

## **Week 4 - DQ 1**

***Discuss contingencies and how they are reported on financial statements. What conditions must be met before a contingency can be charged against income?***

### ***Response #1***

A contingent event is one that is doubtful to occur. A few examples of contingent events in regards to the financial aspects of a company is: uncollectible accounts, estimated liabilities for warranties, estimated losses on lawsuits, and estimated losses related to pollution cause by company operations.

According to SFAS No. 5, only contingencies in which the possible future event may indicate an asset is impaired or a liability has been incurred on the balance sheet date are candidates for accrual or disclosure.

An estimated loss from a loss contingency should be charged to income if the information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements, and the amount can be reasonably estimated

<http://accounting-financial-tax.com/2009/11/accounting-standard-for-contingencies-an-overview/>

According to our text book; once the likelihood of a loss is determined, contingencies are charged against income and a liability is recorded if both of the following conditions are met:

1. Information available before the issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.
2. The amount of the loss can be reasonably estimated.

## ***Response #2***

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## ***Response #3***

A contingency is a possible future event that will have some impact on the firm. The most frequently encountered contingencies are: pending lawsuits, income tax disputes, notes receivable discounted, and accommodation endorsements. If a potential obligation has a high probability of occurrence, it should be reported as a liability. If potential obligations are low probabilities are reported in the footnotes to the financial

statements. Contingencies are charged against income and a liability is recorded if both of the following conditions are met:

1. Information available before the issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements.
2. The amount of the loss can be reasonably estimated.

#### ***Response #4***

A contingency arises when there is an event but there is uncertainty how the event will be resolved and therefore the final financial impact of the event is not known until a future time. There are gain and loss contingencies but gain contingencies are generally not reported in income. You just wait until the contingency is resolved and you know the exact outcome. For loss contingencies, if they are material, you must either disclose them or report them against income. The criteria for charging the loss in the period are:

1. Loss must be probably (likely to occur) and
2. The amount of the loss can be reasonably estimated (you have some idea the dollar impact).

You don't have to know the precise amount but you need to have a general idea, an estimate. Probable is compared to "reasonably possible" or "remotely possible" -- neither of these requires charge against income (just disclose).

#### ***Response #5***

Contingencies, first, are events that may happen in the future that could affect a company. Companies are required to disclose contingencies but there are no specifics as to how the contingencies are to be reported. Contingencies will generally result in a gain or a loss. Gains should be disclosed but not calculated until an amount is known because the financial statements do not need to reflect a false amount. Losses should be calculated to see how much a potential loss could be for a company. Principles of