

**AS 29****Provisions, Contingent Liabilities & Contingent Assets****Question 1**

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 as required by law in its final accounts. You are required to comment on the validity of the treatment done by the company in line with the provisions of AS 29.

(MTP 5 Marks- Oct'19, Aug'18, Nov'21 & April '23)

Answer 1

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 the airline continues to operate aircrafts for more than five years.

Question 2

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, a 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.

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

(MTP 5 Marks Mar'19, Mar'18) (Same concept lesser adjustments RTP Nov'20)

Answer 2

- (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 recognized. 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.



Question 3

S Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2016-17, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2012 based on the recommendations of the commission. The company makes the provision of Rs. 680 lakhs for pay revision in the financial year 2016-17 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by this employees on each job.

The company discloses through notes to accounts:

“Salaries and benefits include the provision of Rs. 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made”. The accountant feels that the company should also book/recognize the income by Rs. 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on the opinion of the accountant with reference to relevant accounting standards.

(MTP 5 Marks Oct'18)

Answer 3

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 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.

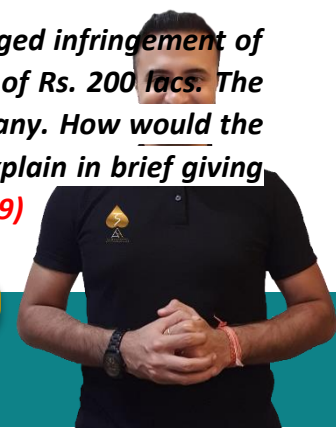
Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. In this case, the provision of salary to employees of Rs. 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of Rs. 680 lakhs are matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of Rs. 680 lakhs are recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of Rs. 680 lakhs are not as per AS-29 and also the concept of prudence will not be followed if Rs. 680 lakhs is simultaneously recognized as income. Rs. 680 lakhs are not the revenue at present but only reimbursement of claim for which an asset is created. However, the accountant is correct to the extent as that non-recognition of Rs. 680 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

Question 4

(i) 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 lacs. 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? Explain in brief giving reasons for your answer.

(RTP Nov 18, May 19)





(ii) What is meant by “Restructuring Provision” as per AS 29? What costs are excluded while computing such provision as per the standard? **(MTP 5 Marks April 21, April 22)**

Answer 4

(i) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when

- an enterprise has a present obligation as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required.

The company will disclose the same as contingent liability by way of the following note:

“Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of Rs. 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company.”

(ii) 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:

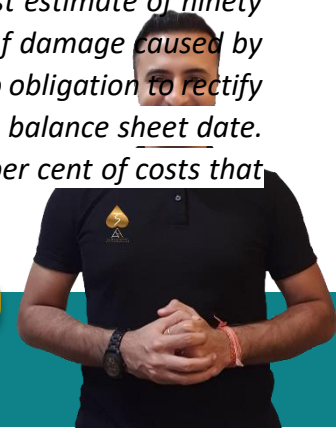
- (a) Retraining or relocating continuing staff;
- (b) Marketing; or
- (c) Investment in new systems and distribution networks.

Question 5

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. With reference to AS 29, how would you deal with this in the annual accounts of the company at the Balance Sheet date? Explain. (MTP 5 Marks March 21, RTP May'20, PYP 2.5 Marks Nov'20, Old & New SM)

Answer 5

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.



Question 6

Saharsh Ltd. is engaged in manufacturing of electric home appliances. The company is in the process of finalizing its accounts for the year ended 31.3.2022 and needs your expert advice on the following issues in line with the provisions of AS 29:

- (i) A case has been filed against the company in the consumer court and a notice for levy of a penalty of Rs. 20 lakhs have 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 finalization of the case. There are 75% chances that the penalty may not be levied.
- (ii) 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. (MTP 5 Marks Oct '21 ,March '23 & Oct '23)

Answer 6

(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 2021-2022.

(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 recognized in the books for 2019-2020		Rs. 3,00,000
	Insurance claim receivable to be recorded in the books		Rs. 27,00,000

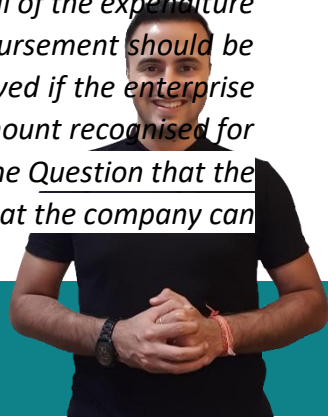
Compensation claim by dealer against company to be provided for in the books = Rs. 30,00,000 x 15% = Rs. 4,50,000.

Question 7

XYZ Ltd. has not made provision for warrantee 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 warrantees 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. (MTP 5 Marks Mar'22 & Sep '22, RTP Nov'19)

Answer 7

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.

Question 8

A Company dealing in software provides after sales warranty for 2 years to its customer. Based on past experience, the company has been following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:

Less than 1 year: 3% provision

More than 1 year: 4% provision

The company has raised invoices as under:

Invoice Date	Amount (₹)
19th January, 2019	1,20,000
29th January, 2020	75,000
15th October, 2020	2,70,000

You are required to calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2020 and 31st March, 2021. Also compute the amount to be debited to Profit and Loss Account for the year ended 31st March, 2021. (MTP 5 Marks Oct'22, PYP 5 Marks Nov '19, RTP May '23)

Answer 8

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

As at 31st March, 2020 = ₹ 1,20,000 x .03 + ₹ 75,000 x .04

= ₹ 3,600 + ₹ 3,000 = ₹ 6,600

As at 31st March, 2021 = ₹ 75,000 x .03 + ₹ 2,70,000 x .04

= ₹ 2,250 + ₹ 10,800 = ₹ 13,050

Amount debited to Profit and Loss Account for year ended 31st March, 2021

	₹
Balance of provision required as on 31.03.2021	13,050
Less: Opening Balance as on 1.4.2020	(6,600)
Amount debited to profit and loss account	6,450

Note:

No provision will be made on 31st March, 2021 in respect of sales amounting ₹ 1,20,000 made on 19th January, 2019 as the warranty period of 2 years has already expired.

Question 9

(a) 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.

(b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. On 31st 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?

(RTP Nov '21)

Answer 9

(a) 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.

(b) As per AS 29 'Provisions, Contingent Liabilities and Contingent Assets', abatement 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 finalized, 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.

Question 10

(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.

(RTP May 21, May 18)





(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.**

(RTP May 21)

Answer 10

(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 recognized. 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 recognized. 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 recognized. No disclosure is required.**

Question 11

How will you distinguish contingent assets with Contingent Liabilities. Explain in brief.

(RTP Nov 20)

Answer 11

(a) A Contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

A present obligation that arises from past events but is not recognized because:

- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
- A reliable estimate of the amount of the obligation cannot be made.

An enterprise should not recognize a contingent liability but should be disclosed. A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise. An example is a claim that an enterprise is pursuing through legal processes, where the outcome is uncertain. An enterprise should not recognize a contingent asset, since



this may result in the recognition of income that may never be realized. However, when the realization of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. A contingent asset is not disclosed in the financial statements. It is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and, the corresponding approving authority in the case of any other enterprise), where an inflow of economic benefits is probable. Contingent assets are assessed continually and if it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.

(b) 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 recognized. Alpha Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Alpha Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Alpha Ltd. should provide for the contingency amounting Rs. 2 crores as per AS 29.

Question 12

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

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 31st Dec. 2019, it goes into liquidation. (Balance Sheet date 31-3-19). (RTP May 20)

Answer 12

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.

Question 13

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. **(RTP May'22)***

Answer 13

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 recognized."*

Accounting treatment under the given scenarios:

- 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 recognized for Rs. 3,00,000 for the amount which may be required to settle the obligation.*
- 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.*
- 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% of Rs. 5,00,00,000 = Rs. 5,00,000. Estimated cost of repair / replacement = Rs. 5,00,000 x 10% = Rs. 50,000.*

Question 14

Chaos Limited is in the process of finalizing its accounts for the year ended 31st March, 2022. It seeks your advice in the following cases:

- (i) Chaos Limited entered into an agreement to supply 1 lac face masks to D Limited by 30th April, 2022 failing which it will have to pay a penalty of ` 10 per item not supplied. On 31st March, 2022 Chaos Limited assessed that it could only supply 50,000 face masks to D Limited by 30th April, 2022.*
- (ii) Chaos Limited has filed a court case in 2014-2015 against its competitors. It is evident to its lawyers that Chaos Limited may lose the case and would have to pay ` 3,00,000 being the cost of litigation. No entries/provisions have been made in the books.*
- (iii) A new regulation has been passed in 2021-22 by the healthcare ministry to upgrade facilities. Deadline set by the government is 31.03.2023. The company estimates an expenditure of ` 10,00,000 for the said upgrade.*

*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. **(RTP Nov'22)***

Answer 14

Principles for recognition of provisions:

As per AS 29, "a provision shall be recognized when:



- a) an entity has a present obligation (legal or constructive) as a result of a past event;
- 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 shall be recognized.”

Accounting treatment under the given scenarios:

In this case, there is no present obligation arising out of a past event as the goods are scheduled for delivery on 30th April, 2022 and there is no delay as at 31st March, 2022. Hence, there is no present obligation to pay the penalty in the current year. Therefore, no provision can be recognized in the instant case.

- (i) On 31st March, 2022, 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 ` 3,00,000, there is a present obligation. Hence, provision should be recognized for ` 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 31st March, 2023. However, on 31st March, 2022, 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, 2022 for upgrading the facilities by 31st March, 2023.

Question 15

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

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.

(PYP 2.5 Marks , Nov 20)

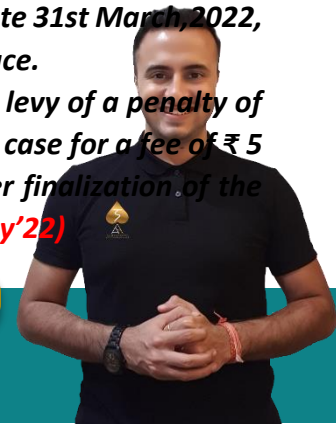
Answer 15

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.

Question 16

Alloy Fabrication Limited is engaged in manufacturing of iron and steel rods. The company is in the process of finalization of the accounts for the year ended 31st 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 ₹ 50 Lakhs has been received. The company has appointed a lawyer to defend the case for a fee of ₹ 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. **(PYP 5 Marks May'22)**



Answer 16

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.

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 70% chances that the penalty may not be levied. Accordingly, Alloy Fabrication Ltd. should not make the provision for penalty. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

However, a provision should be made for remaining 40% fees of the lawyer amounting ₹ 2,00,000 in the financial statements of financial year 2021-2022

Question 17

At the end of the financial year ending on 31st 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 (₹)
In respect of five cases	100%	-
(Win) Next ten cases (Win)	50%	-
Lose (Low damages)	40%	12,00,000
Lose (High damages)	10%	20,00,000
Remaining five cases	50%	-
Win Lose (Low damages)	30%	10,00,000
Lose (High damages)	20%	21,00,000

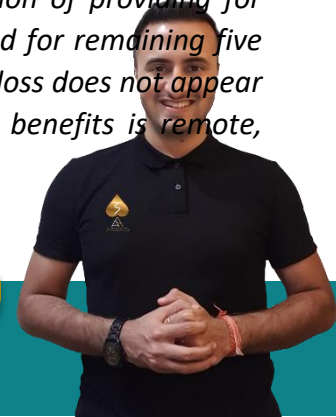
Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof as per AS - 29. **(PYP 5 Marks Nov 22)**

Answer 17

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.

Question 18

(Includes concepts from AS 9- Revenue Recognition)

A Limited sells goods with unlimited right of return to its customers. The following pattern has been observed in the Return of Sales:

Time frame of Return from date of purchase	% of Cumulative Sales
Between 0-1 month	6%
Between 1-2 months	7%
Between 2-3 months	8%

The Company has made Sales of ₹ 36 Lakhs in the month of January, ₹ 48 Lakhs in the month of February and of ₹ 60 Lakhs in the month of March. The Total Sales for the Financial Year have been ₹ 400 Lakhs and the Cost of Sales was ₹ 320 Lakhs. You are required to determine the amount of Provision to be made and Revenue to be recognized as on 31st March.

(PYP 5 Marks, July 21, MTP Sep'23)

Answer 18

Amount of provision

The goods are sold with a right to return. The existence of such right gives rise to a present obligation on the company as per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'. According to the standard, a provision should be created on the Balance sheet date, for sales returns after the Balance Sheet date, at the best estimate of the loss expected, along with any estimated incremental cost that would be necessary to resell the goods expected to be returned.

Sales during	Sales value (₹ in lacs)	Sales value (cumulative) (₹ in lacs)	Likely returns (%)	Likely returns ₹ (in lacs)	Provision @ 20% (₹ in lacs) (Refer W.N.)
March	60	60	6%	3.60	0.720
February	48	108	7%	7.56	1.512
January	36	144	8%	11.52	2.304
Total				22.68	4.536

Revenue to be recognized

Revenue in respect of sale of goods is recognized fully at the time of sale itself assumed that the company has complied with the conditions stated in AS 9 relating to recognition of revenue in the case of sale of goods. As per AS 9, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:



- (i) Seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
- (ii) No significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods. AS 9 also provides that in case of retail sales offering a guarantee of 'money back, if not completely satisfied, it may be appropriate to recognize the sale but to make a suitable provision for returns based on previous experiences.

Therefore, sale of ₹ 36 lakhs, ₹ 48 lakhs and ₹ 60 lakhs made in the months of January, February and March will be recognized at full value. Thus, total revenue to be recognized for RS. 400 lacs for the year.

Working Note:

Calculation of Profit % on sales

	(₹ in lacs)
Sales for the year	400
Less: Cost of sales	(320)
Profit	80
Profit mark up on sales $(80/400) \times 100 = 20\%$	

Question 19

With reference to AS 29, how would you deal with the following in the Annual Accounts of the company at the Balance Sheet date:

- (i) The company operates an offshore oilfield where its licensing agreement requires it to remove the oil rig at the end of production and restore the seabed. Eighty five percent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and fifteen percent arise through the extraction of oil. At the balance sheet date, rig has been constructed but no oil has been extracted.
- (ii) 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.

(RTP Nov '23),(MTP 5 Marks Sep '23)

Answer 19

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 85% 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. 15% of costs that arise through the extraction of oil are recognized as a liability when the oil is extracted.





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.

