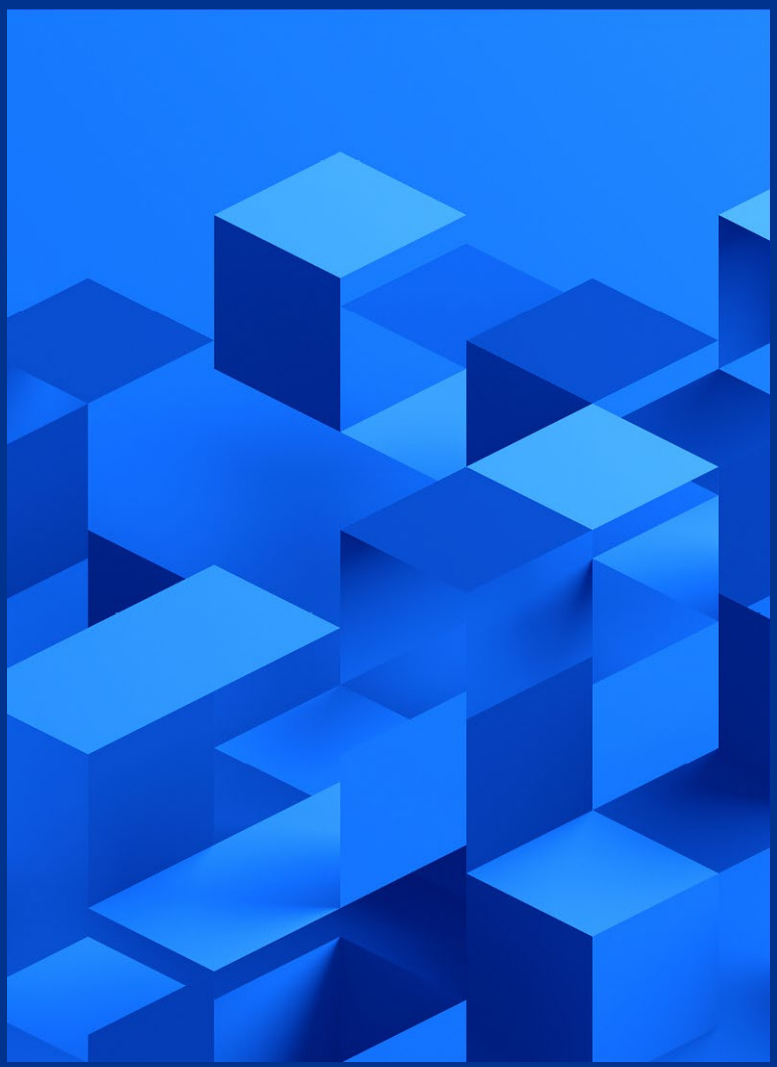
KPMG

Contingencies, commitments and guarantees

Executive summary



US GAAP

October 2026

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The art and science of accounting for contingencies

Companies are frequently faced with contingencies. While the applicable guidance in the area has survived the test of time, the accounting often seems like a rule of thumb exercise guided by the virtues of prudence and transparency.

There are many Topics in the *FASB Accounting Standards Codification*® that address specific types of contingencies, and we highlight one such Topic in this Executive Summary (Topic 460 on guarantees). We also highlight the residual standard used to account for contingencies when no other standard applies (Topic 450). As a residual standard, Topic 450 is necessarily general in nature, but long-standing practices have filled in some of its gaps.

These standards require making probability assessments and using estimation methodologies. Fortunately, there is a science to the art of assessing and estimating contingencies, which we touch on in this Executive Summary by summarizing the accounting and disclosure models codified in these standards and developed through the years. We also explain the limited disclosure guidance in Topic 440 on commitments.

Our related Handbook, Contingencies, commitments and guarantees, provides in-depth guidance on how to account for and disclose the different types of contingencies that may arise. It includes insights and examples – and our perspectives based on our years of experience in this area.

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Contingencies: Key concepts and scope

Subtopic 450-10 establishes the scope for both Subtopic 450-20 (loss contingencies) and Subtopic 450-30 (gain contingencies). Topic 450 applies to all entities.

Loss or gain contingencies

A contingency contains the following three elements.



For a contingency to exist, there must be an existing condition involving uncertainty as to a possible loss or gain that will be resolved when one or more future events occur or fail to occur. The accounting for contingencies often involves estimates; however, measurements of assets and liabilities may require estimates for reasons other than contingencies. For example, if there is nothing uncertain about a liability having been incurred (e.g. services have been received), accrual is required even if the amount and/or timing of settlement are not yet known.

Scope of Topic 450

Topic 450 applies only to contingencies – but not all contingencies are within its scope. When a contingent loss or gain exists, it is not accounted for under Topic 450 if it falls in the scope of another Topic (e.g. asset retirement obligations under Topic 410). There is a long list of contingent losses and gains that are in the scope of other Topics. Some of these other Topics apply the contingency models in Topic 450 in whole or part.

There are also many instances in which a transaction produces multiple contingencies – some in the scope of Topic 450 and some in the scope of other Topics. For example, natural disasters can create multiple contingencies.

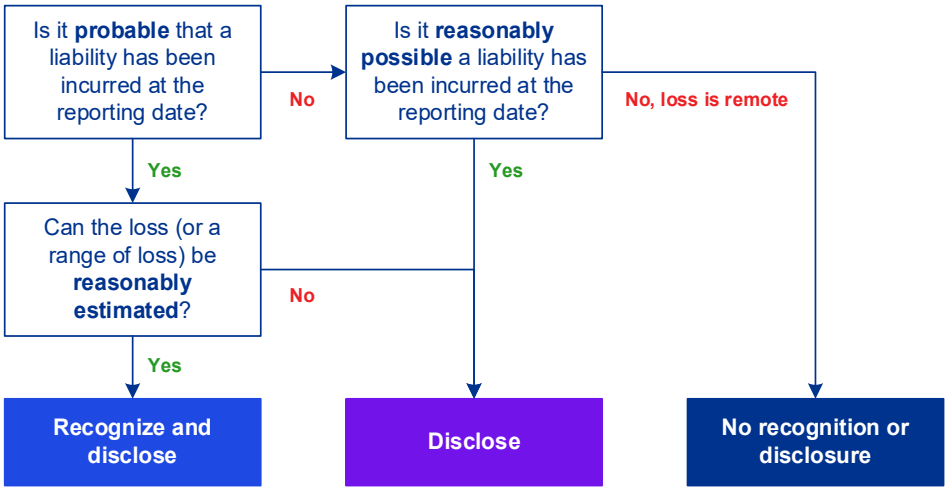
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Loss contingencies: Recognition

There are three potential financial reporting outcomes for a loss contingency in the scope of Subtopic 450-20:

- recognize a loss and disclose;
- do not recognize a loss, but disclose; or
- do not recognize a loss or disclose.

The following decision tree explains which outcome is appropriate in a given situation.



A loss contingency in the scope of Subtopic 450-20 is recognized as a contingent liability when the following two criteria are met at the reporting date.



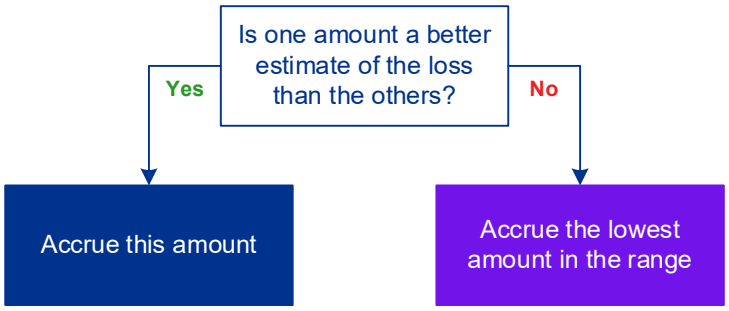
Assessing these criteria considers all information available before the financial statements are issued or available to be issued. This means that subsequent events may affect whether it is probable a liability had been incurred at the reporting date.

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Loss contingencies: Measurement

When a loss contingency meets the recognition criteria, it becomes a contingent liability. Subtopic 450-20 requires a contingent liability to be measured based on the best estimate of the ultimate settlement amount. While requiring judgment, this estimate is not based on fair value or expected value techniques. Instead, it is simply based on the amount for which the entity expects to settle the liability.

The process for measuring a contingent liability when there is a range of possible loss is summarized in the following decision tree.



As a consequence of this process, the amount initially recognized may be different from the actual loss eventually incurred.

Estimating the various possible losses or range of possible losses typically requires judgment as does determining whether there is one possible loss in a range of possible losses that is better than the others.

The amount of the loss is monitored and adjusted to reflect information available at each reporting date. Given the uncertainty inherent in contingent liabilities, it is quite possible that the amount of the liability will change over time as the facts and circumstances change. When this occurs, the change in measurement is a change in accounting estimate and treated prospectively.

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Loss contingencies: Presentation and disclosure

Presentation

The following table summarizes the presentation requirements for loss contingencies in each financial statement.

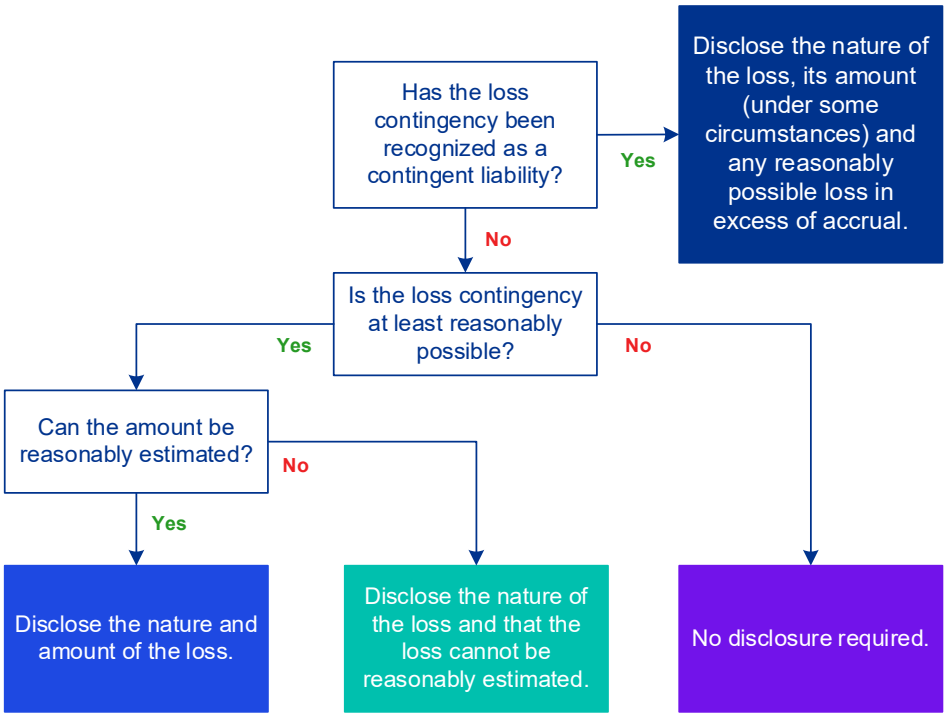
Financial statement	Account/Activity	Presentation requirement
Balance sheet	Contingent liability	• Generally classified as current or noncurrent based on the expected period of settlement. • Not presented net of a related recovery asset except in the rare case that the right of setoff conditions in paragraph 210-20-45-1 are met.
Income statement	Accrual expense or release	• Classified in operating activities when the loss contingency relates to ongoing operations. • Reported in discontinued operations when the loss contingency relates to those operations. • Presented separately when the loss contingency is unusual or infrequent under Subtopic 220-20. • May be presented net of any related recovery income.
Statement of cash flows	Cash settlement	• Classified as cash flows for operating activities.

Disclosure

The disclosure objective of Topic 450 is to provide financial statement users with sufficient information to understand the nature and, when

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applicable, the amount of the contingent liability. The following decision tree summarizes the disclosure requirements.



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Gain contingencies and loss recoveries

Gain contingencies and loss recoveries are accounted for under two different accounting models, but sometimes both models are applied to the same transaction (see discussion of the mixed model below).

Loss recovery model

Recoveries of costs and losses incurred are accounted for under the loss recovery model when there is direct linkage to the loss event. The model typically applies to insured losses – e.g. those related to involuntary conversions, workers' compensation claims and environmental matters.

Under the loss recovery model, a recovery is recognized when it is probable and reasonably estimable. The amount of the recovery recognized is capped at the amount of the costs and losses incurred (i.e. recognized). Probable means likely to occur, as defined in Subtopic 450-20 regarding loss contingencies.

Gain contingency model

A gain contingency is an existing condition, situation or set of circumstances involving uncertainty as to possible gain that will ultimately be resolved when one or more future events occur or fail to occur.

A gain contingency is not recognized before its realization. Realization requires resolution of all uncertainties and is typically when cash or a claim to cash is received.

Unlike for loss contingencies and loss recoveries, probability is not a factor in the recognition of gain contingencies. Therefore, gain contingencies are typically recognized later than loss contingencies and loss recoveries, even when they relate to the same loss event.

Mixed model

Some transactions involving the recovery of losses are bifurcated, with:

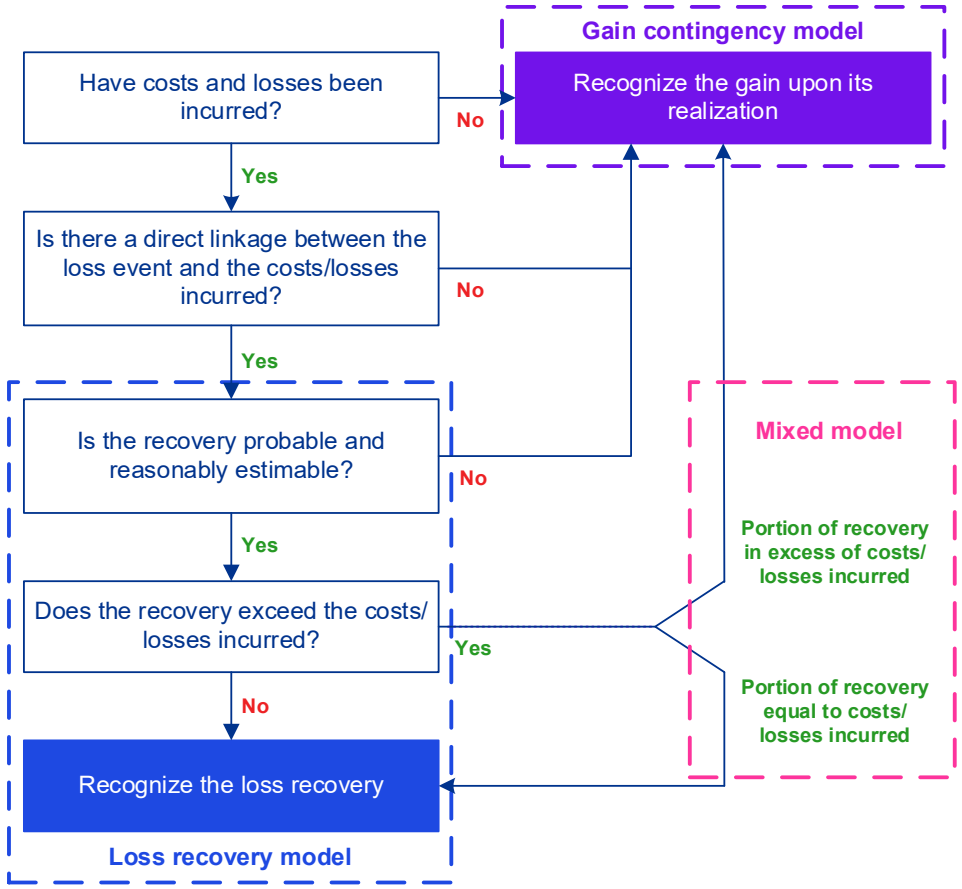
- the loss recovery model applying to the anticipated recovery of costs and losses incurred (with a direct linkage to the loss event); and
- the gain contingency model applying to any remaining amount of the anticipated recovery.

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The mixed model often applies to recoveries from business interruption insurance.

Summary

The following diagram summarizes the decision points involved in accounting for a loss recovery and gain contingency.



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Guarantees and product warranties

Topic 460 establishes accounting and disclosure requirements for the guarantor (obligor) of guarantees, including product warranties. It provides separate scoping, recognition and measurement guidance for product warranties as compared to other guarantees. Some of its disclosure requirements apply to both product warranties and guarantees, and others incrementally apply to product warranties.

References to 'guarantees' in this Executive Summary are to guarantees other than product warranties, and separate discussion is provided for these guarantees and product warranties.

Guarantees

Some guarantees in Topic 460's scope are subject to all of its guidance while others are subject only to its disclosure guidance.

Guarantee contracts in Topic 460's scope	
• Financial guarantees • Performance guarantees	• Indemnifications • Indirect guarantees of indebtedness of others
Guarantee contracts excluded from Topic 460's entire scope	
• Guarantees or indemnifications that are excluded from Topic 450's scope, such as employment-related guarantees • Guarantees or indemnifications in the scope of certain other Topics/Subtopics	• Guarantees or indemnifications whose existence prevents sale accounting • Guarantees or indemnifications of an entity's own future performance
Guarantee contracts excluded from Topic 460's general recognition and measurement guidance (but not disclosure) provisions	
• Certain guarantees issued between entities under common control	• Guarantees in the scope of certain other Topics/Subtopics

A guarantor is required to recognize a liability for both the noncontingent and contingent components of guarantees. How each component is measured and how those measurements interact depends on whether the guarantee is also in the scope of either Subtopic 326-20 (credit

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losses on financial instruments measured at amortized cost) or Topic 480 (distinguishing liabilities from equity) and, if not, on the guarantor's accounting policy election.

Product warranties

Product warranties are guarantees for which the underlying is related to the performance (regarding function, not price) of nonfinancial assets that are owned by the guaranteed party. The obligation may be incurred in connection with the sale of goods or services and, if so, it may require further performance by the seller after the sale has taken place.

Measurement of the guarantee obligation for a product warranty depends on whether it is a service-type (Topics 605 and 606 apply) or an assurance-type warranty (Subtopic 450-20 applies, with incremental guidance provided in Topic 460).

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Commitments

Topic 440 establishes required disclosures for:

- certain commitments; and
- certain unconditional purchase obligations.

Certain commitments

Topic 440 requires the following types of items to be disclosed in the financial statements:

- unused letters of credit;
- leases;
- assets pledged as security for loans;
- pension plans;
- the existence of cumulative preferred stock dividends in arrears; and
- commitments, including:
  - a commitment for plant acquisition;
  - an obligation to reduce debts;
  - an obligation to maintain working capital; and
  - an obligation to restrict dividends.

Topic 440 does not contain specific disclosure requirements for these items – although other Topics may. Instead, it simply states they are to be disclosed in the financial statements.

Unconditional purchase obligations

Although an unconditional purchase obligation is a type of commitment, it is subject to specific disclosures under Topic 440. It is defined as “an obligation to transfer funds in the future for fixed or minimum amounts or quantities of goods or services at fixed or minimum prices.”

Unless an unconditional purchase obligation qualifies for a specific scope exclusion, it is subject to Topic 440’s disclosures when it has all of the following characteristics.

- It is cancelable only under certain conditions.
- It was negotiated as part of arranging financing for facilities that will provide contracted goods or services or for costs related to those goods or services (e.g. carrying costs for contracted goods).
- It has a remaining term in excess of one year.

Topic 440 contains different disclosure requirements for recognized versus unrecognized unconditional purchase obligations.

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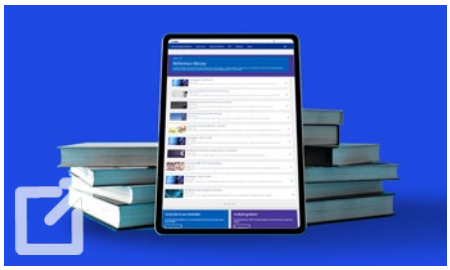
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