Accounting Standards Interpretation (ASI) 29[1]

Turnover in case of Contractors

Accounting Standard (AS) 7, Construction Contracts (revised 2002)

ISSUE

1. AS 7, Construction Contracts (revised 2002) deals, *inter alia*, with revenue recognition in respect of construction contracts in the financial statements of contractors. It requires recognition of revenue by reference to the stage of completion of a contract (referred to as 'percentage of completion method'). This method results in reporting of revenue, which can be attributed to the proportion of work completed. Under this method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting period in which the work is performed.

   The issue is whether the revenue so recognised in the financial statements of contractors as per the requirements of AS 7 can be considered as 'turnover'.

CONSENSUS

2. The amount of contract revenue recognised as revenue in the statement of profit and loss as per the requirements of AS 7 should be considered as 'turnover'.

BASIS FOR CONCLUSIONS

3. The paragraph dealing with the 'Objective' of AS 7 provides as follows:

   "Objective

   The objective of this Statement is to prescribe the accounting treatment of revenue and costs associated with construction contracts. Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Therefore, the primary issue in accounting for construction contracts is the allocation of contract revenue and contract costs to the accounting periods in which construction work is performed. This Statement uses the recognition criteria established in the Framework for the Preparation and Presentation of Financial Statements to determine when contract revenue and contract costs should be recognised as revenue and expenses in the statement of profit and loss. It also provides practical guidance on the application of these criteria."

   From the above, it may be noted that AS 7 deals, *inter alia*, with the allocation of contract revenue to the accounting periods in which construction work is performed.

4. Paragraphs 21 and 31 of AS 7 provide as follows:

   "21. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35."

   "31. When the outcome of a construction contract cannot be estimated reliably:

   (a) revenue should be recognised only to the extent of contract costs incurred of which recovery is probable; and

   (b) contract costs should be recognised as an expense in the period in which they are incurred.

   An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35."

   From the above, it may be noted that the recognition of revenue as per AS 7 may be inclusive of profit (as per paragraph 21 reproduced above) or exclusive of profit (as per paragraph 31 above) depending on whether the outcome of the construction contract can be estimated reliably or not. When the outcome of the construction contract can be estimated reliably, the revenue is recognised inclusive of profit and when the same cannot be estimated reliably, it is recognised exclusive of profit. However, in either case it is considered as revenue as per AS 7.

5. 'Revenue' is a wider term. For example, within the meaning of AS 9, Revenue Recognition, the term 'revenue' includes revenue from sales transactions, rendering of services and from the use by others of enterprise resources yielding interest, royalties and dividends. The term 'turnover' is used in relation to the source of revenue that arises from the principal revenue generating activity of an enterprise. In case of a contractor, the construction activity is its principal revenue generating activity. Hence, the revenue recognised in the statement of profit and loss of a contractor in accordance with the principles laid down in AS 7, by whatever nomenclature described in the financial statements, is considered as 'turnover'.

[1]The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items.

Accounting Standards Interpretation (ASI) 20[1] (Revised)

Disclosure of Segment Information

Accounting Standard (AS) 17, Segment Reporting

ISSUE

1. Whether an enterprise, which has neither more than one business segment nor more than one geographical segment, is required to disclose segment information as per AS 17.

CONSENSUS

2. In case by applying the definitions of 'business segment' and 'geographical segment', contained in AS 17, it is concluded that there is neither more than one business segment nor more than one geographical segment, segment information as per AS 17 is not required to be disclosed. However, the fact that there is only one 'business segment' and 'geographical segment' should be disclosed by way of a note.

BASIS FOR CONCLUSIONS

3. The paragraph of AS 17 dealing with 'Objective' provides as under:

   "The objective of this Statement is to establish principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. Such information helps users of financial statements:

   (a) better understand the performance of the enterprise;

   (b) better assess the risks and returns of the enterprise; and

   (c) make more informed judgements about the enterprise as a whole.

   Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. Information about different types of products and services of an enterprise and its operations in different geographical areas - often called segment information - is relevant to assessing the risks and returns of a diversified or multi-locational enterprise but may not be determinable from the aggregated data. Therefore, reporting of segment information is widely regarded as necessary for meeting the needs of users of financial statements."

   In case of an enterprise, which has neither more than one business segment nor more than one geographical segment, the relevant information is available from the balance sheet and statement of profit and loss itself and, therefore, keeping in view the objective of segment reporting, such an enterprise is not required to disclose segment information as per AS 17. The disclosure of the fact that there is only one 'business segment' and 'geographical segment' and, therefore, the segment information is not provided by the concerned enterprise is useful for the users of the financial statements while making a comparison among various enterprises.

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Accounting Standards Interpretation (ASI) 3[1] (Revised)

Accounting for Taxes on Income in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961

Accounting Standard (AS) 22, Accounting for Taxes on Income

ISSUE

1. Sections 80-IA and 80-IB of the Income-tax Act, 1961 (hereinafter referred to as the 'Act') provide certain deductions, for certain years, in determining the taxable income of an enterprise. These deductions are commonly described as 'tax holiday' and the period during which these deductions are available is commonly described as 'tax holiday period'.

2. The issue is how AS 22 should be applied in the situations of tax-holiday under sections 80-IA and 80-IB of the Act.

CONSENSUS

3. The deferred tax in respect of timing differences which reverse during the tax holiday period should not be recognised to the extent the enterprise's gross total income is subject to the deduction during the tax holiday period as per the requirements of the Act.

4. Deferred tax in respect of timing differences which reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence as laid down in paragraphs 15 to 18 of AS 22.

5. For the above purposes, the timing differences which originate first should be considered to reverse first.

The Appendix to this Interpretation illustrates the application of the above requirements.

BASIS FOR CONCLUSIONS

6. Section 80A (1) of the Act provides that in computing the total income of an assessee, there shall be allowed from his gross total income, in accordance with and subject to the provisions of this Chapter, the deductions specified in sections 80C to 80U. Therefore, the deductions under sections 80-IA and 80-IB are the deductions from the gross total income of an assessee determined in accordance with the provisions of the Act. For example, depreciation under section 32 of the Act is provided for arriving at the amount of gross total income even if it is not claimed in view of Explanation 5 to clause (ii) of sub-section (1) of section 32 of the Act.

7. In view of the above, the amount of the deduction under sections 80-IA and 80-IB of the Act, is based on the gross total income which is determined in accordance with the provisions of the Act. In respect of the situations covered under sections 80-IA and 80-IB, the difference in the relevant accounting income and taxable income (relevant gross total income minus deduction allowed under sections 80-IA and 80-IB) of an enterprise during a tax holiday period is classified into permanent differences and timing differences. The amount of deduction in respect of sections 80-IA and 80-IB is a permanent difference whereas the differences which arise because of different treatment of items of income and expenses for determination of relevant accounting income and relevant gross total income such as depreciation are timing differences.

8. The Framework for the Preparation and Presentation of Financial Statements provides that "An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably". The Framework also provides that "A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably". In the situation of tax holiday under Sections 80-IA and 80-IB of the Act, it is probable that deferred tax assets and liabilities in respect of timing differences which reverse during the tax holiday period, whether originated in the tax holiday period or before that (refer provisions of section 80-IA(2) of the Act), will not be realised or settled. Accordingly, a deferred tax asset or a liability for timing differences which reverse during the tax holiday period does not meet the above criteria for recognition of asset or liability, as the case may be, and therefore is not recognised to the extent the gross total income of the enterprise is subject to the deduction during the tax holiday period.

9. Deferred tax assets/liabilities for timing differences which reverse after the tax holiday period, whether originated in the tax holiday period or before that, are recognised in the period in which these differences originate because these can be realised/paid after the expiry of the tax holiday period by payment of lesser or higher amount of tax after the tax holiday period because of reversal of timing differences.

10. According to one view, during the tax holiday period, no deferred tax should be recognised even for the timing differences which reverse after the tax holiday period, because timing differences do not originate, for example, in the situation of a 100 percent tax holiday period the taxable income is nil. This view was not accepted because in the aforesaid situation, although the current tax is nil but deferred tax, on account of the timing differences which will reverse after the tax holiday period, exists. Further, even in case of carry forward of losses which can be set-off against future taxable income, deferred tax may be recognised, as per AS 22, in respect of all timing differences irrespective of the fact that the taxable income of the enterprise is nil in the period in which the timing differences originate.

11. According to another view, the timing differences which will reverse after the tax holiday period should be recognised at the beginning of the first year after the expiry of the tax holiday period and not in the year in which the timing differences originate. Accordingly, as per this view, during the tax holiday period, deferred tax should not be recognised. This view was also not accepted because as per AS 22 deferred tax should be recognised in the period in which the relevant timing differences originate.

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Appendix

Note:
This appendix is illustrative only and does not form part of the Accounting Standards Interpretation. The purpose of this appendix is to illustrate the application of the Interpretation to assist in clarifying its meaning.

Facts:

1. The income before depreciation and tax of an enterprise for 15 years is Rs. 1000 lakhs per year, both as per the books of account and for income-tax purposes.
2. The enterprise is subject to 100 percent tax-holiday for the first 10 years under section 80-IA. Tax rate is assumed to be 30 percent.
3. At the beginning of year 1, the enterprise has purchased one machine for Rs. 1500 lakhs. Residual value is assumed to be nil.
4. For accounting purposes, the enterprise follows an accounting policy to provide depreciation on the machine over 15 years on straight-line basis.
5. For tax purposes, the depreciation rate relevant to the machine is 25% on written down value basis.

The following computations will be made, ignoring the provisions of section 115JB (MAT), in this regard:

Table 1
Computation of depreciation on the machine for accounting purposes and tax purposes

(Amounts in Rs. lakhs)

Year	Depreciation for accounting purposes	Depreciation for tax purposes
1	100	375
2	100	281
3	100	211
4	100	158
5	100	119
6	100	89
7	100	67
8	100	50
9	100	38
10	100	28
11	100	21
12	100	16
13	100	12
14	100	9
15	100	7

At the end of the 15th year, the carrying amount of the machinery for accounting purposes would be nil whereas for tax purposes, the carrying amount is Rs. 19 lakhs which is eligible to be allowed in subsequent years.

Table 2

Computation of Timing differences

(Amounts in Rs. lakhs)

1	2	3	4	5	6	7	8	9
Year	Income before depreciation and tax (both for accounting purposes and tax purposes)	Accounting Income after depreciation	Gross Total Income (after deducting depreciation under tax laws)	Deduction under section 80-IA	Taxable Income (4-5)	Total Difference between accounting income and taxable income(3-6)	Permanent Difference (deduction pursuant to section 80-IA)	Timing Difference (due to different amounts of depreciation for accounting purposes and tax purposes) (O= Originating and R= Reversing)
1	1000	900	625	625	Nil	900	625	275 (O)
2	1000	900	719	719	Nil	900	719	181 (O)
3	1000	900	789	789	Nil	900	789	111 (O)
4	1000	900	842	842	Nil	900	842	58 (O)
5	1000	900	881	881	Nil	900	881	19 (O)
6	1000	900	911	911	Nil	900	911	11 (R)
7	1000	900	933	933	Nil	900	933	33 (R)
8	1000	900	950	950	Nil	900	950	50 (R)
9	1000	900	962	962	Nil	900	962	62 (R)
10	1000	900	972	972	Nil	900	972	72 (R)
11	1000	900	979	Nil	979	-79	Nil	79 (R)
12	1000	900	984	Nil	984	-84	Nil	84 (R)
13	1000	900	988	Nil	988	-88	Nil	88 (R)
14	1000	900	991	Nil	991	-91	Nil	91 (R)
15	1000	900	993	Nil	993	-93	Nil	74 (R)19 (O)

Notes:

1. Timing differences originating during the tax holiday period are Rs. 644 lakhs, out of which Rs. 228 lakhs are reversing during the tax holiday period and Rs. 416 lakhs are reversing after the tax holiday period. Timing difference of Rs. 19 lakhs is originating in the 15th year which would reverse in subsequent years when for accounting purposes depreciation would be nil but for tax purposes the written down value of the machinery of Rs. 19 lakhs would be eligible to be allowed as depreciation.
2. As per the Interpretation, deferred tax on timing differences which reverse during the tax holiday period should not be recognised. For this purpose, timing differences which originate first are considered to reverse first. Therefore, the reversal of timing difference of Rs. 228 lakhs during the tax holiday period, would be considered to be out of the timing difference which originated in year 1. The rest of the timing difference originating in year 1 and timing differences originating in years 2 to 5 would be considered to be reversing after the tax holiday period. Therefore, in year 1, deferred tax would be recognised on the timing difference of Rs. 47 lakhs (Rs. 275 lakhs – Rs. 228 lakhs) which would reverse after the tax holiday period. Similar computations would be made for the subsequent years. The deferred tax assets/liabilities to be recognised during different years would be computed as per the following Table.

Table 3

Computation of current tax and deferred tax

(Amounts in Rs. lakhs)

Year	Current tax (Taxable Income x 30%)	Deferred tax (Timing difference x 30%)	Accumulated Deferred tax (L= Liability and A= Asset)	Tax expense
1	Nil	47x30%=14 (see note 2 above)	14 (L)	14
2	Nil	181x30%=54	68 (L)	54
3	Nil	111x30%=33	101 (L)	33
4	Nil	58x30%=17	118 (L)	17
5	Nil	19x30%=6	124 (L)	6
6	Nil	Nil[1]	124 (L)	Nil
7	Nil	Nil[1]	124 (L)	Nil
8	Nil	Nil[1]	124 (L)	Nil
9	Nil	Nil[1]	124 (L)	Nil
10	Nil	Nil[1]	124 (L)	Nil
11	294	-79x30%=-24	100 (L)	270
12	295	-84x30%=-25	75 (L)	270
13	296	-88x30%=-26	49 (L)	270
14	297	-91x30%=-27	22 (L)	270
15	298	-74x30%=-22	Nil	270
		-19x30%=-6	6(A)[2]	

[1] No deferred tax is recognised since in respect of timing differences reversing during the tax holiday period, no deferred tax was recognised at their origination.

[2] Deferred tax asset of Rs. 6 lakhs would be recognised at the end of year 15 subject to consideration of prudence as per AS 22. If it is so recognised, the said deferred tax asset would be realised in subsequent periods when for tax purposes depreciation would be allowed but for accounting purposes no depreciation would be recognised.

Exposure Draft

Accounting Standards Interpretation (ASI) 4[1] (Revised)
Losses under the head Capital Gains
Accounting Standard (AS) 22, Accounting for Taxes on Income

(Last Date for Comments: October 1, 2005)

The following is the text of the Exposure Draft of revised Accounting Standards Interpretation (ASI) 4 on 'Losses under the head Capital Gains', issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comment. Members and others are requested to send their comments on the Exposure Draft to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to reach him not later than October 1, 2005. Comments can also be sent by e-mail at tdte@icai.org.

This is a 'marked copy' which indicates the changes proposed vis-à-vis existing ASI 4. Proposed additions are double-underlined whereas proposed omissions are shown in strike-through form.

[This revised Accounting Standards Interpretation replaces ASI 4 issued in December 2002.]

ISSUE

1. The issue is how AS 22 should be applied in respect of 'loss' arising under the head 'Capital gains' of the Income-tax Act, 1961 (hereinafter referred to as the 'Act'), which can be carried forward and set-off in future years, only against the income arising under that head as per the requirements of the Act.

CONSENSUS

2. Where an enterprise's statement of profit and loss includes an item of 'loss' which can be set-off in future for taxation purposes, only against the income arising under the head 'Capital gains' as per the requirements of the Act, that item is a timing difference to the extent it is not set-off in the current year and is allowed to be set-off against the income arising under the head 'Capital gains' in subsequent years subject to the provisions of the Act. In respect of such 'loss', deferred tax asset should be recognised and carried forward subject to the consideration of prudence. Accordingly, in respect of such 'loss', deferred tax asset should be recognised and carried forward only to the extent that there is a virtual certainty, supported by convincing evidence, ~~reasonable certainty~~ that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Act. ~~However, where an enterprise has unabsorbed depreciation or carry forward of business losses under the tax laws, the deferred tax asset in respect of 'loss' under the head 'Capital gains' should be recognised and carried forward only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available under the head 'Capital gains' against which such loss can be set-off as per the provisions of the Act.~~ Whether the test of virtual certainty is fulfilled or not would depend on the facts and circumstances of each case. The examples of situations in which the test of virtual certainty, supported by convincing evidence, for the purposes of the recognition of deferred tax asset in respect of loss arising under the head 'Capital gains' is normally fulfilled, are sale of an asset giving rise to capital gain (eligible to set-off the capital loss) after the balance sheet but before the financial statements are approved, and binding sale agreement which will give rise to capital gain (eligible to set-off the capital loss).

3. In cases where there is a difference between the amounts of 'loss' recognised for accounting purposes and tax purposes because of cost indexation under the Act in respect of long-term capital assets, the deferred tax asset should be recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act.

BASIS FOR CONCLUSIONS

4. Section 71 (3) of the Act provides that "Where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to have such loss set off against income under the other head".

5. Section 74 (1) of the Act provides that "Where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss to the assessee, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and—
   (a) in so far as such loss relates to a short-term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset;
   (b) in so far as such loss relates to a long-term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset not being a short-term capital asset;
   (c) if the loss cannot be wholly so set-off, the amount of loss not so set off shall be carried forward to the following assessment year and so on."

Section 74 (2) of the Act provides that "No loss shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed".

6. AS 22 defines 'timing differences' as "the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods".

7. Where an enterprise's statement of profit and loss includes an item of loss, which is considered a 'loss' under the head 'Capital gains' as per the provisions of the Act, the loss is a timing difference, to the extent the same is not set-off in the current year, because this loss can be allowed to be set-off against income arising under the head 'Capital gains' in future, subject to the provisions of the Act, and to that extent the amount of income under that head will not be taxable in the future year even though the said income would be included in the determination of the accounting income of that year.

8. AS 22 provides that *"Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18"*. Paragraph 15 of AS 22 provides that *"Except in the situations stated in paragraph 17, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised."*

Paragraphs 17 and 18 of AS 22 provide as follows:

> *"17. Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient*

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future taxable income will be available against which such deferred tax assets can be realised.

18. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient income or there is other convincing evidence that sufficient taxable income will be available against which such deferred tax assets can be realised. In such circumstances, the nature of the evidence supporting its recognition is disclosed." The income under the head 'Capital gains' does not arise in the course of the operating activities of an enterprise. Thus, for the purpose of recognition of a deferred tax asset, the degree of certainty of such an income arising in future should be higher. Accordingly, in case of 'loss' under the head 'Capital gains', deferred tax asset should be recognised and carried forward only to the extent that there is a virtual certainty, supported by convincing evidence, that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Act. ~~It may be noted from the above that paragraph 18 explains that the existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. However, when in respect of a particular year, an enterprise has 'loss' under the head 'Capital gains', but has taxable income for that year, it can not be considered a strong evidence that future taxable income under the head 'Capital gains' may not be available. Accordingly, application of paragraphs 17 and 18 of AS 22 for recognition of deferred tax asset in respect of 'loss' under the head 'Capital gains', is not appropriate in case of an enterprise which has a history of business profits.~~

~~In view of the above, paragraph 17 read with explanatory paragraph 18 of AS 22 is in the context of business losses under the tax laws and not the 'loss' under the head 'Capital gains'. Therefore, 'loss' under the head 'Capital gains', when an enterprise does not have unabsorbed depreciation or carry forward of business losses, is not covered by paragraph 17 but is covered by paragraph 15 and accordingly, paragraph 15 is applied. However, the situation where an enterprise has unabsorbed depreciation or carry forward of business losses under the tax laws falls within paragraph 17. Accordingly, in such a situation, for recognition of deferred tax assets including those arising in respect of the 'loss' under the head 'Capital gains', paragraph 17 is applied.~~

In this regard, virtual certainty ~~reasonable certainty or virtual certainty, as the case may be,~~ of the availability of sufficient future taxable income against which deferred tax assets can be realised, will be construed to mean virtual certainty ~~reasonable certainty or virtual certainty, as the case may be,~~ of the availability of taxable income under the head "Capital gains" in future in accordance with the provisions of the Act.

9. In cases where there is a difference between the amounts of 'loss' recognised for accounting purposes and tax purposes because of cost indexation under the Act in respect of long-term capital assets, deferred tax asset is recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act since that is the amount which will be available for set-off in future years as per the provisions of the Act.

Exposure Draft

Proposed Accounting Standards Interpretation (ASI)[1]

Applicability of AS 29 to Onerous Contracts

Accounting Standard (AS) 29, Provisions, Contingent Liabilities and Contingent Assets

(Last date for comments: October 1, 2005)

The following is the text of the Exposure Draft of proposed Accounting Standards Interpretation on Applicability of AS 29 to Onerous Contracts, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comment. Members and others are requested to send their comments on the Exposure Draft to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to reach him not later than October 1, 2005. Comments can also be sent by e-mail at tdte@icai.org.

ISSUE

1. An 'onerous contract' is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The issue is how the recognition and measurement principles of AS 29 should be applied to the 'onerous contracts' covered within its scope.

CONSENSUS

2. If an enterprise has a contract that is onerous, the present obligation under the contract should be recognised and measured as a provision as per AS 29.

3. For a contract to qualify as an onerous contract, the unavoidable costs of meeting the obligation under the contract should exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

4. The amount of provision in respect of an onerous contract should be measured by applying the principles laid down in AS 29. Accordingly, the amount of the provision should not be discounted to its present value.

The Appendix to this Interpretation illustrates the application of the above requirements.

BASIS FOR CONCLUSIONS

5. Paragraph 14 of AS 29 provides as follows:

"14. A provision should be recognised when:

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised."

Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore, there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, a liability exists, which is recognised. In respect of such contracts the past obligating event is the signing of the contract, which gives rise to the present obligation. Besides this, when such a contract becomes onerous, an outflow of resources embodying economic benefits is probable.

6. Recognition of losses with regard to onerous contracts relating to items of inventory are recognised, under

[1]The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items.

AS 2, Valuation of Inventories, by virtue of the consideration of the net realisable value. Further, the recognition of losses in case of onerous construction contracts is dealt with in AS 7, Construction Contracts. Therefore, it is inappropriate if in case of onerous contracts to which AS 29 is applicable, the provision is not recognised.

Appendix

Note: *This appendix is illustrative only and does not form part of the Accounting Standards Interpretation. The purpose of this appendix is to illustrate the application of the Interpretation to assist in clarifying its meaning.*

An enterprise operates profitably from a factory that it has leased under an operating lease. During December 2005 the enterprise relocates its operations to a new factory. The lease on the old factory continues for the next four years, it cannot be cancelled and the factory cannot be re-let to another user.

Present obligation as a result of a past obligating event - The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement - When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the enterprise accounts for the lease under AS 19, Leases).

Conclusion—A provision is recognised for the best estimate of the unavoidable lease payments.

Exposure Draft

Proposed Limited Revision to Accounting Standard (AS) 29, Provisions, Contingent Liabilities and Contingent Assets

(Last date for comments: October 1, 2005)

The following is the text of the Exposure Draft of proposed limited revision to AS 29, Provisions, Contingent Liabilities and Contingent Assets, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, for comment. Members and others are requested to send their comments on the Exposure Draft to the Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to reach him not later than October 1, 2005. Comments can also be sent by e-mail at tdte@icai.org.

In view of the proposed Accounting Standards Interpretation on 'Applicability of AS 29 to Onerous Contracts', paragraphs 1, 3 and 5 of AS 29 are proposed to be modified as under (proposed modifications are shown as underlined):

"Scope

1. **This Statement should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except:**

(a) those resulting from financial instruments* that are carried at fair value;

(b) those resulting from executory contracts; except where the contract is onerous;

(c) those arising in insurance enterprises from contracts with policy-holders; and

(d) those covered by another Accounting Standard."

"3. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Statement does not apply to executory contracts unless they are onerous."

"5. Where another Accounting Standard deals with a specific type of provision, contingent liability or contingent asset, an enterprise applies that Statement instead of this Statement. For example, certain types of provisions are also addressed in Accounting Standards on:

* For the purpose of this Statement, the term 'financial instruments' shall have the same meaning as in Accounting Standard (AS) 20, Earnings Per Share.

(a) construction contracts (see AS 7, Construction Contracts);

(b) taxes on income (see AS 22, Accounting for Taxes on Income);

(c) leases (see AS 19, Leases). However, as AS 19 contains no specific requirements to deal with operating leases that have become onerous, this Statement applies to such cases; and

(d) retirement benefits (see AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers)."

Pursuant to the above limited revision, paragraph 2 of Appendix E (dealing with comparison of AS 29 with IAS 37) to AS 29 would stand withdrawn. Consequently, the numbering of subsequent paragraphs of Appendix E would also be changed.

The limited revisions are proposed to come into effect in respect of accounting periods commencing on or after _____ *(date to be decided later).*

GN (A) 20 (Issued 2005)
Guidance Note on Accounting for Fringe Benefits Tax

(The following is the text of the Guidance Note on Accounting for Fringe Benefits Tax, issued by the Council of the Institute of Chartered Accountants of India[1].)

1. The Finance Act, 2005, has introduced Chapter XII-H on 'Income-tax on Fringe Benefits' [hereinafter referred to as 'Fringe Benefits Tax']. The relevant extracts from Chapter XII-H of the Income-tax Act, 1961 (hereinafter referred to as 'the Act'), governing the Fringe Benefits Tax, have been reproduced in the Annexure to this Guidance Note. This Guidance Note is being issued to provide guidance on accounting for Fringe Benefits Tax, particularly with regard to the recognition and presentation of Fringe Benefits Tax in the financial statements. The Guidance Note does not deal with accounting for 'fringe benefits' as such.
2. The salient features of Fringe Benefits Tax are as below:
   (a) Fringe Benefits Tax is tax payable by an employer in respect of fringe benefits provided or deemed to have been provided by the employer to his employees during the previous year.
   (b) Fringe Benefits Tax is in addition to the income-tax charged under the Act.
   (c) Fringe Benefits Tax is payable at the specified rate on the value of fringe benefits. The value of fringe benefits is calculated in accordance with the provisions of section 115WC of the Income-tax Act, 1961, reproduced in the Annexure to this Guidance Note.
   (d) An employer is required to pay Fringe Benefits Tax even if no income-tax on the total income is payable.
   (e) The term 'employer' means:
      (i) a company;
      (ii) a firm;
      (iii) an association of persons or a body of individuals, whether incorporated or not, but excluding any fund or trust or institution eligible for exemption under clause (23C) of section 10 or registered under section 12AA of the Act;
      (iv) a local authority; and
      (v) every artificial juridical person, not falling within any of the preceding sub-clauses.
   (f) The term 'fringe benefits' means any consideration for employment provided by way of –
      (i) any privilege, service, facility or amenity, directly or indirectly, provided by an employer, whether by way of reimbursement or otherwise, to his employees (including former employee or employees);
      (ii) any free or concessional ticket provided by the employer for private journeys of his employees or their family members; and
      (iii) any contribution by the employer to an approved superannuation fund for employees. The privilege, service, facility or amenity does not include perquisites in respect of which tax is paid or payable by the employee.
   (g) The fringe benefits shall be deemed to have been provided by the employer to his employees, if the employer has, in the course of his business or profession (including any activity whether or not such activity is carried on with the object of

[1]Recommendations contained in this Guidance Note are intended to apply only to items which are material

deriving income, profits or gains), incurred any expense on or made any payment for the purposes stated in section 115WB(2) of the Act. Examples of the purposes stated under the said section are entertainment, festival celebrations, gifts, maintenance of guest house, employees' welfare, hotel, boarding and lodging, conveyance, tour and travel (including foreign travel), etc.

(h) Every employer who during a previous year has paid or made provision for payment of fringe benefits to his employees, is required to furnish a return of fringe benefits to the Assessing Officer in the prescribed form, on or before the due date, in respect of the previous year.

(i) Fringe Benefits Tax, like any other direct tax, is not an allowable expenditure for the purpose of computation of taxable income.

NATURE OF FRINGE BENEFITS TAX

3. With a view to recommend a proper and uniform accounting treatment for the Fringe Benefits Tax, it is necessary to understand the nature of Fringe Benefits Tax which is discussed in paragraph 4.
4. The Fringe Benefits Tax has been introduced under the Income-tax Act, 1961, as 'additional income-tax', vide section 115WA(1) which provides as below:

"In addition to the income-tax charged under this Act, there shall be charged for every assessment year commencing on or after the 1st day of April, 2006, additional income-tax (in this Act referred to as fringe benefit tax) in respect of the fringe benefits provided or deemed to have been provided by an employer to his employees during the previous year at the rate of thirty per cent on the value of such fringe benefits."

Thus, the above stated tax is an additional income-tax payable by the employer on the value of fringe benefits provided or deemed to have been provided to its employees.

RECOGNITION AND MEASUREMENT OF FRINGE BENEFITS TAX

5. An employer becomes liable to pay Fringe Benefits Tax as soon as it incurs an expense which is considered to be a fringe benefit as per the requirements of Chapter XII-H of the Income-tax Act, 1961, even though the actual payment of the tax and/or assessment of the tax takes place on a later date. Accordingly, the employer should recognise, in the financial statements for the period, expense for the Fringe Benefits Tax paid/payable in respect of all expenses giving rise to such tax incurred during that period.
6. As discussed in paragraph 2(c) above, the Fringe Benefits Tax is payable at the specified rate on the value of fringe benefits. The value of fringe benefits is calculated in accordance with the provisions of section 115WC of the Act. The employer should, therefore, measure the amount of the Fringe Benefits Tax keeping in view the aforesaid provisions of the Act.

PRESENTATION OF FRINGE BENEFITS TAX IN FINANCIAL STATEMENTS

7. Paragraph 5 of Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', issued by the Institute of Chartered Accountants of India, provides as below:

   "5. All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise."

   Since the Fringe Benefits Tax is an additional tax for the employer, it should be included in the determination of net profit or loss for the period, i.e., the Fringe Benefits Tax, should be charged to the profit and loss account.
8. In the context of presentation of the Fringe Benefits Tax in the profit and loss account of companies, it has been considered whether the tax is covered by the requirement of clause 3(vi) of Part II of Schedule VI to the Companies Act, 1956, which provides as below:

   "The amount of charge for Indian income-tax and other Indian taxation on profits, including, where practicable, with Indian income-tax any taxation imposed elsewhere to the extent of the relief, if any, from Indian income-tax and distinguishing, where practicable, between income-tax and other taxation."

   As discussed in paragraph 4 above, the Fringe Benefits Tax is an additional income-tax. Accordingly, the Fringe Benefits Tax is covered by the above clause and should be shown separately, if material.
9. Keeping in view the above, the Fringe Benefits Tax should be disclosed as a separate item after determining profit before tax on the face of the profit and loss account for the period in which the related fringe benefits are recognised. An illustration of the disclosure of Fringe Benefits Tax may be as below:

Profit before tax			xxx
Less: Income-tax expense:			
Current tax	xxx		
Deferred tax	xxx	xxx	
Fringe Benefits Tax		xxx	xxx
Profit after tax			xxx

10. The amount of the Fringe Benefits Tax (net of the advance tax thereon), outstanding if any, at the year-end, should be disclosed as a provision in the balance sheet.

Annexure

The Relevant Extracts from Chapter XII-H of the Income-tax Act, 1961, Governing the Fringe Benefits Tax (For assessment year 2006-07)

A.—Meaning of certain expressions

Definitions

115W. In this Chapter, unless the context otherwise requires,—

(a) "employer" means,—
  (i) a company;
  (ii) a firm;
  (iii) an association of persons or a body of individuals, whether incorporated or not, but excluding any fund or trust or institution eligible for exemption under clause (23C) of section 10 or registered under section 12AA;
  (iv) a local authority; and
  (v) every artificial juridical person, not falling within any of the preceding sub-clauses;

(b) "fringe benefit tax" or "tax" means the tax chargeable under section 115WA.

B.—Basis of charge

Charge of fringe benefit tax

115WA.

(1) In addition to the income-tax charged under this Act, there shall be charged for every assessment year commencing on or after the 1st day of April, 2006, additional income-tax (in this Act referred to as fringe benefit tax) in respect of the fringe benefits provided or deemed to have been provided by an employer to his employees during the previous year at the rate of thirty per cent on the value of such fringe benefits.

(2) Notwithstanding that no income-tax is payable by an employer on his total income computed in accordance with the provisions of this Act, the tax on fringe benefits shall be payable by such employer.

Fringe benefits

115WB.

(1) For the purposes of this Chapter, "fringe benefits" means any consideration for employment provided by way of—
  (a) any privilege, service, facility or amenity, directly or indirectly, provided by an employer, whether by way of reimbursement or otherwise, to his employees (including former employee or employees);
  (b) any free or concessional ticket provided by the employer for private journeys of his employees or their family members; and
  (c) any contribution by the employer to an approved superannuation fund for employees.

(2) The fringe benefits shall be deemed to have been provided by the employer to his employees, if the employer has, in the course of his business or profession (including any activity whether or not such activity is carried on with the object of deriving income, profits or gains) incurred any expense on, or made any payment for, the following purposes, namely:—
  (a) entertainment;
  (b) provision of hospitality of every kind by the employer to any person, whether by way of provision of food or beverages or in any other manner whatsoever and whether or not such provision is made by reason of any express or implied contract or custom or usage of trade but does not include—
    (i) any expenditure on, or payment for, food or beverages provided by the employer to his employees in office or factory;
    (ii) any expenditure on or payment through paid vouchers which are not transferable and usable only at eating joints or outlets;
  (c) conference (other than fee for participation by the employees in any conference).
    Explanation—For the purposes of this clause, any expenditure on conveyance, tour and travel (including foreign travel), on hotel, or boarding and lodging in connection with any conference shall be deemed to be expenditure incurred for the purposes of conference;
  (d) sales promotion including publicity:

Provided that any expenditure on advertisement,—
  (i) being the expenditure (including rental) on advertisement of any form in any print (including journals, catalogues or price lists) or electronic media or transport system;
  (ii) being the expenditure on the holding of, or the participation in, any press conference or business convention, fair or exhibition;
  (iii) being the expenditure on sponsorship of any sports event or any other event organised by any Government agency or trade association or body;

(iv) being the expenditure on the publication in any print or electronic media of any notice required to be published by or under any law or by an order of a court or tribunal;

(v) being the expenditure on advertisement by way of signs, art work, painting, banners, awnings, direct mail, electric spectaculars, kiosks, hoardings, bill boards or by way of such other medium of advertisement; and

(vi) being the expenditure by way of payment to any advertising agency for the purposes of clauses (i) to (v) above, shall not be considered as expenditure on sales promotion including publicity;

(e) employees' welfare.

Explanation—For the purposes of this clause, any expenditure incurred or payment made to fulfil any statutory obligation or mitigate occupational hazards or provide first aid facilities in the hospital or dispensary run by the employer shall not be considered as expenditure for employees' welfare;

(f) conveyance, tour and travel (including foreign travel);

(g) use of hotel, boarding and lodging facilities;

(h) repair, running (including fuel), maintenance of motor cars and the amount of depreciation thereon;

(i) repair, running (including fuel) and maintenance of aircrafts and the amount of depreciation thereon;

(j) use of telephone (including mobile phone) other than expenditure on leased telephone lines;

(k) maintenance of any accommodation in the nature of guest house other than accommodation used for training purposes;

(l) festival celebrations;

(m) use of health club and similar facilities;

(n) use of any other club facilities;

(o) gifts; and

(p) scholarships.

(3) For the purposes of sub-section (1), the privilege, service, facility or amenity does not include perquisites in respect of which tax is paid or payable by the employee.

Value of fringe benefits

115WC.

(1) For the purpose of this Chapter, the value of fringe benefits shall be the aggregate of the following, namely:—

(a) cost at which the benefits referred to in clause (b) of sub-section (1) of section 1I5WB, is provided by the employer to the general public as reduced by the amount, if any, paid by, or recovered from, his employee or employees:

Provided that in a case where the expenses of the nature referred to in clause (b) of sub-section (1) of section 115WB are included in any other clause of sub-section (2) of the said section, the total expenses included under such other clause shall be reduced by the amount of expenditure referred to in the said clause (b) for computing the value of fringe benefits;

(b) actual amount of contribution referred to in clause (c) of sub-section (1) of section 115WB;

(c) twenty per cent of the expenses referred to in clauses (A) to (K) of sub-section (2) of section 115WB;

(d) fifty per cent of the expenses referred to in clauses (L) to (P) of sub-section (2) of section 115WB.

(2) Notwithstanding anything contained in sub-section (1),—

(a) in the case of an employer engaged in the business of hotel, the value of fringe benefits for the purposes referred to in clause (B) of sub-section (2) of section 115WB shall be "five per cent" instead of "twenty per cent" referred to in clause (c) of sub-section (1);

(b) in the case of an employer engaged in the business of construction, the value of fringe benefits for the purposes referred to in clause (F) of sub-section (2) of section 115WB shall be "five per cent" instead of "twenty per cent" referred to in clause (c) of sub-section (1);

(c) in the case of an employer engaged in the business of manufacture or production of pharmaceuticals, the value of fringe benefits for the purposes referred to in clauses (F) and (G) of sub-section (2) of section 115WB shall be "five per cent" instead of "twenty per cent" referred to in clause (c) of sub-section (1);

(d) in the case of an employer engaged in the business of manufacture or production of computer software, the value of fringe benefits for the purposes referred to in clauses (F) and (G) of sub-section (2) of section 115WB shall be "five per cent" instead of "twenty-per cent" referred to in clause (c) of sub-section (1);

(e) in the case of an employer engaged in the business of carriage of passengers or goods by motor car, the value of fringe benefits for the purposes referred to in clause (H) of sub-section (2) of section 115WB shall be "five per cent" instead of "twenty per cent" referred to in clause (c) of sub-section (1);

(f) in the case of an employer engaged in the business of carriage of passengers or goods by aircraft, the value of fringe benefits for the purposes referred to in clause (I) of sub-section (2) of section 115WB shall be taken as *Nil*.

C.— Procedure for filing of return in respect of fringe benefits, assessment and payment of tax in respect thereof

Return of fringe benefits

115WD.

(1) Without prejudice to the provisions contained in section 139, every employer who during a previous year has paid or made provision for payment of fringe benefits to his employees, shall, on or before the due date, furnish or cause to be furnished a return of fringe benefits to the Assessing Officer in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed, in respect of the previous year.

Explanation—In this sub-section, "due date" means,—

(a) where the employer is—

(i) a company; or

(ii) a person (other than a company) whose accounts are required to be audited under this Act or under any other law for the time being in force,

the 31st day of October of the assessment year;

(b) in the case of any other employer, the 31st day of July of the assessment year.

Payment of fringe benefit tax

115WI.

Notwithstanding that the regular assessment in respect of any fringe benefits is to be made in a later assessment year, the tax on such fringe benefits shall be payable in advance during any financial year, in accordance with the provisions of section 115WJ, in respect of the fringe benefits which would be chargeable to tax for the assessment year immediately following that financial year, such fringe benefits being hereafter in this Chapter referred to as the "current fringe benefits".

Advance tax in respect of fringe benefits

115WJ.

(1) Every assessee who is liable to pay advance tax under section 115WI, shall on his own accord, pay advance tax on his current fringe benefits calculated in the manner laid down in sub-section (2).

(2) The amount of advance tax payable by an assessee in the financial year shall be thirty per cent of the value of the fringe benefits referred to in section 115WC, paid or payable in each quarter and shall be payable on or before the 15th day of the month following such quarter:

Provided that the advance tax payable for the quarter ending on the 31st day of March of the financial year shall be payable on or before the 15th day of March of the said financial year.

(3) Where an assessee, has failed to pay the advance tax for any quarter or where the advance tax paid by him is less than thirty per cent of the value of fringe benefits paid or payable in that quarter, he shall be liable to pay simple interest at the rate of one per cent on the amount by which the advance tax paid falls short of, thirty per cent of the value of fringe benefits for any quarter, for every month or part of the month for which the shortfall continues.

Applicability of Accounting Standards to an Unlisted Indian Company, which is a Subsidiary of a Foreign Company Listed Outside India

Announcement

1. The Council of the Institute of Chartered Accountants of India has issued an Announcement (see *The Chartered Accountant*, November 2003 (pp. 480-489)) on 'Applicability of Accounting Standards' with a view to lay down the scheme of applicability of Accounting Standards to Small and Medium Sized Enterprises (SMEs). As per the said scheme, all accounting standards are applicable to Level I enterprises. Level I enterprises, *inter alia*, include (i) enterprises whose equity or debt securities are listed whether in India or outside India, and (ii) holding or a subsidiary of a Level I enterprise.
2. With regard to above, an issue has been raised as to whether, as per the above scheme, a foreign company, which is incorporated and listed outside India would also be considered as a Level I enterprise and consequent to this, whether an unlisted Indian company, which is a subsidiary of this foreign company, would become a Level I enterprise merely because of it being a subsidiary of the said foreign company.
3. It is clarified that, in the above-stated scheme,

the term 'enterprise' includes all entities that are required to prepare their financial statements as per the Indian GAAPs. Accordingly, all Indian entities, *i.e.*, the entities, which are incorporated in India, are covered in the said scheme. The scheme also covers those foreign entities which are required to prepare their financial statements as per the Indian GAAPs. Thus, in case a foreign company, which is incorporated and listed outside India, is required to prepare its financial statements as per the Indian GAAPs, it will be considered as a Level I enterprise. In such a case, the Indian company, which is a subsidiary of the aforesaid foreign company, would also be considered as a Level I enterprise for the reason that it is a subsidiary of another Level I enterprise. In case the parent foreign company is not required to prepare its financial statements as per the Indian GAAPs, its Indian subsidiary would not be considered to be a Level I enterprise provided it does not meet any other criteria for becoming Level I enterprise as per the said scheme. Thus, in such a situation, the status of the Indian company under the above scheme will be determined independent of the status of its parent foreign company.

REGULAR ANNOUNCEMENTS

THREE-DAYS TRAINING PROGRAMME ON 'INDEPENDENT DIRECTORS – TOOL FOR CORPORATE GOVERNANCE'

Organised by Corporate and Allied Laws Committee & Committee on Financial Markets and Investor's Protection at Ahmedabad Branch of WIRC of ICAI from 7th to 9th October, 2005

CPE: 17 Hours **Course Fees: Rs. 2,500/- (Non-Residential)**

The good corporate governance is the imperative need to ensure development across the globe. To ensure good corporate governance, the role of independent directors of a company can hardly be over-emphasised. There is a need for Independent Directors to be inducted in all listed companies as a Corporate Governance compliance. The Council of the Institute, while appreciating the role of Chartered Accountants as independent directors, has decided to impart training to the members to sharpen their competitive edge and excellence for these crucial jobs. Nearly 15,000 Independent Directors are to be inducted in the Board of various companies as part of corporate governance compliance in future.

This is an opportunity for the members to sharpen their competitive edge, excellence and professionalism to grab the opportunities as well as meet the emerging challenges in the corporate sector. In this Training Programme, distinguished Speakers will deliver lectures/presentation on various facets of the topics such as, Concept of Independent Director, Role of Independent Director in Corporate governance, Rights & duties of Independent Director, Art of being independent and Knowledge Management of Independent Director. The Registration will be on First-cum-First Serve basis.

Course Contents

The ICAI has designed the training programme on independent directors for the benefit of the persons who wishes to join the profession of Independent directors or who is already in the profession. The Training Modules includes:--

* Corporate Governance - Trends in India and Global Practices - Role & Functions of Board;
*Board Responsibility to Risk Management;