AS-4: Contingencies & Events Occurring after the Balance Sheet Date

IPCC PAPER 5 ADVANCED ACCOUNTING
CHAPTER 2

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Scope

- Contingencies
  - Covered by AS 29 – Provisions, Contingent Liabilities and Contingent Assets (on or after 1.4.2004)
- Events occurring after the balance sheet date

Why?

- Balance sheet date – 31 March
- Balance sheet sign date – 31 August
- i.e. 5 months later
- Transactions in those 5 months might be material/ significant for the investor/ stake holders

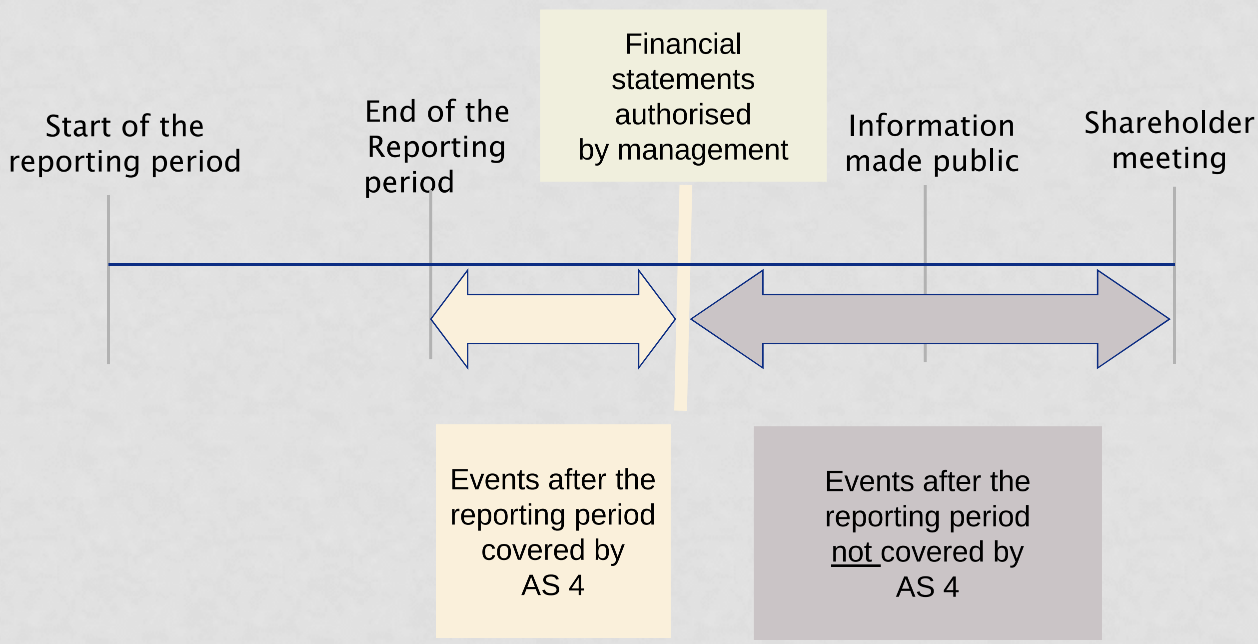
Definition

- Contingency
  - A *contingency* is a condition or situation,
  - the ultimate outcome of which, gain or loss,
  - will be known or determined only on
  - the occurrence, or nonoccurrence,
  - of one or more uncertain future events.

Definition

- Events occurring after the balance sheet date
  - *Events occurring after the balance sheet date* are
  - those significant events, both favourable and unfavourable,
  - that occur between the balance sheet date and
  - the date on which the financial statements are approved by the Board of Directors in the case of a company, and, by the corresponding approving authority in the case of any other entity.
- Two types of events can be identified:
  - those which provide further evidence of conditions that existed at the balance sheet date; and
  - those which are indicative of conditions that arose subsequent to the balance sheet date.

Events to be considered



Types of Events

- Adjusting events
  - Requires appropriate adjustment in the financial statements
- Non-adjusting events
  - Requires disclosure through report of approving authority i.e. Directors’ report in case of companies and report of corresponding approving authority in case of other entities

Adjusting Events

- Adjustments to assets, liabilities, expenses, income and equity are required for events occurring after the balance sheet date
- that provide additional information
- materially affecting the determination of the amounts
- relating to conditions existing at the balance sheet date.

Requirements

- Event should occur between the balance sheet date and the approval by Board date
- It should provide additional information
- Regarding a condition existing on the balance sheet date

Example

- a loss on a trade receivable account which is confirmed by the insolvency of a customer which occurs after the balance sheet date.

- Event occurred – insolvency of customer
- Condition existing – provision for doubtful debt

Example

- a fraud during the accounting period is detected after the balance sheet date but before the approval of financial statements
- Event occurred – Detection of fraud
- Condition existing – fraud happened during the accounting period

Case Study

- A Ltd. Agreed in principle to sell a plot of land on 18 March 2012 at a price to be determined by an independent valuer. Pending the agreement for sale and due to non-receipt of valuers report, the sale of land could not be completed up to the accounting year end i.e. 31 March 2012. The Company received the report on 07 April 2012 and the agreement was signed on 10 April 2012. The financial statements were approved by the board on 12 May 2012. Is it an adjusting event?

Answer

- Event occurred – Signing of the agreement for sale of land
- Timing of event – between balance sheet date and date of approval by the board. Hence, its an event occurring after the balance sheet date
- Condition existing – Company agreed in principle to sell the plot of land

- Hence, it is an adjusting event and the Company should record sale transaction in books as on 31 March 2012

Non-adjusting events

- Adjustments to assets, liabilities, expenses, income and equity are not appropriate
- for events occurring after the balance sheet date,
- if such events do not relate to conditions existing at the balance sheet date.

- To be disclosed through report of approving authority i.e. Directors' report in case of companies and report of corresponding approving authority in case of other entities

Example

- A decline in market value of investments between the balance sheet date and the date on which the financial statements are approved.
- Ordinary fluctuations in market values do not normally relate to the condition of the investments at the balance sheet date, but reflect circumstances which have occurred in the following period.

Example

- An announcement after balance sheet date but before approval of financial statement, of a formal plan to discontinue an operation does not justify adjustment of financial statement
- It is a non-adjusting event. Hence, only disclosure is required.

Disclosure - Non-adjusting event

- The directors (or other approving authority, as the case may be) should state the
  - nature of the event
  - their estimate of financial effect of the event
- Where estimate of financial effect cannot be made, the report should state the fact that such an estimate cannot be made.

Case Study

- An earthquake destroyed a major warehouse of C Ltd. on 20 April 2012. The last accounting year ended on 31 March 2012 and the accounts were approved on 08 May 2012.

Answer

- Event occurred – Destruction of major warehouse
- Timing of event – between balance sheet date and date of approval by the board
- Condition existing – None. The earthquake did not exist on the balance sheet date.
- Hence, the destruction of warehouse is a non-adjusting event.
- The report of directors must disclose the fact of earthquake together with estimate of loss.

Case Study

- A company follows April-March as its financial year. Sometimes the company receives cheques dated 31 March or before, after 31 March but before approval of financial statements. It recognizes such cheques by debiting Cheques in hand A/c and crediting the Debtors A/c. The Cheques in hand is shown in the balance sheet as an item of cash and cash equivalents. All the Cheques in hand are presented to bank in the month of April and are also realized in the same month in the normal course after deposit in the bank.

Answer

- Event occurred – Receipt of cheques
- Timing of event – between balance sheet date and date of approval by the board
- Condition existing – None. The cheques were received after the balance sheet date
- Hence, the collection of cheques is not an adjusting event.
- Recognition of cheques in hand is therefore not consistent with the requirements of AS 4.
- Also, it does not represent material change or commitments affecting financial position and so no disclosure in Directors' Report is necessary.

Exception - 1

- Going concern assumption
  - The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis.

Exception - 1

- Going concern assumption
  - In case of an event occurring after the balance sheet date that indicates that the fundamental accounting assumption of going concern is no longer appropriate,
  - It shall be considered as an adjusting event, even if it does not reflect any condition existing on the balance sheet date

Example

- Suppose a fire occurred in the factory and the office premises of an enterprise after 31 March 2012 but before approval of financial statements. The loss on fire is of such magnitude that it is not reasonable to expect the enterprise to start operations again.
- Since the fire occurred after 31 March 2012, the loss on fire is not a result of any condition existing on 31 March 2012.
- Yet the loss should be recognized in profit and loss account and the assets lost should be written off in the financial statements as on 31 March 2012

Exception - 2

- Proposed Dividends
  - The directors propose dividends after the balance sheet date
  - The obvious reason being that no dividend can be proposed till the year is over and profit is ascertained
  - The dividend proposed does not reflect any condition existing on the balance sheet date
  - Yet, the proposed dividend should be treated as an adjusting event and be recognized in the balance sheet as provision

Case Study

- In X Co. Ltd., theft of cash of Rs. 5 lacs by cashier in January 2012 was detected only by May 2012. The accounts of the company were not yet approved by the Board of Directors of the company.

- Whether the theft of cash has to be adjusted in the accounts of the company for the year ended 31 March 2012.

Answer

- Event occurred – Detection of theft
- Timing of event – between balance sheet date and date of approval by the board. Hence, its an event occurring after the balance sheet date
- Condition existing – Theft had occurred during the accounting period

- Hence, it is an adjusting event and the Company should adjust the accounts as on 31 March 2012

Summary

- Event should occur between the balance sheet date and the date of approval of accounts
- Adjusting events –
  - if condition existing as on the balance sheet date
  - Accounts to be adjusted
- Non-adjusting event –
  - if condition is not existing as on the balance sheet date
  - Only disclosure is required