Exposure Draft

Accounting Standard (AS) 37

Provisions, Contingent Liabilities and Contingent Assets

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Accounting Standards Board
The Institute of Chartered Accountants of India

Exposure Draft

Accounting Standard (AS) 37
Provisions, Contingent Liabilities and Contingent Assets

The Indian Accounting Standards (Ind AS), as notified by the Ministry of Corporate Affairs in February, 2015, have been applicable to the specified class of companies. Accounting Standards are applicable to entities to whom Ind AS are not applicable. However, the Ministry of Corporate Affairs has requested the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) to upgrade Accounting Standards, as notified under Companies (Accounting Standards) Rules, 2006, to bring them nearer to Indian Accounting Standards. Accordingly, the Accounting Standards Board (ASB) of ICAI has initiated the process of upgradation of these standards which will be applicable to all companies having net-worth less than Rs. 250 crores including non-corporate entities.

In this direction, the ASB has finalised AS 37, *Provisions, Contingent Liabilities and Contingent Assets.* For formulating AS 37, Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*, has been taken as the base. Major differences between draft AS 37 and Ind AS 37 are given in Appendix 1 of the AS 37. Major differences between draft AS 37 and AS 29 are given in Appendix 2 of the AS 37.

Following is the Exposure Draft of the Accounting Standard (AS) 37, *Provisions, Contingent Liabilities and Contingent Assets*, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comments. AS 37 refers to following ASs which are under formulation:

1. *AS 11, Construction Contracts*
2. *AS 12, Income Taxes*
3. *AS 17, Leases*
4. *AS 18, Revenue*
5. *AS 103, Business Combinations*
6. *AS 105, Non-current Assets Held for Sale and Discontinued Operations*

The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

How to Comment:
Comments can be submitted using one of the following methods so as to receive not later than January 28, 2019:

1. *Electronically:* *Visit the link http://www.icai.org/comments/asb/*
2. *Email:* *Comments can be sent at commentsasb@icai.in*
3. *Postal:* *Secretary, Accounting Standards Board,*
   The Institute of Chartered Accountants of India, ICAI Bhawan,
   Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002

Further clarifications on any aspect of this Exposure Draft may be sought by email to asb@icai.in.

(This Accounting Standard includes paragraphs set in **bold** *type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles).*

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount.

Scope

1 **This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:**

(a) those resulting from executory contracts, except where the contract is onerous; and

(b) [Refer Appendix 1]

(c) those covered by another Standard

(d) those arising in insurance entities from contracts with policy-holders.

2 [Refer Appendix 1]

3 [Refer Appendix 1].

4. [Refer Appendix 1]

5 When another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, some types of provisions are addressed in Standards on:

(a) construction contracts (see AS 11, *Construction Contracts);*

(b) income taxes (see AS 12, *Income Taxes*);

(c) leases (see AS 17, *Leases*). However, as AS 17 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases;

(d) employee benefits (see AS 19, *Employee Benefits*);

(e) [Refer Appendix 1]

(f) contingent consideration of an acquirer in a business combination (see AS 103, *Business Combinations*);

(g) [Refer Appendix 1]

(h) Financial instruments that are within the scope of AS 109, *Financial Instruments.*

6 Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This standard does not address the recognition of revenue. AS 18, *Revenue*, identifies the circumstances in which revenue is recognised. This standard does not change the requirements of AS 18.

7 This Standard defines provisions as liabilities of uncertain timing or amount. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

8 Other Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

9 This Standard applies to provisions for restructurings (including discontinued operations). When a restructuring meets the definition of a discontinued operation, additional disclosures may be required by AS 105, *Non-current Assets Held for Sale and Discontinued Operations*.

Definitions

10 The following terms are used in this Standard with the meanings specified:

A *provision* is a liability of uncertain timing or amount.

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

An *obligating event* is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

A *legal obligation* is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

(b) legislation; or

(c) other operation of law.

A *constructive obligation* is an obligation that derives from an entity's actions here:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A *contingent liability* is:

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

(b) a present obligation that arises from past events but is not recognised because:

  (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

  (ii) the amount of the obligation cannot be measured with sufficient reliability.

A *contingent asset* is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

***Executory contracts* are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.**

***An onerous contract* is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.**

A *restructuring* is a programme that is planned and controlled by management, and materially changes either:

(a) the scope of a business undertaken by an entity; or

(b) the manner in which that business is conducted.

Provisions and other liabilities

11 Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

(a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and

(b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.

Relationship between provisions and contingent liabilities

12 In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard the term 'contingent' is used for liabilities and assets that are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. In addition, the term 'contingent liability' is used for liabilities that do not meet the recognition criteria

13 This Standard distinguishes between:

(a) provisions – which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations; and

(b) contingent liabilities – which are not recognised as liabilities because they are either:

(i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits; or

(ii) present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

Recognition

Provisions

14 **A *provision* shall be recognised 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 recognised.

Present obligation

15 **In rare cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period.**

16 In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and

(b) where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).

Past event

17 A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.

18 Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an entity's balance sheet are those that exist at the end of the reporting period.

19 It is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

20 An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed—indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

21 An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an

obligating event when a new law requires the existing damage to be rectified or when the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.

22 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 as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. Differences in circumstances surrounding enactment make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases it will be impossible to be virtually certain of the enactment of a law until it is enacted.

Probable outflow of resources embodying economic benefits

23 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. For the purpose of this Standard[1], an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, ie the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).

24 Where there are a number of similar obligations (eg product warranties or similar contracts) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised (if the other recognition criteria are met).

Reliable estimate of the obligation

25 The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other items in the balance sheet. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision.

26 In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 86).

[1] The interpretation of 'probable' in this Standard as 'more likely than not' does not necessarily apply in other Accounting Standards.

Contingent liabilities

27 An entity shall not recognise a contingent liability.

28 A contingent liability is disclosed, as required by paragraph 86, unless the possibility of an outflow of resources embodying economic benefits is remote.

29 Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.

30 Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

Contingent assets

31 An entity shall not recognise a contingent asset.

32 Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.

33 Contingent assets are not recognised in financial statements since this may result in the recognition of income that may never be realised. However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

34 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 entity), where an inflow of economic benefits is probable.

35 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.

Measurement

Best estimate

36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The amount of provision shall not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognised as cost of Property, Plant and Equipment. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted. Periodic unwinding of discount should be recognised in the statement of profit and loss.

37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

38 The estimates of outcome and financial effect are determined by the judgement of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting period.

39 [Refer Appendix 1]

40 [Refer Appendix 1]

41 The provision is measured before tax, as the tax consequences of the provision, and changes in it, are dealt with under AS 12.

Risks and uncertainties

42 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

43 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of

excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

44 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 85(b).

45-47 [Refer Appendix 1]

Future events

48 Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

49 Expected future events may be particularly important in measuring provisions. For example, an entity may believe that the cost of cleaning up a site at the end of its life will be reduced by future changes in technology. The amount recognised reflects a reasonable expectation of technically qualified, objective observers, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an entity does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.

50 The effect of possible new legislation is taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases sufficient objective evidence will not exist until the new legislation is enacted.

Expected disposal of assets

51 Gains from the expected disposal of assets shall not be taken into account in measuring a provision.

52 Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the

provision. Instead, an entity recognises gains on expected disposals of assets at the time specified by the Standard dealing with the assets concerned.

Reimbursements

53 **Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement shall not exceed the amount of the provision.**

54 **In the statement of profit and loss, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.**

55 Sometimes, an entity is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the entity or pay the amounts directly.

56 In most cases the entity will remain liable for the whole of the amount in question so that the entity would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognised for the full amount of the liability, and a separate asset for the expected reimbursement is recognised when it is virtually certain that reimbursement will be received if the entity settles the liability.

57 In some cases, the entity will not be liable for the costs in question if the third party fails to pay. In such a case the entity has no liability for those costs and they are not included in the provision.

58 As noted in paragraph 29, an obligation for which an entity is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

Changes in provisions

59 **Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision shall be reversed.**

60 [Refer Appendix 1]

Use of provisions

61 **A provision shall be used only for expenditures for which the provision was originally recognised.**

62 Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognised for another purpose would conceal the impact of two different events.

Application of the recognition and measurement rules

Future operating losses

63 **Provisions shall not be recognised for future operating losses.**

64 Future operating losses do not meet the definition of a liability in paragraph 10 and the general recognition criteria set out for provisions in paragraph 14.

65 An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An entity tests these assets for impairment under AS 36, *Impairment of Assets*.

Onerous contracts

66 **If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.**

67 [Refer Appendix 1]

68 This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

69 Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract (see AS 36).

Restructuring

70 The following are examples of events that may fall under the definition of restructuring:

(a) sale or termination of a line of business;

(b) the closure of business locations in a country or region or the relocation of business activities from one country or region to another;

(c) changes in management structure, for example, eliminating a layer of management; and

(d) fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

71 A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 14 are met. Paragraphs 72– 83 set out how the general recognition criteria apply to restructurings.

72 A constructive obligation to restructure arises only when an entity:

(a) has a detailed formal plan for the restructuring identifying at least:

(i) the business or part of a business concerned;

(ii) the principal locations affected;

(iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

(iv) the expenditures that will be undertaken; and

(v) when the plan will be implemented; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

73 Evidence that an entity has started to implement a restructuring plan would be provided, for example, by dismantling plant or selling assets or by the public announcement of the main features of the plan. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (ie setting out the main features of the plan) that it gives rise to valid expectations in other parties such as customers, suppliers and employees (or their representatives) that the entity will carry out the restructuring.

74 For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes

to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the entity is at present committed to restructuring, because the timeframe allows opportunities for the entity to change its plans.

75 management or board decision to restructure taken before the end of the reporting period does not give rise to a constructive obligation at the end of the reporting period unless the entity has, before the end of the reporting period:

(a) started to implement the restructuring plan; or

(b) announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting period, disclosure is required under, AS 10, *Events after the Reporting Period*, if the restructuring is material and non-disclosure could influence the economic decisions that users make on the basis of the financial statements.

76 Although a constructive obligation is not created solely by a management decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale of an operation, may have been concluded subject only to board approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure, if the conditions of paragraph 72 are met.

77 [Refer Appendix 1].

78 **No obligation arises for the sale of an operation until the entity is committed to the sale, ie there is a binding sale agreement.**

79 Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the entity will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When the sale of an operation is envisaged as part of a restructuring, the assets of the operation are reviewed for impairment, under AS 36. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.

80 A restructuring provision shall 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 entity.

81 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.

These expenditures relate to the future conduct of the business and are not liabilities for restructuring at the end of the reporting period. Such expenditures are recognised on the same basis as if they arose independently of a restructuring.

82 Identifiable future operating losses up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph 10.

83 As required by paragraph 51, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

Disclosure

84 For each class of provision, an entity shall disclose:

(a) the carrying amount at the beginning and end of the period;

(b) additional provisions made in the period, including increases to existing provisions;

(c) amounts used (ie incurred and charged against the provision) during the period ;

(d) unused amounts reversed during the period ; and

(e) [Refer Appendix 1]

Comparative information is not required.

Provided that a Small and Medium-sized Companies as defined in the MCA notification and Small and Medium-sized Entity (level II and Level III non-

corporate entities) as per the criteria prescribed by the ICAI, may not comply with paragraph 84 above.

85 An entity shall disclose the following for each class of provision:

(a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

(b) an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48;and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Provided that a Small and Medium-sized Companies as defined in the MCA notification and Small and Medium-sized Entity (level II and Level III non-corporate entities) as per the criteria prescribed by the ICAI, may not comply with paragraph 85 above.

86 Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect, measured under paragraphs 36–52;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement.

87 In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs 85(a) and (b) and 86(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.

88 Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs 84–86 in a way that shows the link between the provision and the contingent liability.

89 [Refer Appendix 1]**.**

90 [Refer Appendix 1].

91 Where any of the information required by paragraphs 86 and 89 is not disclosed because it is not practicable to do so, that fact shall be stated.

92 In extremely rare cases, disclosure of some or all of the information required by paragraphs 84–89 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

Illustration A

Tables - Provisions, Contingent Liabilities and Reimbursements

The purpose of this illustration is to summarise the main requirements of the Accounting Standard. It does not form part of the Accounting Standard and shall be read in the context of the full text of the Accounting Standard.

Provisions, Contingent Liabilities

Where, as a result of past events, there may be an outflow of resources embodying future economic benefits in settlement of: (a) a present obligation the one whose existence at the balance sheet date is considered probable; or (b) a possible obligation the existence of which at the balance sheet date is considered not probable.		
There is a present obligation that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation.	**There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.**	**There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.**
A provision is recognised (paragraph 14). Disclosures are required for the provision (paragraphs 84 and 85).	No provision is recognised (paragraph 27). Disclosures are required for the contingent liability (paragraph 86).	No provision is recognised (paragraph 27). No disclosure is required (paragraph 86).

Reimbursements

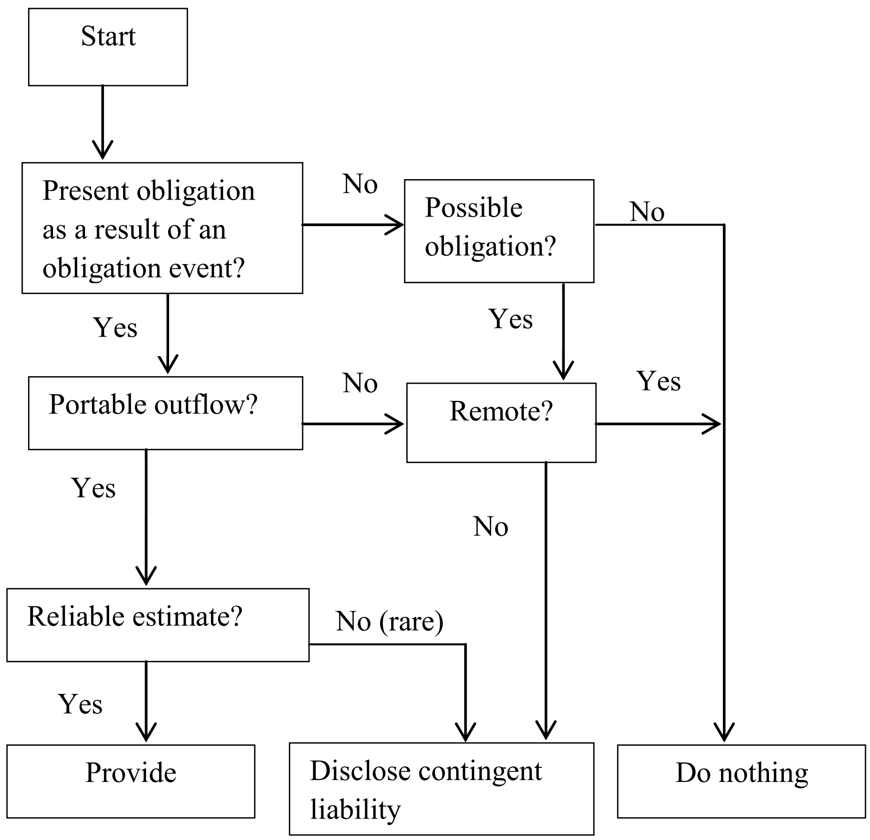
Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.		
The entity has no obligation for the part of the expenditure to be reimbursed by the other party.	**The obligation for the amount expected to be reimbursed remains with the entity and it is virtually certain that reimbursement will be received if the entity**	**The obligation for the amount expected to be reimbursed remains with the entity and the reimbursement is not virtually certain if the**

	settles the provision.	**entity settles the provision.**
The entity has no liability for the amount to be reimbursed (paragraph 57).	The reimbursement is recognised as a separate asset in the balance sheet and may be offset against the expense in the statement of profit and loss. The amount recognised for the expected reimbursement does not exceed the liability (paragraphs 53 and 54).	The expected reimbursement is not recognised as an asset (paragraph 53).
No disclosure is required.	The reimbursement is disclosed together with the amount recognised for the reimbursement (paragraph 85(c)).	The expected reimbursement is disclosed (paragraph 85(c)).

Illustration B

Decision Tree

The purpose of the decision tree is to summarise the main recognition requirements of the Accounting Standard for provisions and contingent liabilities. The decision tree does not form part of the Accounting Standard and shall be read in the context of the full text of the Accounting Standard.



Note: in rare cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period (paragraphs 15-16 of the Standard).

Illustration C

Illustrations: Recognition

This illustration illustrates the application of the Accounting Standard to assist in clarifying its meaning. It does not form part of the Accounting Standard.

All the entities in the Illustration have 31 March year ends. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some Illustrations the circumstances described may have resulted in impairment of the assets - this aspect is not dealt with in the Illustrations.

The cross references provided in the Illustrations indicate paragraphs of the Accounting Standard that are particularly relevant. The illustration shall be read in the context of the full text of the Accounting Standard.

Illustration 1: Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product with a warranty, which gives rise to an obligation.

An outflow of resources embodying economic benefits in settlement - Probable for the warranties as a whole (see paragraph 24).

Conclusion - A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date (see paragraphs 14 and 24).

Illustration 2: Contaminated Land - Legislation Virtually Certain to be Enacted

An entity in the oil industry causes contamination but does not clean up because there is no legislation requiring cleaning up, and the entity has been contaminating land for several years. At 31 March 2018, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

Present obligation as a result of a past obligating event - The obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.

An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the costs of the clean-up (see paragraphs 14 and 22).

Illustration 3: Offshore Oilfield

An entity 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 per cent of the eventual costs relate to the removal of the oil rig and restoration of damage caused by building it, and ten per cent arise through the extraction of oil. At the balance sheet date, the rig has been constructed but no oil has been extracted.

Present obligation as a result of a past obligating event - The construction of the oil rig creates an obligation under the terms of the licence 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 - Probable.

Conclusion - A provision is recognised 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 (see paragraph 14). These costs are included as part of the cost of the oil rig. The ten per cent of costs that arise through the extraction of oil are recognised as a liability when the oil is extracted.

Illustration 4: Refunds Policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event - The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

An outflow of resources embodying economic benefits in settlement - Probable, a proportion of goods are returned for refund (see paragraph 24).

Conclusion - A provision is recognised for the best estimate of the costs of refunds (see paragraphs 14 and 24).

Illustration 5: Legal Requirement to Fit Smoke Filters

Under new legislation, an entity is required to fit smoke filters to its factories by 30 September, 2017. The enterprise has not fitted the smoke filters.

(a) At the balance sheet date of 31 March 2017

Present obligation as a result of a past obligating event - There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion - No provision is recognised for the cost of fitting the smoke filters (see paragraphs 14 and 17-19).

(b) At the balance sheet date of 31 March 2018

Present obligation as a result of a past obligating event - There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement - Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion - No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 14 and 17-19).

Illustration 6: Staff Retraining as a Result of Changes in the Income Tax System

The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the balance sheet date, no retraining of staff has taken place.

Present obligation as a result of a past obligating event - There is no obligation because no obligating event (retraining) has taken place.

Conclusion - No provision is recognised (see paragraphs 14 and 17-19).

Illustration 7: A Single Guarantee

During 2016-17, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 2017-18, the financial condition of Entity B deteriorates and at 30 September 2017 Entity B goes into liquidation.

(a) At 31 March 2017

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to an obligation.

An outflow of resources embodying economic benefits in settlement - No outflow of benefits is probable at 31 March 2017.

Conclusion - No provision is recognised (see paragraphs 14 and 23). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraph 86).

(b) At 31 March 2018

Present obligation as a result of a past obligating event - The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - At 31 March 2018, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Conclusion - A provision is recognised for the best estimate of the obligation (see paragraphs 14 and 23).

Note: This example deals with a single guarantee. If an entity has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefit is probable (see paragraph 24). Where an entity gives guarantees in exchange for a fee, revenue is recognised under AS 18, *Revenue*.

Illustration 8: A Court Case

After a wedding in 2016-17, ten people died, possibly as a result of food poisoning from products sold by the entity. Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of approval of the financial statements for the year 31 March 2017, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year 31 March 2018, its lawyers advise that, owing to developments in the case, it is probable that the enterprise will be found liable.

(a) At 31 March 2017

Present obligation as a result of a past obligating event - On the basis of the evidence available when the financial statements were approved, there is no present obligation as a result of past events.

Conclusion - No provision is recognised (see paragraph 15 and 16). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraph 86).

(b) At 31 March 2006

Present obligation as a result of a past obligating event - On the basis of the evidence available, there is a present obligation. An outflow of resources embodying economic benefits in settlement - Probable.

Conclusion - A provision is recognised for the best estimate of the amount to settle the obligation (paragraphs 14-16).

Illustration 9A: Refurbishment Costs - No Legislative Requirement

A furnace has a lining that needs to be replaced every five years for technical reasons. At the balance sheet date, the lining has been in use for three years.

Present obligation as a result of a past obligating event - There is no present obligation.

Conclusion - No provision is recognised (see paragraphs 14 and 17-19).

The cost of replacing the lining is not recognised because, at the balance sheet date, no obligation to replace the lining exists independently of the company's future actions - even the intention to incur the expenditure depends on the company deciding to continue operating the furnace or to replace the lining.

Illustration 9B: Refurbishment Costs - Legislative Requirement

An airline is required by law to overhaul its aircraft once every three years.

Present obligation as a result of a past obligating event - There is no present obligation.

Conclusion - No provision is recognised (see paragraphs 14 and 17-19). The costs of overhauling aircraft are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in illustration 9A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity's future actions - the entity could avoid the future expenditure by its future actions, for example by selling the aircraft.

Illustration 10: An Onerous Contract

An entity operates profitably from a factory that it has leased under an operating lease. During December 2017 the entity relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user.

Present obligation as a result of a past obligating event - The obligating event occurs when the lease contract becomes binding on the entity, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - When the lease becomes onerous, an outflow of resources embodying economic benefits is probable, (Until the lease becomes onerous, the entity accounts for the lease under AS 17, *Leases*).

Conclusion - A provision is recognised for the best estimate of the unavoidable lease payments.

Illustration D

Illustrations: Disclosure

This illustration does not form part of the Accounting Standard. Its purpose is to illustrate the application of the Accounting Standard to assist in clarifying its meaning.

An illustration of the disclosures required by paragraph 85 is provided below.

Illustration 1 Warranties

A manufacturer gives warranties at the time of sale to purchasers of its three product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the balance sheet date, a provision of Rs. 60,000 has been recognised. The following information is disclosed:

A provision of Rs. 60,000 has been recognised for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years of the balance sheet date.

An illustration is given below of the disclosures required by paragraph 92 where some of the information required is not given because it can be expected to prejudice seriously the position of the entity.

Illustration 2 Disclosure Exemption

An entity is involved in a dispute with a competitor, who is alleging that the entity has infringed patents and is seeking damages of Rs. 1000 lakh. The entity recognises a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 84 and 85 of the Standard. The following information is disclosed:

Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of Rs. 1000 lakh. The information usually required by AS 37, Provisions, Contingent Liabilities and Contingent Assets is not disclosed on the grounds that it can be expected to prejudice the interests of the company. The directors are of the opinion that the claim can be successfully resisted by the company

Appendix 1

Note: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard (AS) 37 and the corresponding Indian Accounting Standard (Ind AS) 37, Provisions, Contingent Liabilities and Contingent Assets.

Comparison with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*

1 Paragraph 2 of Ind AS 37 has been shifted to 5(h) in AS 37 since it relates to exclusion of financial instruments from the scope of this standard and covered by AS 109.

2 Paragraph 3 of Ind AS 37 defining executory contracts has been shifted under Definitions in AS 37.

3 Since it was decided to formulate upgraded standards on construction contracts and revenue corresponding to Ind AS 11, *Construction Contracts,* and Ind AS 18, *Revenue,* respectively and not to formulate standard corresponding to Ind AS 115, *Revenue from Contracts with Customers,* paragraph 5(a) and paragraph 6 of Ind AS 37 are modified and paragraph 5(g) of Ind AS 37 is deleted.

4 Accounting Standard corresponding to Ind AS 104, *Insurance Contracts*, will not be formulated. In order to clarify the position in this regard, provisions, contingent liability and contingent asset of those arising in insurance entity from contracts with policyholders have been specifically excluded from the scope of AS 37. Consequently, paragraph 5(e) of Ind AS 37 has been deleted and appropriately added in paragraph 1(d) in AS 37.

5 Ind AS 37 requires disclosure of contingent assets in the financial statements when the inflow of economic benefits is probable. While AS 37 does not require so and prescribes that usually contingent assets are disclosed in the report of approving authority instead of disclosure in the financial statements. Consequently, paragraphs 34-35 of Ind AS 37 have been modified and paragraphs 89-90 of Ind AS 37 have been deleted.

6 Ind AS 37 requires that where the effect of the time value of money is material the amounts of provisions should be the present value of the expenditures expected to be required to settle the obligation. AS 37 prohibits discounting the amounts of provisions, however, it requires discounting in case of decommissioning, restoration and similar liabilities that are recognised as cost of Property, Plant and Equipment. Accordingly, paragraph 36 of Ind AS 37 has been modified and following paragraphs of Ind AS 37 have been deleted:

(i) paragraphs 45-47 and their related heading,
(ii) paragraph 60 and
(iii) paragraph 84(e).

7 Paragraph 39 and following example and paragraph 40 of Ind AS 37 providing explanation on measurement of provision where there is a large population of items and where there is individual most likely outcome has been deleted for simplification.

8 Paragraph 67 and paragraph 77 of Ind AS 37 have been deleted for simplification of standard since it was felt that these paragraphs are only clarificatory in nature.

9 Exemptions have been provided to the Small and Medium-sized Companies as defined in the MCA Notification and Small and Medium-sized entity (level II and Level III non-corporate entities), as per the criteria prescribed by the ICAI, from providing the disclosures regarding provisions prescribed under paragraphs 84 and 85.

10 Appendix A, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds,* and Appendix B, *Liabilities arising from Participating in a Specific Market— Waste Electrical and Electronic Equipment,* of Ind AS 37 have not included since it was felt that Appendix A is not relevant for entities to whom Ind AS are not applicable. Appendix B has been deleted since it is specific to European Union's Directive on Waste Electrical & Electronic Equipment (WE&EE) and is practically not applicable in India. Appendix C, *Levies,* has not been included since it was felt that it is not relevant for the entities to whom Ind AS are not applicable.

11 Illustration A, *Tables – Provisions, Contingent Liabilities and Reimbursements,* Illustration B, *Decision Tree,* and Illustration C, *Illustrations: Recognition,* and Illustration D, *Illustrations: Disclosures,* of AS 29, *Provisions, Contingent Liabilities and Contingent Assets*, have been included for providing guidance.

12 The following paragraph numbers appear as 'Deleted' in Ind AS 37. In order to maintain consistency with paragraph numbers of Ind AS 37, the paragraph numbers are retained in AS 37 :

(i) paragraph 1(b)
(ii) paragraph 4

Appendix 2

Note: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard (AS) 37 and the Accounting Standard (AS) 29, Provisions, Contingent Liabilities and Contingent Assets.

Comparison with AS 29, *Provisions, Contingent Liabilities and Contingent Assets*

1. Unlike AS 29, AS 37 requires creation of provisions in respect of constructive obligations also [However, AS 29 requires creation of provisions arising out of normal business practices, custom and a desire to maintain good business relations or to act in an equitable manner]. This has resulted in some consequential changes also. For example, definitions of provision and obligating event have been revised in AS 37, while the terms 'legal obligation' and 'constructive obligation' have been inserted and defined in AS 37. Similarly, the portion of AS 29 pertaining to restructuring provisions has been revised in AS 37.

2. AS 37 makes it clear that before a separate provision for an onerous contract is established, an entity should recognise any impairment loss that has occurred on assets dedicated to that contract in accordance with AS 36. There is no such specific provision in AS 29.

3. AS 29 states that identifiable future operating losses up to the date of restructuring are not included in a provision. AS 37 gives an exception to this principle viz. such losses related to an onerous contract.