ICDS X – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

SCOPE OF ICDS X

This Income Computation and Disclosure Standard deals with provisions, contingent liabilities and contingent assets, except those:

- Resulting from financial instruments;
- Resulting from executory contracts;
- Arising in insurance business from contracts with policyholders; and
- Covered by another Income Computation and Disclosure Standard

- ICDS X does not deal with recognition of revenue which is dealt with by ICDS IV on revenue recognition
- The term used in context of items such as depreciation, impairment of assets and doubtful debts are adjustments to carrying amount of assets; these are also not covered by this ICDS

SOME IMPORTANT TERMS USED IN THE STANDARD

- "**Provision**" is a liability which can be measured only by using a substantial degree of estimation.
- "**Liability**" is a present obligation of the person arising from past events, the settlement of which is expected to result in an outflow from the person of resources embodying economic benefits.
- "**Obligating event**" is an event that creates an obligation that results in a person having no realistic alternative to settling that obligation.

SOME IMPORTANT TERMS USED IN THE STANDARD

- "**Contingent liability**" is:
  - (i) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person; or
  - (ii) a present obligation that arises from past events but is not recognised because:
    - (A) it is not reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation; or
    - (B) a reliable estimate of the amount of the obligation cannot be made.

SOME IMPORTANT TERMS USED IN THE STANDARD

- “**Contingent asset**” is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the person.
- “**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.
- “**Present obligation**” is an obligation if, based on the evidence available, its existence at the end of the previous year is considered reasonably certain.
- **“Onerous Contracts”** s a contract in which the aggregate cost required to fulfill the agreement is higher than the economic benefit to be obtained from it.

RECOGNITION OF PROVISIONS

- A provision should be recognised when –a person has a '**present obligation'** as a result of a past event; –it is **'reasonably certain**' that an outflow of resources embodying economic benefits will be required to settle the obligation; and –a **reliable estimate** can be made of the obligation amount
- Provision should not be recognised for costs that need to be incurred to operate in the future
- Provisions are recognised only for those obligations arising from past events that exist independently of the assessee's future actions
- Where the details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is enacted.

MEASUREMENT OF PROVISIONS, IMPACT OF REIMBURSEMENT AND USE OF PROVISIONS

- **Measurement of provisions**
  - The **best estimate** of the expenditure required to settle the present obligation at the end of the previous year will be recognised as provision
  - The amount of provision shall not be discounted to its present value –
- **Impact of reimbursements**
  - Reimbursement shall be recognised when it is **reasonably certain** that reimbursement will be received if the person settles the obligation; the amount recognised as reimbursement shall not exceed the amount of provision

MEASUREMENT OF PROVISIONS, IMPACT OF REIMBURSEMENT AND USE OF PROVISIONS

- Where a person is not liable for payment of Costs in case the Third Party Fails to Pay, No Provisions Shall be made for those Costs.
- An Obligation, for which a person is jointly and severally liable, is a contingent liability to the extent it is expected that the obligation will be settled by other parties.

CONTINGENT LIABILITIES AND CONTINGENT ASSETS

- **Contingent Liabilities**
  - Contingent liabilities should not be recognised
- **Contingent Assets**
  - Contingent assets should not be recognised –
  - Contingent asset must be assessed continually and if it becomes ‘reasonably certain’ that inflow of economic benefit will arise, the asset and the income are recognised in previous year in which the change occurs.

REVIEW AND TRANSITIONAL PROVISIONS

- **Provisions** shall be **reviewed** at the end of each Previous Year and adjsuted to reflect the current year best estimate. f it is no Longer reasonably certain that an outflow of resources embodying economic benefits will be required to settle the obligation the provision shall be **reversed.**
- **An Asset and related income** shall be **reviewed** at the end of each previous year and adjusted to reflect the current best estimate. If it is no longer reasonably certain that an outflow of economic benefits will arise, the asset and related income shall be **reversed.**
- All the provisions or assets and related income shall be recognised for FY 2016- 17 and future years in accordance with the provisions of this standard after taking into account the amount recognised, if any, for the same for FY 2015-16 and earlier

DISCLOSURE I

- Following disclosure shall be made in respect of each class of provision, namely:-
  - A **brief description** of the nature of the obligation; –
  - The **carrying amount** at the beginning and end of the previous year;
  - **Additional provisions** made during the previous year, including increases to existing provisions;
  - **Amounts used**, that is incurred and charged against the provision, during the previous year;
  - **Unused amounts** reversed during the previous year; and
  - The amount of any **expected reimbursement**, stating the amount of any asset that has been recognised for that expected reimbursement.

SAMPLE DISCLOSURE I FORMAT IN FORM 3CD

Particulars (with description)	Amount
Opening Balance of provisions	XXX
Add: Provision Made during the year	XXX
Less: Amount charges against provision	(XXX)
Less : Amount reversed during previous years	(XXX)
Closing balance	XXX

DISCLOSURE II

- Following disclosure shall be made in respect of each class of contingent asset and related income recognised, namely:-
  - A **brief description** of the nature of the asset and related income;
  - The **carrying amount** of asset at the beginning and end of the previous year;
  - **Additional amount** of asset and related income recognised during the year, including increases to assets and related income already recognised; and
  - Amount of **asset and related income reversed** during the previous year

SAMPLE DISCLOSURE II FORMAT IN FORM 3CD

Particulars (with description)	Amount
Opening Balance of provisions	XXX
Add: Amount added during the year	XXX
Less: Income received against asset	(XXX)
Less : Amount reversed during previous years	(XXX)
Closing balance	XXX

COMPARISON

Particulars	AS 29	ICDS X
Applicability	Applies for the purpose of **preparation of financial statements**	Applies for **computation of income** under the heads 'profits and gains of business or profession' and 'capital gains'
Recognition of Provisions	Provision to be recognised when outflow of resources is **probable**	Provision to be recognised when outflow of resources is **reasonably certain**
Onerous executory contracts	Not excluded from purview of AS 29	Excluded from purview of ICDS X

COMPARISON

Particulars	AS 29	ICDS X
Recognition of contingent assets	When it becomes **virtually certain** that inflow of economic benefit will arise, asset and related income are recognised in the financial year in which the change occurs	When it becomes **reasonably certain** that inflow of economic benefit will arise, asset and related income are recognised in the financial year in which the change occurs
Recognition of reimbursement in respect of a provision	When it is **virtually certain** that reimbursement will be received if the obligation is settled, reimbursement should be recognised	When it is **reasonably certain** that reimbursement will be received if the obligation is settled, reimbursement should be recognised

IMPACT

- The criteria of recognition of provisions on the basis of the test of 'probable' (i.e. more likely than not criteria) replaced with the requirement of **'reasonable certain'**
- In the absence of definition and scope of 'reasonable certain' criteria, an **ambiguity** would arise on assessment of 'reasonable certain' criteria.
- **Virtual certainty-** is not a matter of perception and it should be supported by convincing evidence. Evidence is a matter of fact. To be convincing, the evidence should be available at the reporting date in a concrete form, for example, a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party

IMPACT

- **ICDS doesn't provide any specific guidance** on meaning of '**Obligation'** whereas as per AS Obligations may be legally enforceable and may also arise from normal business practise, customs and desire to maintain good business relations or act in equitable manner.
- Provisions made on Obligations recognised out of Customary Business Practises or Voluntary Obligations **may not be allowed**

  Eg: Informal Refund Policy to dissatisfied Customers.
- Revenue authorities may contend that 'reasonably certain' is a **lower threshold** than 'virtually certain'

THANK YOU

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