

Proposed IGAS 8:
*Contingent Liabilities (other than guarantees) and
Contingent Assets: Disclosure Requirements*

Request for comments

Government Accounting Standards Advisory Board (GASAB), constituted by the Comptroller and Auditor General of India, with the support of Government of India, to formulate and recommend Indian Government Accounting Standards, approved this Exposure Draft, **Contingent Liabilities (Other than guarantees) and Contingent Assets: Disclosure Requirements**, for publication. The proposals in this Exposure Draft may be modified in the final Standard in the light of comments received before being recommended by the Comptroller and Auditor General of India for notification by the Government of India in the form of Indian Government Accounting Standard.

Please submit your comments so that they will be received by **15 December, 2010**. All comments will be considered a matter of public record.

Comments should be addressed to:

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Copies of this exposure draft may be downloaded from the GASAB website
<http://www.gasab.gov.in>

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Indian Government Accounting Standard (IGAS) 8

Contingent Liabilities (other than Guarantees) and Contingent Assets: Disclosure Requirements

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**ED 8: Contingent Liabilities (other than guarantees) and Contingent Assets:
Disclosure Requirements**

The Standard, which is set in bold italic type, should be read in the context of the explanatory paragraphs in this Standard, which are in plain type and in the backdrop of the “Preface to Indian Government Accounting Standards”. The Indian Government Accounting Standards are not intended to apply to immaterial items.

Introduction

1. The purpose of the proposed IGAS on *Contingent Liabilities (other than guarantees) and Contingent Assets* is to provide for disclosure requirements of contingent liabilities (other than guarantees) and contingent assets of Governments in the financial statements. Disclosure of contingent liability is relevant from the point of view of knowing what risk of future liability the government carries. Disclosure of contingent assets is relevant in knowing what possible assets may accrue to government.
2. GASAB has already issued IGAS1 on guarantees. Other than guarantees (and letter of comfort) included in IGAS1, there are be other types of contingent liabilities. Fiscal Responsibility and Budget Management (FRBM) Acts and Rules framed there under require a variety of information to be disclosed in the budget documents that are in the nature of contingent liabilities and contingent assets. This standard aims at bringing in some of the Contingent Liabilities (other than guarantees) and Contingent Assets being disclosed in the financial statements for improved transparency.

3. Under cash basis of accounting and financial reporting, generally, cash receipts and cash payments and cash balance are reported. However, in some jurisdictions additional information on financial assets and financial liabilities may also be reported. Financial assets such as loans and advances and investments made by governments and financial liabilities in the nature of long-term debt are reported. Further, governments may disclose certain types of contractual obligations such as guarantees, which are not present liability. Certain possible assets such as revenue in arrears, which are under litigation, may also be disclosed. These are contingent because actual position of liability or asset will be confirmed only when related future events become certain. Disclosure of such information is relevant from the point of view of assessing possible future liability in case of contingent liability and future economic benefits and service potential in case of contingent assets. Guarantees given and other such uncertain liabilities relate to contingent liability and revenue in arrears under litigation and such other uncertain assets relate to contingent assets.

Objective

4. The objective of the proposed IGAS on the subject is to lay down the principles for disclosure requirements of Contingent Liabilities (other than guarantees) and Contingent Assets of both the Union and the State Governments including Union Territories with Legislatures, in their respective Financial Statements in order to ensure uniform and appropriate disclosure of such liabilities and assets. It also ensures consistency with international best practices leading to transparency and improved quality of disclosure in the financial reports of Governments for the benefit of various stakeholders. An important objective of the proposed IGAS is to ensure that Governments portray the risks associated with contingent liabilities and contingent assets in a transparent manner.

Scope

5. The proposed IGAS shall apply to both the Union and the State Governments including Union Territories with Legislatures in preparation of their financial reports. The IGAS shall not include in its ambit guarantees (including letters of comfort) for which IGAS 1 would apply. The standard also excludes treatment

of off budget borrowings, for which a separate statement may be developed, when found necessary.

Definitions

6. *The following terms are used in this Statement with meaning specified, unless the context otherwise requires:*

Accounting Authority is the authority which prepares the Financial Statements of the Governments.

Accounting Period means the period covered by the Financial Statements.

Cash Basis of accounting is that wherein accounting transactions of an entity represent the actual cash receipts and disbursements during an accounting period as distinguished from the amount due to or by the entity during the same period.¹

Consolidated Fund of India is the fund referred to in clause (1) Article 266 of the Constitution of India.

Debt is the amount owed by Government for borrowed funds.

Financial Statements means the Annual Finance Statements of the Governments.²

Government means the Union Government or any State Government or Government of any Union Territory with Legislature.

Sector consists of a grouping of specific functions or services as per the 'List of Major and Minor Heads of Account of Union and States'.

¹ Government Financial Rules, 2005, Rule 68, Government Accounting Rules, 1990, Rule 21

² as distinct from budget document

Budget refers to the ‘Annual Financial Statement’ of the State Government in terms of the provisions of the Article 202 of the Constitution.

Accounts of the State Government refer to the annual and the periodical accounts as prepared by the accounting authority. They include the Monthly Civil Accounts, Finance Accounts, etc.

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.’

Contingent asset is ‘a possible asset that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the control of the entity’.

Accounting for Contingent Liabilities and contingent assets

7. A contingent liability may arise due to either *legal obligation* or *constructive obligation*. A *legal obligation* relates to specific government obligation defined by law or contract, e.g., crop insurance, tax refunds under litigation, uncalled capital, indemnities, etc. A *constructive obligation* is an obligation that may arise when a government indicates to other parties that it accepts certain responsibilities and has created certain valid expectation on the part of those parties that it will discharge the responsibilities. Letter of comfort issued by governments (Union and States), expectation of bailing out public sector insurance, banking and other entities, etc. This also represents a moral obligation or expected burden for the government not in the legal sense, but based on public expectations and political pressures.

8. Based on legal and constructive obligations, contingent liabilities can be grouped as :

- i. Explicit & Implicit Contingent Liabilities;
- ii. Funded and Unfunded Contingent Liabilities;
- iii. Quantifiable & Unquantifiable Contingent Liabilities.

Types of Contingent Liabilities	Items / examples
Explicit	<ul style="list-style-type: none"> a. Guarantees (not covered in this standard), b. Indemnities/ compensations, c. Tax refund litigations d. Litigation by pensioners for claim of revised pension due to law change e. State insurance payments due for crop failures, etc., f. Uncalled capital etc., (callable capital subscription to international body or bank, e.g., ADB etc.),
Implicit	<ul style="list-style-type: none"> a. Letter of comfort (not covered in this standard), b. Default of public sector entities on non-guaranteed debt, c. Liability clean up in entities being privatized/ liability arising out of privatization; etc.,
Funded	<ul style="list-style-type: none"> a. Guarantees (when Guarantee fee, Guarantee Redemption/ Reserve Fund is matched with possible liability)
Unfunded	<ul style="list-style-type: none"> a. Liabilities arising from legislated commitments as mentioned in Paragraph b. Liability arising from a change in legislation with retrospective effect c. Payments arising from termination of contractual agreements/ indemnity payments to compensate etc., d. Environmental liabilities (e.g., Bhopal tragedy where some relief expenditure incurred by Governments)
Quantifiable	Many of the contingent liabilities like guarantees, letter of comfort, tax refund litigations etc., would be quantifiable
Unquantifiable	Many of the contingent liabilities arising from liability clean up in entity being privatized, liability arising from legislated commitments would not be quantifiable

9. For the purpose of clarity and to distinguish contingent liability from liability, the two can be differentiated as follows:

	Liability	Contingent Liability
Obligation	Present / certain	Present/ possible
Timing	Certain	Uncertain
Amount	Certain	Uncertain and a reliable estimate can not be made
Outflow of resources	Certain	No probability/ probability depending upon occurrence / non-occurrence of certain other events in future
Recognition	Recognised	Not recognised but disclosed

10. **A contingent liability which is a possible obligation and not a present obligation (of nature (a) in definition of Contingent Liabilities) is not recognized in the financial statements.**
11. **Under cash basis of accounting, provision will not be created and recognised even if there is a present obligation that probably requires an outflow of resources.**
12. Under cash basis of accounting and reporting, liabilities, e.g., current liability such as accrued liability and bills payable may not be recognised. As such, even when a present obligation has taken place and timing of payment is certain as well as the amount to be paid is reliably measurable, no liability is recognised and no provision is made until cash payment is actually made. It recognises only that current portion of cash flow, which goes towards liquidating the liability. However, disclosure of contingent liability is not restricted due to cash basis of accounting and its disclosure would help in tracking possible future obligations.
13. Contingent liabilities are liabilities of uncertain timing or uncertain amount or both and hence are not recognised even under accrual basis of accounting. Direct liabilities are predictable obligations that will arise in any event.

Contingent liabilities are obligations triggered by uncertain event, timing, amount or all of them.

14. Given the wide range of involvement of Governments and the variety of possible liabilities, they are exposed to some or the other kind of contingent liabilities. To appreciate their total financial commitment and also risk and exposure to loss along with their financial impact on the exchequer, the Governments should disclose their contingent liabilities. More so, this is needed not only to maintain inter-generational equity but also to assess future sustainability. **Assessment of risk** involved in contingent liabilities periodically may help make suitable decisions with respect to fiscal sustainability.
15. **Contingent Assets are not recognised in financial statements as they are dependent on uncertain future events and actual cash flow did not take place.**
16. Ownership of contingent asset is uncertain. It is only when certain events in future will take place that give rise to possibility of an inflow of economic benefits or service potential to an entity. Thus, inflow/ outcome is not certain and depends upon occurrence and non-occurrence of certain future events. For example, tax arrears, which are under litigation, may flow to government or may not flow depending upon the final verdict. Similarly, ownership of land acquired but under litigation may come to government or it may not. As such, these are contingent assets. However, disclosure of contingent assets is not restricted due to cash basis of accounting.
17. Contingent assets may arise due to legal or sovereign claim of government going under litigation. For example, tax demands raised but has been contested by the party involved in the court of law or designated tribunal may not be shown as tax arrears receivable but only contingent assets. Similarly, tax demands appearing difficult to be recovered due to assesses not traceable, companies having gone under either BIFR or liquidation, cases having gone to Settlement Commission, etc. may be disclosed only as contingent assets until declared irrecoverable.

Disclosure Requirements

18. **Disclosure requirements of guarantees and letter of comfort given by Governments have been mandated in IGAS1: *Guarantees given by Governments: Disclosure Requirements.***

19. **Contingent liabilities (i) where there is a present obligation that probably requires an outflow of resources or (ii) where there is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources needs to be disclosed in the financial statements as a footnote or a separate statement listing the contingent liabilities.**
20. **Contingent Assets needs to be disclosed in the financial statements as a footnote or a separate statement listing the contingent assets.**
21. Government may disclose for each class of contingent liability at the reporting date:
 - (a) a brief description of the nature of the contingent liability,
 - (b) amount of financial effect or an estimate of its financial effect,
 - (c) an indication of the uncertainties relating to the amount or timing of any outflow, and
 - (d) the possibility of any reimbursement.
22. In case of contingent asset, Government may disclose:
 - (a) a brief description of the nature of the contingent asset,
 - (b) amount of financial effect or an estimate of its financial effect,
 - (c) an indication of the uncertainties relating to the amount or timing of any inflow.
- 23 In case information as required is not disclosed because it is not practicable to do so, the fact should be stated.

Effective date

23. This Indian Government Accounting Standard becomes effective for the Financial Statements covering periods beginning on 1st April of the year after the notification of the Standard by the Government.