*
2. **Requirement of Inspection / Major Overhaul:**
    - Only those provisions are recognised for which the entity has **no realistic alternative** rather than settling it.
    - If the entity can **avoid such expenditure by its future actions** (e.g., by selling the asset before the inspection is due), then **No provision is recognised**.
    - *Note: Provision can be made after 5 years of use of the asset, when the inspection cost becomes due.*
3. **Future Operating Losses:**
    - **No Provision** is to be recognised as it **does not meet the definition of Provision** (It does not arise from a **Past Event**).
4. **Onerous Contract (Loss making contract):**
    - It is a contract where the **unavoidable cost** of meeting the obligation **Exceeds** the **Benefits to be received** from it.
    - *Rule:* Create Provision for the **lower of:** unavoidable loss **or** cancellation penalty.
5. **Restructuring:**
    - **Restructuring** is a program that materially changes the **Scope of Business OR the Manner in which Business is conducted**.
    - A provision for restructuring cost is recognised **only when recognition criteria of Provision are met**.
        - *Example: Restructuring plan ready, announced restructuring, steps started for restructuring → Recognise Provision.*
        - *Example: Restructuring Karne ka soch rahe hai, no steps undertaken → No Provision.*
    - **Restructuring Provision Amount:**
        - **Includes:** Only the **direct expenditure** arising from restructuring which are **BOTH**:
            1. Necessarily entailed by the restructuring, **AND**
            2. Not associated with ongoing activities of the entity.
            - *Example of Included:* 10 employees lay off - 2 month salary, 2 Years rent payable (agreement was non-cancellable), Other relevant expense for closing the business.
        - **Excludes:** Expenses related to the **future conduct of business**, such as:
            - Retaining cost of continuing staff.
            - Relocation cost of continuing staff.
            - Marketing of online teaching.
            - Investment in new systems (Mic, Projector, camera, iPad, etc.).
            - *(No Provision is created for these as this relates to future conduct of Business).*

IV. Reimbursements

- In this case, some or all of the expenditure required to settle a provision is **expected to be reimbursed by another party**.
- **Reimbursement is recognised only when it is virtually certain that such reimbursement will be received.**
- The amount of reimbursement shall **NOT Exceed the amount of provision**.
- **Presentation in Financial Statements:**
    - **Profit and Loss Account:** Expense and Reimbursement Income are shown **net off** (Net Expense).
    - **Balance Sheet:** Provision (Liability) and Reimbursement Asset (Asset) are **NOT net off** (No net off allowed).

V. Contingent Liability

- **Definition (Any 1 condition to be met):**

    1. It is a **Possible Obligation** arising out of a **Past Event**, the existence of which will be confirmed by the occurrence/non-occurrence of one or more future uncertain events.
    2. It is a **Present Obligation** arising out of a **Past Event** where the outflow is **NOT probable** (less than 50% chance), but the amount can be estimated reliably.
    3. It is a **Present Obligation** arising out of a **Past Event** where the outflow is **probable** (more than 50% chance), but the **amount cannot be estimated reliably**.

- **Recognition of Contingent Liability:**

    - Contingent liability should **NOT be recognised** in the financial statements but should be **disclosed in Notes to Accounts**.
    - **Exception:** If the probability of contingent liability is **very Remote** (e.g., chance of losing the case is 5% or less), there is **No need to disclose** such contingent liability.

VI. Contingent Asset

- **Definition:**
    - It is a **possible Asset** arising out of **Past Events**, the existence of which will be confirmed **only by the occurrence or non-occurrence** of one or more uncertain future events.
- **Recognition of Contingent Asset:**
    - Contingent Asset is **Neither recognised NOR disclosed in the Financial Statements**.
    - If the company wants to disclose it, it can disclose it in the **Report of Approving Authority (Director's Report)**.
    - **Exception:** If inflow is **virtually certain**, then it is **no more a contingent asset**. It becomes a **normal asset**, and therefore, it is **Recognised in the Financial Statements**.

Summary of Accounting Treatment (Implicit from Definitions and Rules)

Item	Outflow Probability	Reliable Estimate of Amount	Recognition	Disclosure
Provision	Probable (>50%)	Yes	Yes	Yes
Contingent Liability	Not Probable (≤50%)	Yes / No	No	Yes*
Contingent Asset	Probable / Possible	Yes / No	No	No**

Notes:

- *Contingent Liability is disclosed unless the probability is very remote (5% or less).*

- *Contingent Asset is neither recognised nor disclosed in Financial Statements (but can be disclosed in the Directors' Report).*