# SPECIFIC ITEMS
# SECTION 3290
# contingencies



## PURPOSE AND SCOPE

.01 This Section establishes standards for the treatment of contingencies in financial statements. The issues discussed concern both the accrual for and the disclosure of contingencies in presenting the financial position and results of operations of an enterprise. (With reference to contingencies involving related parties, see also RELATED PARTY TRANSACTIONS, Section 3840. With reference to disclosures about guarantees, see ACCOUNTING GUIDELINE AcG-14, Disclosure of Guarantees.)

.02 Contingencies would include, but are not limited to, pending or threatened litigation, threat of expropriation of assets, guarantees of the indebtedness of others and possible liabilities arising from discounted bills of exchange or promissory notes.

.03 In the preparation of the financial statements of an enterprise, estimates are required for many ongoing and recurring activities. However, the mere fact that an estimate is involved does not of itself constitute the type of uncertainty that characterizes a contingency. For example, amounts owed for goods or services received but not billed are not contingencies, even though the amounts may be estimated. There is nothing uncertain about the fact that these obligations have been incurred; any uncertainty is related solely to the amounts thereof.

.04 While allowances for impaired loans and doubtful accounts (see FINANCIAL INSTRUMENTS, Section 3856), as well as non-discretionary vendor rebates and provisions for warranties, have many of the characteristics of contingencies, such estimates are not usually regarded as contingencies, and for the purposes of this Section are excluded.

## DEFINITION

.05 The following term is used in this Section with the meaning specified:

A **contingency** is an existing condition or situation involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability.

## MEASUREMENT OF UNCERTAINTY

.06 The uncertainty relating to the occurrence or non-occurrence of the future event(s), which determines the outcome of a contingency, can be expressed by a range of probabilities that provide a basis for establishing the appropriate accounting treatment. This Section identifies three areas of this range by a general description as follows:

(a) likely — the chance of the occurrence (or non-occurrence) of the future event(s) is high;

(b) unlikely — the chance of the occurrence (or non-occurrence) of the future event(s) is slight; and

(c) not determinable — the chance of the occurrence (or non-occurrence) of the future event(s) cannot be determined.

.07 Prediction of the outcome of contingencies, including estimation of the financial effects, is a matter for judgment by those responsible for preparing financial statements, taking into account the particular circumstances. In identifying contingencies and determining their amount, consideration would be given to all information available prior to completion of the financial statements (see SUBSEQUENT EVENTS, Section 3820), supplemented by experience in similar transactions and, in some cases, reports from independent experts.

**ACCOUNTING TREATMENT**

**Contingent losses**

.08 The treatment of contingent losses in financial statements depends upon the likelihood that a future event will confirm that an asset had been impaired or liability incurred as at the financial statement date.

.09 If it is likely that a contingency existing at the financial statement date will result in a loss, accrual of its financial effects would be required. This accounting treatment recognizes that the likely impairment of an asset or incurrence of a liability is related to a condition or situation existing at the end of the reporting period and not to the confirming future event.

.10 The appropriateness of accruing the effects of a contingent loss would be influenced by the extent to which the amount of the loss is known or can be reasonably estimated. If a reasonable estimate cannot be made, accrual could result in the inclusion in the financial statements of amounts so uncertain as to impair the integrity of those statements.

.11 A likely loss to an enterprise may be reduced or avoided by a counterclaim or a claim against a third party. In such a case, the amount of the likely recovery is an element of the likely loss and, therefore, would be taken into account in determining the amount to be recognized in the income statement. However, if the probability of success in the related action is less than likely, a potential recovery would not be taken into account.

.12 *The amount of a contingent loss shall be accrued in the financial statements by a charge to income when both of the following conditions are met:*

*(a) it is likely that a future event will confirm that an asset had been impaired or a liability incurred at the date of the financial statements; and*

*(b) the amount of the loss can be reasonably estimated.*

.13 The estimation of the amount of a contingent loss to be accrued in the financial statements may be based on information that provides a range of the amount of loss. When a particular amount within such a range appears to be a better estimate than any other, that amount would be accrued. However, when no amount within the range is indicated as a better estimate than any other, the minimum amount in the range would be accrued.

.14 If there is conflicting or insufficient evidence on which to base a decision as to the outcome of a contingent loss, one or both of the conditions for accrual set out in paragraph 3290.12 may not be met. In these circumstances, accrual of an estimated amount would be inappropriate.

.15 The lack of adequate insurance against risks, such as loss or damage to property of the enterprise or loss resulting from injury to others or damage to property of others, constitutes an uncertainty as to the amount and timing of any losses that may occur. However, the lack of adequate insurance does not mean that an asset has been impaired or a liability incurred at the financial statement date. Fires, explosions, and other similar perils are random in their occurrence and, since no impairment of an asset or incurrence of a liability can exist prior to the occurrence of such an event, accrual is inappropriate.

**Contingent gains**

.16 Contingent gains are not accrued in financial statements, as this accounting treatment could result in the recognition of revenue that might never be realized.

.17 *Contingent gains shall not be accrued in financial statements.*

**DISCLOSURE**

**Contingent losses**

.18 *The existence of a contingent loss at the date of the financial statements shall be disclosed in notes to the financial statements when:*

*(a) the occurrence of the confirming future event is likely but the amount of the loss cannot be reasonably estimated;*

*(b) the occurrence of the confirming future event is likely and an accrual has been made but there exists an exposure to loss in excess of the amount accrued; or*

*(c) the occurrence of the confirming future event is not determinable.*

.19 *At a minimum, the note disclosure shall include:*

*(a) the nature of the contingency;*

*(b) an estimate of the amount of the contingent loss or a statement that such an estimate cannot be made; and*

*(c) any exposure to loss in excess of the amount accrued.*

.20 Users of financial statements shall be advised of conditions or situations existing at the end of a reporting period when management considers that the probability of realization of a loss or incurrence of a liability is likely or not determinable. Such information would be important in evaluating the future prospects of an enterprise.

.21 Disclosures about guarantees are provided in accordance with ACCOUNTING GUIDELINE AcG-14, Disclosure of Guarantees.

**Contingent gains**

.22 *When it is likely that a future event will confirm that an asset had been acquired or a liability reduced at the date of the financial statements, the existence of a contingent gain shall be disclosed in notes to the financial statements.*

.23 *At a minimum, the note disclosure shall include:*

*(a) the nature of the contingency; and*

*(b) an estimate of the amount of the contingent gain or a statement that such an estimate cannot be made.*

.24 Disclosure of the existence of a contingent gain that is considered likely to be realized provides useful information and, therefore, would be included in a note to the financial statements. However, it is necessary to exercise particular care in the disclosure of contingent gains to avoid a misleading implication as to the likelihood of realization. It would not be appropriate to disclose the existence of a contingent gain that is unlikely to be realized.

**EFFECTIVE DATE**

.25 This Section applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.

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