PRACTICAL INSIGHTS INTO AS 15 & AS 22

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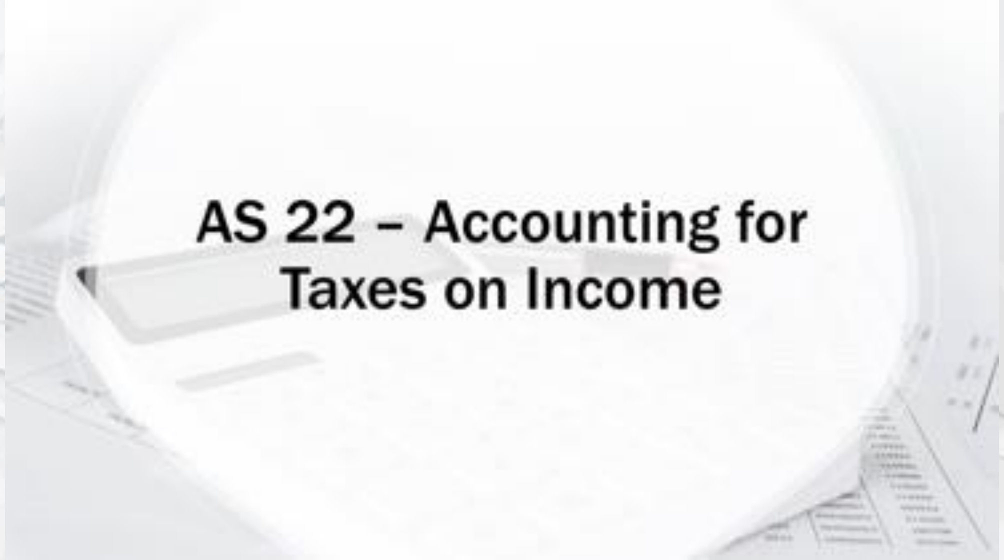
Common non-compliances with AS identified by FRRB

Agenda for the session



AS 15 – Employee Benefits

Certain fundamental questions…

Whether Directors are employees?

Whether formal employee-employer relationship required for applicability of AS 15?

Whether provision required for obligations arising out of informal practices (constructive obligations)?

Whether this standard is applicable to all entities?

Scenario 1: Accounting policy of a company

"The Company had not provided the provision for gratuity considering the employee turnover and uncertainties regarding estimating the obligation. None of the employees had completed 5 years of service as at Balance Sheet date. Gratuity payable, if any, will be accounted as and when payments are made."

How do you deal with the same as an auditor of non-SMC?

What will be your view if it is an SMC?

Applicability of AS 15 - Companies

Non-SMC	Applicable in its entirety No relaxations are available
SMC	Applicable with relaxations. Provisions are recognised based on actuarial valuation. Disclosures are exempted except the actuarial assumptions

Scenario 2: Accounting policy for a non-company

"The provision for gratuity is recognized at undiscounted values based on the assumption that such benefits are payable to all employees at the end of the accounting year."

Whether the above policy is acceptable?

What if it is a Level II/ Level III/ Level IV entity?

Applicability of AS 15 – Non-companies

Level I	Level II/III (with employees of 50 or more)	Level II/III (with employees less than 50) & Level IV
• Applicable in its entirety	• Applicable with exemptions on disclosures	• Applicable with exemptions on to actuarial valuation and disclosures • Provision based on another rational method required

Types of Employee Benefits

- Short-term employee benefits
- Post-employment benefits
- Termination benefits
- Other long-term employee benefits

Types of post-employment benefits

Defined Contribution Plan

- Plan under which the employer pays a fixed contribution to a fund and the employer's liability is restricted to such contributions.
- Ultimate liability for settlement not with the employer.

Defined benefit Plan

- Plans other than defined contribution plan.
- The ultimate liability remains with the employer.

Let’s clarify…

- What is the nature of Employer’s Contribution to Provident Fund?
- What will be nature of Gratuity?

Scenario 3: Provident Fund

‘Defined contribution plans are provident fund scheme and part of the pension fund scheme for eligible employees. The Company’s contribution to defined contribution plans are recognised in the Statement of Profit and Loss in the financial year to which they relate. The Company makes specified monthly contribution towards employee provident fund and pension fund to respective trusts administered by the Company. The minimum interest payable by the provident fund trust to the beneficiaries every year is notified by the Government. The company has an obligation to make good the shortfall, if any, between the return on investments of the trust and the notified interest rate.’

Accounting for Provident Fund

Company contributes to State Fund and no obligation for further contribution

- Defined Contribution Plan
- Contribution due for the period will be recognised as expense

Company has an obligation to make good the short-fall

- Defined benefit plan
- Accounted based on actuarial valuation under projected units credit method

Accounting for Gratuity

Defined benefit Plan

Actuarial valuation is required using projected units credit method

Net defined benefit obligation will be recognised in Balance Sheet and corresponding expense is recognised.

Audit perspective

- SA 620 – If valuation is taken by the Auditor's expert
- SA 500 – If the valuation is taken by Management's expert / Management itself
- Competency of the Actuary to be verified – Fellow Actuary with valid CoP.
- The information provided to the actuary and its appropriateness to be verified
- Scheme details to be verified, whether as per Company policy and legal requirements
- Reasonableness of assumptions should be checked
- Tax treatment and deferred tax impact

Scenario 4: Leave encashment

A Company has a policy for providing paid leave for the employees. It can be carried forwarded to subsequent years.

What will be the nature of employee benefit?

Accounting for lease encashment

If the benefit falls due and expected to be availed wholly within 12 months from reporting date

- Short-term employee benefit
- Provision will be recognised at undiscounted amount for the expected cost of settling the obligation

If the benefit falls due/expected to be availed after 12 months

- Other long-term employee benefits
- Actuarial valuation is required (similar to gratuity)

AS 22 – Accounting for Taxes on Income

Certain fundamental questions…

Whether AS 22 is applicable to non-companies?

Whether current tax assets and liabilities can be offsetted?

Whether deferred tax to be computed using current year tax rate or future tax rate?

Applicability of AS 22

For Companies

- Applicable to all companies in its entirety.

For other than companies

- Level I, II & III – Applicable in its entirety
- Level IV – Only current tax portion is applicable

Components of tax expenses

Current tax

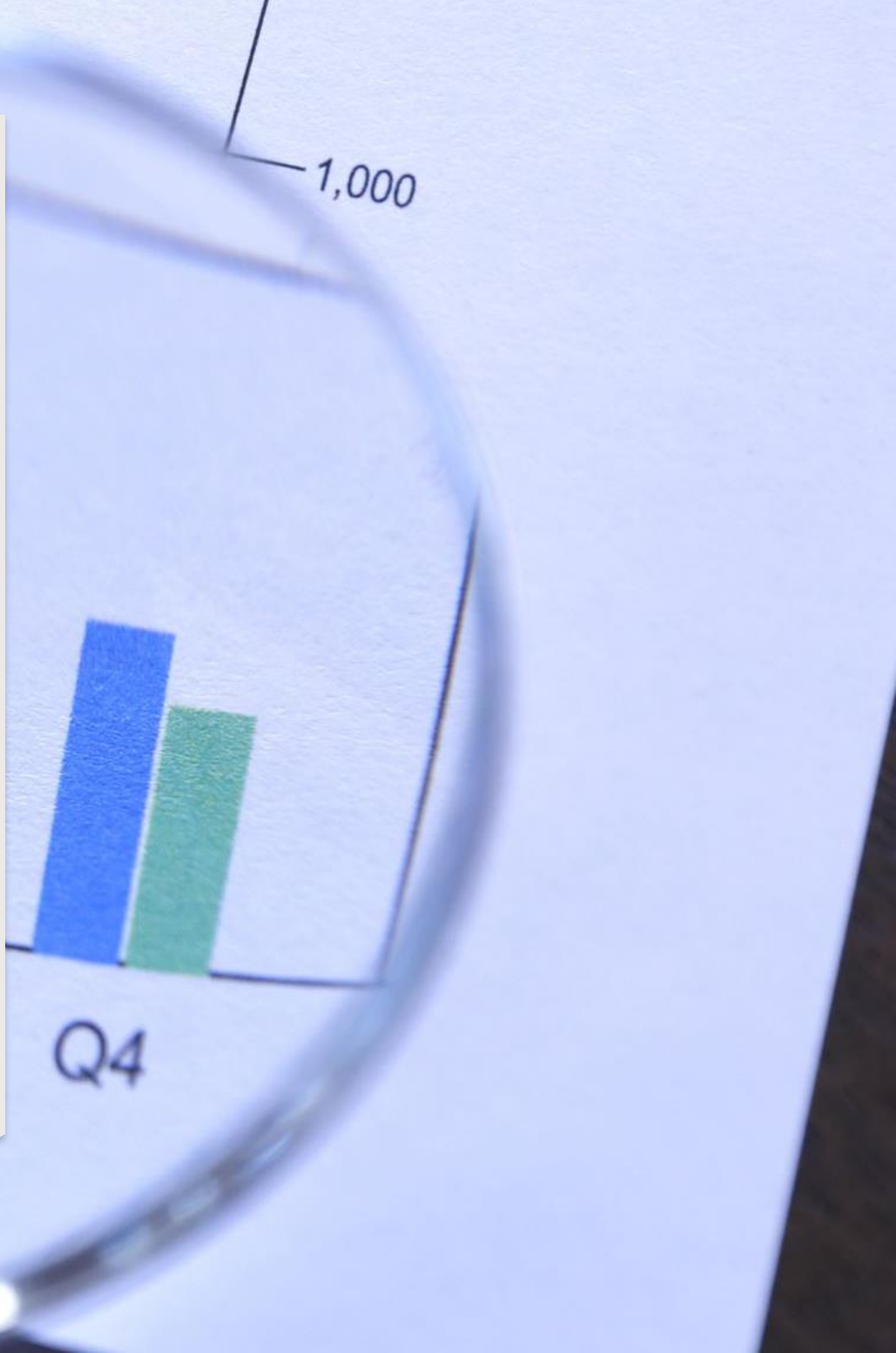
- Tax payable/ (recoverable) on taxable profit/ (loss) for the period

Deferred tax

- Future tax consequence on the timing differences between accounting income and taxable income

Provisions on current tax

- It is the tax computed in accordance with tax laws.
- Enacted tax rates to be used.
- Current tax assets and liabilities should be offset if:
    - Legally enforceable right to offset exists and
    - Entity intends to settle it on net basis



Differences between accounting income and taxable income

Permanent Differences

- Differences originate in one period and do not reverse subsequently.
- No effect on matching concept and no deferred tax recognised

Timing Differences

- Differences originate in one period and capable of being reversed in one or more subsequent periods.
- Matching concept is affected and deferred tax to be considered.

Types of timing differences

Taxable timing differences

- It will result in more tax in future when it reverses.
- Deferred tax liability to be recognised

Deductible timing differences

- It will result in more tax in future when it reverses
- Deferred tax asset to be recognised (subject to prudence)

Certain common timing differences

- Depreciation charge on PPE and Section 32 & Section 35AD
- Disallowance u/s 40(a)(i)/(ia)/(ib)
- Disallowance u/s 40A(9) – Contribution to funds
- Disallowance u/s 40A(13) – Market to market loss/ expected loss
- Disallowance u/s 43B
- Allowance u/s 35D

How to compute deferred tax?

Ind AS 12: Balance Sheet Approach	Compare the account base with tax base to identify temporary difference Tax effect on temporary difference will be the closing deferred tax liability/ (asset) Difference between closing and opening will be the charge/credit to P&L/OCI
AS 22: Income statement approach	Compare the P&L with the tax computation and identify the timing difference Tax effect on such timing difference (originating/reversal) will be the charge/credit to P&L

Recognition of Deferred Tax Assets

Differences other than unobserved depreciation and carried forwarded losses	Unobserved depreciation and carried forwarded losses
• Recognise if there is a **reasonable certainty** that sufficient future taxable income will be available against which it can be utilised.	• Recognise if there is a **virtual certainty supported by convincing evidence** that sufficient future taxable income will available

Reassessment as at year-end

- At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets.
- The carrying amount of deferred tax assets should be reviewed at each balance sheet date.
- An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain.

Tax holiday and deferred tax

Deferred tax in respect of timing differences which reverse during the tax holiday period

Deferred tax in respect of timing differences which reverse after the tax holiday period is recognised in the year in which the timing differences originate.

The timing differences which originate first are considered to reverse first.

Tax rate to be used

- Uses the tax rates and tax laws that have been **enacted or substantively enacted by the balance sheet date.**
- When different tax rates apply to different levels of taxable income, average rates are used.
- Deferred tax should not be discounted to their present value.

Applicability of MAT

- Current tax will the higher of tax under normal provisions & tax under MAT provisions
- MAT Credit Entitlement will be recognised as an asset if there is a convincing evidence that entity will pay normal tax in future with corresponding credit to tax expense
- MAT Credit Entitlement will be presented under “Loans & Advances”
- Deferred tax will be computed based on taxable income under normal provisions and normal tax rates only.

Disclosures

No exemption on disclosures to SMC/ Level II/ Level III entities

The break-up of deferred tax assets and deferred tax liabilities into major components should be disclosed in the notes to accounts.

The nature of the evidence supporting the recognition should be disclosed for unabsorbed depreciation or carry forward of losses under tax laws.

Audit perspective

- Review of tax computation
- Opening balances of 43B claims etc.
- Disputed cases and settlements
- Adequacy of disclosures and accounting policy disclosure
- Documentation of recognition of deferred tax asset
- Classification of 234B/C interest?
- Presentation of tax relating earlier years

Thank you..!

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