

# Provisions, Contingent Liabilities and Contingent Assets

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Accounting Standard for Local Bodies (ASLB) 19

## **Provisions, Contingent Liabilities and Contingent Assets**

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the Preface to the Accounting Standards for Local Bodies<sup>1</sup>)*

The Accounting Standard for Local Bodies (ASLB), '*Provisions, Contingent Liabilities and Contingent Assets*' issued by the Council of the Institute of Chartered Accountants of India, will be recommendatory in nature in the initial years for use by the local bodies. This Standard will be mandatory for Local Bodies in a State from the date specified in this regard by the State Government concerned<sup>2</sup>.

### **Objective**

The objective of this Standard is to define provisions, contingent liabilities and contingent assets, identify the circumstances in which provisions should be recognised, how they should be measured and the disclosures that should be made about them. The Standard also requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements to enable users to understand their nature, timing and amount.

### **Scope**

- 1. An entity which prepares and presents financial statements under***

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<sup>1</sup> Attention is specifically drawn to paragraph 4.2 of the '*Preface to the Accounting Standards for Local Bodies*', according to which Accounting Standards are intended to apply only to items which are material.

<sup>2</sup> Reference may be made to the paragraph 7.1 of the '*Preface to the Accounting Standards for Local Bodies*' providing the discussion on the compliance with the Accounting Standards for Local Bodies.

***the accrual basis of accounting should apply this Standard in accounting for provisions, contingent liabilities and contingent assets, except:***

- (a) ***Those provisions and contingent liabilities arising from social benefits of an entity for which it does not receive any consideration or receives a nominal consideration;***
- (b) ***[Refer to appendix 1];***
- (c) ***Those resulting from executory contracts, other than where the contract is onerous subject to other provisions of this paragraph;***
- (d) ***[Refer to Appendix 1];***
- (e) ***Those covered by another Accounting Standard for Local Bodies;***
- (f) ***[Refer to Appendix 1];***
- (g) ***Those arising from employee benefits except employee termination benefits that arise as a result of a restructuring as dealt with in this Standard; and***
- (h) ***Those resulting from financial instruments<sup>3</sup> that are carried at fair value.***

***2. This Standard applies to all entities that are described as the Local Bodies in the Preface to Accounting Standards for Local Bodies<sup>4</sup>.***

3. [Refer to Appendix 1]

4. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.

5. [Deleted]

<sup>3</sup> A *financial instrument* is any contract that gives rise to both a financial asset of one entity and a financial liability or equity shares of another entity.

<sup>4</sup> Refer paragraph 1.3 of the '*Preface to the Accounting Standards for Local Bodies*'.

6. This Standard applies to provisions for restructuring (including discontinuing operations). Where a restructuring meets the definition of a discontinuing operation, Guidance for additional disclosures may be drawn from AS 24, 'Discontinuing Operations' till the time ASLB on the subject is issued.

## **Social Benefits**

7. For the purposes of this Standard “social benefits” refer to goods, services and other benefits provided in the pursuit of the social policy objectives of a local body. These benefits may include:

- (a) The delivery of health, education, housing, transport and other social services etc. in pursuit of social policy objective. In many cases, beneficiaries of these services are not required to pay anything or required to pay a nominal amount for these services; and
- (b) Local bodies may make payments of benefits to families, the aged, the disabled, the unemployed, veterans and others. In other words, local bodies may provide financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their income.

8. In many cases, social benefits arise as a consequence of a commitment by the Government or Local Body to undertake particular activities on an on-going basis over the long term in order to provide particular goods and services to the community. The need for, and nature and supply of, goods and services to meet social policy will often depend on a range of demographic and social conditions and are difficult to predict. These benefits generally fall within the “social protection,” “education” and “health” and may often require an actuarial assessment to determine the amount of any liability arising in respect of them. For example, if a local body is providing free health care upto age of 5 years or subsidized health care to senior citizens over the age of 70, the differential between the cost of providing the service and the amount recovered against it will be outside the purview of this standard.

9. The exclusion of these provisions and contingent liabilities from the scope of this Standard reflects that both (a) the determination of what constitutes the obligating event, and (b) the measurement of the liability in case of social

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benefits require further consideration and, accordingly, will be dealt through a separate Standard. For example, there are differing views about whether the obligating event occurs when the individual meets the eligibility criteria for the benefit or at some earlier stage. To continue the example in para 8, where the benefit of free health care upto the age of 5 is announced, the determination of what constitutes an obligating event is difficult. Is it the birth of the child? Or registration for the benefit? Or registration of birth? Whether the question of the survival of the children upto the age of 5 is also to be considered?

10. Provisions and contingent liabilities arising from social benefits are excluded from the scope of this Standard. However, when an entity elects to recognise a provision for such benefits, the entity discloses the basis on which the provisions have been recognised and the measurement basis adopted. The entity also makes other disclosures required by this Standard in respect of those provisions. ASLB 1, '*Presentation of Financial Statements*', provides guidance on dealing with matters not specifically dealt with by another ASLB. ASLB 1 also includes requirements relating to the selection and disclosure of accounting policies.

11. In some cases, social benefits may give rise to a liability for which there is:

- (a) Little or no uncertainty as to amount; and
- (b) The timing of the obligation is not uncertain.

Accordingly, these are not likely to meet the definition of a provision in this Standard. Where such liabilities for social benefits exist, they are recognised where they satisfy the criteria for recognition as liabilities (refer also to paragraph 19). An example would be a period-end accrual for an amount owing to the existing beneficiaries in respect of aged or disability pensions that have been approved for payment consistent with the provisions of a contract or legislation.

### **Other Exclusions from the Scope of the Standard**

12. This Standard does not apply to executory contracts unless they are onerous. Contracts giving rise to social benefits are excluded from the scope of this Standard.

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13. Where another Accounting Standard for Local Bodies deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, certain types of provisions are also addressed in the Standards on:

- (a) Construction contracts (see ASLB 11, '*Construction Contracts*'); and
- (b) Leases (see ASLB 13, '*Leases*'). However, as ASLB 13 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases<sup>5</sup>.

14. This standard does not apply to provisions arising from employee benefits (guidance on accounting for employee benefits is found in ASLB 25, '*Employee Benefits*'<sup>6</sup>).

15. 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. ASLB 9, '*Revenue from Exchange Transactions*', identifies the circumstances in which revenue from exchange transactions is recognised and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of ASLB 9.

16. This Standard defines provisions as liabilities of uncertain timing and amount which can be measured only by using a substantial degree of estimation. 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.

17. Other Accounting Standards for Local Bodies 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.

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<sup>5</sup> This ASLB 13, '*Leases*' is under formulation.

<sup>6</sup> This ASLB 25, '*Employee Benefits*' is under formulation.

## Definitions

18. *The following terms are used in this Standard with the meanings specified:*

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

- (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 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.*

*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 or service potential will be required to settle the obligation; or*
  - (ii) The amount of the obligation cannot be measured with sufficient reliability.*



**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.

**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.

**Liabilities** are present obligations 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 or service potential.

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.

An **onerous contract** is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.

**Present obligation** an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

**Possible obligation** an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

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

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

- (a) ***The scope of an entity's activities; or***
- (b) ***The manner in which those activities are carried out.***

## **Provisions and Other Liabilities**

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

- (a) 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 include payments in respect of social benefits where formal agreements for specified amounts exist); 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 leave encashment). 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 accounts payable, whereas provisions are reported separately.

## **Relationship between Provisions and Contingent Liabilities**

20. 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.

21. This Standard distinguishes between:

- (a) Provisions—which are recognised as liabilities (assuming that a reliable estimate can be made) because they are present obligations

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and it is probable that an outflow of resources embodying economic benefits or service potential 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 service potential; 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 or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

## **Recognition**

### **Provisions**

**22. A provision should 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 or service potential will be required to settle the obligation; and**
- (c) A reliable estimate can be made of the amount of the obligation.**

***If these conditions are not met, no provision should be recognised.***

## *Present Obligation*

**23. In some 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 reporting date.**

24. In most cases, it will be clear whether a past event has given rise to a present obligation. In other 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 cases, an entity determines whether a present obligation exists at the reporting date 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 date. On the basis of such evidence:

- (a) Where it is more likely than not that a present obligation exists at the reporting date, 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 reporting date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph 100).

## *Past Event*

25. 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.

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26. 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 continue an entity's ongoing activities in the future. The only liabilities recognised in an entity's balance sheet are those that exist at the reporting date.

27. It is only those obligations arising from past events existing independently of an entity's future actions (that is, the future conduct of its activities) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage imposed by legislation on an entity. Both of these obligations would lead to an outflow of resources embodying economic benefits or service potential in settlement regardless of the future actions of that entity. Similarly, an entity would recognise a provision for the decommissioning costs of sewage treatment plant, to the extent that the entity is obliged to rectify damage already caused. ASLB 17, '*Property, Plant and Equipment*', deals with items, including dismantling and site restoring costs, that are included in the cost of an asset. In contrast, because of legal requirements, pressure from constituents, or a desire to demonstrate community leadership, an entity may intend or need to carry out expenditure to operate in a particular way in the future. An example would be where an entity decides to fit emission controls on certain of its vehicles, or a local body owned laboratory decides to install extraction units to protect employees from the fumes of certain chemicals. Because the entities can avoid the future expenditure by their future actions — for example, by changing their method of operation, they have no present obligation for that future expenditure, and no provision is recognised.

28. 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 decision by an entity's management, governing body, or controlling entity does not give rise to a constructive obligation at the reporting date, unless the decision has been communicated before the reporting date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

29. 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

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obligation. For example, when environmental damage is caused by a *local body agency*, 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 controlling local body or the individual agency publicly accepts responsibility for rectification in a way that creates a constructive obligation.

30. 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. However, differences in circumstances surrounding enactment often make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases, it is not possible to judge whether a proposed new law is virtually certain to be enacted as drafted, and any decision about the existence of an obligation should await the enactment of the proposed law.

### *Probable Outflow of Resources Embodying Economic Benefits or Service Potential*

31. 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 or service potential to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, 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 or service potential is remote (see paragraph 100).

32. Where there are a number of similar obligations (for example, a local body's obligation to compensate individuals who have received contaminated blood from a hospital owned by the local body), 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*

33. 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 assets or liabilities. 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.

34. 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 100).

### **Contingent Liabilities**

**35. *An entity should not recognise a contingent liability.***

36. A contingent liability is disclosed, as required by paragraph 100, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.

37. 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. For example, in the case of joint venture debt, that part of the obligation that is to be met by other joint venture participants 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 or service potential is probable, except in the rare circumstances where no reliable estimate can be made.

38. 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 or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential 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). For example, an entity may have breached an environmental law, but it remains unclear whether any damage was caused

to the environment. Where, subsequently it becomes clear that damage was caused and remediation will be required, the entity would recognise a provision because an outflow of economic benefits is now probable.

## **Contingent Assets**

### **39. *An entity should not recognise a contingent asset.***

40. Contingent assets usually arise from unplanned or other unexpected events that (a) are not wholly within the control of the entity, and (b) give rise to the possibility of an inflow of economic benefits or service potential to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.

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

42. A contingent asset is disclosed, as required by paragraph 105, where an inflow of economic benefits or service potential is probable.

43. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits or service potential will arise and the asset's value can be measured reliably, the asset and the related revenue are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits or service potential has become probable, an entity discloses the contingent asset (see paragraph 105).

## **Measurement**

### **Best Estimate**

**44. *The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the reporting date.***



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45. 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 reporting date 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 reporting date. 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 reporting date.

46. The estimates of outcome and financial effect are determined by the judgment 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 date.

47. [Refer to Appendix 1]

48. [Refer to Appendix 1]

49. [Refer to Appendix 1]

## **Risks and Uncertainties**

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

51. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgments under conditions of uncertainty, so that revenue 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.

52. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 98(b).

53-57. [Refer to Appendix 1]

## Future Events

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

59. Expected future events may be particularly important in measuring provisions. For example, certain obligations may be index linked to compensate recipients for the effects of inflation or other specific price changes. If there is sufficient evidence of likely expected rates of inflation, this should be reflected in the amount of the provision. Another example of future events affecting the amount of a provision is where a local body believes that the cost of cleaning up the tar, ash, and other pollutants associated with a gasworks site at the end of its life will be reduced by future changes in technology. In this case, the amount recognised reflects the cost that technically qualified, objective observers reasonably expect to be incurred, 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.

60. The effect of possible new legislation which may affect the amount of an existing obligation of an entity is taken into consideration in measuring that 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 (a) of what legislation will demand, and (b) 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

**61. *Gains from the expected disposal of assets should not be taken into account in measuring a provision.***

62. 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 Accounting Standard for Local Bodies (ASLBs) dealing with the assets concerned.

## Reimbursements

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

**64. *In the statement of income and expenditure, the expense relating to a provision may be presented net of the amount recognised for a reimbursement.***

65. 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. For example, an entity may have legal liability to an individual as a result of misleading advice provided by its employees. However, the entity may be able to recover some of the expenditure from professional indemnity insurance.

66. 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.

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67. 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.

68. As noted in paragraph 37, 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**

***69. Provisions should be reviewed at each reporting date, and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, the provision should be reversed.***

70. [Refer to Appendix 1]

## **Use of Provisions**

***71. A provision should be used only for expenditures for which the provision was originally recognised.***

72. 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 Net Deficits**

***73. Provisions should not be recognised for net deficits from future operating activities.***

74. Net deficits from future operating activities do not meet the definition of liabilities in paragraph 18 and the general recognition criteria set out for provisions in paragraph 22.

75. An expectation of net deficits from future operating activities is an indication that certain assets used in these activities may be impaired. An entity tests these assets for impairment. Guidance on accounting for impairment is found in ASLB 21, '*Impairment of Non-Cash-Generating Assets*' or ASLB 26, '*Impairment of Cash-Generating Assets*',<sup>7</sup> as appropriate.

## **Onerous Contracts**

**76. *If an entity has a contract that is onerous, the present obligation (net of recoveries) under the contract should be recognised and measured as a provision.***

77. Paragraph 76 of this Standard applies only to contracts that are onerous. Contracts of social benefits are excluded from the scope of this Standard.

78. Many contracts evidencing exchange transactions (for example, some routine purchase orders) can be canceled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard, and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.

79. 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 or service potential expected to be received under it, which includes amounts recoverable. Therefore, it is the present obligation net of recoveries that is recognised as a provision under paragraph 76. 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 fulfill it.

80. Before a separate provision for an onerous contract is established, an entity recognises any impairment loss as per ASLB 17, '*Property, Plant and Equipment*', that has occurred on assets dedicated to that contract.

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<sup>7</sup> These ASLBs are under formulation.

## Restructuring

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

- (a) Termination or disposal of an activity or service;
- (b) The closure of a ward office or termination of activities of a local body's department or the relocation of activities from one place to another within the jurisdiction of that local body;
- (c) [Refer to Appendix 1];
- (d) Fundamental reorganizations that have a material effect on the nature and focus of the entity's operations.

82. A provision for restructuring costs is recognised only when the general recognition criteria for provisions set out in paragraph 22 are met. Paragraphs 83 to 96 set out how the general recognition criteria apply to restructurings.

**83. A constructive obligation to restructure arises only when an entity:**

- (a) **Has a detailed formal plan for the restructuring identifying at least:**
  - (i) **The activity/operating unit or part of an activity/operating unit 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**

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- (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.***

84. Within the local body, restructuring may occur at local body level, or it's department level.

85. Evidence that a local body has started to implement a restructuring plan would be provided, for example, by (a) the public announcement of the main features of the plan, (b) the sale or transfer of assets, (c) notification of intention to cancel leases, or (d) the establishment of alternative arrangements for clients of services. 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 (that is, setting out the main features of the plan) that it gives rise to valid expectations in other parties, such as users of the service, suppliers, and employees (or their representatives) that the local body will carry out the restructuring.

86. 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 local body is at present committed to restructuring, because the timeframe allows opportunities for the local body to change its plans.

87. A decision by management or the governing body to restructure, taken before the reporting date, does not give rise to a constructive obligation at the reporting date unless the entity has, before the reporting date:

- (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.

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If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting date, disclosure may be required under ASLB 14, '*Events after the Reporting Date*', if the restructuring is material and non-disclosure could influence the economic decisions of users taken on the financial statements.

88. Although a constructive obligation is not created solely by a management or governing body 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 or transfer of an operation, may have been concluded subject only to governing body or 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 83 are met.

89. In some cases, (a) the ultimate authority for making decisions about an entity is vested in a governing body or board whose membership includes representatives of interests other than those of management (for example, employees), or (b) notification to these representatives may be necessary before the governing body or – competent authority's decision is taken. Because a decision by such a governing body or competent authority involves communication to these representatives, it may result in a constructive obligation to restructure.

### *Sale or Transfer of Operations*

**90. *No obligation arises as a consequence of the sale or transfer of an operation until the entity is committed to the sale or transfer, that is, there is a binding agreement.***

91. 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 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.



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92. Restructuring within a local body often involves the transfer of operations from one controlled entity to another, and may involve the transfer of operations at no or nominal consideration. Such transfers will often take place under a government or directive of competent authority, and will not involve binding agreements as described in paragraph 90. An obligation exists only when there is a binding transfer agreement. Even where proposed transfers do not lead to the recognition of a provision, the planned transaction may require disclosure under other ASLBs, such as the ASLB 14, *Events after the Reporting Date*, and ASLB 20, *Related Party Disclosures*<sup>8</sup>.

*Restructuring Provisions*

**93. A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both:**

- (a) Necessarily entailed by the restructuring; and**
- (b) Not associated with the ongoing activities of the entity.**

94. A restructuring provision does not include such costs as:

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

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

95. Identifiable future operating net deficits up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract, as defined in paragraph 18.

96. As required by paragraph 61, 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.

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<sup>8</sup> The formulation of the ASLB is under formulation.

## Disclosure

**97. For each class of provision, an entity should 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 (that is, incurred and charged against the provision) during the period;**
- (d) Unused amounts reversed during the period; and**
- (e) [Refer to Appendix 1]**

**Comparative information is not required.**

**98. An entity should 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 or service potential;**
- (b) An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity should disclose the major assumptions made concerning future events, as addressed in paragraph 58; and**
- (c) The amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.**

**99. Where an entity elects to recognise in its financial statements provisions for social obligations of an entity, it should make the disclosures required in paragraphs 97 and 98 in respect of those provisions.**

**100. Unless the possibility of any outflow in settlement is remote, an entity should disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, where practicable:**

- (a) An estimate of its financial effect, measured under paragraphs 44 to 62;**
- (b) An indication of the uncertainties relating to the amount or timing of any outflow; and**
- (c) The possibility of any reimbursement.**

101. 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 fulfill the requirements of paragraphs 98(a) and (b) and 100(a) and (b). Thus, it may be appropriate to treat, as a single class of provision, amounts relating to one type of obligation, but it would not be appropriate to treat, as a single class, amounts relating to environmental restoration costs and amounts that are subject to legal proceedings.

102. Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs 97, 98 and 100 in a way that shows the link between the provision and the contingent liability.

103. An entity may in certain circumstances use external valuation to measure a provision. In such cases, information relating to the valuation can usefully be disclosed.

104. The disclosure requirements in paragraph 100 do not apply to contingent liabilities that arise from social benefits of an entity (see paragraphs 1(a) and 7–11 for a discussion of the exclusion of social benefits from this Standard).

**105. Where an inflow of economic benefits or service potential is probable, an entity should disclose a brief description of the nature of the contingent assets at the reporting date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 44 to 62.**

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106. The disclosure requirements in paragraph 105 are only intended to apply to those contingent assets where there is a reasonable expectation that benefits will flow to the entity. That is, there is no requirement to disclose this information about all contingent assets (see paragraphs 39 to 43 for a discussion of contingent assets). It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of revenue arising. The contingent asset should be quantified, where a reasonable estimate of the same can be made.

107. The disclosure requirements in paragraph 105 encompass contingent assets from both exchange and non-exchange transactions. Whether a contingent asset exists in relation to taxation revenues rests on the interpretation of what constitutes a taxable event. The determination of the taxable event for taxation revenue and its possible implications for the disclosure of contingent assets related to taxation revenues are to be dealt with as a part of a separate project on non-exchange revenue.

**108. Where any of the information required by paragraphs 100 and 105 is not disclosed because it is not practicable to do so, that fact should be stated.**

***109. In extremely rare cases, disclosure of some or all of the information required by paragraphs 97 to 107 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 should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.***

## **Transitional Provisions**

***110. The effect of adopting this Standard on its effective date (or earlier) should be reported as an adjustment to the opening balance of accumulated surpluses/(deficits) for the period in which the Standard is first adopted.***

111-112. [Refer to Appendix 1]

## Appendix A

### Provisions, Contingent Liabilities, Contingent Assets, and Reimbursements

*These Tables accompany, but are not part of ASLB 19.*

#### Provisions and Contingent Liabilities

<p><b>Where, as a result of past events, there may be an outflow of resources embodying future economic benefits or service potential in settlement of (a) a present obligation, or (b) a possible obligation 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.</b></p>		
<p><b>There is a present obligation that probably requires an outflow of resources.</b></p>	<p><b>There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.</b></p>	<p><b>There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.</b></p>
<p>A provision is recognised (paragraph 22).</p>	<p>No provision is recognised (paragraph 35).</p>	<p>No provision is Recognised (paragraph 35).</p>
<p>Disclosures are required for the provision (paragraphs 97 and 98).</p>	<p>Disclosures are required for the contingent liability (paragraph 100).</p>	<p>No disclosure is required (paragraph 100).</p>

A contingent liability also arises in the extremely rare case where there is a liability that cannot be recognised because it cannot be measured reliably. Disclosures are required for the contingent liability.

## Contingent Assets

<p>Where, as a result of past events, there is a possible asset 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.</p>		
<p>The inflow of economic benefits or service potential is virtually certain.</p>	<p>The inflow of economic benefits or service potential is probable, but not virtually certain.</p>	<p>The inflow of economic benefits or service potential is not probable.</p>
<p>The asset is not contingent (paragraph 41).</p>	<p>No asset is recognised (paragraph 39).</p>	<p>No asset is recognised (paragraph 39).</p>
	<p>Disclosures are required (paragraph 105).</p>	<p>No disclosure is required (paragraph 105).</p>

## Reimbursements

<p>Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.</p>		
<p>The entity has no obligation for the part of the expenditure to be reimbursed by the other party.</p>	<p>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 settles the provision.</p>	<p>The obligation for the amount expected to be reimbursed remains with the entity, and the reimbursement is not virtually certain if the entity settles the provision.</p>
<p>The entity has no liability for the amount to be reimbursed (paragraph 67).</p>	<p>The reimbursement is recognised as a separate asset in the balance sheet, and may be offset against the expense in the income and expenditure statement.</p>	<p>The expected reimbursement is not recognised as an asset (paragraph 63).</p>

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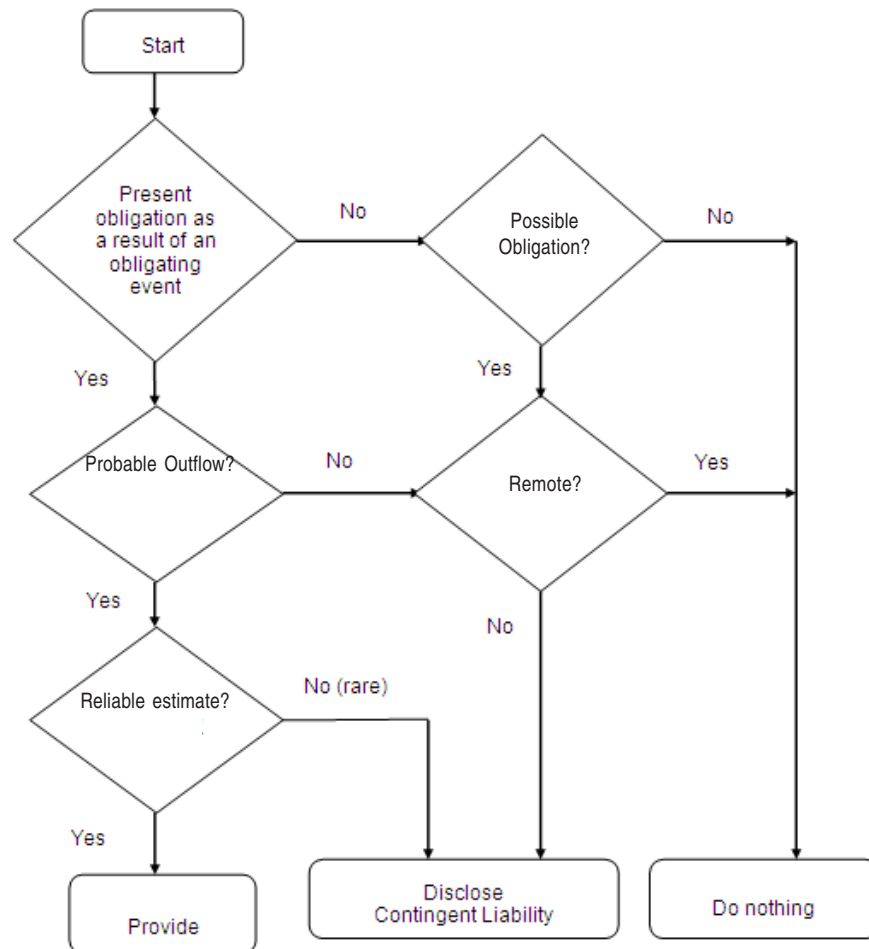
	The amount recognised for the expected reimbursement does not exceed the liability (paragraphs 63 and 64).	
No disclosure is required.	The reimbursement is disclosed, together with the amount recognised for the reimbursement (paragraph 98(c)).	The expected reimbursement is disclosed (paragraph 98(c)).

## Appendix B

### Illustrative Decision Tree

This decision tree accompanies, but is not part of ASLB 19.

Note: In some 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 reporting date (paragraph 23 of this Standard).





## Appendix C

### Implementation Guidance

*This guidance accompanies, but is not part of, ASLB 19.*

#### Recognition

IG1. All the entities in the examples have a reporting date of March 31. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples, the circumstances described may have resulted in impairment of the assets – this aspect is not dealt with in the examples.

IG2. The cross-references provided in the examples indicate paragraphs of this Standard that are particularly relevant. This guidance should be read in the context of the full text of this Standard.

IG3. [Refer to Appendix 1]

IG4. [Refer to Appendix 1]

#### Contaminated Land—Legislation Virtually Certain to be Enacted

IG5. A local body owns a warehouse on land near a port. The local body has retained ownership of the land because it may require the land for future expansion of its operations. For the past ten years, the property had been leased out to a group of farmers as a storage facility for agricultural chemicals. The government announces its intention to enact environmental legislation requiring property owners to accept liability for environmental pollution, including the cost of cleaning-up contaminated land. As a result, the local body introduces a hazardous chemical policy and begins applying the policy to its activities and properties. At this stage it becomes apparent that the agricultural chemicals have contaminated the land surrounding the warehouse. The local body has no recourse against the farmers or its insurance company for the clean-up costs. At March 31, 2013 it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

### **Analysis**

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 the clean-up.

An outflow of resources embodying economic benefits or service potential in settlement – Probable.

### **Conclusion**

A provision is recognised for the best estimate of the costs of the clean-up (see paragraphs 22 and 30).

### **Contamination and Constructive Obligation**

IG6. A local body has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The local body has a record of honoring this published policy. There is no environmental legislation in place in the jurisdiction. During the course of travelling, an oil tanker vessel carrying oil is damaged and leaks a substantial amount of oil. The local body agrees to pay for the costs of the immediate clean-up.

### **Analysis**

Present obligation as a result of a past obligating event – The obligating event is the contamination of the environment, which gives rise to a constructive obligation because the policy and previous conduct of the local body has created a valid expectation that the local body will clean up the contamination.

An outflow of resources embodying economic benefits or service potential in settlement – Probable.

### **Conclusion**

A provision is recognised for the best estimate of the costs of the clean-up (see paragraphs 22 and 30).

### **Gravel Quarry**

IG7. A local body operates a gravel quarry on land that it leases on a commercial basis from a private sector company. The gravel is used for the construction and maintenance of roads. The agreement with the landowners requires the local body to restore the quarry site by removing all buildings, reshaping the land, and replacing all topsoil. 60% of the eventual restoration costs relate to the removal of the quarry buildings and restoration of the site, and 40% arise through the extraction of gravel. At the reporting date, the quarry buildings have been constructed, and excavation of the site has begun but no gravel has been extracted.

### **Analysis**

Present obligation as a result of a past obligating event – The construction of buildings and the excavation of the quarry creates a legal obligation under the terms of the agreement to remove the buildings and restore the site, and is thus an obligating event. At the reporting date, however, there is no obligation to rectify the damage that will be caused by extraction of the gravel.

An outflow of resources embodying economic benefits or service potential in settlement – Probable.

### **Conclusion**

A provision is recognised for the best estimate of 60% of the eventual costs that relate to the removal of the buildings and restoration of the site (see paragraph 22). These costs are included as part of the cost of the quarry. The 40% of costs that arise through the extraction of gravel are recognised as a liability progressively when the gravel is extracted.

IG8. [Refer to Appendix 1]

### **Discontinuation of an operation/service—No Implementation before Reporting Date**

IG9. On 12 December 2012, a local body decides to discontinue the collection of octroi in a particular area within its jurisdiction which is collected through a contractor. The decision was not communicated to the contractor and others

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who are affected before the reporting date (March 31, 2013), and no other steps were taken to implement the decision.

**Analysis**

Present obligation as a result of a past obligating event – There has been no obligating event and so there is no obligation.

**Conclusion**

No provision is recognised (see paragraphs 22 and 83).

**Outsourcing of a Division—Implementation Before the Reporting Date**

IG10. On December 12, 2012, a local body decided to outsource a division of a local body department. On December 20, 2012, a detailed plan for outsourcing the division was agreed by the local body, and redundancy notices were sent to the staff of the division.

**Analysis**

Present obligation as a result of a past obligating event – The obligating event is the communication of the decision to employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be outsourced.

An outflow of resources embodying economic benefits or service potential in settlement – Probable.

**Conclusion**

A provision is recognised at March 31, 2013 for the best estimate of the costs of outsourcing the ward office (see paragraphs 22 and 83).

**Legal Requirement to Fit Air Filters**

IG11. Under new legislation, a local body is required to fit new air filters to its public buildings by 30 June 2013. The entity has not fitted the air filters.

**Analysis**

(a) At the reporting date of March 31, 2013

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 air filters or for fines under the legislation.

**Conclusion**

No provision is recognised for the cost of fitting the filters (see paragraphs 22 and 25–27).

**Analysis**

(b) At the reporting date of March 31, 2014

Present obligation as a result of a past obligating event – There is still no obligation for the costs of fitting air 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-compliance of the public buildings).

An outflow of resources embodying economic benefits or service potential in settlement – Assessment of probability of incurring fines and penalties for non-compliance depends on the details of the legislation and the stringency of the enforcement regime.

**Conclusion**

No provision is recognised for the costs of fitting air 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 22 and 25–27).

**Staff Retraining as a Result of Changes in the Property Tax System**

IG12. The local body introduces a number of changes to the property tax system. As a result of these changes, the local body X (reporting entity) will need to retrain a large proportion of its administrative and compliance staff in order to

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ensure continued compliance with property tax regulations. At the reporting date, no retraining of staff has taken place.

#### **Analysis**

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 22 and 25–27).

#### **An Onerous Contract**

IG13. A hospital laundry operates from a building that the hospital (the reporting entity) has leased under an operating lease. During March 2014, the laundry relocates to a new building. The lease on the old building continues for the next four years; it cannot be canceled. The hospital has no alternative use for the building and the building cannot be re-let to another user.

#### **Analysis**

Present obligation as a result of a past obligating event – The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits or service potential in settlement – When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the hospital accounts for the lease under ASLB 13, 'Leases').

#### **Conclusion**

A provision is recognised for the best estimate of the unavoidable lease payments (see paragraphs 13(b), 22 and 76).

#### **A Single Guarantee**

IG14. During F.Y. 2013-14, a local body gives a guarantee of certain borrowings of a private sector operator providing public services for a fee, whose financial

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condition at that time is sound. During F.Y. 2013-14, the financial condition of the operator deteriorates and, at June 30, 2013, the operator files for protection from its creditors.

**Analysis**

(a) At March 31, 2013

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 or service potential in settlement – No outflow of benefits is probable at March 31, 2013.

**Conclusion**

No provision is recognised (see paragraphs 22 and 31). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraph 100).

**Analysis**

(b) At March 31, 2014

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 or service potential in settlement – At March 31, 2014, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.

**Conclusion**

A provision is recognised (see paragraphs 22 and 31).

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

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32). Where an entity gives guarantees in exchange for a fee, revenue is recognised in accordance with ASLB 9, “*Revenue from Exchange Transactions*”.

**A Court Case**

IG15. In a school (the reporting entity) run by local body in January 2013, ten students died, possibly as a result of food poisoning from food provided under mid-day meal scheme. Legal proceedings are started seeking damages from the entity, but it disputes liability. Up to the date of authorisation of the financial statements for the year to March 31, 2013 for issue, 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 to March 31, 2014, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable.

**Analysis**

**(a) At March 31, 2013**

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 obligation as a result of past events.

**Conclusion**

No provision is recognised by the school (see paragraphs 23 and 24). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraphs 100 and 109).

**Analysis**

**(b) At March 31, 2014**

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 or service potential in settlement – Probable.



### **Conclusion**

A provision is recognised for the best estimate of the amount to settle the obligation (paragraphs 22–24 and 109).

### **Repairs and Maintenance**

IG16. Some assets require in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. ASLB 17, *Property, Plant, and Equipment*, gives guidance on allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

### **Refurbishment Costs—No Legislative Requirement**

IG17. A furnace has a lining that needs to be replaced every five years for technical reasons. At the reporting date, the lining has been in use for three years.

### **Analysis**

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

### **Conclusion**

No provision is recognised (see paragraphs 22 and 25–27).

The cost of replacing the lining is not recognised because, at the reporting date, no obligation to replace the lining exists independently of the entity's future actions—even the intention to incur the expenditure depends on the entity deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognised, the depreciation of the lining takes account of its consumption, that is, it is depreciated over five years. The re-lining costs then incurred are capitalised, with the consumption of each new lining shown by depreciation over the subsequent five years.

### **Refurbishment Costs—Legislative Requirement**

IG18. Replacement of a major part of oil tanker is required by law to overhaul it once every three years.

#### **Analysis**

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

#### **Conclusion**

No provision is recognised (see paragraphs 22 and 25–27).

The costs of overhauling oil tanker are not recognised as a provision for the same reasons as the cost of replacing the lining is not recognised as a provision in Example IG17. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the oil tanker independently of the entity's future actions – the entity could avoid the future expenditure by its future actions, for example by selling the oil tanker.

#### **Disclosures**

An example of the disclosure required by paragraph 98 is given below.

IG 19. [Refer to Appendix 1]

### **Decommissioning Costs**

IG20. In 2013, a local body - uses a waste disposal and recycling plant, recognises a provision for decommissioning costs of Rs. 100 lakhs. The provision is estimated using the assumption that decommissioning will take place in 20-30 years' time. The following information is disclosed:

A provision of Rs. 100 lakhs has been recognised for decommissioning costs. These costs are expected to be incurred between 2033 and 2043.

### **Disclosure Exemption**

An example is given below of the disclosures required by paragraph 109 where some of the information required is not given because it can be expected to prejudice seriously the position of the entity.

IG21. A local body research agency is involved in a dispute with a company, which is alleging that the research agency has infringed copyright in its use of genetic material, and is seeking damages of Rs. 100 million. The research agency recognises a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 97 and 98 of the Standard. The following information is disclosed:

Litigation is in process against the agency relating to a dispute with a company that alleges that the agency has infringed patents, and is seeking damages of Rs. 100 million. The information usually required by ASLB 19, '*Provisions, Contingent Liabilities and Contingent Assets*', is not disclosed, on the grounds that it can be expected to prejudice seriously the outcome of the litigation. The management is of the opinion that the claim can be successfully defended by the agency.

### **Disclosure of contingent asset**

An example is given below of the disclosure required by paragraph 105 which requires an entity to disclose a brief description of the nature of the contingent asset at the reporting date where an inflow of the economic benefits or service potential is probable.

IG 22 A local body has filed a legal case on its supplier for liquidated damages of Rs. 1 lakh . The supplier has disagreed with the claim and is unwilling to make settlement outside court. The position was same at the reporting date i.e. March 31, 2013. Subsequently, during the March 2014, the court ruled a judgment in favour of the local body. However, the supplier has filed an appeal against the court order. Management of the local body is of the opinion that again the court order will be in its favour.

### **Analysis:**

- (a) At March 31, 2013

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In this case an inflow of economic benefits is not probable.

**Conclusion:**

No disclosure of contingent asset is required.

**Analysis:**

(b) At March 31, 2014

In this case an inflow of economic benefits is probable.

**Conclusion:**

A disclosure of the best estimate of the amount of contingent asset is made.

## **Appendix 1**

*Note: This Appendix is not a part of the Accounting Standard for Local Bodies. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard for Local Bodies (ASLB) 19 and the corresponding International Accounting Standard (IPSAS) 19, 'Provisions, Contingent Liabilities and Contingent Assets'*

### **Comparison with IPSAS 19, 'Provisions, Contingent Liabilities and Contingent Assets'**

- IPSAS 19 clearly mentions provisions, contingent liabilities and contingent assets arising from insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts and those arising in relation to income taxes or income tax equivalents are excluded from the scope of this standard. However, the same has been deleted in ASLB 19.
- As per IPSAS 19, where the effect of the time value of money is material, the amount of a provision shall be discounted at a pre-tax discount rate and certain disclosures are required to be made in this regard. Whereas, ASLB 19 does not require discounting of the provisions keeping in view that the Local Bodies in India are at very initial stages of implementation of accrual basis of accounting.
- IPSAS 19 does not apply to financial instruments (including guarantees) that are within the scope of IPSAS 29, '*Financial Instruments: Recognition and measurements*' whereas ASLB 19 applies to financial instruments (including guarantees) that are not carried at fair value but excludes that are carried at fair value.
- Some examples in the Standard and in implementation guidance have been deleted and some have been modified to better address the circumstances of the local bodies. An example on disclosure of contingent assets has also been included which is not there in the corresponding IPSAS.

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- Definitions of 'Obligation', 'Present Obligation' and 'Possible Obligation' have been included in ASLB 19.
- The IPSAS 19 excludes provisions, contingent liabilities and contingent assets arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided directly in return from the recipients of those benefits from the scope of the Standard. Whereas in ASLB 19 the said exclusion has been modified as provisions, contingent liabilities and contingent assets arising from social benefits of an entity for which it does not receive any consideration or receives a nominal consideration.
- ASLB 19 uses different terminology, in certain instances, from existing IPSAS 19, for example, use of 'Statement of Income and Expenditure' in ASLB 19. The equivalent term in IPSAS 29 is 'Statement of Financial Performance'.
- In order to simplify the guidance with respect to the 'best estimate', the *'requirements of weighting all possible outcomes by their associated probabilities in case of large populations of item'* and *'considering all possible outcomes along with most likely outcome in case of a single obligation'*, have been removed from the ASLB 19.
- In IPSAS 19, under transitional provisions entities are encouraged, but not required, to (a.) adjust the opening balance of accumulated surpluses/ (deficits) for the earliest period presented, and (b.) to restate comparative information. If comparative information is not restated, this fact should be disclosed. The aforesaid transitional provisions have been deleted in ASLB 19.
- Paragraphs relating to effective date have been removed as ASLB 19 would become mandatory for Local Bodies in a state from the date specified by the State Government concerned.
- Consequential changes resulting from above departures have been made in ASLB 19. However, paragraph numbers have been retained in order to maintain consistency with IPSAS 19.

## **Appendix 2**

*Note: This Appendix is not a part of the Accounting Standard for Local Bodies. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard for Local Bodies (ASLB) 19 and the corresponding existing AS 29, 'Provisions, Contingent Liabilities and Contingent Assets'*

### **Major differences between Existing AS 29 and ASLB 19, 'Provisions, Contingent Liabilities and Contingent Assets'**

- The scope of ASLB 19 clarifies that it does not apply to provisions, contingent liabilities and contingent assets arising from social benefits of an entity. ASLB 19 also provides that if the entity elects to recognise provisions for social benefits, certain disclosures are required to be made. Existing AS 29 does not deal with the same.
- AS 29 excludes provisions, contingent liabilities and contingent assets arising in insurance enterprises from contracts with policy-holders from the scope of this standard. However, the said exclusion is not there in the ASLB 19 as this is not relevant in context of local bodies.
- The existing AS 29 prohibits disclosure of a contingent asset in the financial statements but the same is usually disclosed in the report of the approving authority but whereas ASLB 19 requires disclosure of contingent assets in the financial statements when an inflow of economic benefits is probable.
- Unlike the existing AS 29, ASLB 19 requires creation of provisions in respect of constructive obligation also. Consequential changes resulted from the same has also been made in the ASLB.
- ASLB 19 uses different terminology, in certain instances, from existing AS 29. For example use of 'Statement of Income and expenditure' and 'net deficit' in ASLB 19. The equivalent term in existing AS 29 is 'statement of profit and loss' and 'loss' respectively.
- ASLB 19 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 ASLB 17, '*Property, Plant and Equipment*'. There is no such specific

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provision in the existing AS 29. The ASLB 19 also provides additional guidance on the subject.

- Examples and Implementation Guidance in the ASLB 19 are more reflective of the circumstances of the Local Bodies.