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EVALUATION OF CONTINGENT LIABILITY WITH REFERENCE TO INDIA AND THE U.K.

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ABSTRACT

A contingent liability is any potential future expense that depends on a “triggering event” to convert it into an actual loss. It is stated as a likely liability that may arise in the future, some instances are undecided lawsuits or honouring product warranties. Contingent liability status ranges from industry to industry and business-to-company, some firms are extremely likely to have a contingent liability, and some are minimal. This paper would mainly focus on the broader area of understanding the concept of contingent liability as a basic introduction to the topic. Following this would be the comparative analysis of both contingent liability in India and the United Kingdom. The study involves extensive coverage of various online sources combined with personal observations and opinion surveys. Various case laws, articles and scholarly literature were referred for the study that was excessed through online databases. This research paper expects to investigate the components that persuade learning by looking into the writing. This paper will jump at the chance to overcome any barrier and proceed in this area and make recommendations for future examinations. The suggestion and commitment of this system are remembered for this exploration paper. At last, an all-encompassing inspiration learning system is proposed.

INTRODUCTION

A contingent obligation is characterized as a risk that may emerge contingent upon the result of a particular occasion. It is a potential commitment that could conceivably emerge contingent upon how a future situation develops. A contingent liability is recorded when it tends to be assessed, else it should be unveiled. Contingent liabilities could be unequivocal that is expressed or understood that is implied. Express risk is perceived by law or agreement through the certain commitment of the public authority mostly reflects public desires. The state ensures

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gave in the interest of sub-public governments and public and private area substances fall in the classification of express unforeseen liabilities. Credit ensures, exchange a lot rate ensures offered by the State, state protection plans, for example, for stores, crops, floods, least get back from benefits reserves and so forth, are additionally in the classification of unequivocal contingent liabilities' commitment that isn't and fixed and total, yet which will turn out to be so on the occurrence of some future and unsure occasion. An assurance commitment is an illustration of an unforeseen commitment. Under the particulars of the assurance, the underwriter accepts risk for all ensured commitments; however, its obligation to make installments is contingent. In assurance, the possibility is regularly the disappointment of the gathering that is fundamentally answerable for the installment commitments to make installment. If this happens, the underwriter's installment commitment is not, at this point unexpected.

LITERATURE REVIEW

Contingent Liabilities can be isolated into two expansive sorts - unequivocal and certain. Express liabilities are authoritative commitments of state governments, while verifiable liabilities are non-authoritative and reflect public desires towards an extended part of the state uphold a long way past its lawful commitment. On account of sub-public governments, ensures in the interest of public ventures and the private area, and state protection plans fall under the principal classification. Understood unforeseen liabilities of States remember default of public elements for a non-insured obligation or different commitments, risk tidy up in substances being privatized, disappointments of insufficiently financed benefits assets, and characteristic disasters.

"An administration gives assurance for the benefit of a substance when it doesn't have the essential reliability/history to raise capital or agreement an advance all alone and subsequently, looks for insurance under the general umbrella of the public authority. In this manner, unexpected liabilities are the authoritative commitments of the public authority to accommodate any projection of default by the borrower either on chief sum acquired or interest instalment on such sum or both. Otherwise called unexpected risk."[2]

Understood contingent liabilities, for example, trade ensures, monetary framework rescue, store protection, and so on are more significant at the public level. Unforeseen Liabilities can

[2] Sakshi Agarwal, *Contract of Indemnity in India & UK*, (August 10,2018), http://lawtimesjournal.in/contract-of-indeminity/

likewise be arranged into two gatherings supported or unfunded. “Financed liabilities are coordinated by a save or charge against benefits equivalent to the actuarial estimation of the obligation i.e., the hold approaches the present limited estimation of the settlements while unfunded liabilities don't have coordinating stores.”[3]

RESEARCH METHODOLOGY

The study is confined to India. The data is collected from the primary and immediate source, first-hand data which includes raw data, original research, data sets, and survey data as well. The scope of the study is wide as this study interprets legal phenomena and relationships between the wide society of India. “There are mainly doctrinal and non-doctrinal methods of study for conducting research work. The doctrinal method mainly emphasizes research by analyzing materials available while non-doctrinal requires researchers to undergo fieldwork to do the research work.” In this research paper, the doctrinal method has been used.

MEANING AND IMPORTANCE

A contingent liability is thus a type of financial event that might or might not evolve into an obligation in the future for the company. As per the definition provided by General Accepted Accounting Standards (GAAP), a contingent liability is any potential future expense that depends on a “triggering event” to convert it into an actual loss. As the concept of contingent liability borders on vagueness and considerations regarding which event is recognized as a potential expense is unclear, there are two yardsticks to follow when dealing with a contingent liability – Whether an event is 50% or more likely to occur in the future and it can be expressed in monetary figures or not.

For every contingency that meets these two conditions, it is possible to post such a case in the books. A contingent liability is reported first in the Benefit & Loss Account as an expense and later on the balance sheet on the liability side.

- Contingent liabilities are reported to ensure that corporations, “government, and non-government organizations are compensated for any potential emergency.
- The documentation of certain liabilities allows determining the financial status of the country or the business correctly.
- It allows a business or government to prepare its spending easier.

[3]Sunando Roy, *Contingent Liabilities at the State Level: The Indian Experience* 5 (Oxford University Press 2004)

- The number and type of contingent liabilities are often regarded by credit firms when approving credit to a firm.
- Investors would also like to know the possible obligations that the firm might have to face in the future before investing.
- Analysts can say for contingent liability which incidents can turn out to be a detrimental influence for the company's sustainability.
- These are important for research since they commonly represent hazards that are easily exploited or left out.
- They also affect the actions of the company's creditors. For example, if they have a reason to assume that the liabilities could occur and that the company may not be able to repay the loan, they may harm the lending decision.
- Contingent debt decreases not only the assets of the company but also impacts the cash balance and net profit of the company.
- The extent of the effect on the company's share price also relies on the emergence of contingent liabilities and the amount correlated with them. The extent of effects is often based on the company's financial soundness. If the report reveals that the business is financially sound to handle the risks that will result from the contingent liability, so investors may continue to invest in the business."[4]

LIST, TIME TO RECORD, AND TYPES OF CONTINGENT LIABILITY

The list of contingent liabilities are as follows:

1. Potential Lawsuits- Potential lawsuits occur where an entity assures on behalf of the other party when the actual person or person fails to pay that the money must be paid by the person who gave the guarantee.

2. Product Warranties- Once a product is made and available for delivery then certain firms offer a product warranty, i.e. a minimum warranty for a certain time and if the product fails to work during the warranty period, the person responsible for the company must substitute or fix the product."Let us see the scenario where a person bought a motorcycle from a showroom and has a two-year warranty for the engine and the motorcycle, and the engine fails to perform within six months of the purchase, so the engine would be replaced by the business."[5] This is,

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[4] Finance Management, https://efinancemanagement.com/financial-accounting/contingent-liability-meaning-importance, (Last visited Jan. 28, 2021)

[5] Vibhuti Narayan, *What are the Different Types of Contingent Liabilities?*,Groww, (Jan. 14, 2021), https://groww.in/p/contingent-liabilities/

however, a contingent responsibility for the corporation. This is, however, a contingent responsibility for the corporation.

3. Pending investigations-Any pending prosecution or court case by statute whether the entity or corporation was found to be defaulting then they were intended to bear the punishment as prescribed by the court of law.

Correct time to record contingent liability are as follows:

1. Probable contingency- Any financial obligation with a probability of arising in the future of at least 50 percent is called a likely contingency and the failure to be realized is considered a probable contingent liability. For example, if a corporation faces a lawsuit where a solid argument is made by the plaintiff, then such an occurrence may be viewed as a possible contingency. The weight of a case will be measured by a practitioner such as a legal attorney, its risk extracted, and where the odds of a loss are 50 percent or higher, the loss will be expressed in monetary terms. It shall, after that, be registered in the records of the company.That is because the rule of conservatism is observed in accountancy, which specifies the theory that failure is often inevitable and therefore is reported at a 50 percent or greater likelihood of occurrence; while gains are impossible and thus are deferred before benefit realization, or chances are more probable than a loss, to record them in the records.

2. Possible contingency- A possible contingency is when there may or may not be a liability, but the probability of its occurrence is less likely than that of a probable contingency, i.e. less than 50%. Usually, therefore, a possible contingency is not recorded in the books but rather mentioned in the footnotes. Due to the minimal likeliness of occurrence, another explanation for why a potential contingency is not reported in the books is that it cannot be represented in monetary terms. As stated earlier, the accounts of a corporation shall not report any contingency which does not follow the two requirements.

3. Remote contingency- Any liability that has a limited probability of arising that is not probable under usual conditions is known as a remote contingency, as the name implies. Although the likelihood of such contingencies leading to losses for the company is small, they are not reported in books or alluded to in footnotes.

Types of Contingent liability are as follows:

1. Implicit Contingent Liability- Implicit responsibilities reflect moral duties or burdens that are expected to be assumed by states because of popular expectations or political forces, while not legally binding. Direct tacit liabilities are mostly a presumed, longer-term product of decisions on public procurement that is not included on government balance sheets. For instance, in countries with pay-as-you-go pension plans, prospective benefits represent tacit direct liabilities. Whose significance is determined by how generous pension payments are, how many persons are entitled to receive them, and at what age retirees become eligible, as well as by the demographic and economic trends in the future.

   Until after a loss occurs, dependent implicit obligations are not publicly recognized. The triggering cause, the risk-benefit, and the amount of government spending that would potentially be needed are all unknown. In most countries, the most serious contingent implied obligation is reflected by the financial system. "Experience has demonstrated that markets generally expect the government to offer financial assistance that far exceeds its legal responsibility when the integrity of a country's financial system is at stake.

2. Explicit liabilities- They are particular duties to be agreed upon by states, established by statute or contract. The conventional fiscal theory attempts to reflect on the clear direct obligations of states."[6] This includes sovereign debt repayments, discretionary spending for the next fiscal year, and longer-term expenditure for legally binding commitments (such as civil service salaries and pensions and, in some countries, the overall social security system). Explicit contingent liabilities are legal requirements for states to make compensation only if real incidents happen.

   State guarantees and funding by state-guaranteed institutions can, due to their secret existence, be more appealing in the short run than outright budgetary support. However, these contingent explicit liabilities can well turn out to be costlier in the long run. Besides, they can establish moral hazards in markets, particularly if policymakers guarantee all, rather than part of, the underlying assets (such as corporate credit) and all risks, rather than the preferred political and commercial risks. For example, state insurance policies also cover uninsurable costs of uncommon but theoretically enormous losses; such schemes redistribute capital because they do not appear to be insurable, they won't be self-financed, through fees, but rely on government financing.

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[6] Hana Polackova, *Contingent Government Liabilities A Hidden Fiscal Risk*, Volume 36, number 1, Finance and Development, March 1999, https://www.imf.org/external/pubs/ft/fandd/1999/03/index.htm

INTERPRETATION AND IMPLEMENTATION OF INDIAN AND UK LAW

It would be apparent in almost all situations whether a past occurrence has given rise to a pending responsibility. "In rare cases, such as in a court, it is possible to question whether certain events have happened or whether those events have culminated in a contractual responsibility. "In such a case, the undertaking shall determine if the present responsibility remains at the balance sheet date by taking into account all the facts available, including, for example, the experts' view."[7] Any new information given by incidents after the balance sheet date is included in the evidence considered"[8]based on such proof:

(a) if the current requirement is more likely than not to occur at the balance sheet date, the enterprise recognizes a provision (if the recognition requirements are met);

(b) if there is a greater chance of no current liability at the balance sheet date, the company shall report a contingent liability where the probability of an outflow of capital embodying economic benefits is remote where the enterprise is more likely than not to have an actual liability at the balance sheet date.

According to UK law, "usually directors face huge repercussions if unforeseen liabilities are overlooked or their significance in different circumstances isn't perceived. As a chief, you could confront individual risk if an unexpected obligation brings about the bankruptcy of your business when you have announced a profit or paid yourself a compensation the organization can't uphold."[9] Contingent upon the conditions, aside from being held subject for a few or the entirety of the business's obligations, you may likewise be precluded from holding the workplace of the chief for as long as 15 years. Unforeseen liabilities don't generally become genuine liabilities; however, they should be considered in different circumstances to guarantee the organization and its chiefs work inside UK organization law. This can be a mind-boggling region of business, and if you need additional data or guidance about unforeseen liabilities in your organization, kindly call our group of specialists. Genuine Business Rescue is a huge piece of Begbies Traynor Group and can give the dependable unprejudiced direction you need.

CONCLUSION

In the income statement, corporations and other organizations may report a contingent

[7] Contingent liability Laws in India, https://tallysolutions.com/business-guides/contingent-liabilities/ , (Last Visited Jan. 28, 2021)

[8] Ravi Sharma, *Contingent Liability*, Economic Times, (Jan. 28, 2021, 02:01 PM), https://economictimes.indiatimes.com/definition/contingent-liability

[9] Paul Stanley, *Recognizing contingent liabilities*, Real Business Rescue, (May 11, 2020, 10:00 a.m.), https://www.realbusinessrescue.co.uk/articles/directors-advice/what-is-a-contingent-liability

obligation as a loss or cost. That can also be shown by the organizations on the balance sheet as a loss. In certain cases, by a meager memo in fiscal reports, a corporation can also report such liabilities. In the financial statement or balance sheet, whether or not the firm reveals such liability depends on certain parameters. On the other hand, in the financial statement or even in a footnote, there are a few contingent commitments that companies do not display. For example, a lawsuit against a corporation has almost no likelihood of being proven against the company on the grounds of the historical success record of such a lawsuit.

A contingent liability is a very subjective concern that, with good judgment, requires an eye for information. Contingent liability status ranges from industry to industry and business-to-company, some firms are extremely likely to have a contingent liability, and some are minimal. The company's board must settle on the disclosure of contingent liabilities when it is valued by customers. In a financial statement review, it is imperative to consider the contingent obligation because it will cost a business several million and impair net profitability.