



IND AS 37 - Provisions, Contingent Liabilities & Assets  
THEORY DOMINATED LTD

## Liability

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

A liability basically means the company is already committed to pay or sacrifice resources (usually cash) because of something that has already happened in the past.

## Key Logic of Liability

### Past Event Requirement

You cannot have a liability for something that will happen in the future unless a past event has already created an unavoidable responsibility.

### Outflow of Resources

"Outflow of resources" means the company will have to give up economic benefits — cash, goods, or services.

This present obligation can arise from two types of obligations: legal obligation and constructive obligation.

## Legal Obligation

This present obligation can be **due to legal obligation that derives from a contract/legislation** (E.g. Penalty for breach of contract).

A legal obligation exists because law forces you to settle it.

**Example logic:** If you break a contract, the penalty is compulsory — you cannot escape it. Therefore, a present obligation exists.



## Constructive Obligation

This present obligation can be **due to constructive obligation that derives from past practice, policy, specific statement or commitment of the entity.** (E.g. Promise to clean river due to pollution).

A constructive obligation exists even when the law does not force payment, but your own actions or commitments create a valid expectation in others.

### Logic:

- If the company has a history of cleaning pollution it caused, or has publicly promised to do so, the public expects it to act.
- This expectation makes the company obligated in substance.

## Provision: Definition Eg ①

A provision is a liability of **uncertain** amount or timing. It is to be recognised when:

01

### A present obligation arising from past events

Meaning: You already owe something today because a past event created the obligation. Without this, no provision can ever be booked.

02

### An outflow of resources is probable

"Probable" means more than 50% likelihood of paying. Logic: If the chance is less than 50%, it becomes a contingent liability, not a provision.

03

### A reliable estimate can be made

Even if exact figure is not known, you must be able to estimate reasonably. Otherwise, it cannot be recognised.

## Treatment of Provisions

### Recognition in Financial Statements

▮ Provision shall be recognised as a liability in financial statements.

Meaning: It appears like any other liability because it represents an expected future outflow.

### Best Estimate

▮ The provision amount should reflect the **Best Estimate** of the expenditure required to settle the obligation.

This is the amount the entity expects will need to be paid. The standard focuses on **realistic expectations, not optimistic or pessimistic ones.**

↓  
Most likely



## Calculating Provision Amount Eg ②

### Large Population

If there are many possible outcomes (E.g. Customer refunds, warranties, pending law suits, etc.): Calculate expected value by using probability of each item.

**Logic:**

- When dealing with a large number of similar cases, the company should use statistical probability.
- Expected value = Sum of (Probability × Amount).

### Individual Item

If there is only 1 possible outcome (Individual Item): Consider most likely outcome (amount directly to be considered).

**Logic:**

- For a single event, like a single lawsuit, you don't take probability-weighted average.
- You consider the amount that is most likely to occur.

☐ "1 year = 365 possibilities"

This phrase helps students remember that probability-based expected value calculations consider multiple outcomes.

## Discounting Long-Term Provisions

▮ If expenditure is to be incurred after 1 year, then provision should be recognised at **Present Value** by discounting the expenditure using **Pre Tax Discounting Rate** and by charging **Interest Expense (Finance Cost)** on such provisions to unwind the discount over the period in P&L at discounting rate.

**Logic:**

- Money today is more valuable than money in the future.
- If settlement is in future, you record liability at present value.
- Over time, you "unwind" the discount by charging finance cost.

That is why discounting is required only for long-term provisions.

Eg ①

Pk 11A  $\xrightarrow[\text{Vacuum Cleaner}]{\text{Sold}}$  SK

SK  $\rightarrow$  Product damaged

↓  
Case filed on PK  
Claiming Compensation of 100000

Pk 11A books

- ① Present obligation due to Past event
  - ② Probable  $\checkmark >50\%$
  - ③ Reliable estimate  $\checkmark 100000$
- } Create Provision



## Journal Entries for Provisions

| 1  | 2  |         |                  |     |  |                      |         |                |  |                  |     |
|--|--|---------|------------------|-----|--|----------------------|---------|----------------|--|------------------|-----|
| <b>Recognition of Provision</b>  | <b>Unwinding Discount</b>  |         |                  |     |  |                      |         |                |  |                  |     |
| <table border="0"> <tr> <td>P&amp;L A/c</td> <td style="text-align: right;">Dr. xxx</td> </tr> <tr> <td style="padding-left: 20px;">To Provision A/c</td> <td style="text-align: right;">xxx</td> </tr> </table> | P&L A/c  | Dr. xxx | To Provision A/c | xxx | <table border="0"> <tr> <td>Interest Expense A/c</td> <td style="text-align: right;">Dr. xxx</td> </tr> <tr> <td style="padding-left: 20px;">(Finance Cost)</td> <td></td> </tr> <tr> <td style="padding-left: 40px;">To Provision A/c</td> <td style="text-align: right;">xxx</td> </tr> </table> | Interest Expense A/c | Dr. xxx | (Finance Cost) |  | To Provision A/c | xxx |
| P&L A/c  | Dr. xxx  |         |                  |     |  |                      |         |                |  |                  |     |
| To Provision A/c   | xxx  |         |                  |     |  |                      |         |                |  |                  |     |
| Interest Expense A/c   | Dr. xxx  |         |                  |     |  |                      |         |                |  |                  |     |
| (Finance Cost)   |  |         |                  |     |  |                      |         |                |  |                  |     |
| To Provision A/c   | xxx  |         |                  |     |  |                      |         |                |  |                  |     |
| <p>This entry records the recognition of a provision. Expense is charged to profit &amp; loss because it relates to past events.</p>   | <p>This entry is used in later years to unwind discount. It increases the provision back to its full settlement value.</p> |         |                  |     |  |                      |         |                |  |                  |     |

## When NOT to Recognise Provisions

Only those provisions are recognised for which entity has no realistic alternative rather than settling it. If entity can avoid such expenditure by its future actions, then no provision is recognised.

E.g.- Future operating cost like overhauling or inspection of ships/aircrafts, Future operating Losses etc.

*(By selling (returning) the aircraft)*

### Explanation:

A provision requires an obligation that the entity cannot escape. If the company is free to avoid the cost through future decisions, then there is no present obligation.

Examples such as inspections, overhauling, or future operating losses relate to future operations, not past events. Hence, these cannot be provisions.

**Logic:** A present obligation must be created by a past event, not by future business decisions.

|             |  |   |
|-------------|--|---|
| <u>Eg 2</u> | <p>Sale with warranty</p> <p>Annual sales = 5000 units</p> <p>10% prob ⇒ 400 units warranty claim</p> <p>40% prob ⇒ 600                   "</p> <p>50% prob ⇒ 2000                   "</p> <p>0% prob ⇒ 2500                   "</p> | <p>Repair Cost 100/unit</p> <p>10% x 400<br/>+<br/>40% x 600<br/>+<br/>50% x 2000<br/>+<br/>0% x 2500</p> <hr/> <p>1280 units</p> |
|-------------|--|---|



## Provisions and Proposed Legislation

Where details of a proposed new law are yet to be finalized, obligation would arise only when the law is **virtually certain** to be enacted.

### Explanation:

A company does not create a liability merely because a draft law exists.

The obligation arises only when:

- The law is almost certain to come into force, and
- The company cannot avoid complying.

**Logic:** Until the law becomes virtually certain, the obligation is still avoidable and therefore does not meet the definition of a present obligation.

## Future Events and Provisions

CA PRASANNA KUMAR  
(PK SIR)

**Future Events that may affect the amount of provision, should be considered only when there is sufficient evidence available that they will occur.**

E.g. Cost of cleaning of site may be reduced by future changes in technology.

**If evidence of such change is available**

**Reduce the Provision**

**If no evidence is available**

**No change in Provision**

**Explanation:** Future events are considered only if there is reliable evidence that they will happen. If new technology is already developed and proven, the cost to clean a site may reduce — so the provision should reflect that. But if the technology is merely hypothetical, not yet proven, the provision must remain unchanged. Ind AS 37 requires prudence and avoids optimistic assumptions without evidence.



# Risks, Uncertainties, and Review of Provisions

## Accounting for Risks & Uncertainties

▮ All risks & uncertainties that would result in increase in the amount of provision, should be taken into account while measuring a provision.

**Explanation:** Provisions should reflect realistic worst-case considerations, not just base estimates. If there is uncertain risk that could make the cost higher, that uncertainty must be included in the best estimate.

**Logic:** A provision is not a budget — it must represent the full expected obligation after considering risk.

## Review at Each Balance Sheet Date

▮ Provision should be reviewed at each Balance sheet date & adjusted to reflect the current best estimate. If it is no longer required, then it should be reversed.

**Explanation:** Provisions must not remain static. Conditions may change each year.

- If the cost increases → provision increases
- If the obligation reduces or disappears → provision is reversed

**Logic:** Provisions must always reflect the latest, updated best estimate at reporting date.

## Contingent Liability: Definition Eq ②

A Contingent Liability is a

### Type 1

**Possible obligation** arising from past events that will be confirmed only on occurrence or non-occurrence of uncertain future events

### Type 2

**Present obligation** arising from past events where:

- outflow of resources is not probable [Less than 50%] or
- amount cannot be reliably estimated.

### Explanation:

There are two types of contingent liabilities:

1. **Possible obligations** — outcome depends entirely on uncertain future events (e.g., customer lawsuit).
2. **Present obligations** but not recognised because: Payment is not likely (>50%), or Amount cannot be measured reliably.

**Logic:** Financial statements should be conservative — if an obligation is uncertain or unlikely, it should not be recognised but only disclosed.





## Contingent Assets: Definition

A Contingent Asset is a possible asset that arises from past events whose existence will be confirmed only on the occurrence or non-occurrence of uncertain future events not within the control of the entity.

### Explanation:

These are potential gains (e.g., winning a court case) that depend on future events.

**Logic:** Accounting does not recognise uncertain gains because it would lead to early profit recognition.

Only when inflow becomes virtually certain (>95%) can it be recognised as an asset.

## Treatment of Contingent Assets

1

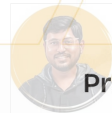
### Virtually Certain

**More than 95%**

Not a contingent Asset. It becomes an asset. So recognise the asset.

**Explanation:** When the chance of receiving the asset is more than 95%, the uncertainty is effectively removed. The inflow is no longer "possible", it is "almost guaranteed". Hence, the item no longer meets the definition of a contingent asset — it satisfies the definition of a real asset. Recognition is mandatory.

2



### Probable

**50% - 95%**

Not to be recognised but Disclosed in Notes to financial statements.

**Explanation:** Here, the event is more likely than not, but still not virtually certain. To prevent premature recognition of gains, Ind AS 37 requires: No recognition in financial statements, Only disclosure in the notes. **Logic:** Prudence — avoid recognising income before it is almost guaranteed.

3

### Not Probable

**Less than 50%**

Neither recognised nor disclosed.

**Explanation:** If likelihood is below 50%, the potential gain is too uncertain to even disclose. **Logic:** Users of financial statements should not be misled by unlikely gains.



## Tabular Presentation: Liabilities vs Assets

| Likelihood of outcome                | Contingent liability | Contingent asset          |
|--------------------------------------|----------------------|---------------------------|
| Virtually certain (> 95%)            | Recognize provision  | Recognize asset           |
| Probable (50% - 95%)                 | Recognize provision  | Disclose contingent asset |
| Possible but not probable (5% - 50%) | Disclose contingency | No disclosure             |
| Remote (< 5%)                        | No disclosure        | No disclosure             |

### Explanation:

This table compares how liabilities and assets are treated under different probability levels.

- Liabilities are recognised earlier (at "probable"), because losses must be anticipated.
- Assets are recognised only at "virtually certain", because gains must not be overstated.

This is the essence of the **prudence concept**.

## Onerous Contract: Definition & Treatment

### Definition

Eg ① & ②

It is a contract in which unavoidable costs of meeting the obligation exceeds economic benefits to be received under it.

**Explanation:** An onerous contract forces the entity into a loss situation.

- "Unavoidable costs" = minimum expenditure needed to either fulfil the contract or pay penalty.
- If these costs exceed the expected benefit, a present obligation to take a loss arises.

### Treatment

Provision is to be recognised in case of Onerous contract at **Lower of:**

#### Costs of fulfilling it

#### Penalty for Non-Performance

(i.e. failure to fulfil it)

**Explanation:** Logic for taking the lower of the two: It represents the minimum unavoidable economic sacrifice. The entity must recognise this loss immediately, even if the contract is not yet completed.



## Onerous Contract: Cost Components

### Note:

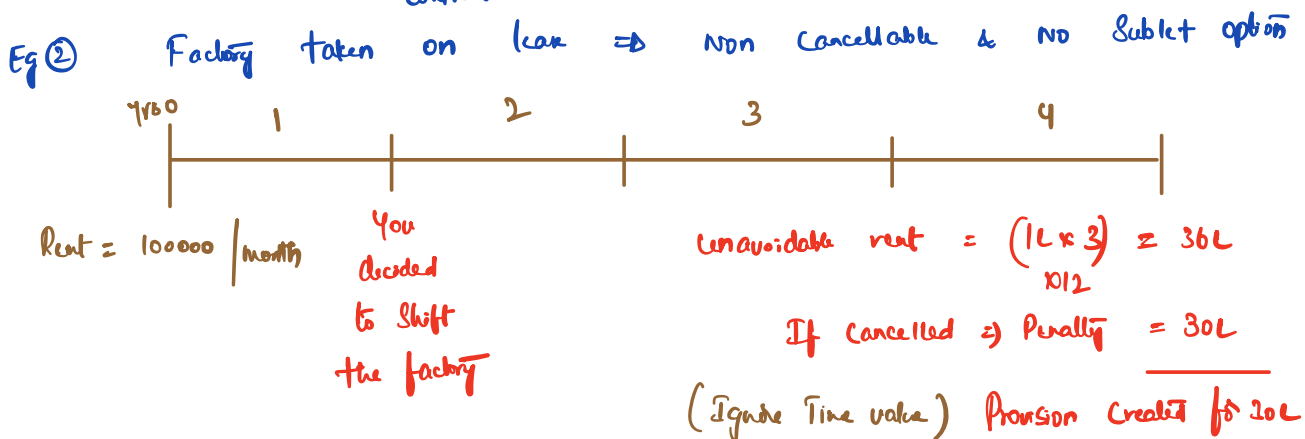
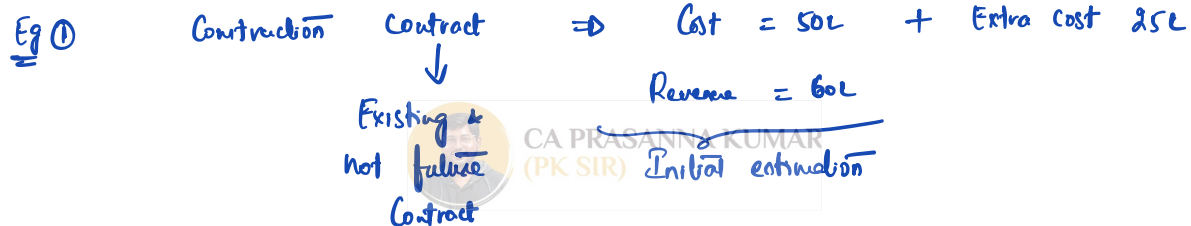
Both the incremental costs to fulfil a contract and allocation of directly attributable costs will form part of the cost used for determination of onerous contract.

### Explanation:

Cost includes:

- Incremental costs (direct labour, direct materials)
- Directly attributable overhead allocation for that specific contract

This prevents under-calculating the unavoidable cost.



## Reimbursements: Definition Eg ① & ②

### Definition

If some or all of the expenditure required to settle a provision is expected to be reimbursed by other party.

### Explanation:

A reimbursement is a recovery from another party (e.g., insurance company, supplier, indemnity contract) that compensates for the provision expense.



## Treatment of Reimbursements

### If virtually certain (More than 95%)

- Reimbursements shall be recognised as a separate asset in Balance Sheet
- Provision Expense & Reimbursement Income can be Netted off & presented in P&L
- Reimbursement shall not exceed Provision Amount.

#### Explanation:

- The asset is recorded separately — not netted in the balance sheet.
- But in P&L, netting is allowed for clarity.
- The reimbursement cannot exceed the provision — Ind AS does not allow recognising profit from reimbursements.

### If not virtually certain

It should be disclosed in the notes to the financial statements.

#### Explanation: If probability is less than 95%:

- No asset is recognised
- Only disclosure is required

This matches the rules for contingent assets.

CA PRASANNA KUMAR  
(PK SIR)

## Restructuring: Definition & Treatment

### Definition

A plan that materially changes scope of business or manner in which business is conducted

(E.g. discontinuing a line of business or closing operations in a specific region)

#### Explanation:

Restructuring refers to a major change — not a routine cost or a small internal adjustment.

Examples include:

- Shutting down a product line
- Closing a factory or regional office
- Changing the entire way operations are run

**Logic:** The change must significantly alter the business structure or operations. Small operational changes do not qualify as restructuring under Ind AS 37.

### Treatment

Provision for Restructuring Costs is recognised when **constructive** obligation to restructure arises. i.e.- Entity has a detailed Formal Plan & Entity has raised a valid expectation for restructuring by announcing the Plan.



## Restructuring: Recognition Criteria

### Explanation:

A restructuring provision is recognised only when both conditions are met:

1. **Detailed formal plan exists** — including scope, timing, locations, affected employees, and financial impact.
2. **Valid expectation is created** — the company has communicated the plan to those affected (employees, customers, suppliers).

### Logic:

- A plan that exists only on paper does not create a present obligation.
- Only when the plan is communicated does the company lose the ability to withdraw without consequences.

## Computation of Restructuring Provision

### Inclusions:

Only direct expenditures arising from Restructuring which are necessarily entailed & not associated with ongoing activities of entity. i.e.-

- Staff Termination or redundancy Costs
- Compensation to Customer
- Lease Termination cost, etc.

### Explanation:

Only those costs that:

- Are directly caused by restructuring, AND
- Will not continue once business returns to normal

are included.

**Logic:** These costs arise solely because of the restructuring plan.

### Exclusions:

- Relocation or Retraining cost for continuing staff
- Marketing cost
- Investment in new systems & distribution networks
- Impairment on Assets

### Explanation:

These items are not restructuring costs because:

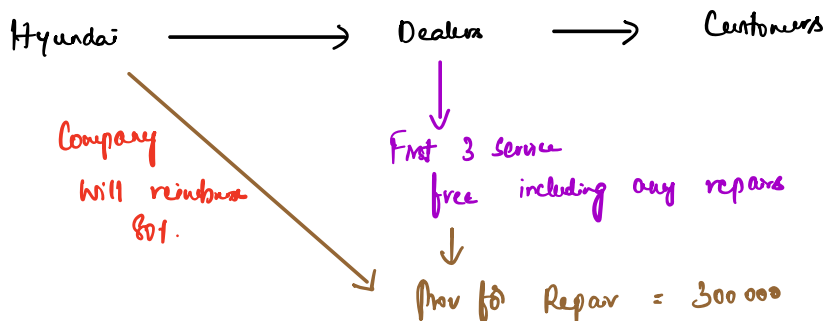
- Relocation/retraining costs relate to ongoing operations
- Marketing and new system investments relate to future operations
- Impairment on assets is accounted under Ind AS 36 separately

**Logic:** These costs are not caused directly by the restructuring itself — they would occur as part of continuing business activities or other accounting standards.

\* Restructuring provision only covers the cost to close the old business not the cost to run the new one.



Eg ①

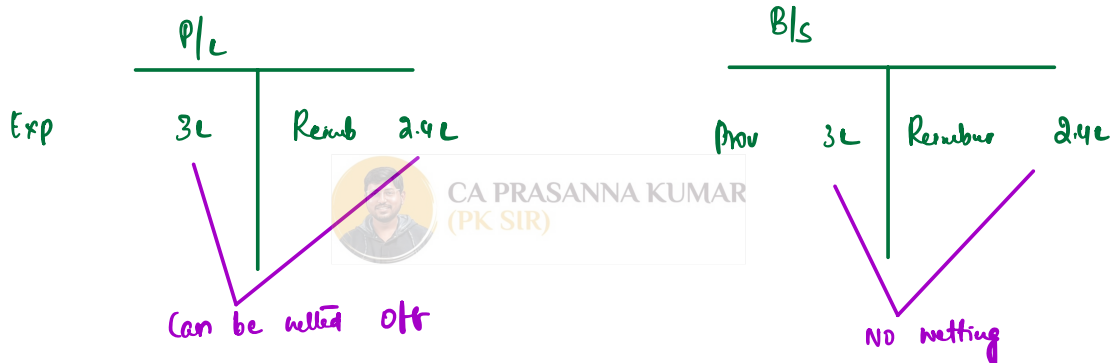


Year ①

Repair exp (P/L) 300000  
 To Prov for repair 300000

Year ②

Reimbursement rec 240000  
 To Reimb Income 240000



\* Eg ②

