# ISSUES ON ACCOUNTING STANDARDS (AS 15, 22 & 29)

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# AS 15 – EMPLOYEE BENEFITS

**Types of Employee Benefits**

**Payable during Service**

- Short term Benefits are paid immediately
- In any case < 12 mths (Salary, Bonus) etc)

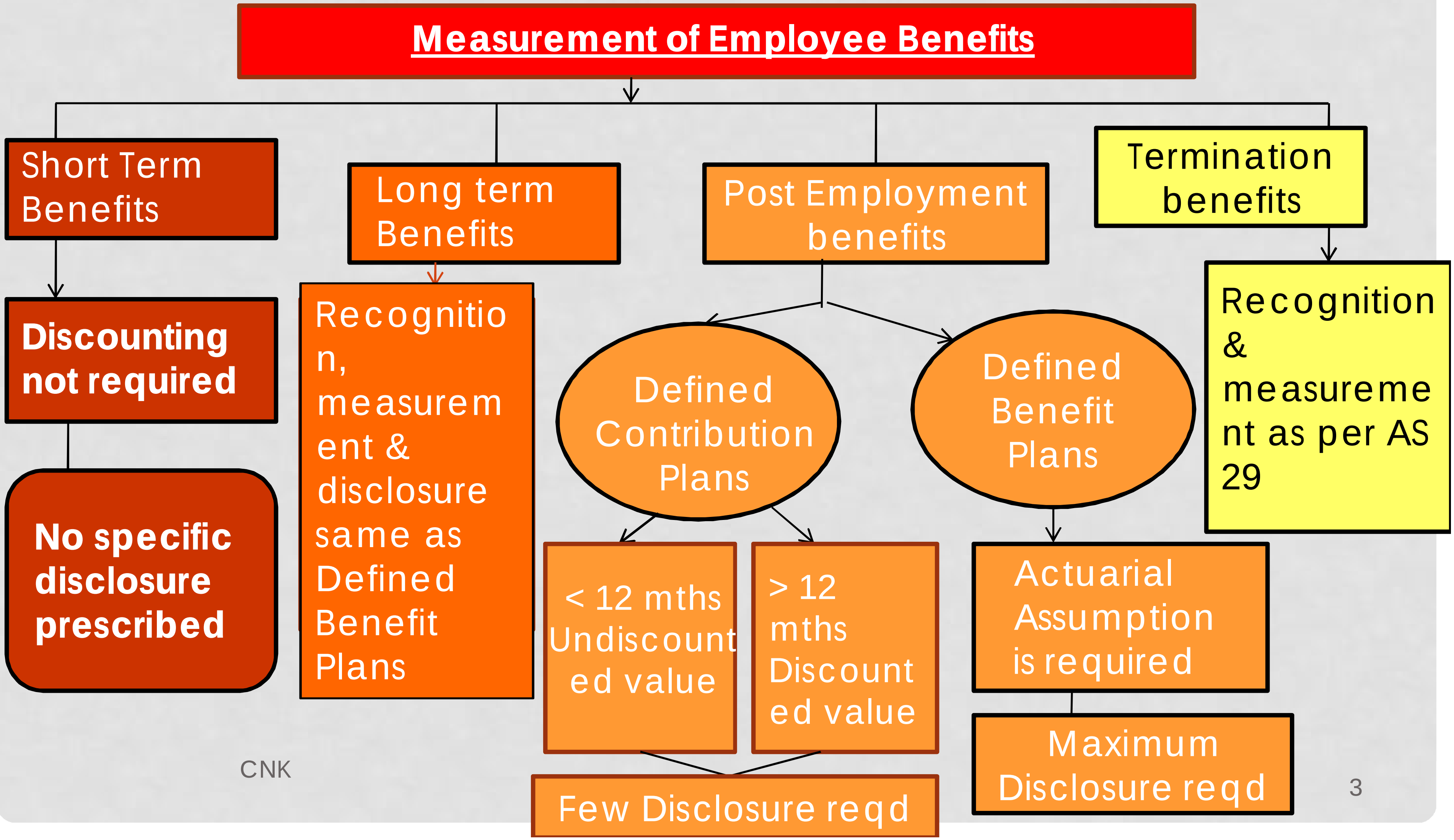
- Long term Benefits fall due for payment later > 12mths (Sabbatical, disability)

**Payable Post Employment**

Gratuity, Pension, Other retirement benefits payable on and after retirement

Termination benefits Lump sum payments payable on employer terminating employee's services

# AS 15 – EMPLOYEE BENEFITS …



# AS 15 – EMPLOYEE BENEFITS …

**Exemptions to SMCs are as follows :**

- Para 11 to 16 of the standard to the extent they deal with recognition and measurement of short term accumulating compensated absences which are non-vesting.
- Para 46 and 139 of the standard which deal with discounting of amounts that fall due more than 12 months after the balance sheet.
- Disclosure requirements of Para 119 to 123 of AS 15 in respect of accounting for defined benefit plans. However the SMC should disclose the actuarial assumptions as per para 120(1) of AS 15.
- An SMC need not apply the measurement and recognition principles of paras 129 to 131 regarding accounting for other long term employee benefits. However the SMC should actuarially determine and provide for accrued liability in respect of such benefit (under Project Unit Credit Method). The discount rate is to be determined with reference to market yields on government bonds as on BS date.

# AS 15 – SOME ISSUES

**Issue :** In case the rules of an enterprise provide that no gratuity would be payable if an employee leaves during the first five years of service, whether the enterprise is required to create a provision in respect of gratuity payable during the first five years of service of an employee.

**Solution:**

- The employee's right to receive the benefit is conditional on future employment for a period of five years.
- Although there is a possibility that the benefit may not vest, there is also a probability that the employee would serve for the minimum period of five years and become eligible for gratuity.
- An obligation exists even if a benefit is not vested.

Cont'd

# AS 15 – SOME ISSUES …

**Solution…**

- The obligation arises when the employee renders the service though the benefit is not vested.
- The measurement of this obligation at its present value takes into account the probability that the benefit may not vest and this is appropriately factored in the calculation of the present value of the defined benefit obligation.
- An enterprise should, therefore, create a provision in respect of gratuity payable during the first five years of service of an employee.

# AS 15 – SOME ISSUES …

**Issue:** Whether an entitlement to earned leave which can be carried forward to future periods is a short-term employee benefit or a long-term employee benefit.

**Solution:**

- Para 7.2 of the Standard defines 'Short-term' benefits as employee benefits which ***fall due*** wholly within twelve months after the end of the period in which the employees render the related service.
- Para 8(b) of the Standard illustrates the term 'Short-term benefits' to include "*short term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service*".

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# AS 15 – SOME ISSUES …

**Solution…**

- Para 8(b) together with Para 7.2 would imply that the classification of short-term compensated absences should be only when absences have ***"fallen due"*** and are also "***expected to occur"***.
- where employees are entitled to earned leave which can be carried forward to future periods the benefit would be a 'short-term benefit' provided the employee is ***entitled*** to either encash / utilise the benefit during the twelve months after the end of the period when he became entitled to the leave and is also ***expected to do so***.
- Where there are restrictions on encashment / availment, clearly the compensated absence has not fallen due and the benefit of compensated absences is more likely to be a long term benefit. …

# AS 15 – SOME ISSUES …

**Solution…**

- The value of short-term benefits should be determined without discounting and if the benefit is determined as long term, it would be recognised and measured as “Other long term benefits” in accordance with paragraph 129 of the Standard.
- The categorisation in ‘short-term’ or ‘long-term’ employee benefits should be done on the basis of the overall behavioral pattern of all the employees of the enterprise and not on individual basis.

# AS 15 – SOME ISSUES …

**Issue :** There is a major change in the Actuarial valuation report from the previous year, affecting the valuation of retirement benefits. How should the same be dealt with?

**Solution:**

The following assumptions on which the valuation of retirement benefits is done needs to be compared on a year to year basis and any change in the assumption needs to be reviewed in detail to ascertain whether it is appropriate for the company:

- The discount rate
- Retirement age
- Future Salary and benefit levels
- In the case of medical benefits, future medical costs including where material, the cost of administering claims and benefit payments and
- The expected rate of return on plan assets.

# AS 15 – SOME DISCLOSURE ISSUES

**Disclosures Made**

- **No accounting policy disclosed for treatment of actuarial gains and losses (other than SMC).**
- **Requirement:**

  As per Para 120(a) of AS 15, the accounting policy used for recognizing actuarial gains and losses should be disclosed.

- **Estimates of future contribution to be made, category of plan assets not disclosed (other than SMC).**
- **Requirement:**

  Para 120(o) and 120(h) of AS 15 requires the disclosure of estimate of future contribution and category of plan assets respectively.

# AS 15 – SOME DISCLOSURE ISSUES …

**Disclosures Made…**

- **The amount recognized under defined contribution plan not separately disclosed in the profit and loss account.**
- **Requirement:**

  Para 47 of AS 15 requires the disclosure of the amount recognized as an expense for the defined contribution plan.

- **Accounting policy was silent on use of project unit credit method to determine present value of defined benefit plans.**
- **Requirement:**

  Para 65 of AS 15 requires that enterprise should use the Projected Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost.

# AS 15 – SOME DISCLOSURE ISSUES …

**Disclosures Made…**

- **Disclosure of present value of defined benefit obligation, fair value of the plan assets and experience adjustment done for current and previous year.**
- **Requirement:**

  Para (n) of clause 120 requires disclosure for the current annual period and previous four annual periods of the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan as also the experience adjustments arising on the plan liabilities / assets.

# AS 15 – SOME DISCLOSURE ISSUES …

- **Disclosure Made…**

  **Post Retirement Medical Benefit (Unfunded)**

  - **Defined Benefit Obligation**
  - **Plan Assets**
  - **Surplus/(Deficit)**
  - **Experience adjustment on plan liabilities**
  - **Experience adjustment on plan assets**

- **Requirement:**

  Disclosure as required by Para 120(m) of AS 15 relating to "the effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates on: (i) the aggregate of the current service cost and interest cost components of net periodic post-employment medical costs; and (ii) the accumulated post-employment benefit obligation for medical costs" should have been provided.

# AS 15 – SOME DISCLOSURE ISSUES …

- <u>**Disclosure Made…**</u>

  **Defined Benefit Plan**

  - ❑ **Actuarial Assumptions**
  - ❑ **Discount Rate (%)**
  - ❑ **Annual Salary**
  - ❑**Escalation Rate (%)**
  - ❑ **Expected Return on**
  - ❑**Plan Assets (%)**

  **No further notes.**

<u>Cont'd</u>

# AS 15 – SOME DISCLOSURE ISSUES …

**Requirement:**

Assertion as required by second proviso to para 120(l) not made:

- Apart from the above actuarial assumptions, an enterprise should include an assertion under the actuarial assumptions to the effect that estimates of future salary increases, considered in actuarial valuation, take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

# AS 15 – SOME DISCLOSURE ISSUES …

- **Disclosure Made…**

  **Disclosure made on aggregate basis irrespective of whether the plans were funded / partly funded/ unfunded.**

- **Requirement:**

  Para 120 (a) requires analysis of the defined benefit obligation into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly funded or partly funded.

# AS 15 – SOME DISCLOSURE ISSUES …

- **<u>Issue:</u> Provident Fund is administered through a Trust set up for the purpose and the contributions were bifurcated as follows:**
  - ❑ **Amount pertaining to contribution (employer and employee) made as "Defined Contribution Plan" and**
  - ❑ **Amount pertaining to interest on the contribution as "Defined Benefit Plan"**

- **<u>Solution:</u>**

  **As per Para 25 to 27, when entity sets up a Trust to administer provident Fund plan, the actuarial and investment risk is on the entity and not restricted to interest portion alone. Accordingly the entire contribution should have been classified as "Defined Benefit Plan"**

# AS 15 – SOME DISCLOSURE ISSUES …

- **Issue :** **Provision for Gratuity is made on the basis of an actuarial valuation at the Balance Sheet date carried out by an independent actuary The Gratuity Fund is administered through a scheme of Life Insurance Corporation of India / ING Vysya Life insurance Company Private Limited. The contribution to the said fund is charged to the Profit & Loss Account.**

- **Solution:**

  **The policy does not mention that valuation is done using Projected Unit Credit Method (para 65). Also does not disclose the accounting policy relating to recognizing actuarial gains and losses (para 120(a))**

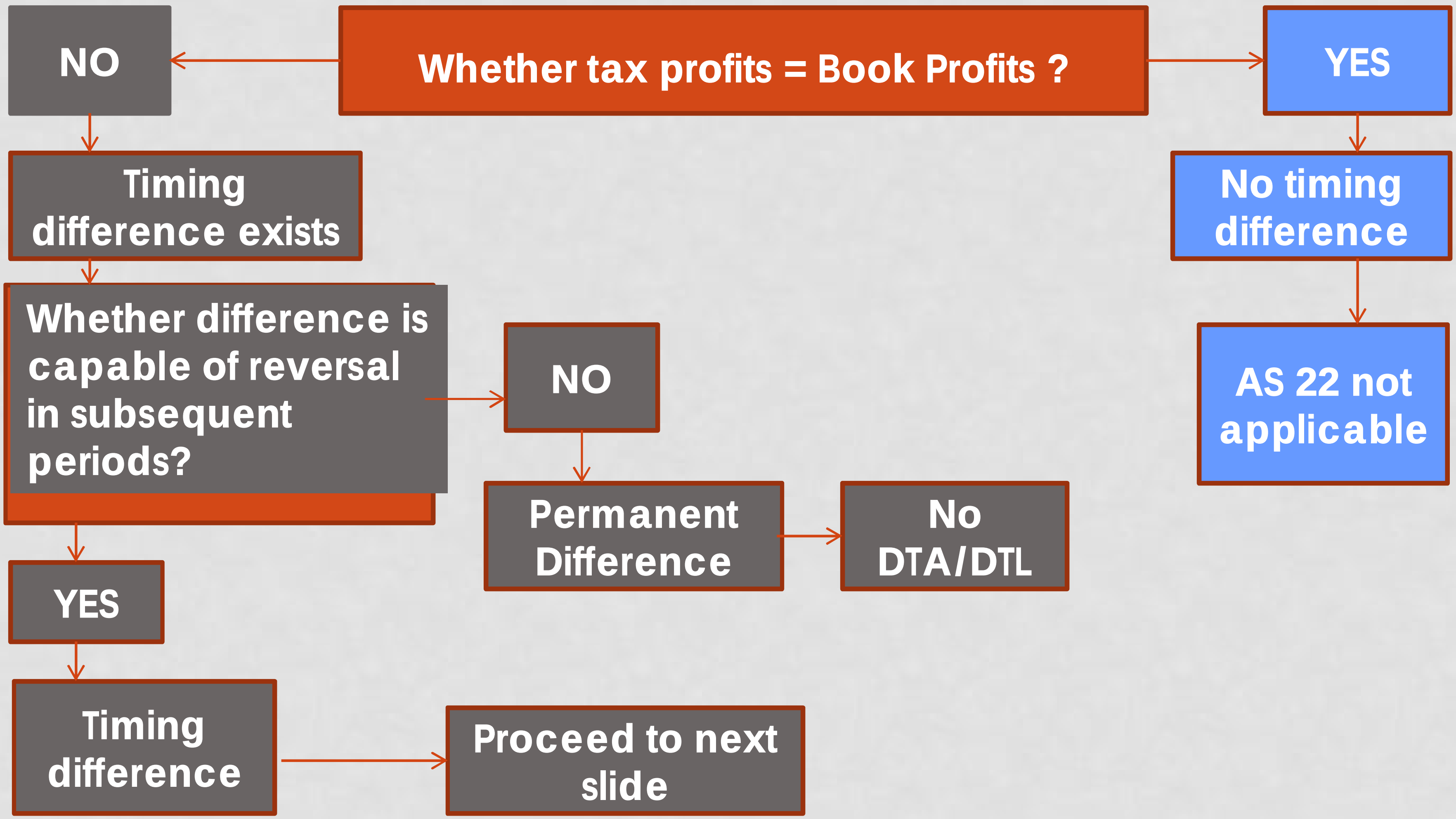
# AS 15 – SOME DISCLOSURE ISSUES …

**Accounting Policy…**

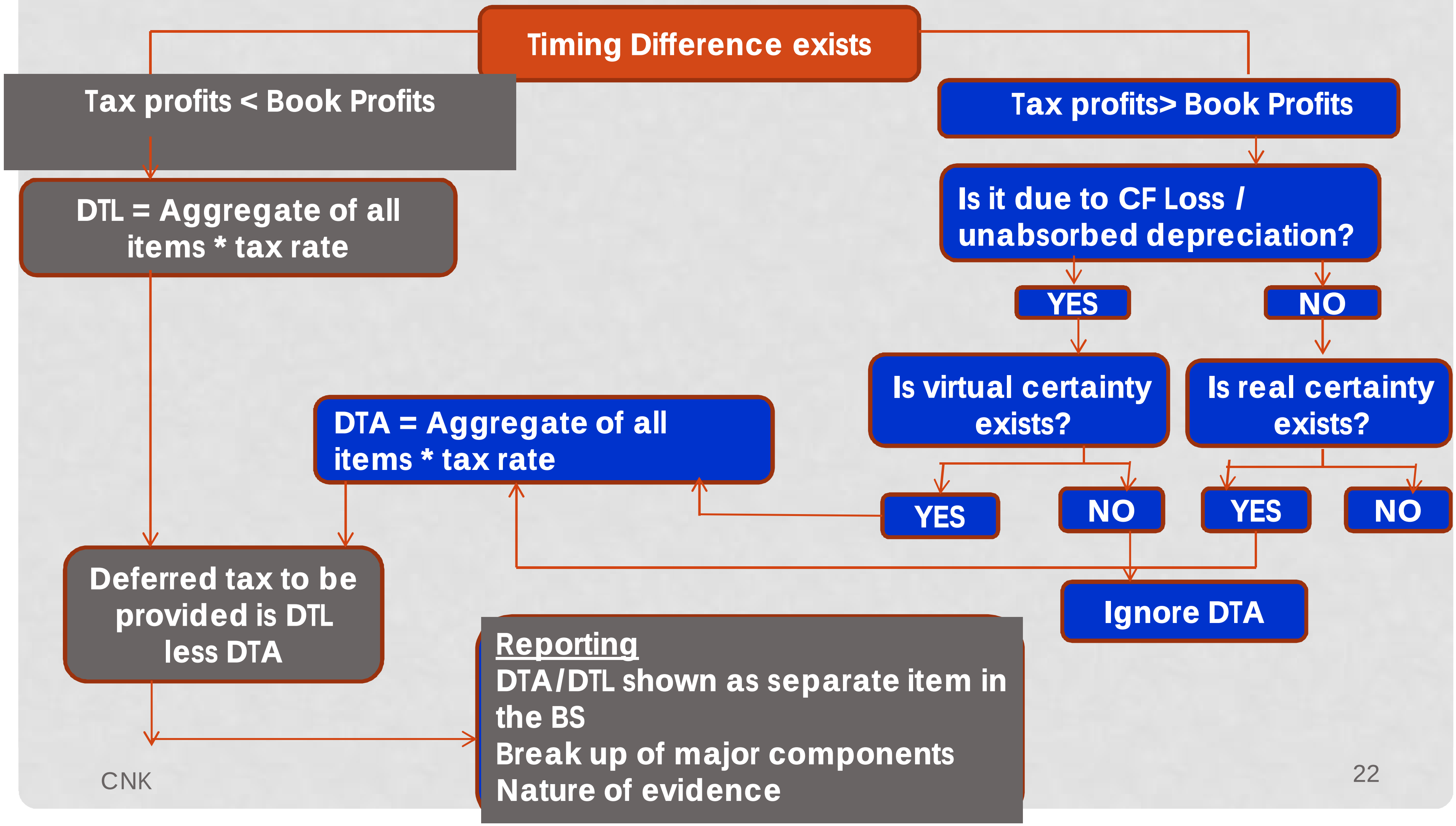
- **Issue :** **Company's contribution to Provident Fund & Family Pension Fund are statutorily deposited with the Government and charged to Profit & Loss A/c. For eligible employees year end liability on account of Gratuity under the payment of Gratuity Act 1972 is provided for on accrual basis as at Balance Sheet date.**
- **Requirement:**

  **The liability should have been provided as per Actuarial valuation as required by para 65.**

# AS 22 – ACCOUNTING FOR TAXES ON INCOME



# AS 22 – ACCOUNTING FOR TAXES ON INCOME...



# AS 22 – SOME ISSUES

**Issue** : S Ltd a listed company was incurring heavy losses (including unabsorbed depreciation) since the last several years and the industry in which it was functioning was not expected to perform better in the next few years. While finalising the accounts for the year ended 31st March 20XX, the CFO of the Company decided to create a deferred tax asset for the tax benefits that would arise in future years from the earlier years losses and unabsorbed depreciation that had remained unabsorbed in income tax.

**Solution:**

- In absence of virtual certainty, creation of deferred tax asset on brought forward losses of the company would be incorrect.

Cont'd

# AS 22 – SOME ISSUES …

**Solution…**

- There is no time limit under income tax act for set off of unabsorbed depreciation against future profits.
- As the depreciation is available for set off for unlimited period and the company cannot perennially continue to sustain losses, it would be reasonable to recognise the unabsorbed depreciation as deferred tax asset for set off against future profits of the company.
- However DTA can be created in respect of unabsorbed depreciation to the extent that future taxable income will be available from future reversal of any DTL recognised at the balance sheet date.
  - ***To that extent it would not be necessary to consider the level of virtual certainty supported by convincing evidence.***

# AS 22 – SOME ISSUES ...

**Issue :** Incase of Consolidated Financial Statements (CFS) where some companies in the group may have a deferred tax asset and others a deferred tax liability whether the two can be set off ?

**Solution**

- Deferred tax assets/liabilities can be offset only within a legal jurisdiction, there is no legal right to offset deferred tax assets/liabilities across different legal jurisdictions.
- Separate computations are required in respect of holding companies and various entities in a group, the Indian Income tax act is based on a single entity concept rather than a group concept.
- There is no legal right to offset tax assets/liabilities across these entities.
  - ***Thus deferred tax assets/liabilities cannot be offset across these companies.***

# AS 22 – SOME DISCLOSURE ISSUES

**Disclosure made**

- **The company has not disclosed the breakup of deferred tax liability in the notes to accounts.**
- **Requirement:**

  It was noted that paragraph 31 of AS 22, Accounting for Taxes on Income requires that the break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

# AS 22 – SOME DISCLOSURE ISSUES …

**Disclosure made…**

- **It has been noted that the company has disclosed advance income tax paid (current tax asset) and provision for income tax (current tax liability) separately, i.e., it has not offset the amounts.**

**Requirement:**

- It was noted that Para 27 of AS 22, inter alia, requires that an enterprise should offset assets and liabilities representing current tax if the enterprise :
  - has a legally enforceable right to set off the recognised amounts; and
  - intends to settle the asset and the liability on a net basis.”

Cont’d

# AS 22 – ACCOUNTING FOR TAXES ON INCOME...

**Requirement…**

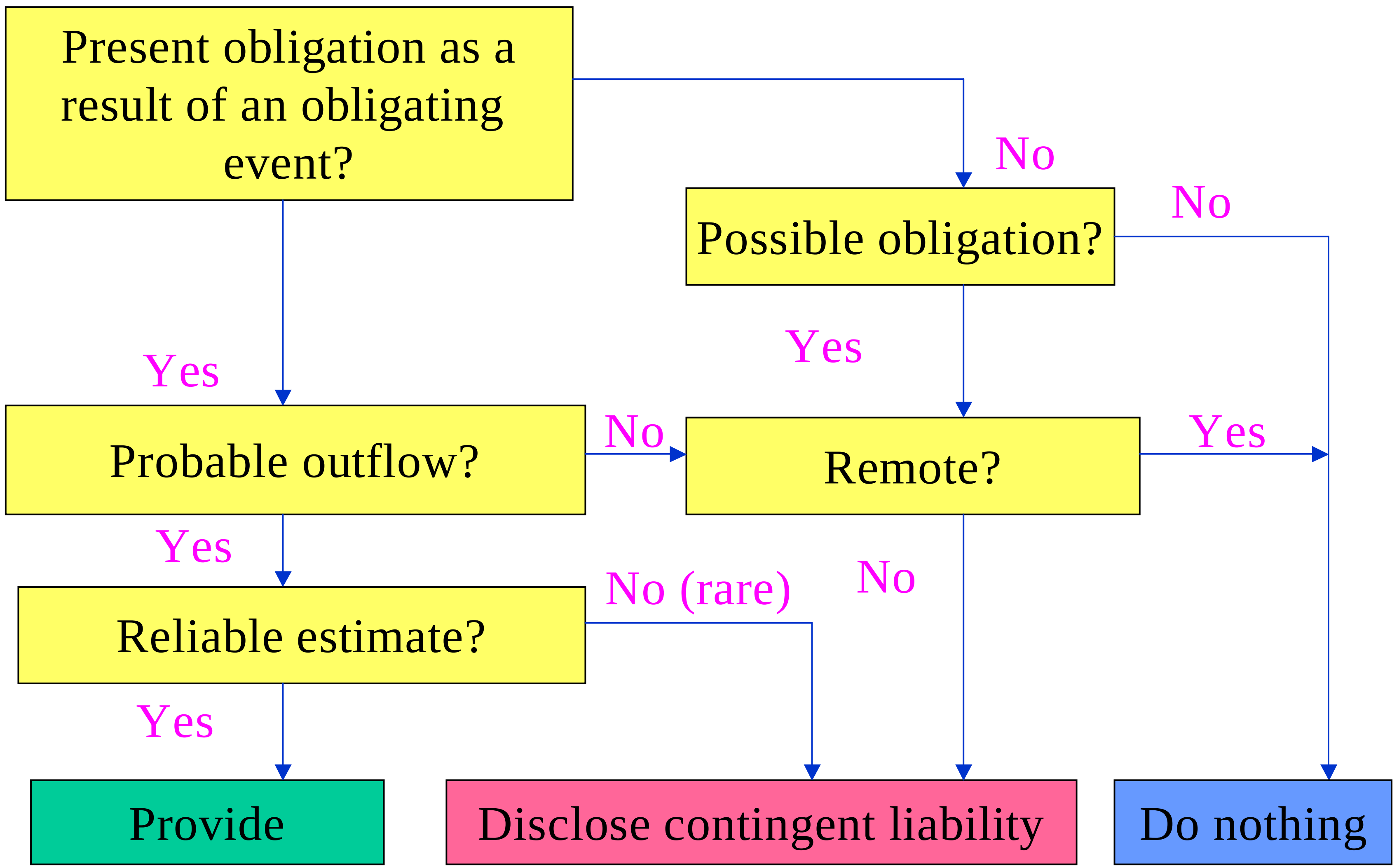
- It was also noted that under the Income tax Act, 1961, advance tax representing current tax is paid against the provision for income tax representing current tax liability.
- Under the Act, an enterprise has a legal right to set off the two amounts and normally; the enterprise settles these amounts on net basis only.
- Keeping this in view, the enterprise should have offset advance income tax paid against the provision for income tax and shown only the net amount in the balance sheet.
- Disclosing two amounts separately is contrary to AS 22

# AS 29: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

**Provision required when:**

- There is a Present Obligation;
- Which Results from a past event;
- There is Outflow of resources embodying economic benefits;
- Reliable estimate can be made for the same.

# AS 29 -- Recognition Criteria Decision Tree



# AS 29: SOME ISSUES

- Recall of a part of an automobile (due to technical reasons)

  YES (since there is a present obligation at the balance sheet date of replacing the parts)

- Cost of replacing Catalyst in a chemical plant every 5 years (in years 1 to 4)

  NO (At the balance sheet date no obligation to replace replace)

- Decision taken by Board to extensively renovate the office premises

  NO (no obligation exists to renovate the office independently of the enterprise's future actions)

- Free flights / gifts on accumulation of points

  YES (Reliable estimate of Outflow of resources can be made)

- In Search carried out, incriminating evidence found, but no final orders passed

  NO (Reliable estimate of Outflow of resources cannot be made)

# AS 29: SOME ISSUES …

- **Issue:** A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

**Solution:**

- It is a present obligation arising out of past events.
- The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.
- A provision is recognised for the best estimate of the costs of refunds.

# AS 29: SOME ISSUES …

**Issue:**

- An enterprise has contaminated land by dumping hazardous material in the backyard of its factory. The management got wind of it only recently when it conducted an exhaustive environmental audit. The enterprise has not violated any existing legislation; however, it belongs to an international group which maintains high environmental standards.

**Solution:**

- There is a present obligation because the company is obligated by its Group policies and hence provision is required, though the actual clean up may take place much later.

# AS 29: SOME ISSUES …

- **A manufacturer gives free 3-year warranty at the time of sale.**

  **YES** (The past obligating event is the sale of the product with a warranty, which gives rise to a present obligation).

- **A vendor will be paid a bonus of Rs. 2 million if certain performance parameters are met before the end of the second year. At the end of the first year it is very probable that those parameters would be met.**

**YES**

  - A past event has taken place, i.e. the vendor has provided the service making him eligible for the bonus. Thus, provision would be recognised.
  - The performance parameters will be met over a two year period, a pro-rata provision of Rs. 1 million may be recognised in the first year.

# AS 29: SOME ISSUES …

- **Issue :** Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 20XX. The enterprise has not fitted the smoke filters at the balance sheet date of 31 March 20X1.

**Solution:**

- There is no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters).
- An obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

# AS 29: SOME ISSUES …

**Solution…**

- Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.
- No provision is recognised for the costs of fitting smoke filters.
- A provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed.

# AS 29: MEASUREMENT OF PROVISION

- **Issue :** An enterprise pays VRS in installments rather than lump-sum. For the purpose of making a provision in the books for such VRS expenses can it be made at the discounted value?
- **Solution:**
  - ❑VRS is not a retirement benefit under AS 15.
  - ❑Retirement benefits under AS 15 are those that are provided on retirement and not for voluntarily retiring.
  - ❑Therefore VRS to be paid in installment post AS 29 technically cannot be recorded at discounted value.
  - ❑A point to be noted is that pre AS 29, since discounting was not prohibited, VRS paid in installments could be recorded at discounted value.

# AS 29: CONSTRUCTIVE V LEGAL OBLIGATION

**Issue :** A Company gives Diwali bonus each year to all its employees. This has been a practice for the past 20 years. The bonus is not linked to performance and was given even when the Company made a loss. Whether a provision for the bonus would be required ?

**Solution:**

- It is a present obligation arising out of past events.
- The obligating event is the rendering of service by the employee, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.
- A provision is recognised for the best estimate of the costs of bonus.

# AS 29: SOME ISSUES …

**ISSUE**

- VRS scheme announced in March 2013
- VRS applications to be filed by June 2013
- VRS granted to selected employees in July 2013

**Assuming FS finalised in May 2013: Whether provision required in 2012-13 or 2013-14?**

**Solution:**

- **Does any present obligation arise in 2012-13?**
- **If not then provision necessary only in 2013-14**

**ISSUE:**

- ONEROUS CONTRACTS


Thank you!