

## TOPIC – 25

### ACCOUNTING STANDARD - 29

#### “PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS”

**Total No. of Questions 19**

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### SERIES 100 – ICAI STUDY MODULE QUESTIONS

#### Q.AS29.SM.101: (SIMILAR IN Exam Nov22)

At the end of the financial year ending on 31<sup>st</sup> March, 2022, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:



particulars	probability	Loss (Rs.)
In respect of five cases (Win)	100%	-
Next ten cases (Win)	50%	-
Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000
Remaining five cases		
Win	50%	-
Lose (Low damages)	30%	10,00,000
Lose (High damages)	20%	21,00,000

Outcome of each case is to be taken separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS – 29.

#### Q.AS29.SM.102: (MTP April'19, RTP May'21)

EXOX Ltd. is in the process of finalising its accounts for the year ended 31st March, 20X2. The company seeks your advice on the following:



- (i) The Company's sales tax assessment for assessment year 20X1-X2 has been completed on 14th February, 20X4 with a demand of Rs.2.76 crore. The company paid the entire due under protest without prejudice to its right of appeal. The Company files its appeal before the appellate authority wherein the grounds of appeal cover tax on additions made in the assessment order for a sum of 2.10 crore.

- (ii) The Company has entered into a wage agreement in May, 20X2 whereby the labour union has accepted a revision in wage from June, 20X1. The agreement provided that the hike till May, 20X2 will not be paid to the employees but will be settled to them at the time of retirement. The company agrees to deposit the arrears in Government Bonds by September, 20X2.

**Q.AS29.SM.103: (Similar to Exam Nov'19 & Exam Jan'25)**

A Ltd. provides after sales warranty for two years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period.

Less than 1 year: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	Amount (Rs)
11 <sup>th</sup> Feb, 2017	60,000
25 <sup>th</sup> Dec, 2017	40,000
04 <sup>th</sup> Oct, 2018	1,35,000

Calculate the provision to be made for warranty under AS-29 as at 31<sup>st</sup> March, 2018 and 31<sup>st</sup> March, 2019. Also compute amount to be debited to P & L account for the year ended 31<sup>st</sup> March, 2019.



**Q.AS29.SM.104: (Similar to RTP Nov'21)**

An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31<sup>st</sup> March 2021, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary considering the circumstances in line with provisions of AS 29?

**Q.AS29.SM.105: (Similar to MTP Mar19)**

Sun Ltd. has entered into a sale contract of Rs. 5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is Rs. 1 crore. The delivery of goods to take place during the first month of 2016-2017 financial year. In case of failure of Sun Ltd. To deliver within the schedule, compensation of Rs. 1.5 crores is to be paid to X Ltd. Sun Ltd. Planned to manufacture the goods during the last month of 2015-2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

- Should Sun Ltd. provide for contingency as per AS 29? Explain.
- Should provision be measured as the excess of compensation to be paid over the profit?



**SOLUTIONS OF ABOVE QUESTIONS OF SERIES 100****SOLUTION Q101**

According to AS 29 (Revised) 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:

- (i) There is a present obligation arising out of past events but not recognized as provision.
- (ii) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- (iii) The possibility of an outflow of resources embodying economic benefits is not remote.
- (iv) The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 50% and for remaining five cases is 50%. As per AS 29 (Revised), we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is remote, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

$$\begin{aligned} \text{Expected loss in next ten cases} &= 40\% \text{ of } ₹ 12,00,000 + 10\% \text{ of } ₹ 20,00,000 \\ &= ₹ 4,80,000 + ₹ 2,00,000 \\ &= ₹ 6,80,000 \end{aligned}$$

$$\begin{aligned} \text{Expected loss in remaining five cases} &= 30\% \text{ of } ₹ 10,00,000 + 20\% \text{ of } ₹ 21,00,000 \\ &= ₹ 3,00,000 + ₹ 4,20,000 \\ &= ₹ 7,20,000 \end{aligned}$$

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of ₹ 1,04,00,000 (₹ 6,80,000 x 10 + ₹ 7,20,000 x 5) as contingent liability.

**SOLUTION Q102**

- (i) Since the company is not appealing against the addition of Rs.0.66 crore the same should be provided for in its accounts for the year ended on 31st March, 20X4. The amount paid under protest can be kept under the heading 'Loans & Advances' and disclosed along with the contingent liability of Rs.2.10 crore.
- (ii) The arrears for the period from June, 20X1 to March, 20X2 are required to be provided for in the accounts of the company for the year ended on 31st March, 20X2.

**ANSWER: Q103**

Provision to be made for warranty under AS 29 'Provisions, Contingent Liabilities and Contingent Assets'

$$\begin{aligned} \text{As at 31st March, 2018} &= ₹ 60,000 \times .02 + ₹ 40,000 \times .03 \\ &= ₹ 1,200 + ₹ 1,200 = ₹ 2,400 \end{aligned}$$

$$\begin{aligned} \text{As at 31st March, 2019} &= ₹ 40,000 \times .02 + ₹ 1,35,000 \times .03 \\ &= ₹ 800 + ₹ 4,050 = ₹ 4,850 \end{aligned}$$

Amount debited to Profit and Loss Account for year ended 31st March, 2019

	Rs
Balance of provision required as on 31.03.2019	4,850
Less: Opening Balance as on 1.4.2018	<u>(2,400)</u>
Amount debited to profit and loss account	<u>2,450</u>

**Note:** No provision will be made on 31st March, 2019 in respect of sales amounting Rs 60,000 made on 11th February, 2017 as the warranty period of 2 years has already expired.

**SOLUTION Q104**

As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event. However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted. In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean-up cost in the year in which the law is virtually certain to be enacted.

**ANSWER: Q105**

- (i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting Rs. 1.5 crores as per AS 29.
- (ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting Rs. 1.50 crores.

## SERIES 200 – QUESTIONS OF RTPs/MTPs/PAST EXAMS

### Q.AS29.RMP.201: (RTP May20 and Exam Nov20)

With reference to AS 29, how would you deal with the following in the annual accounts of the company at the Balance Sheet dates:



- (i) An organization operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Ninety percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten percent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.
- (ii) During 2018-19 Ace Ltd. gives a guarantee of certain borrowings of Brew Ltd., whose financial condition at that time is sound. During 2019-20, the financial condition of Brew Ltd. deteriorates and on 31<sup>st</sup> Dec. 2019, it goes into liquidation. (Balance Sheet date 31-3-19).

### Q.AS29.RMP.202: (RTP May21)

(a) The company has not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier.

You are required to examine in line with the provisions of AS 29.

- (b) Explain whether provision is required in the following situations in line with AS 29:
- (i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation;
  - (ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.
  - (iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.



### Q.AS29.RMP.203: (MTP May22)

XYZ Ltd. has not made provision for warranty in respect of certain goods due to the fact that the company can claim the warranty cost from the original supplier. Hence the accountant of the company says that the company is not having any liability for warranties on a particular date as the amount gets reimbursed. You are required to comment on the accounting treatment done by the XYZ Ltd. in line with the provisions of AS 29.

### Q.AS29.RMP.204: (RTP Nov21)

A company, incorporated as NPO under the Companies Act, is having main objective to promote the trade by organizing trade fairs / exhibitions. While organizing the trade fair and exhibitions, it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.



The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third-party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The accounting treatment and disclosure was made by the company in its financial statements as: (i) 5% contingency charges are treated as income and matching provision for the same is also being made in accounts and (ii) suitable disclosure to this effect is also made in the notes forming part of accounts. You are required to comment whether creation of provision for contingencies considering the facts and circumstances of the case is required in line with AS 29.

### **Q.AS29.RMP.205: (RTP May22, Nov22)**

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2020. It seeks your advice in the following cases:

- (i) Chaos Limited has filed a court case in 2014-2015 against its competitors. It became evident to its lawyers during the year ended 31st March, 2020 that Chaos Limited may lose the case and would have to pay Rs. 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.
- (ii) A new regulation has been passed in 2019-2020 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2021. The company estimates an expenditure of Rs. 10,00,000 for the said upgrade.
- (iii) The company gives one year warranty for its healthcare equipment under the contract of sale that it will make good any manufacturing defect by repair or replacement. As per past experience, it is probable that there will be 1% such cases and estimated cost of repair / replacement is estimated at 10% of such sale value. During the year, the company has made a sale of Rs. 5 crores.

Kindly give your answer for each of above with proper reasoning according to the relevant Accounting Standard. Also state the principles for recognition of provision, as per AS 29.

### **Q.AS29.RMP.206: (MTP Aug18, Nov21, May23)**

An airline is required by law to overhaul its aircraft once in every five years. The Pacific Airlines which operate aircrafts does not provide any provision of as required by law in its final accounts. Discuss with reference to relevant Accounting Standard 29.



### **Q.AS29.RMP.207: (MTP Nov'21, May'23 & RTP May' 25)**

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2020 and needs your expert advice on the following issues in line with the provisions of AS 29:

A case has been filed against the company in the consumer court and a notice for levy of a penalty of Rs. 20 lakhs has been received. The company has appointed a lawyer to defend the case for a fee of Rs. 2 lakhs. 50% of the fees has been paid and balance 50% will be paid after finalisation of the case. There are 75% chances that the penalty may not be levied.

The company had committed to supply a consignment worth Rs. 1 crore to one of its dealers by the year-end. As per the contract, if delivery is not made on time, a compensation of 15% is to be paid on the



value of delayed/lost consignment. While the consignment was in transit, one of the trucks carrying goods worth Rs. 30 lakhs met with an accident. It was however covered by Insurance. According to the surveyor's report, the policy amount is collectable, subject to 10% deduction. Before closing the books of accounts, the company has received the information that the policy amount has been processed and the dealer has also claimed the compensation for the consignment of goods worth Rs. 30 lakhs which was in transit.

### Q.AS29.RMP.208: (MTP May'22)

What is meant by "Restructuring Provision" as per AS 29? What costs are excluded while computing such provision as per the standard?

### Q.AS29.RMP.209: (Exam Nov'20)

The Government introduces a number of changes to the taxation laws. As a result of these changes, the company will need to train a large proportion of its accounting and legal workforce in order to ensure continued compliances with tax law regulations. At the balance sheet date, no retraining of staff has taken place.

### Q.AS29.RMP.210: (Exam May'22)

Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is in the process of finalisation of the accounts for the year ended 31 st March, 2022 and needs your advice on the following issues in line with the provisions of AS-29:

- (i) On 1st April, 2019, the company installed a huge furnace in their plant. The furnace has a lining that needs to be replaced every five years for technical reasons. At the Balance Sheet date 31st March, 2022, the company does not provide any provision for replacement of lining of the furnace.
- (ii) A case has been filed against the company in the consumer court and a notice for levy of a penalty of Rs. 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of Rs. 5 Lakhs. 60% of the fees have been paid in advance and rest 40% will be paid after finalization of the case. There are 70% chances that the penalty may not be levied.

### Q.AS29.RMP.211: (MTP Nov22) (RTP May23)

An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year: 2% provision

More than 1 year: 3% provision

The company has raised invoices as under:

Invoice Date	Amount
19 <sup>th</sup> Jan, 20X1	40,000
29 <sup>th</sup> Jan, 20X2	25,000
15 <sup>th</sup> Oct, 20X2	90,000



Calculate the provision to be made for warranty under AS – 29 as at 31<sup>st</sup> March, 20X2 and 31<sup>st</sup> March, 20X3. Also compute the amount to be debited to Profit and Loss a/c for the year ended 31<sup>st</sup> March, 20X3. (Answer: (i) 2012 – 1,550/-; 2013 – 3,200/- (ii) Amount debited to P&L – 1,650/-)

**Q.AS29.RMP.212: (Nov18 EXAM & Nov18 and May19 RTP) (MTP May22)**

M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of Rs 200 lakhs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? You are required to explain in brief giving reasons for your answer.



**Q.AS29.RMP.213: (RTP Sep'24)**

A company incorporated under Section 8 of the Companies Act, 2013, have main objective to promote the trade by organizing trade fairs / exhibitions. When company was organizing the trade fair and exhibitions it decided to charge 5% contingency charges for the participants/outside agencies on the income received from them by the company, while in the case of fairs organized by outside agencies, 5% contingency charges are levied separately in the invoice, the contingency charges in respect of fairs organized by the company itself are inbuilt in the space rent charged from the participants. Both are credited to Income and Expenditure Account of the company.

The intention of levying these charges is to meet any unforeseen liability, which may arise in future. The instances of such unforeseen liabilities could be on account of injury/loss of life to visitors/ exhibitors, etc., due to fire, terrorist attack, stampede, natural calamities and other public and third party liability. The chances of occurrence of these events are high because of large crowds visiting the fair. The decision to levy 5% contingency charges was based on assessment only as actual liability on this account cannot be estimated.

The following accounting treatment and disclosure was made by the company in its financial statements:

1. 5% contingency charges are treated as income and matching provision for the same is also being made in accounts.
2. A suitable disclosure to this effect is also made in the notes forming part of accounts.

Required:

- (i) Whether creation of provision for contingencies under the facts and circumstances of the case is in conformity with AS 29
- (ii) If the answer of (i) is "No" then what should be the treatment of the provision which is already created in the balance sheet.

**Q.AS29.RMP.214: (RTP Jan'25)**

During the year, QA Ltd. delivered manufactured products to customer K. The products were faulty and on 1st October, 2023 customer K commenced legal action against the Company claiming damages in respect of losses due to the supply of faulty product. Upon investigating the matter, QA Ltd. discovered that the products were faulty due to defective raw material procured from supplier F. Therefore, on 1st December, 2023, the Company commenced legal action against F claiming damages in respect of the supply of defective raw materials.

QA Ltd. has estimated that it's probability of success of both legal actions, the action of K against QA Ltd. and action of QA Ltd. against F, is very high.

On 1st October, 2023, QA Ltd. has estimated that the damages it would have to pay K would be ₹ 5 crore. This estimate was revised to ₹ 5.2 crore as on 31st March, 2024 and ₹ 5.25 crore as at 15th May, 2024. This case was eventually settled on 1st June, 2022, when the Company paid damages of ₹ 5.3 crore to K.

On 1st December, 2023, QA Ltd. had estimated that it would receive damages of ₹ 3.5 crore from F. This estimate was revised to ₹ 3.6 crore as at 31st March, 2024 and ₹ 3.7 crore as on 15th May, 2024. This case was eventually settled on 1st June, 2022 when F paid ₹ 3.75 crore to QA Ltd. QA Ltd. had, in its financial statements for the year ended 31st March, 2024, provided ₹ 3.6 crore as the financial statements were approved by the Board of Directors on 26th April, 2024.

- (i) Whether the Company is required to make provision for the claim from customer K as per applicable AS? If yes, please give the rationale for the same.
- (ii) If the answer to (a) above is yes, what is the entry to be passed in the books of account as on 31st March, 2024?
- (iii) What will the accounting treatment of the action of QA Ltd. against supplier F as per applicable AS?

**SOLUTIONS OF ABOVE QUESTIONS OF SERIES 200****ANSWER: Q201**

(i) The construction of the oil rig creates an obligation under the terms of the license to remove the rig and restore the seabed and is thus an obligating event. At the balance sheet date, however, there is no obligation to rectify the damage that will be caused by extraction of the oil. An outflow of resources embodying economic benefits in settlement is probable. Thus, a provision is recognized for the best estimate of ninety per cent of the eventual costs that relate to the removal of the oil rig and restoration of damage caused by building it. These costs are included as part of the cost of the oil rig. However, there is no obligation to rectify the damage that will be caused by extraction of oil, as no oil has been extracted at the balance sheet date. So, no provision is required for the cost of extraction of oil at balance sheet date.

Ten per cent of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.

(ii) As per AS 29, for a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. The obligating event is the giving of the guarantee by Ace Ltd. for certain borrowings of Brew Ltd., which gives rise to an obligation. No outflow of benefits is probable at 31 March 2019. Thus no provision is recognized. The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

During 2019-20, the financial condition of Brew Ltd. deteriorates and finally goes into liquidation. The obligating event is the giving of the guarantee, which gives rise to a legal obligation. At 31 March 2020, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Thus, provision is recognized for the best estimate of the obligation.

**ANSWER: Q202**

a) As per provisions of AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it can be said that the accounting treatment adopted by the company with respect to warranty is not correct.

b)

i) There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation – Provision is recognised. Disclosures are required for the provision.

ii) There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources – No provision is recognised. Disclosures are required for the contingent liability.

iii) There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote – No provision is recognised. No disclosure is required.

**SOLUTION Q203**

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will

be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision. It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

### **SOLUTION Q204**

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", a provision should be recognized when (a) An enterprise has a present obligation as a result of a past event and (b) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

From the above, it is clear that for the contingencies considered by the company, neither a present obligation exists because of past event, nor a reliable estimate can be made of the amount of the obligation. Accordingly, a provision cannot be recognized for such contingencies under the facts and circumstances of the case.

### **SOLUTION Q205**

Principles for recognition of provisions: As per AS 29, "a provision shall be recognised when:

- (i) an entity has a present obligation (legal or constructive) as a result of a past event;
- (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (iii) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."

#### **Accounting treatment under the given scenarios:**

- (i) On 31st March, 2020, since it is evident to the lawyer that Chaos Limited may lose the case and also a reliable estimate of the outflow can be made as Rs. 3,00,000, there is a present obligation. Hence, provision should be recognised for Rs. 3,00,000 for the amount which may be required to settle the obligation.
- (ii) Under new regulation, an entity is required to upgrade its facilities by 31 st March, 2021. However, on 31st March, 2020, i.e. at the end of the reporting period, there is no obligation because there is no obligating event either for the costs of upgrading the facilities or for fines under the regulations. Hence, no provision should be recognized on 31st March, 2020 for upgrading the facilities by 31st March, 2021.
- (iii) The obligating event is the sale of health care equipment with a warranty, which gives rise to a legal obligation. Here, an outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole. Hence, a provision is recognized for the best estimate of the costs of making good under the warranty products sold before the end of the reporting period as follows:

Probability of warranty cases for the entity where repair/replacement may be required as per past experience

$$= 1\% \text{ of Rs. } 5,00,00,000 = \text{Rs. } 5,00,000$$

$$= \text{Rs. } 5,00,000 \times 10\% = \text{Rs. } 50,000.$$

Estimated cost of repair / replacement

### **SOLUTION: Q206**

A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29.

The cost of overhauling aircraft is not recognized as a provision because it is a future obligation and the incurring of the expenditure depends on the company's decision to continue operating the aircrafts. Even a legal requirement to overhaul does not require the company to make a provision for the cost of overhaul because there is no present obligation to overhaul the aircrafts. Further, the enterprise can avoid the future expenditure by its future action, for example by selling the aircraft. However, an obligation might arise to pay fines or penalties under the legislation after completion of five years. Assessment of probability of incurring fines and penalties depends upon the provisions of the legislation and the stringency of the enforcement regime. A provision should be recognized for the best estimate of any fines and penalties if airline continues to operate aircrafts for more than five years.

### **SOLUTION Q207**

(i) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In the given case, there are 75% chances that the penalty may not be levied. Accordingly, Saharsh Ltd. should not make the provision for penalty.

However, a provision should be made for remaining 50% fees of the lawyer in the financial statements of financial year 2019-2020.

(ii)

Loss due to accident	Rs. 30,00,000
Insurance claim receivable by company = Rs. 30,00,000 x 90%	Rs. 27,00,000
Loss to be recognised in the books for 2019-2020	Rs. 3,00,000
Insurance claim receivable to be recorded in the books	Rs. 27,00,000
Compensation claim by dealer against company to be provided for in the books = Rs. 30,00,000 x 15%	Rs. 4,50,000

### **SOLUTION Q208**

As per AS 29, a restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and (b) Not associated with the ongoing activities of the enterprise. A restructuring provision does not include such costs as: (a) Retraining or relocating continuing staff; (b) Marketing; or (c) Investment in new systems and distribution networks.

### **SOLUTION: Q209**

As per AS 29, a provision for restructuring costs is recognized only when the recognition criteria for provisions are met. A restructuring provision does not include costs as of retraining or relocating continuing staff.

The expenditures of training the staff related to the future conduct of the business and are not liabilities for restructuring at the balance sheet date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring. At the balance sheet date, no such expenditure has been incurred hence no provision is required.

### **SOLUTION Q210**

(i) A provision should be recognized only when an enterprise has a present obligation arising from a past event or obligation. In the given case, there is no present obligation but a future one, therefore no provision is recognized as per AS 29. The cost of replacement of lining of furnace is not recognized as a provision because it is a future obligation. Even a legal requirement does not require the company to make a provision for the cost of replacement because there is no present obligation. Even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

(ii) As per AS 29, an obligation is a present obligation if, based on the evidence available, its existence





Student Notes:-