

**Accounting and Reporting Procedure for
Contingent Liabilities of Public (State-Owned)
Enterprises, 2082**



Government of Nepal

Ministry of Finance

Public Debt Management Office

Tripureshwor, Kathmandu

Accounting and Reporting Procedure for Contingent Liabilities of Public (State-Owned) Enterprises, 2082

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Section 12 of the Financial Procedures and Fiscal Responsibility Act, 2019 provides that the Ministry of Finance shall maintain records in a manner that clearly shows the amount of liability created based on the financial liabilities created under the prevailing federal law and the potential financial liabilities to be borne pursuant to various treaties, agreements or court decisions and orders, or the commitment to provide revenue exemption. Similarly, Section 14 of the Public Debt Management Act, 2022 BS provides that the government may provide guarantees. Sub-rule (2) of Rule 20 of the Financial Procedures and Fiscal Responsibility Regulations, 2021 provides that the Public Debt Management Office shall maintain records related to liabilities other than those created under the treaty or agreements entered into by the Government of Nepal with the donor agencies.

Currently, there are 45 Public Enterprises (SOEs/PEs) in which the Government of Nepal owns more than 50 percent. The total operating income of these enterprises is equivalent to 11.57 percent Gross Domestic Product (GDP)¹ of the country. According to the Annual Status Review of Public Enterprises 2082, it is estimated that there will be contingent liabilities of 21 trillion rupees, which is seen as a major financial risk in the management of Public Enterprises. The contingent liabilities may also affect the national budget and financial stability, if the operation of Public Enterprises are unable to strengthen their financial position. On this basis, it has become necessary to account for and record the contingent liabilities of Public Enterprises owned and operated by the Government of Nepal.

The objective is for the Public Enterprises being liable to manage the contingent liabilities properly, considering the potential financial risk that could arise from such liabilities due to lack of the identification, measurement, classification, accounting, reporting, and disclosure in a timely manner, the Ministry of Finance—pursuant to sub-section (2) of Section 65 of the Financial Procedures and Fiscal Accountability Act, 2019 (including the first amendment)—

¹ Annual Status Review of Public Enterprises 2082, Page 18

has issued the 'Accounting and Reporting Procedure for Contingent Liabilities of Public (State-Owned) Enterprises, 2082' This procedure shall provide guidelines to maintain a standardized framework for the identification, classification, evaluation, reporting, and disclosure of contingent liabilities.

Chapter-1

Preliminary

1. Short title and commencement: (1) The name of this procedure shall be "Accounting and Reporting Procedure for Contingent Liabilities of Public (State-owned) Enterprises, 2082".

(2) This procedure shall come into force from the date of approval by the Government of Nepal, Ministry of Finance.

2. Definition: Unless the subject or context otherwise requires, in these procedures:-

- a) "Act" means the Financial Procedures and Fiscal Responsibility Act, 2019.
- b) "Office" means the Public Debt Management Office.
- c) "Guarantee" means a legally binding commitment made by a guarantor to assume full or partial responsibility for a loan or other obligation in the event of defaults or non-payment of the liabilities by the borrower. The term also includes a guarantee provided pursuant to Section 14 of the Public Debt Management Act, 2022.
- d) "Ministry" means the Ministry of Finance, Government of Nepal.
- e) "Provision" means an obligation for which the time or amount is not fixed.
- f) "Enterprise" or "PEs" means those enterprises included by the Government of Nepal as Public Enterprises in the Annual Review of Public Enterprises, in which more than fifty percent of the shares or assets are owned by the Government of Nepal, a Provincial Government, or a Local Level; and the term also includes other Public Enterprises in which more than fifty percent of the shares or assets are owned jointly by the Government of Nepal and any other enterprise.

- g) "Contingent liability" means a contingent liability as per Nepal Accounting Standard 37.

Chapter-2

Identification of Provision and Disclosure of Contingent Liability

- 3. Identification of Provision:** (1) While preparing the annual financial statements of the Enterprise subject to this procedure, the provision shall be accounted for, if the following conditions are met as per Nepal Accounting Standard 37 :-

- a) Any past event must have created a situation to bear a legal or constructive obligation at present,
- b) It must be probable that the outflow of economic resources will have occurred to fulfill the responsibility under clause (a),
- c) It must be possible to account the reliable estimate on outflows of economic resources in accordance with clause (b).

(2) Events that cannot be identified as a provision in accordance with the conditions set out in clauses (a), (b) and (c) may be contingent liabilities.

- 4. Contingent liabilities:** (1) An event that occurred in the enterprise's past may not create liabilities at present but may create a liability in the future, such liability should be disclosed as a contingent liability.

(2) For there to be a contingent liability pursuant to sub-section (1), the following conditions must be met:-

- a) The occurrence of future events is uncertain and beyond the control of PEs, so that the obligation whether to be fulfilled or not of the past event depends upon the future event, or
- b) Whether an obligation has arisen at present from the past events or the possibility of an outflow of resources to meet the obligation is remote, or

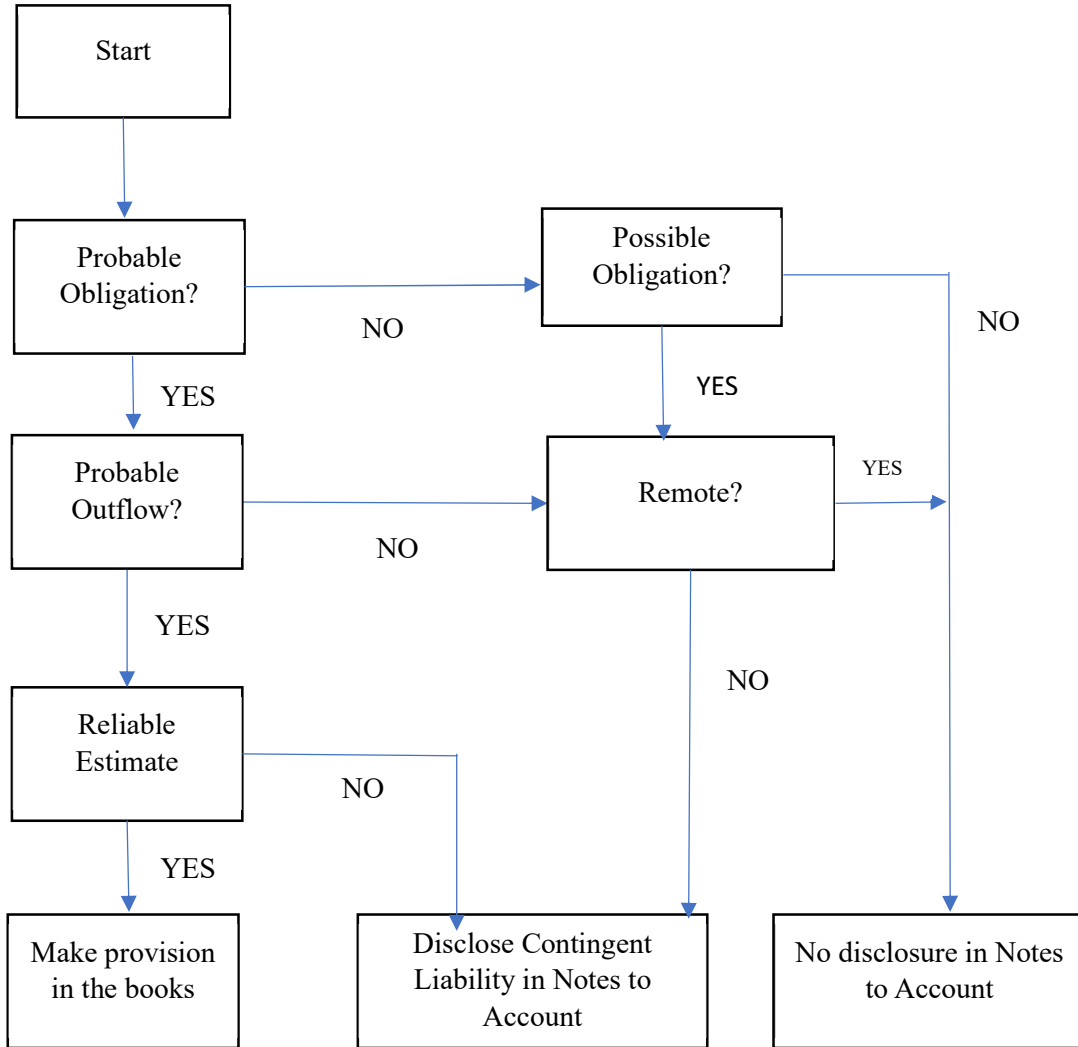
c) Is difficult to measure the total amount of the liability reliably.

Example:

A food trading enterprises is established with the purpose of providing foods to the consumers at a reasonable price through buying at fair price from the farmers. On the other hand, being a government enterprise, it has an obligation to support the policies and programs of the government. Since the past, the government has been involving this enterprise in distributing foods to the residents of the communities affected by the floods during the monsoon season at free of cost. Although there is no legal obligation as per the objectives of this enterprise (Limited), there is a situation where it is required to provide free food assistance to the people who may be affected by future floods and the potential victims are expected to receive assistance through it. This enterprise (Limited) will have to disclose the foregoing type of obligation as a constructive obligation.

(4) The following decision tree can be adopted by the enterprise to identify contingent liabilities. The process mentioned in this decision tree has been constructed in accordance with the principles of Nepal Accounting Standard 37. Its use helps the Public Enterprise to determine whether to make a provision for the liability, disclose a contingent liability, or take no further action on the matter.

Decision Tree for Contingent liability Recognition



Stepwise Explanation

Step 1: Is the event a Probable Obligation?

- If yes, assess whether there is a high likelihood of an outflow of resources.
- If not, consider whether it is a possible obligation.

Step 2: Is there a possibility of an outflow of economic resources in the event?

- If yes, determine whether a reliable estimate can be made about the event or not.

- If not, disclose it in the notes to account as a contingent liability without accounting for it in the financial statements.

Step 3: Can it be possible to estimate reliably the amount of liability arising from the event?

- If possible, record the provision amount in the financial statements.
- If not, then, since the possibility is low, it should not be recorded in the financial statements but disclosed in the notes to account as a contingent liability.

Step 4: If the event does not have a high probability of creating a liability, is there a medium probability liability?

- If yes, is there the possibility of economic resource outflows remote?
- If the probability is low, disclosure is not necessary in the notes to account.

Step 5: Is the possibility of economic outflow remote?

- If yes, the contingent liability does not need to be disclosed in the financial statements.
- If not, disclose in the notes to account as a contingent liability

Case: Liabilities Arising from Internal Factors

A manufacturing enterprise established in 1978/79 (2035 B.S.) has been incurring operating losses continuously for the past five years. As a result, the enterprise's accumulated losses are being equal to the level of its net fixed capital. Despite various efforts taken to increase its operating income to make the enterprise profitable, the expected results have not been achieved. Additionally, the government has also been pressurizing the enterprise to become able to generate operating profits. Based on multiple studies conducted by independent consultants, the main reason for the operating loss was identified as the outdated technology installed in the production unit. It was found that the enterprise is still using the same technology and equipment since the time of the enterprise's establishment. Continuously using the old technology and equipment for the production has led to increase the cost of production, and heavy production losses due to significant wastage.

If the enterprise installs equipment to use new technology, several related factors emerge: the stock of raw materials usable only with the current equipment will become obsolete, supply contracts for such goods and maintenance services will have to be terminated, employees

may need to be retired or trained for the new technology, old equipment must be removed, and structural modifications to the production unit's building will be required. The Board of Directors, deeming reform necessary, has decided to decommission the existing equipment.

To illustrate how the Decision Tree is utilized, the following hypothetical scenarios have been considered:

- a) The decision made by the Board of Directors before the balance sheet date was not implemented.
 - b) The decision made by the Board of Directors before the balance sheet date was implemented.
- a) The decision made by the Board of Directors before the balance sheet date was not implemented.**

Although the Board of Directors of this enterprise decided to close the production unit, the affected parties—such as the workers and the suppliers of goods and maintenance services—were not informed of this decision by the balance sheet date. Therefore, there is no likelihood of the Board's decision being implemented as of the balance sheet date. A step-by-step analysis of this event reveals:

Use of Decision Tree: Analysis as per Nepal Accounting Standard 37

Step 1: Is the event likely to create a liability in the present?

- This decision does not currently appear to be giving rise to any event that would create any obligation, therefore no liability is created.

Step 2: Is the likelihood of an outflow of economic resources high or medium?

- There is no likelihood of an outflow of economic resources since the liability has not been created yet.

Step 3: Can the liability amount be reliably estimated?

- Since the liability has not been incurred, it is not necessary to estimate the contingent liability.

Conclusion under Nepal Accounting Standard 37:

In this case, no provision is accounted for (as obligation) and it does not even need to be disclosed as a contingent liability.

- b) The decision made by the Board of Directors before the balance sheet date was implemented.**

The board of directors of this enterprise has informed the employees who will be directly affected by the closure of the production unit, suppliers who supply necessary raw materials for production, and maintenance services by the balance sheet date. Therefore, the likelihood of the board of directors' decision being implemented seems high. When analyzing this incident step by step:

Step 1: Is the event likely to create a liability in the present?

- Yes. Obligation has been created in this situation because the decision was communicated to the concerned parties, creating a clear and definite expectation that the production unit would be closed.

Step 2: Is the likelihood of economic resource outflows high or medium?

- High. There is a high possibility of economic resource outflows to cover the incurred expenses for the closure of production unit.

Step 3: Can the liability amount be reliably estimated?

- As per the provisions of Nepal Accounting Standard 37, reliable estimation of obligation incurred in closing the department should be done. For this, it is easy to estimate and identify the amount to be paid as per the agreement for the affected employee retirement benefits, costs for removing equipment, and cancellation of contracts with suppliers.

Conclusion under Nepal Accounting Standard 37

A provision should be recorded in the financial statements based on a reliable estimate of the costs incurred when the production department is closed at the end of Ashad 2081.

Case: Liability created by external causes

Considering air pollution, the government had issued a new Air Pollution Control Act in Magh 2074 BS, making it mandatory for industries emitting smoke from coal to install smoke filtering equipment. The act itself had provided a time limit of five years from the date of its issuance to install such equipment. If an industry fails to install smoke filtering equipment within the said period, it has also made provision for imposing a fine of 5 percent of the industry's coal consumption or NPR 2 million per year, whichever is higher. While preparing the financial statements for the fiscal year 2080/81 of a Public Enterprise that has been using coal to produce goods, the auditor asked a question regarding the compliance with this law. It has been found that the enterprise has been producing goods without installing any smoke filtering equipment till now.

Decision Tree Analysis according to Nepal Accounting Standard 37

Step 1: Is the event likely to create a liability in the present?

- Yes. Since the enterprise has not yet installed the smoke filtering equipment, there is currently no liability for the costs incurred to carry out the work, because the event that created the liability (connection work) has not occurred. On the other hand, the enterprise has been carrying out production work contrary to compliance with the law. Since the act has been violated here, the enterprise may be liable to pay a fine. Because this enterprise has already violated the act and created the liability.

Step 2: Is the likelihood of economic resource outflows high or medium?

- Yes. There is a possibility of paying a fine as the Factory has been operating contrary to the provisions of Act. The possibility of creating liability depends on how strictly the government implements this Act.

Step 3: Can the liability amount be reliably estimated?

- The enterprise must make a reliable estimate of the potential penalty, which is 5 percent of the cost of coal consumption or NPR 2 million, whichever is higher, in accordance with the provisions of Nepal Accounting Standard 37.

Conclusion under Nepal Accounting Standard 37

As the government has not taken any legal action so far, no obligation has been created. Since the enterprise has not even approved the plan to install smoke filtering equipment immediately, no provision should be made for the estimated cost of the work. However, if the probability of paying a fine is high, a contingent liability amount should be recorded as a provision based on a reliable estimate.

Case: Liability created by external causes

The government has made several significant changes to the Income Tax laws. Due to these changes, an enterprise working in financial services sector will have to conduct intensive training programs for its revenue generating and administrative staff to ensure full compliance with the financial services rules. However, as of the balance sheet date, the company has not initiated any training for these employees.

Decision Tree Analysis according to Nepal Accounting Standard 37

Step 1: Is the event likely to create a current liability?

- No. No Obligating Event has occurred.

Step 2: Is the likelihood of economic resources outflows high or medium?

- Not applicable.

Step 3: Can the liability amount be reliably estimated?

- Not applicable.

Conclusion under Nepal Accounting Standard 37

In this case, no provision for the training needs to be accounted for and it does not even need to be disclosed as a contingent liability.

Case: Maintenance Costs – Legal Requirement

AN Airlines Corporation is a Public Enterprise wholly owned by the Government of Nepal. It operates air services for domestic and international flights. The Corporation purchased a new aircraft and brought it into operation at the beginning of the fiscal year. As per the rules issued by the Civil Aviation Authority, there is a legal provision that every aircraft must undergo a comprehensive overhaul every three years to ensure its flight permit and safe flight.

Decision Tree Analysis according to Nepal Accounting Standard 37

Step 1: Is the event likely to create a current liability?

- No. Since the aircraft will be due for maintenance after three years, there has been no obligating event at present. There is currently no event that is likely to occur or has occurred.

Step 2: Is the likelihood of economic outflow high or medium?

- Since there is no possibility of creating a liability, there is no possibility of an outflow of economic resources.

Step 3: Can the liability amount be reliably estimated?

- Since no liability has been created, it is not necessary to make a reliable estimate.

Conclusion under Nepal Accounting Standard 37

In this case, the Corporation does not have to account for any provision and does not have to disclose it as a contingent liability. Since the company's decision to repair the aircraft is an event that will occur in the future accounting period, no definite obligation is created at present. Although the law requires the maintenance of the aircraft, the Corporation can eliminate the obligation to pay for the maintenance in the future by selling the aircraft before the period when it is required to repair it.

Case: Contingent liability created by legal proceedings

A cement factory owned by the government of Nepal was operating a large-capacity cement factory near a densely populated area. In 2023, the Department of Environment (DoE) issued a notice of non-compliance with environmental regulations for excessive pollution and

improper management of industrial waste. A group of local residents filed a class action lawsuit seeking compensation of Rs 100 million for environmental damage and negative health impacts. The case was registered in court and is currently in the preliminary hearing stage.

The legal advisors of the cement industry have estimated a 40% chance of crystallization.

Analysis according to Nepal Accounting Standard 37:

Step 1: Is the event likely to create a current liability?

- The affected local residents have filed a lawsuit in court.
- The Department of Environment (DoE) has issued a notice regarding pollution emissions and improper waste management.
- There is a possibility of creating liability at this time, as the outcome will depend on the court's decision.

Step 2: Is there a possibility of outflow of economic resources?

- The final decision is likely to come in a few months.
- According to the company's legal advisor, there is a 40% chance that liability will crystallize.
- There is a medium possibility (Possible) of the source being released, but not a high possibility (Probable).

Step 3: Can the liability amount be reliably estimated?

- The amount can be reliably estimated because the legal registration and related documents state that the amount of compensation sought is NPR 100 million.

Conclusion according to Nepal Accounting Standard 37:

There is a moderate possibility of an outflow of economic resources. Since it is not highly probable and the amount can be clearly estimated, this event remains a contingent liability. The cement industry should disclose it in the notes to account in the financial statements as a contingent liability. Since the probability of the liability crystallizing is 30-49%, the risk

category of this contingent liability falls within the "Moderate" category according to the procedure.

Case Study: Contingent liability created due to legal process

Nepal's government-owned Life and Non-Life Insurance Company has issued a group life insurance policy for employees of a large government hydropower project. In 2023, 20 workers died in a landslide and an insurance claim of Rs 250 million was filed. The insurance company refused to pay the claim, saying that the employer (the insured party) had not disclosed the existing safety violations from the beginning. The hydropower project has filed a case in the Patan High Court against the insurance company, demanding full payment of the amount, alleging breach of the insurance contract. The case is currently pending in court. The insurance company's Legal advisors have estimated the probability of liability crystallization in this case at 30%.

Analysis according to Nepal Accounting Standard 37:

Step 1: Is the event likely to create a current liability?

- A legal case has been filed and there is a dispute regarding the contract.
- Based on the assessment of legal counsel, there appears to be a moderate contingent liability.

Step 2: Is there a possibility of outflow of economic resources?

- A decision on this case is expected within the next fiscal year.
- The legal advisors of the insurance company have assessed the probability of liability crystallization at 30%.
- Therefore, there is a medium possibility of economic resources outflows (Possible) but not a high probability (Probable).

Step 3: Can the amount of the liability be reliably estimated?

- Based on the evidence submitted and the terms of the insurance contract, a reliable estimate of the amount can be made (as the claim is NPR 250 million).

Conclusion according to Nepal Accounting Standard 37:

Since the possibility of an outflow of resources is not currently high, but rather medium, the company should disclose this event as a contingent liability in its financial statements. No provision needs to be recorded in the balance sheet.

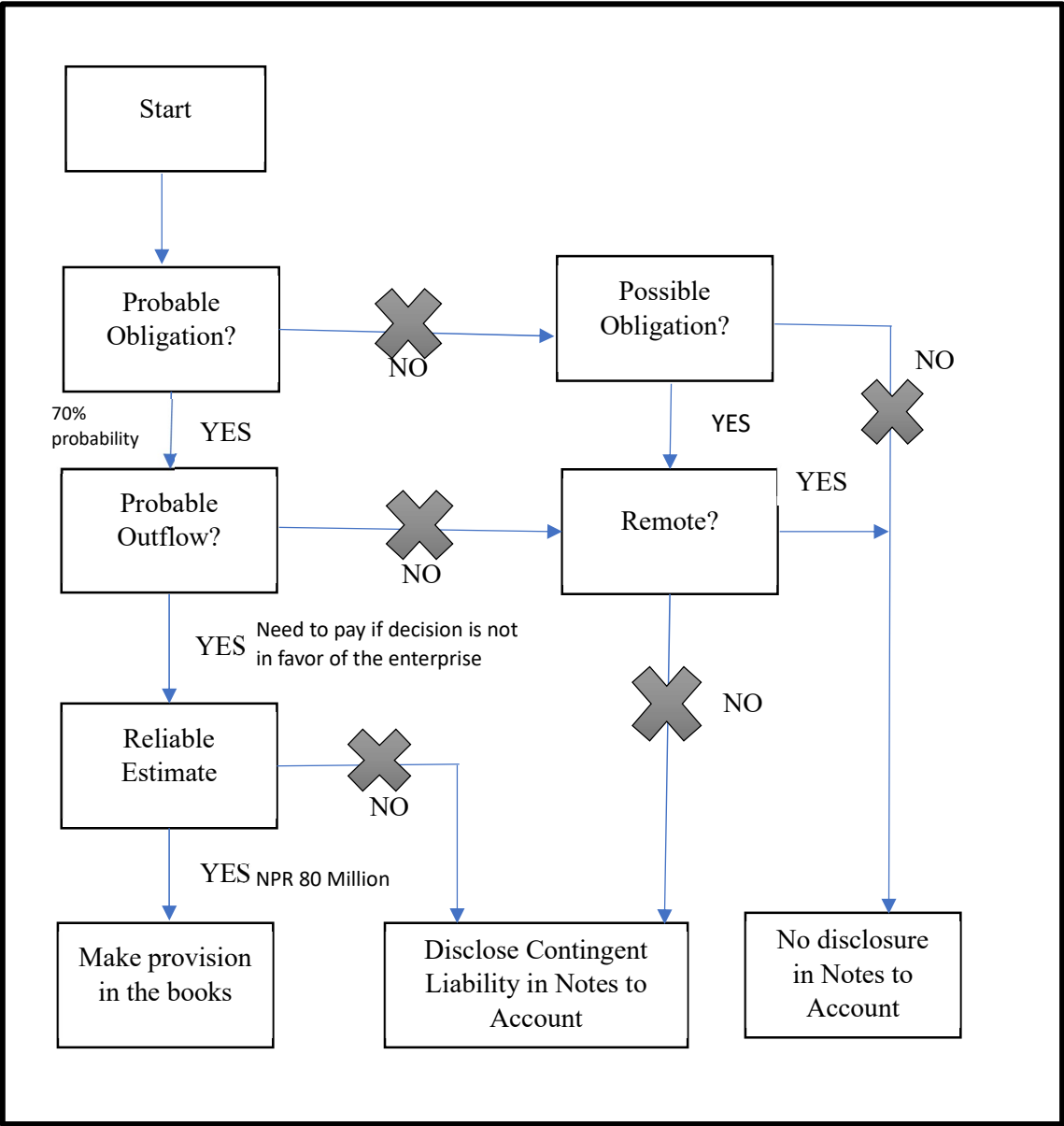
As the probability of liability crystallization is within 30-49% according to the procedure, the risk category of liability created by this event will be moderate.

Analysis based on the use of a decision tree

A former customer filed a lawsuit against an enterprise, demanding compensation of NPR 100 million for breach of contract.

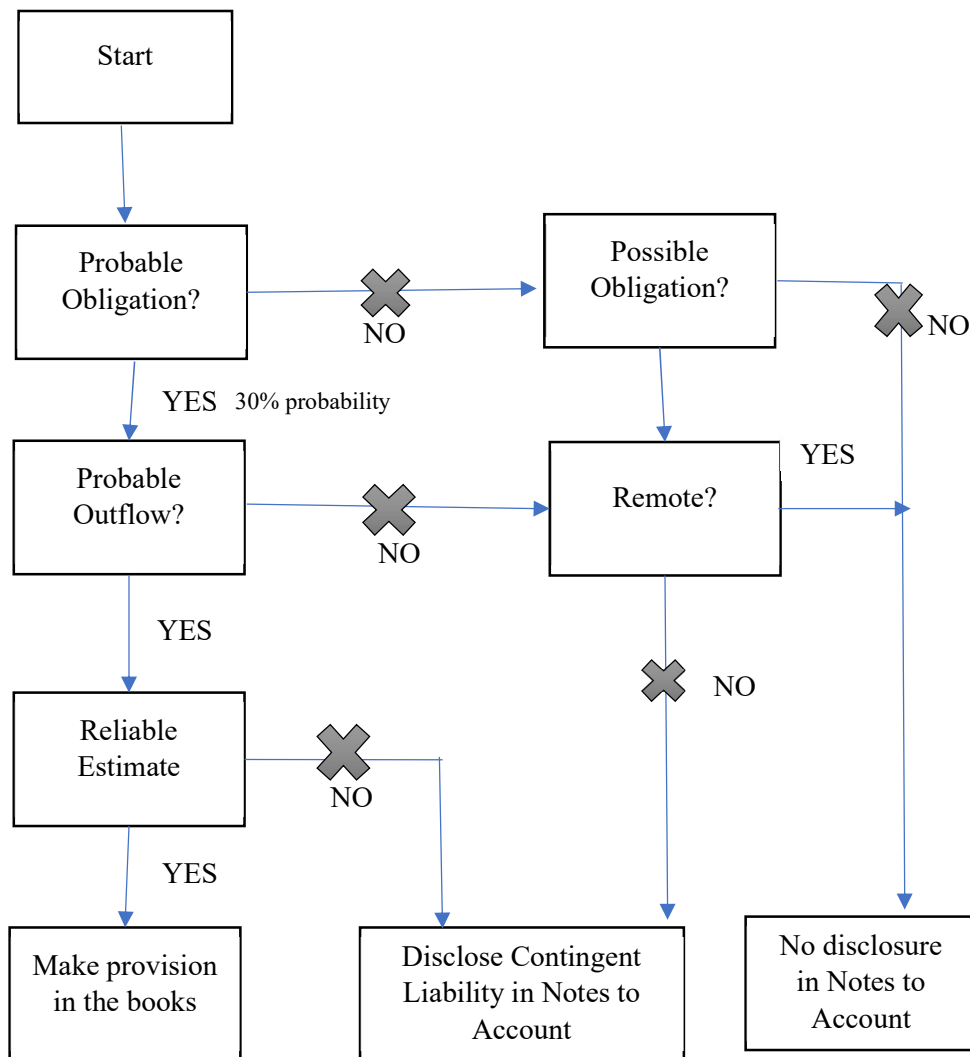
- a) **Scenario 1-** According to the legal advisors of the company, the client has estimated a 70% chance of winning the case. The company has estimated that the potential compensation for this could be around NPR 80 million.

Use of Decision Tree based on Nepal Accounting Standard 37:



Conclusion: The enterprise has to make a provision of NPR 80 Million in its Financial Statement

b) **Scenario 2-** Some Environment Activists have filed a lawsuit against an enterprise in the court on the charge of causing environmental damage. The enterprise's experts estimate that the probability of the company being found guilty of this charge is up to 30%. However, if this charge is proven by the court, the company may be liable to pay compensation of NPR 200 million.



Conclusion: The enterprise needs to Disclose Contingent Liability in Notes to Account

c) **Scenario 3-** A Public Enterprise has been manufacturing goods. Another private company has filed a complaint with the Department of Quality and Metrology and the Department of Commerce alleging patent infringement while manufacturing the goods. The enterprise has consulted legal counsel regarding this complaint and has analyzed that the claims made in the complaint are very weak and the probability of the enterprise having to pay compensation is less than 5%.

Conclusion: Since the possibility of creating a liability is not even remote, it is not necessary to disclose it in the notes to the balance sheet.

Summary of the above case analysis:

Nepal Accounting Standard 37 emphasizes the need for careful accounting for contingent liabilities. The decision tree ensures consistency and clarity in the decision to account for, disclose, or provide for liabilities in the financial statements.

5. Accounting for contingent liabilities: (1) As per Nepal Accounting Standard 37, an enterprise should not account for contingent liabilities in its financial statements. However, contingent liabilities should be disclosed in the notes to account unless the possibility of an outflow of resources is remote.

6. Decision on recognition and disclosure of liability: (1) The decision to recognize as a provision or disclose in the notes to account as contingent liabilities should be based on the following method.

Situation	Identification in financial statements	Disclosure in the notes to account as a contingent liability
Has high potential and is measurable	Should be accounted for as a provision.	If the possibility is high but not measurable, a contingent

Situation	Identification in financial statements	Disclosure in the notes to account as a contingent liability
		liability should be disclosed in the notes to account.
Possible but not Probable	Does not need to be accounted for as a provision.	Contingent liabilities should be disclosed in the notes to account.
Low probability	Does not need to be accounted for as a provision.	Contingent liabilities do not need to be disclosed in the notes to account.

Some issues related to identifying current liabilities

1) Decision of the Board of Directors

(a) The decision of the board of directors was not communicated to the relevant parties.

On 31 Ashad 2081, the board of directors of a Public Enterprise decided to close the production department due to the fact that the company was continuously incurring losses, had outdated equipment with outdated technology, and was unable to compete with other manufacturers in the market due to high production costs, resulting in a decline in sales. The closure of the department is expected to incur expenses for employee retirement benefits as per the Labor Act, termination of contracts with suppliers, removal of equipment, and factory rehabilitation.

Scenario: On 31 Ashad, the board of directors decided to close the production department, but has not yet given written or verbal notice to employees and other stakeholders.

Conclusion: Since the decision has not been formally communicated to the stakeholders, it is not considered a responsibility to bear liability. Therefore, there is no contingent liability at this time in this event.

b) The decision of the Board of Directors has been formally communicated.

On 25th Ashad 2081, the board of directors of a Public Enterprise decided to close down the production department, which was identified as having a direct impact on operating income, within three days. The enterprise's administration informed the concerned employees, production material suppliers and all other stakeholders of this decision on 26th Ashad 2081. The enterprise has also mentioned the plan and time frame for the closure of production. The stakeholders have also received the information in a timely manner.

Scenario: As the incident occurred when the board of directors decided to close the production department within three days on Ashad 25 and informed all stakeholders – the incident is of the present time.

Conclusion: Since the decision has formally reached the stakeholders and has entered the implementation phase, it creates the responsibility to bear the liability. Therefore, in this situation, since the liability is currently being created, a provision should be made in the balance sheet by making reliable estimates for the contingent liability.

Some cases of measurable costs

a) The costs can be measured reliably.

On 25 Ashad 2081, the board of directors of a Public Enterprise to close the production department, which was identified as having a direct impact on operating income, within three days. The enterprise's administration informed the concerned workers, suppliers of production materials and all other stakeholders of this decision on 26 Ashad 2081. The operations and management branch of the enterprise has also determined the liabilities that the enterprise will have to bear immediately when the production is stopped. According to which, it is estimated that NPR 1 million will be given as retirement benefits to 5 workers who will be retrenched, NPR 6 Hundred Thousand will be spent on fines and NPR 4 Hundred Thousand for legal fees when terminating the contract with the supplier.

Scenario: The closure of the production department has been confirmed and a reliable estimate of the contingent liability arising from this has been made.

Conclusion: Since the amount of the contingent liability has been reliably measured, a provision of NPR 2 million should be made in the balance sheet as a contingent liability.

b) If a reliable measurement of the amount of the liability is not available, nevertheless a reasonable estimate can be made.

It is not certain how many employees working in the department will be laid off due to the decision to close the production department of this enterprise, but it is estimated that a maximum of 4 workers will have to be laid off, a fine of about NPR 7 Hundred Thousand, and legal fees of about NPR 3 Hundred Thousand needs to be paid, based on the costs incurred in adopting other legal procedures in the past.

Scenario: It has been determined that the production department will be closed and an attempt has been made to appropriately estimate the contingent liability that will arise from the foregoing.

Conclusion: Since the contingent liability amount has been estimated appropriately, a provision of NPR 1 million should be made in the balance sheet for contingent liabilities.

c) **If a reliable measurement or appropriate estimate of the liability cannot be made.**

The decision was made to close the production department of this enterprise, but due to installation of new equipment, it is not possible to determine how many direct and indirect workers and employees will have to be laid off. The agreement with the supplier also states that the penalty to be paid to be estimated if the contract is terminated by mutual consent of both parties. Since this is the first time the enterprise has made such a legal decision, it is not possible to even estimate the amount of legal fees that will be incurred.

Scenario: The closure of the production department is certain and there is no scope to reliably measure and appropriately estimate the contingent liability arising from this.

Conclusion: Since the amount of the contingent liability cannot be measured reliably, no provision needs to be made in the balance sheet. It should be disclosed in the notes to account.

High probability, medium probability and low probability cases

A Public Enterprise had entered into an agreement with Manakamana Supply and Transport Pvt. Ltd. to supply the required raw materials for 5 years. The said Pvt. Ltd. was obstructing the supply of raw materials on time and in the required quantity by making various excuses. In the meantime, the enterprise had entered into an agreement with another Samara Suppliers for the supply of raw materials. Manakamana Supply and Transport Pvt. Ltd. claiming that the responsibility of supply

had been given to it solely and the contract had been breached by engaging another supplier within the contract period filed a case in 2080 Jetha in court alleging breach of the contract by the enterprise, claiming compensation of NPR 2 million.

Analysis of the three situations in this case

a) High probability of creating liability

- The legal counsel of the enterprise has presented to the management that the probability of the enterprise losing this case is more than 50%. Since the probability of the enterprise losing this case is more than 50%, this is a highly probable liability. The liability created in this case is NPR 2 million.

b) Possible but not probable

- While collecting additional documentary evidence in this case, on Ashad 11, 2080, the enterprise submitted evidence to the court with new evidence against the said Pvt. Ltd. The enterprise's lawyers, analyzing the case based on this evidence, have estimated that the enterprise's probability of losing is about 30-40% (medium probability but not high probability). On this basis, the amount claimed in the case remains unchanged at NPR 2 million.

c) Remote Possibility of creating liability

- On 15 Kartik 2081, the court dismissed the case filed by Manakamana Supply and Transport Pvt. Ltd. against the enterprise. The Pvt. Ltd. has also formally announced that it will not appeal the case. As of mid-Ashar 2082, the dispute has been resolved and the enterprise is unlikely to bear any liability for this incident.

7. Measurement of Provision: (1) The enterprise shall measure the provision for contingent liabilities as per Nepal Accounting Standard 37 based on the present value of the amount required to settle the obligation at the balance sheet date and on the basis of the best estimate.

Explanation: For the purposes of this section, a best estimate means a reliable estimate made by an enterprise to pay an obligation or transfer an obligation to a third party, which is sufficient to actually meet the obligation.

(2) In making best estimates for the measurement of provisions pursuant to sub-section (1), the enterprise shall base its estimates on the following matters.

- a) A reliable estimate of the economic impact should be made by objectively assessing the potential outcomes.
- b) The opinions of experts outside the Institute may be taken into account based on experience and needs in similar incidents.
- c) The evidence used to measure a provision should include any additional evidence arising from events after the balance sheet date.

Case: Dispute over lease payments and fines when purchasing an aircraft on lease

An enterprise involved in the aviation sector in Nepal had entered into an aircraft lease agreement with a foreign airline company to purchase two Airbus aircraft in 2076 BS. In the same year, due to the decrease in international air travel due to the COVID-19 pandemic that spread around the world, it could not operate regular flights. This resulted in low income for the enterprise and delays in making some quarterly lease payments as per the lease agreement. On the basis that the amount to be paid as per the agreement was outstanding, the foreign airline company issued a notice in the month of Jestha 2079 to pay NPR 850 million along with a fine to the enterprise. The enterprise took the matter to negotiations and arbitration. The arbitration process is currently ongoing.

Case Analysis: As per Nepal Accounting Standard 37

- a) Is the event likely to create a liability in the present?

- The enterprise has entered into a binding lease agreement and has not paid any of the lease payments as per the agreement. Since the lessor has issued legal notice, the present liability under the agreement remains.
- b) Is the likelihood of economic outflow high or medium?
- If the company does not have a strong legal defense, the probability of payment is high (more than 50%). If the outcome of the arbitration is uncertain and the probability of payment is not high, it is considered a contingent liability.
- c) Can the amount of the liability be reliably estimated?
- NPR 850 million has been formally demanded from the lessor. The fine may be negotiated, but the principal amount is a fixed amount.

Conclusion under Nepal Accounting Standard 37:

If management and legal counsel believe that the probability of payment is high (more than 50%), then a provision should be made based on the best estimate (the full amount claimed or the amount discounted). If the probability of payment is not high, then it should be treated as a contingent liability and all the facts (risk of NPR. 850 million, arbitration status, uncertainty etc., subject to dispute) should be disclosed in the notes to account.

Case: Law almost certain to be implemented

The cement manufacturing Public Enterprise, which is wholly owned by the Government of Nepal, did not have to pay environmental fees for dust emission control in the past. The prevailing environmental policy clearly provides for the payment of environmental fees. The enterprise shall bear the expenses related to environmental management only if the government has issued a notice mandatorily requiring the payment of fees:

Scenario (a): By the end of FY 2079/80, it is almost certain that the government will strictly implement the prevailing law in the coming year. The policy will be implemented in the current fiscal year as well. On this basis, the situation of resource outflow for environmental charges will continue in the current year as well. However, there is a high possibility that the government will not strictly implement the environmental policy in the current year and will implement it soon after the end of the fiscal year.

Analysis according to Nepal Accounting Standard 37 (for the fiscal year 2079/80)

Step 1: Is the event likely to create a liability in the present?

- Yes. The government has already implemented the environmental policy. If the government asks for payment of fees as per the policy, the current liability is confirmed.

Step 2: Is the likelihood of economic resource outflows high or medium?

- Medium. There is a moderate possibility of economic resource outflow in the current fiscal year as the information has been received that government will strictly implement environmental policies.

Step 3: Can a reliable estimate of the liability amount be made?

- Yes. A reliable estimate of the contingent liability can be made based on the basis specified in the environmental fee policy.

Conclusion under Nepal Accounting Standard 37

At the end of FY 2079/80, a reliable estimate should be made to pay the environmental fee liability that is due in accordance with the policy in force and disclosed in the notes to account. However, if it is estimated that there will be a high probability of an outflow of economic resources, the contingent liability should be accounted for by

making a provision in the balance sheet. For FY 2080/81, it is mandatory to make a provision in the balance sheet.

(b): However, the Public Enterprise has a publicly announced environmental policy. Under this, the enterprise has committed to properly managing and minimizing dust emissions. The enterprise has been implementing the policy clearly and honestly in practice, and therefore the enterprise has a good record of compliance.

Analysis according to Nepal Accounting Standard 37

Step 1: Is the event likely to create a liability in the present?

- Yes. Constructive Obligation confirms the present obligation because the incident occurred in accordance with the dust emissions generated in the past and the public environmental policy of the government.

Step 2: Is the likelihood of economic resource outflows high or medium?

- High. The likelihood of exit is high due to compliance with public policy and past practices.

Step 3: Can a reliable estimate of the liability amount be made?

- Yes. A reliable estimate of the required costs can be made based on the costs incurred in following environmental policies in the past.

Conclusion under Nepal Accounting Standard 37

At the end of FY 2079/80, a provision should be recorded as a reliable estimate of the expected expenditure related to the constructive obligation arising from the enterprise's public environmental policy.

(3) The enterprise shall comply with the following conditions to measure provisions in various circumstances;

- a) **Risks and Uncertainties:-** The enterprise should analyze the risks and uncertainties in potential events and circumstances and make best estimates to make provisions for contingent liabilities.
- b) **Present Value:-** In cases where the effect of the 'time value of money' is significant, the provision in the balance sheet for a contingent liability is estimated and recorded at the present value of the expected expenditure to meet the obligation in the future. While calculating the present value, a discount rate that reflects the current market valuation of the value of money and the risks associated with the obligation should be used. For this, the discount rate should be equal to the pre-tax rate. Risks that have already been adjusted in the estimate of future cash flows should not be included in the discount rate. The following formula should be used to calculate the present value:

$$Present\ Value = \frac{Future\ Cost}{(1 + Discount\ Rate)^{Years}}$$

Case: Displacement costs and land disputes

A Public Enterprise wholly owned by the Government of Nepal operating a hydropower project has a legal provision under the license agreement and environmental regulations to return the project site to its original condition when it closes after 25 years of operation. The enterprise has estimated that it will cost NPR 50 million to return the project site to its original condition as per the legal provisions. In this context, a land dispute arose with some local communities at one location. The community claims that the project illegally acquired the land during the construction of the project. This dispute is currently pending in court.

Scenario: Recognition and measurement of provision (displacement cost)

Information available:

- According to government and environmental guidelines, the company has a legal obligation to return the land to its original condition after project closure.
- The estimated cost of displacement will be NPR 50 million after 25 years.
- A reliable estimate can be made and the obligation has arisen as a result of past events (construction of the project).
- The discount rate is 6%, based on the government bond rate.

Measuring Provision:

- Provision should be made for relocation expenses as there is a current legal obligation.
- There is a high probability that expenditure will occur.
- A reliable estimate of the contingent liability (NPR 50 million) has been made.

Measurement:

- Provisions for liabilities should be measured at present value.

Present Value:

Present value = estimated future expenses / (1 + discount rate)^{years}

=Rs.5,00,00,000 / (1 + 0.06)²⁵

= Rs. 1,16,49,931.53

Conclusion under Nepal Accounting Standard 37

- The enterprise should account for the depreciation of the project assets by including Rs. 1,16,49,931.53 as the basis

Scenario: Disclosure of contingent liability (land dispute)

Information available:

- The local community had filed a lawsuit alleging that land related to the project had been illegally acquired.

- The institute's legal advisor has determined that the likelihood of losing the case is moderate but not high (Possible but not Probable).
- If the case is lost, the estimated liability for compensation and rehabilitation could be NPR 10 million.
- Provisions have not been made for contingent liabilities but have been disclosed in the notes to account as contingent liabilities because:
 - There is a medium chance of the source being released, but not a high chance.
 - A reliable estimate is not required to account for a provision in the balance sheet, but the estimated amount should be included in the disclosure in the notes to account.

When disclosing the aforementioned incident

Provision: The enterprise has recognized a provision of NPR 1.6 million for the liability to decommission its hydropower projects after the end of their operational life. This estimate is based on an estimated cash outflow of NPR 50 million after 25 years at a discount rate of 6%.

Contingent Liability: The enterprise is a party to a land dispute case related to land acquisition during the construction of a project. The claimants have sought compensation of NPR 10 million. According to the legal advisor, no provision has been made as the enterprise is not likely to have to pay the liability even though the outcome is uncertain, but it has been disclosed in the notes to account as a contingent liability.

- c) **Future Events:** - Any future event that may occur in the future and may have an impact on the provision of funds required to meet the obligation is a future event. The impact of such an incident should also be accounted for the provision, if there is reliable and adequate evidence seems proven that such an event may occur in the future.
- d) **Expected Disposal of Assets:** - While estimating the amount of provision, the potential profit that may be gained from the sale of assets to be disposed of in the future should not be included.

- e) **Reimbursements:** - If the provision for a contingent liability is made and it is virtually certain that some or all of the expenditure required for settlement will be recovered from another party, such expenditure should be treated as reimbursements. Such reimbursements should be treated as a separate asset in the financial statements. The amount recognized for reimbursement shall not exceed the amount of the provision.

In the income statement, the expense relating to a provision may be presented net of amount recognized for a reimbursement.

- f) **Changes in Provisions:-** The amount of provision made by the enterprise in the balance sheet should be reviewed at each balance sheet date and adjusted to reflect the current best estimates. If it is no longer probable that an outflow of resources embodying economic resource outflows will be required to settle the obligations, the provisions shall be reversed.
- g) **Use of Provisions:** - The provision amount can only be spent by the enterprise to settle the obligation that was originally recognized accounting head at the beginning.
- h) **Future Operating Losses:** - The enterprise is not allowed to recognize any provision for future operating losses.
- i) **Onerous Contract:** - If an onerous contract has been entered into by the enterprise, the present obligation under such contract should be recognized as a provision and estimated accordingly.

(**Explanation:** An onerous contract is a contract in which the mandatory expenses incurred to fulfill the obligations under the contract exceed the expected economic benefits to be derived from it.)

Case Study: Onerous Contract

An enterprise leased a factory from a company to operate its business for 10 years in 2073 Shrawan. In Ashad 2079, the enterprise transferred the business to a new factory owned by it. However, the lease term of the old factory was still valid four years. The enterprise was not in a position to terminate this contract and could not re-lease it to any third party as per the terms of the contract.

Analysis according to Nepal Accounting Standard 37

Step 1: Is the event likely to create a liability in the present?

- Yes. Legal obligation arises from the date of signing the lease agreement.

Step 2: Is the likelihood of economic resource outflows high or medium?

- Yes. When a lease becomes onerous, i.e., cost benefit comparison of an investment seems to be at losses, there is a possibility of an outflow of economic resources. However, until the lease becomes onerous, the enterprise should account for the lease in accordance with the rules of Nepal Financial Reporting Standard 16.

Step 3: Can the liability amount be reliably estimated?

- As per the provisions of Nepal Accounting Standard 37, reliable estimates must be accounted for unavoidable lease payments.

Conclusion according to Nepal Accounting Standard 37

This agreement is an onerous contract because the event created by contract cannot be avoided. A provision should be recorded in the balance sheet based on a reliable estimate of the lease payments as stated in the agreement.

8. Disclosure of Contingent Liabilities: (1) According to Nepal Accounting Standard 37, no provision is required for moderately probable contingent only. Unless the possibility of an outflow of resources in such contingent liabilities is extremely remote, the notes to account should disclose details that clearly illustrate the contingent liability, such as its uncertainties or estimated time of the outflow of resources, the financial impact and the source of the reimbursement/recovery costs, if any. Accordingly, the enterprise shall disclose the following facts while disclosing a brief description of the nature of the liability under the relevant expense heading for each category of contingent liability (high, medium or low) at the balance sheet date:

- 1) An estimate of financial impact,
- 2) An indication of uncertainties related to the amount or timing of any outflows,

3) The possibility of any reimbursements.

Case: Disclosure of Contingent liability

A Public Enterprise owned by the Government of Nepal, signed an agreement with a foreign contractor in 2010 to supply and install a high-voltage substation under a transmission line project supported by the Asian Development Bank (ADB).

In 2011, there was a delay in the transfer of land and customs clearance process due to internal reasons of the enterprise. While claiming payment, the contractor submitted a formal claim demanding compensation of NPR 850 million for cost escalation and penalty as per the "Delay Attributable to Employer" clause of the contract.

The enterprise has rejected the contractor's claim, saying that the delay in the contract work was also due to poor coordination and document management errors by the contractor. Currently, this matter is in the dispute resolution process as per the contract.

The enterprise's legal and contract management team has estimated that there is a 40% chance that liability will be created and liability will crystallize in this incident.

Analysis according to Nepal Accounting Standard 37:

Step 1: Is this event likely to create a liability in the present?

- The claim under the formal contract has been submitted and the dispute resolution process is ongoing.
- There is a moderate contingent liability as a result of the dispute resolution.

Step 2: Is there a possibility of outflow of economic resources?

- Assessment of the management is that the probability of crystallization of the liability is 40%.

- Since it depends on the final outcome of the dispute resolution, there is a medium possibility of the resource being released (Possible) but not a high possibility (Probable).

Step 3: Can the amount of the liability be reliably estimated?

- The contractor has clearly claimed NPR 850 million as per the agreement and related expenditure details.

Conclusion according to Nepal Accounting Standard 37:

This situation will remain as a contingent liability because;

- The current liability is medium probability but not high probable,
- There is a medium but not high probable of economic resources outflows,
- The amount can be clearly estimated,

The enterprise should disclose this as a contingent liability in the notes to account. Since the claim crystallization probability is 30-49%, the risk category of the contingent liability for this event will be "Moderate" as per the procedure

Case:

A Public Enterprise owned by the Government of Nepal which is involved in infrastructure construction had received a contract from the Government of Nepal to construct a bridge over the Bagmati River. The enterprise had completed the construction of a bridge over the river within stipulated time. However, due to internal engineering errors during the construction, structural problems were observed in some parts of the bridge. The Ministry of Physical Infrastructure and Transport has sent a formal letter instructing the enterprise to rectify the structural errors at its own economic resource.

The technical team of the enterprise has estimated that reconstruction work will be required to resolve the problem and that the reconstruction will cost NPR 10 million, including compensation to affected parties (local businesses affected by the bridge collapse).

Analysis according to Nepal Accounting Standard 37:

Step 1: Is there a possibility that the event will create a liability in the present?

- Yes. A present obligation has been created due to an event that occurred in the past. The liability was created by the contract and the Ministry of Physical Infrastructure and Transport has formally issued instructions. It has been confirmed that the cause of the problem was due to a defect in the design by the enterprise. This has created an obligation in a legal and constructive manner.

Step 2: Is there a possibility of economic resources being outflowed?

- Yes. Since the Ministry of Physical Infrastructure and Transport is required to be followed pursuant the law, the enterprise will have to carry out the reconstruction work to comply with the terms of the agreement as well as avoid being fined or blacklisted.

Step 3: Can the claim amount be reliably estimated?

- Yes. The technical team estimates that this cost will be NPR 10 million.

Conclusion (according to Nepal Accounting Standard 37):

All three criteria for recognition according to Nepal Accounting Standard 37 have been met:

- Present obligation (created from past events)
- The possibility of economic resources being withdrawn is certain (Probable).
- Reliable estimation of the amount

The enterprise is required to make a provision as a contingent liabilities of Rs 10 million in its financial statements.

Case Study:

A financial enterprise owned by the Government of Nepal provided a long-term project loan of NPR 2 billion in the FY 2078/79 to a private company that was going to build a 40-megawatt hydroelectric project in the Karnali region.

The project has been indefinitely stalled due to land acquisition disputes with some communities in the affected areas and delays in obtaining approval from the Government of Nepal for the use of government forests to start construction of the hydropower plant. The company has not been able to pay interest for two consecutive years. This is likely to directly impact the interest income received from the enterprise's long-term investments.

Despite repeated attempts by the enterprise to restructure this debt, the enterprise's Internal Debt Risk Committee has concluded the following in FY 2080/81:

- The chances of debt recovery are slim unless the government intervenes.
- This loan needs to be classified as a non-performing loan and recognized as a provision for bad debts.
- Based on the independent third-party Actuary and the enterprise's internal risk analysis methodology, the expected credit loss is estimated to be around NPR 900 million when calculating the expected credit loss by discounting future cash flows.

Analysis according to Nepal Accounting Standard 37:

Step 1: Is this event likely to create a liability in the present?

- Yes. The enterprise, as a lender, is at risk of financial loss if the borrower does not pay interest.
- This has created a present obligation from a past event.

Step 2: Is there a possibility of outflow of economic resources?

- Yes. (Although there is no possibility of outflow of economic resources, interest will be eroded due to non-receipt of interest income). There is a high probability of financial loss as the project is likely to be postponed indefinitely and the possibility of receiving interest income from the borrower in the near future is low.

Step 3: Can the liability amount be reliably estimated?

- According to independent valuation and the company's internal analysis, the expected credit loss is NPR 900 million.

Conclusion (according to Nepal Accounting Standard 37):

All three requirements have been met based on Nepal Accounting Standard 37 have been met:

- Present Obligation
- High probability of economic resources outflows (Probable)
- Reliably Estimable

Therefore, the enterprise is required to recognize a provision of NPR 900 million in its financial statements for impairment of loan interest.

Case:

An enterprise owned by the Government of Nepal has been importing and distributing petroleum products in Nepal. The enterprise has a long-term petroleum supply agreement with an international supplier.

In early 2022, the enterprise was accused of violating the "Take-or-Pay" terms by failing to ship petroleum products on time as per the contract due to geopolitical tensions and port disruptions. The supplier has issued a formal notice demanding compensation of NPR 1.2 billion, citing loss of revenue and demurrage charges as per the contract.

The enterprise has contested this claim through international arbitration, rejecting it on the grounds of a breach of the "Force Majeure" (unforeseen event) clause.

Legal advisors have stated that there is a 60% chance of liability crystallization, based on the complexity of the "Force Majeure" clause and similar events in the past.

Analysis according to Nepal Accounting Standard 37:

Step 1: Is the event likely to create a current liability?

- Formal compensation has been demanded from these suppliers.

- The arbitration process has begun but no final award has been declared.
- Therefore, based on the final arbitration award, this incident has moderate contingent liability.

Step 2: Is there a possibility of outflow of economic resources?

- There is a 60% chance of crystallization.
- Due to the complexity of the "Force Majeure" condition and historical background, there is a moderate possibility of an outflow of economic resources (Possible), not a high probability (Probable).

Step 3: Can the liability amount be reliably estimated?

- Yes. The supplier has clearly demanded NPR 1.2 billion in the contract documents and the demurrage fee invoice.

Conclusion (according to Nepal Accounting Standard 37):

This liability is classified as a contingent liability because:

- Liability is possible but not certain.
- The possibility of economic resources outflows is not high, but it can be estimated.

Therefore, the company must disclose it in the notes to account as a contingent liability.

However, based on the risk level measurement matrix, the probability of a claim being crystallized is 50-70%, so the risk category of this contingent liability will be "High" according to the procedure.

Case Study:

An enterprise owned by the Government of Nepal has approved the Voluntary Retirement Scheme (VRS) in the FY 2079/80 under the Human Resource Management Strategy by setting various conditions. This scheme was formally made public in the month of Jestha 2080. There is a provision that employees who are affiliated with the scheme must apply and retire by end of Ashar 2080. There is a provision that if employees under this scheme take

retirement, they will be provided with an early retirement package including a lump sum financial benefit.

The plan:

- All employees of the institute have been publicly notified.
- Although voluntary, the deadline for submitting applications has been clearly set and the budget has also been approved.
- Based on past experience and applications received so far, at least 200 employees are expected to apply for the voluntary retirement scheme.
- The estimated cost per employee (including compensation, pension) is NPR 1 million, which brings the total estimated cost to NPR 200 million.
- There is a provision that once employees apply for the voluntary retirement scheme, the application cannot be withdrawn. Employees have started applying even before the end of the fiscal year.

Analysis according to Nepal Accounting Standard 37:

Step 1: Is the event likely to create a current liability?

- Yes. Since the enterprise has made a commitment by formally publicizing the plan along with budget approval, a constructive obligation has been created towards the employees who accept the plan.

Step 2: Is there a possibility of outflow of economic resources?

- Yes. Employees have already started applying and based on past experience, there is a high probability that many employees will accept the plan.

Step 3: Can the amount of the liability be reliably estimated?

- Yes. The amount can be clearly estimated based on the expected number of employees and the benefits to be provided under the plan.

Conclusion (according to Nepal Accounting Standard 37):

All the necessary bases according to Nepal Accounting Standard 37 have been met:

- Present Obligation
- High probability of economic resources outflows (Probable)
- Reliably Estimable

Therefore, the enterprise should account for a provision for a contingent liability of NPR 200 million, the estimated cost for the voluntary retirement scheme, in the financial statements for the FY 2079/80.

Case:

An enterprise owned by the Government of Nepal is involved in the telecommunications sector. The enterprise is expanding 4G services in various parts of Nepal to compete with private companies. During the technical audit conducted in the FY 2079/80, the enterprise has identified a large amount of old 2G and 3G technology equipment (including Base Transceiver Stations, Switches, and Routers) stored in various warehouses. The board of directors of the enterprise has approved a plan to dispose of these unused equipment.

These equipment:

- It was purchased 6 to 8 years ago under a new plan for network expansion.
- It has never been connected due to delays in the approval process and changes in technology.
- The technology currently in operation is obsolete and there is no possibility of it being sold in the market or reused.

The Internal Engineering Committee and the audit report of the Office of the Auditor General (OAG) have recommended the disposal of these assets and the write-off of the enterprise's assets. It is estimated that the estimated cost of removing, segregating and safely managing electronic waste (e-waste) is around NPR 200 million.

Analysis according to Nepal Accounting Standard 37:

Step 1: Is the event likely to create a liability in the present?

- Yes. The constructive and regulatory obligation of the enterprise has arisen due to the following reasons:
- Electronic waste (e-Waste) management rules set by the government
- Internal decision to remove equipment that has become unusable due to technological advancements
- Past practices and public accountability of the enterprise

Step 2: Is there a possibility of economic resources being outflowed?

- Yes. To comply with environmental regulations and to clear the warehouse and make room for 4G, it is necessary to remove and dispose of the equipment. The enterprise's board of directors has approved the disposal plan.

Step 3: Can the amount of the liability be reliably estimated?

- The estimated cost has been clearly calculated at NPR 200 million based on internal evaluation and quotations received from the vendor.

Conclusion (according to Nepal Accounting Standard 37):

All the necessary bases according to Nepal Accounting Standard 37 have been met:

- Present Obligation
- High probability of economic resources outflows (Probable)
- Reliably Estimable

Therefore, the enterprise has included a contingent liability of NPR 200 million for equipment disposal and e-waste management in its financial statements for the FY 2079/80. Provisions must be accounted for.

Chapter-3

Guarantee

9. Government Guarantee: (1) A guarantee provided by the government as per Section 14 of the Public Debt Management Act, 2022. This guarantee provides that if the enterprise fails to repay the principal and interest as per the loan agreement, the amount of principal and interest not repaid will be charged to the Federal Consolidated Fund or other government funds. The office should categorize the risks into four types as serious, high, medium and low, along with a brief description of the various types of guarantees issued by the Government of Nepal.

(2) The format for collecting details of guarantee shall be as per Schedule 1.

10. Collection of Government Guarantee: (1) The process of collection of Government Guarantee shall be as follows:-

- a) The Office may request details of the guarantee issued by the Government of Nepal. It shall be the duty of the enterprise to provide the details requested by the Office.
- b) While determining the probability of liability crystallization and risk assessment for government guarantees, the Office may determine the risk level by analyzing the risk of government guarantees based on the risk matrix mentioned in the report section of Chapter 5 and the determination of the probability of liability crystallization mentioned in Schedule 4.

Chapter-4

The process of integrating contingent liability

11. Process for integrating contingent liabilities: (1) The Office may adopt certain procedures for integrating data on contingent liabilities of the enterprise, conducting risk assessments, monitoring, directing and reporting.

(2) The Office may issue directions to all Public Enterprises to collect details of provisions made for contingent liabilities and constructive obligations in accordance with Schedule 2. The directions shall specify the following:-

a) Guarantees given by enterprise: Guarantees provided by Public Enterprise should be classified as follows based on their nature:

1. **Corporate guarantee:** Corporate guarantee means a guarantee given or to be given by the enterprise to pay the debts or liabilities of a subsidiary or related party.
2. **Bank guarantee:** Bank guarantee means a guarantee given or to be given by a bank to a third party (government, vendor) on behalf of the enterprise.
3. **Performance guarantee:** A performance guarantee is a guarantee given to its customer by the enterprise assuring that the company will fulfill its obligations under the contract (such as construction or service contracts).
4. **Financial guarantee:** Financial guarantee refers to a guarantee for the payment of a financial obligation, such as a debenture, in which the enterprise providing the guarantee must pay if the principal obligation holder fails to pay.
5. **Import/export guarantee:** Import/export guarantee refers to the guarantee, payment or compliance risk provided in international trade transactions. This type of guarantee includes instruments such as bank guarantees, export credit security (export insurance and guarantees), and customs duty guarantees.
6. **Litigation guarantee:** Litigation guarantee means guarantee provided by the concerned enterprise in a court case or dispute. It includes security, a bank guarantee, a property guarantee, or other similar guarantees.

b) **Letter of Credit:** A letter of credit is a promise by a bank to pay a seller on behalf of a buyer (enterprise). Letters of credit are often used in international trade. Letters of credit are measured as a contingent liability until the terms of the transaction are met.

- c) **Contingent liabilities claimed against the enterprise but not accepted as an obligation:** This type of liability is classified as a contingent liability. In this case, the enterprise has not accepted its liability but there is a possibility that in the future, it may incur an outflow of economic resources or incur an obligation as a result of legal or other consequences. Such obligations are required to be disclosed in the notes to account as contingent liabilities.

Some examples of liabilities claimed against the enterprise but not accepted as an obligation:

(1) Cases and legal disputes

- Cases (civil or criminal) pending in the court where the enterprise is a defendant
- Cases related to claims for compensation or compensation claimed by a former employee for wrongful termination from the enterprise.
- Cases filed by customers regarding product defects, inadequate service, or breach of contract
- Environmental damage or pollution related litigation
- Intellectual property disputes (e.g., patent or trademark infringement)
- Ongoing arbitration in any forum

(2) Tax disputes

- Income tax claims under appeal.
- VAT/Excise Duty claims under dispute.
- Customs duty claims for alleged under-invoicing or misclassification.
- Disallowed deductions of expenses by the tax authorities.
- Transfer pricing adjustments challenged by the enterprise.

(3) Claims made by sellers/suppliers

- Disputed invoices or supply contracts that have not yet been recognized as liabilities.
- Claims for fines or compensation due to delays or breaches of contract.

(4) Claims made by customers

- Claims for refunds, penalties, or damages for alleged product defects, service delays, or poor project performance.
- Compensation sought for unauthorized profits earned by a business or losses suffered by a customer from the use of goods or services.

(5) Claims from governments or regulatory authorities

- Liabilities arising from violation of license conditions or non-compliance with or disobedience to the instructions of regulatory bodies.
- Notice of fines or penalties under laws such as the Companies Act, Foreign Exchange Regulation Act, etc.
- Demands related to telecommunications (spectrum) or mining licenses.

(6) Disputed employees benefit claims

- Issues related to gratuities, bonuses, pensions, or ex gratia payments.
- Disputes arising from the denial of retirement benefits or opportunities for employee career upliftment (promotion).

(7) Property and land disputes

- Disputed claims regarding ownership or possession of property.
- Cases filed by local authorities or third parties over encroachment, zoning violation, or land acquisition.

(8) Insurance disputes

- Claims for accidents or damage filed by third parties owing to the enterprise's operation or its personnel
- Disputes regarding compensation for insurance claims.

d) **Bills for Collection:** Refers to commercial documents such as bills of exchange or promissory notes sent for collection, which are presented by an enterprise to a bank to collect payment from its customers. The risk of dishonoring the customer when the bank collects the payment remains with the enterprise. The risk of dishonoring is not currently recognized as a liability in the enterprise's accounts. Until the collection of

the amount is completed, the enterprise should disclose it as a contingent liability in the notes to account.

- e) **Acceptance:** Acceptance refers to a bill of exchange issued by or on behalf of the enterprise accepting payment in the future. It does not create a current obligation of payment for the enterprise. In this, the supplier prepares the bill of exchange. The enterprise does not hold such an obligation until it matures. Such amounts should be disclosed in the notes to account as a contingent liability.
- f) **Collateral:** If an enterprise has provided collateral (security or commitment) for the debt of a third party (such as a subsidiary, associate or other enterprises within the group) and the enterprise itself is not the primary obligor (the party bearing the main liability), the debt of the third party is recognized as a contingent liability. If the enterprise has guaranteed the debt of someone else and has provided its own assets as collateral, then in such a case, it is mandatory to disclose the debt of the third party as a contingent liability in the notes to account.

Examples of some collateral that may be subject to contingent liability:

Assets pledged for third-party loans:

- For loans taken by an enterprise under a group, the enterprise has agreed to provide its fixed deposits, land, shares or similar assets as collateral.

Shares pledged as collateral:

- Shares invested by the enterprise in a subsidiary or other enterprise as collateral for providing loans to that subsidiary or other enterprise.

Pledged assets of the enterprise:

- The assets, machinery and equipment owned by the enterprise are pledged as collateral for financial loans taken from third parties.

Lien on Bank Account:

- The enterprise has provided its bank account or fixed deposit as a collateral to borrow a loan for other enterprise. If the third party does not repay the loan amount, the financial institution shall be allowed to have a priority right to recover the loan against the enterprise's savings or fixed deposit.

Hypothecation:

- A third party has pledged their own stocks or receivables to the lending financial institution to obtain a loan for working capital.

12. Capacity Development: (1) The Office may provide orientation the employees of the enterprise to ensure consistency in the implementation of this procedure and reporting.

(2) The objectives of the orientation pursuant to sub-section (1) shall be as follows:-

- a) Explain the definition and classification of contingent liabilities, including legal and constructive obligations,
- b) To provide guidance on the possibility of a contingent liability becoming an actual liability,
- c) To ensure consistency, completeness and clarity in the facts reported by the enterprise,
- d) Clarifying common areas of ambiguity regarding reporting procedures and terminology.

13. Review and confirmation: (1) The office may review and confirm the statement of contingent liability after receiving from Public Enterprises.

(2) The review and confirmation to be carried out pursuant to Sub-section (1) shall include the following procedures:-

- a) To examine the prescribed format, consistency and completeness of the statements submitted by the Public Enterprise,
- b) Identifying anomalies, missing or unclear data entries that require clarification,

- c) Contact the concerned enterprise for corrections or additional information as required,
- d) May direct to submit additional details for the liability in case where its probability of crystallization is measured more than 50% at the time of the report preparation as potential.

14. Preparation of integrated statements: (1) The office shall prepare integrated statements by centralizing the potential responsibilities of the enterprise for preparing national level statistics.

(2) To prepare the integrated statement pursuant to Sub-section (1), the Office shall perform the following tasks:-

- a) Line-by-Line-Aggregation of each detail reported under each category in the Standard Template,
- b) Identify overlapping or misclassified entries during consolidation.
- c) The format as per Schedule 3 will be used to ensure consistency in presentation and analysis.

Chapter-5

Report

15. Report: (1) To ensure financial risk management, the Office shall assess contingent liabilities related to the enterprise that may have an adverse impact on the financial position of the Government.

(2) The Office shall submit the annual report as per Schedule 3 to the Ministry.

(3) The report shall include the following main topics:-

- a) **Assessment of the potential impact on the fiscal deficit:** To assess the potential fiscal impact of contingent liabilities, the Office will need to conduct a detailed analysis focusing on the following aspects:

(1) Determination of the amount of potential economic resource outflow: If a contingent liability is created, it is required to assume the

possible economic outflows to cover such contingent liability. This should include government guarantee calls, liabilities arising from court judgments, and amounts of compensation issued to the enterprise or guaranteed resources.

(2) Future obligation: When projecting financial needs, if there is a possibility that the government will have to provide grants or financial assistance, or if there is a possibility that a guarantee will have to be given to the enterprise to operate or resolve financial problems, this type of liability should be created.

(3) High-risk liabilities to the government: Contingent liabilities with a high probability of falling within the direct responsibility of the government should be identified. This should include government guarantees given to financially weak enterprises, legal obligation with a high probability of loss, and financial obligations assumed through public-private partnerships (PPPs).

b) Classification of contingent liabilities: The enterprise should determine the percentage of probability of contingent liabilities being crystallized. The basis for determining and classifying the percentage of probability of contingent liabilities being crystallized is given in Schedule-4. Contingent liabilities should be classified into four types, namely high, medium-high, medium and low, based on the percentage of probability of such liabilities being crystallized. According to the risk assessment, contingent liabilities should be measured in Critical, High, Moderate & Low risk levels. The matrix for measuring risk levels is as follows

Risk Level Measurement Matrix

Category of risk	Risk potential to be determined	Evaluation of Risk	Examples of contingent liability
High Risk	More than 70%	Critical	Guarantees to loss making enterprises; disputes or cases with a high probability of losing; minimum

Category of risk	Risk potential to be determined	Evaluation of Risk	Examples of contingent liability
			revenue guarantee amounts to be paid upon termination of a public-private partnership (PPP) agreement.
Medium-High Risk	From 50% up to 70%	High	Guarantees given to enterprises in financial distress; pending arbitration of major infrastructure projects.
Medium Risk	From 30% Up to 49%	Moderate	Payments of Grant or assistance under review; legal claims for partial obligation.
Low Risk	Up to 29%	Low	Letters of Acceptance with low potential to create claims; contingent liabilities in early stages legal proceedings; historical guarantees provided to competent enterprises; inactive legal disputes;

c) Management of contingent liabilities: The enterprise shall manage contingent liabilities as follows:-

- (1) In theory, contingent liabilities do not have an immediate impact on financial losses as they are recorded in notes to account off the balance sheet.² However, liabilities with 'Critical' and 'High' risk levels must be analyzed; if necessary, a provision should be recognized using a pre-tax rate, or potential financial risks and mitigation measures must be clearly disclosed in the notes to account.
- (2) Contingent liabilities with a moderate risk rating should be disclosed in the form of a credit management or financial risk report. This should include information on the nature of the liability, the estimated risk, the risk mitigation measures adopted by the relevant enterprise, as well as an

² Off-balance sheet items include contingent liabilities that are not measured or disclosed in the enterprise's financial statements, but whose events could create a financial risk or liability for the enterprise.

assessment of the risk (e.g. probability and impact) and monitoring or contingency planning.

- (3) Contingent liabilities with a low level of risk should be disclosed in a summary or table in the notes to account of the balance sheet. This should indicate the type of liability involved (e.g., guarantee, compensation, etc.). A detailed analysis is not required unless such liability is material.

d) Sectoral Classification of Risks - To identify and prioritize primary areas of financial risk, the Office will conduct a sectoral analysis of the Enterprise as follows:

- 1) Industrial Sector
- 2) Trading Sector
- 3) Service Sector
- 4) Social Sector
- 5) Public Utility Sector
- 6) Finance Sector
- 7) Development Committee

e) Risk Mapping: For risk mapping, a Sectoral Fiscal Risk Matrix should be developed and analyzed in the following aspects:

- (1) Sectors with high risk collectively (e.g. financial sector)
- (2) Cluster within the high-risk sectors (such as commercial banks or development banks or other groups within the financial sector)
- (3) Enterprises that have repeatedly received financial assistance or grants (Enterprises that have been repeatedly given grants or assistance due to the enterprise's weak financial condition)

16. Database Management: (1) The Office may develop and operate a centralized statistical system to record, monitor and prepare reports on the contingent liabilities of the enterprise.

(2) In order to maintain consistency and reliability in the collection of data required to operate the system pursuant to Sub-section (1), the Office may provide a standardized data collection format to the reporting Public Enterprise.

(3) It shall be the duty of the concerned enterprise to enter the necessary data into the system put into operation by the office pursuant to Sub-section (1).

(4) The Office may amend the framework prepared pursuant to Sub-section (2) as per the nature and requirement of the enterprise on timely manner.

17. Interpretation and removal of difficulties: If there is any ambiguity or difficulty in the implementation of this procedure, the Ministry may provide interpretation and remove difficulties