

# Provision for Wage Revision

*The following is the opinion given by the Expert Advisory Committee of the ICAI in response to a query sent by a member. This is being published for the information of readers.*

## A. Facts of the Case

1. A public sector undertaking (PSU), is a leading steel-making company in India having five integrated steel plants located at Bhilai, Durgapur, Rourkela, Bokaro and Burnpur and three special steel plants at Salem, Durgapur and Bhadravati. The company produces both basic and special steels for domestic construction, engineering, power, railways, automotive and defence industries as well as for sale in export markets. The turnover (gross) of the company in the year 2017-18 was approx. ₹ 58,297 crore. It provides direct employment to about 76,000 people.
2. The company also owns iron ore, flux and coal mines located in various states of the country. The entire iron ore required for the production of steel is sourced from the captive mines of the company. The mines are located close to the steel plants and ensure easy availability of iron ore, limestone, and dolomite.
3. The querist has stated that wage revision in case of non-executive employees of the company is due w.e.f. 1.1.2017 after expiry of 5 years' wage settlement agreement on 31.12.2016. Salary revision in case of executive employees of the company is also due w.e.f. 1.1.2017.
4. *Salary revision of executive employees:*
  - (i) The company, being a central public sector undertaking, is required to follow the Guidelines issued by Department of Public Enterprises (DPE) for revising the pay scales of its employees. Guidelines for 2017 salary revision in case of executives and non-unionized supervisors were issued by the Department of Public Enterprises (DPE) vide its Office Memorandum (OM) dated 3.8.2017.
  - (ii) Clause 3 of the DPE Guidelines dated 3.8.2017 provides as under :

**“Affordability:** The revised pay scales would be implemented subject to the condition that the additional financial impact in the year of implementing the revised pay-package for Board level executives, Below Board level executives and Non-Unionised Supervisors should not be more than 20% of the average Profit Before Tax (PBT) of the last three financial years preceding the year of implementation.”

- (iii) In the DPE Guidelines, it has further been provided that if the additional financial impact of revised pay package in the year of implementation is more than 20% of the average PBT of last 3 financial years, then the revised pay package should not be implemented in full but only partly as given below:

Part stages	Additional financial impact of the full revised pay package as a % of average PBT of last 3 financial years	Fitment Benefit (% of BP+DA)
I	More than 20% but upto 30% of average PBT of last 3 financial years	10%
II	More than 30% but upto 40% of average PBT of last 3 years	5%

- (iv) Also it has been clearly mentioned in the Guidelines that no fitment or any other benefit of pay revision will be implemented in the central public sector enterprises (CPSEs) where the additional financial impact of the revised pay package is more than 40% of the average PBT of last 3 financial years.
- (v) The financial [profit before tax (PBT)]

details of the company during last three financial years prior to financial year 2017-18 are as under:

Financial year	PBT (₹ crore)
2016-17	(-) 4851.00
2015-16	(-) 7007.50
2014-15	2358.91
Average of 3 (preceding) years	(-) 3166.53

- (vi) As evident from the above, the average PBT for 3 years in case of the company is negative. Therefore, benefit of salary revision cannot be implemented/extended to executive employees of the company as per the conditions specified in clause 3 of DPE Guidelines dated 3.8.2017.
5. *Wage revision of non-executive employees:*
- (i) The wage revision of non-executive employees is carried through bilateral negotiation through a Body known as National Joint Committee on Steel (NJCS) comprising representatives from management as well as trade unions. NJCS was constituted in October 1969 and its scope of work covers :
- Negotiations for wage agreement and its implementation;
  - Matters pertaining to and steps to be taken for increase in production, productivity, improvement in quality, reduction of cost and wastages, etc.;
  - Review of welfare amenities and facilities;
  - Matters on which it is necessary to draw the attention of the Government; and
  - Any other matter pertaining to steel industry and its employees, as may be agreed to in the NJCS, from time to time.
- (ii) NJCS arrived at a Memorandum of Agreement (Bipartite Agreement) with management, covering the wage structure and other conditions of service for workers.
- On expiry of Memorandum of Agreement dated 29<sup>th</sup> April, 2010, effective for a period of 5 years from 1<sup>st</sup> January, 2007 to 31<sup>st</sup> December, 2011, the NJCS arrived at, on 1<sup>st</sup> July, 2014, another Memorandum of Agreement covering the wage structure and allied matter for categories of employees covered under the said agreement. This agreement was effective from 1<sup>st</sup> January, 2012 and expired on 31<sup>st</sup> December, 2016.
- (iii) DPE vide its OM dated 24.11.2017 has issued Guidelines for 8<sup>th</sup> round of wage revision for workmen in CPSEs, which *inter alia*, provides the following:
- Management of CPSEs would be free to negotiate wage revision for workmen where the periodicity of wage settlement of five years or ten years has expired generally on 31.12.2016 keeping in view the *affordability and financial sustainability* of such wage revision for the CPSEs concerned.
  - The management of the concerned CPSEs where the five year periodicity is followed have to ensure that negotiated scales of pay for two successive *wages negotiations do not exceed the existing scales of pay of executives/officers and non-unionized supervisors of respective CPSEs for whom ten years periodicity is being followed.* (Emphasis supplied by the querist.)
- (iv) The current pay scales of some of the grades of non-executive employees in the company after wage revision effective from 01.01.2012 for 5 years are already higher than the pay scale of certain executive employees.
- (v) Since no wage revision of executive employees can be effected w.e.f. 1.1.2017 due to non-fulfilment of affordability clause as discussed above, wage revision of non-executive employees w.e.f. 1.1.2017 cannot be taken up at the present time.
6. According to the querist, keeping in view the above-mentioned OMs of DPE containing Guidelines for salary/wage revision of executive and non-executive employees

w.e.f. 1.1.2017, it is evident that salary/wage revision of executive and non-executives employees cannot be undertaken w.e.f. 1.1.2017 in terms of the extant Guidelines issued by DPE on the subject. The same can be done only when the criteria prescribed in the aforesaid OMs of the DPE are met.

7. Pending the issue of Guidelines of the Government, the company had made an adhoc provisions for salary/wage revision in its accounts for the period 1.1.17 to 31.03.2017 and 1.4.2017 to 31.12.2017.
8. Based on the clarifications mentioned above in paragraphs 4 (ii) and 5 (iii) above, the management of the company was of the view that provisions for salary/wage revision made in the books of account for executive and non-executive employees for the period from 01.01.2017 to 31.12.2017 are not in line with the directions issued by the Government of India, Ministry of Heavy Industries and Public Enterprises, Department of Public Enterprises. Hence, the Board of Directors of the company at its meeting held on 30<sup>th</sup> May, 2018, resolved that the provision for wage revision for executive and non-executive employees for the period 1<sup>st</sup> January, 2017 to 31<sup>st</sup> December, 2017, pending implementation of recommendations of 3<sup>rd</sup> Pay Revision Committee (PRC) and negotiations with the NJCS respectively, should be withdrawn/written back. Further, no provision should be made in respect of wage revision for the period 1<sup>st</sup> January, 2018 to 31<sup>st</sup> March, 2018.

## B. Query

9. On the basis of the above, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) has been sought as to whether in view of the non-fulfillment of affordability clause and likely conflict of scales persisting vide OMs issued by DPE (dated 3.8.2017 and 24.11.2017), any provision is required to be made in the books of account towards wage revision of non-executive employees of the company.

## C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query is whether in view of the non-fulfillment of affordability clause and likely conflict of scales persisting vide OMs issued by DPE (dated 3.8.2017 and

24.11.2017), any provision is required to be made in the books of account towards wage revision of non-executive employees of the company which as per the wage settlement agreement is due to be made w.e.f. 1.1.2017. The Committee has, therefore, considered only this issue and has not examined any other issue arising from the Facts of the Case such as, accounting treatment for salary revision (if any) of executive employees, legal interpretation of the DPE Guidelines, computation of average PBT of last three financial years as per the DPE Guidelines, etc. At the outset, the Committee wishes to point out that the opinion expressed hereinafter, is in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015.

11. The Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 19, 'Employee Benefits', notified under the Companies (Indian Accounting Standards) Rules, 2015 and the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards (Framework), issued by the ICAI:

*Ind AS 19:*

"4 The employee benefits to which this Standard applies include those provided:

- (a) under formal plans or other formal agreements between an entity and individual employees, groups of employees or their representatives;
- (b) ...
- (c) by those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

- 5 Employee benefits include:

- (a) short-term employee benefits, such as the following, if expected to be settled wholly before twelve months after the end of the annual reporting

period in which the employees render the related services:

- (i) wages, salaries and social security contributions;
- ...

**“11 When an employee has rendered service to an entity during an accounting period, the entity shall recognise the undiscounted amount of short-term employee benefits *expected to be paid* in exchange for that service:**

- (a) **as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.**
- (b) **as an expense, unless another Ind AS requires or permits the inclusion of the benefits in the cost of an asset (see, for example, Ind AS 2, *Inventories*, and Ind AS 16, *Property, Plant and Equipment*).”**

(Emphasis supplied by the Committee.)

*Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards:*

“49 (b) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.”

“60 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period

has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.”

“64 Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. The definition of a liability in paragraph 49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations.”

From the above, the Committee notes that when an employee has rendered service during a period, the employee benefits which are *expected to be paid* in exchange for that service are required to be provided for as liability.

Further, as per the requirements of the Framework, liability is a present obligation arising from past events, the settlement of which is *expected to result in an outflow* of resources embodying economic benefits and a provision should be recognized where liability can be measured only by using a substantial degree of estimation provided it meets the definition of liability.

12. The Committee further notes that Ind AS 19 does not provide detailed guidance as to when and in what circumstances, employee benefits should be considered to be expected to be paid and accordingly whether there is any need to provide for the same in the financial statements. Similarly, the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards also does not give detailed guidance on present obligation and when can it be considered to exist. In this regard, the Committee notes that Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’ provides detailed guidance on present obligation and the circumstances in which liability/provision should be recognised. Accordingly, although provisions relating to employee benefits have not been addressed in Ind AS 37, the Committee notes the following paragraphs of Ind AS 37 dealing with the recognition of a provision:

**“14 A provision shall be recognised when:**

- (a) **an entity has a present obligation (legal or constructive) 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 shall be recognised.”**

“16 In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

- (a) where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and
- (b) where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).

17 A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

- (a) where the settlement of the obligation can be enforced by law; or
- (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.”

“20 An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed—indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.”

“23 For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, ie the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).”

**“A contingent liability is:**

- (a) **a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or**
- (b) **a present obligation that arises from past events but is not recognised because:**
  - (i) **it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or**
  - (ii) **the amount of the obligation cannot be measured with sufficient reliability.”**

The Committee notes from the above that a provision is recognised when an entity has a present obligation (legal or constructive), for which it is probable that an outflow of resources will be required and a reliable estimate can be made for the same. An element of judgement is required to determine whether

there exists an obligation and therefore whether a provision needs to be recognised or not. It is for the management of the entity to exercise that judgement and the auditor to assess in the specific facts and circumstances of the entity, considering all the evidences/factors available as on the reporting date.

In this regard, the Committee notes that the extracts of OM dated 24.11.2017 containing guidelines for 8<sup>th</sup> round of wage revision for workmen (paragraph 5(iii) above) states that the management would be free to negotiate wage revision for workmen keeping in view the affordability and financial stability and have to ensure that negotiated scales do not exceed the existing scales of pay of executives/officers and non-unionised supervisors of respective CPSEs. The Committee also notes from the Facts of the Case that as the average PBT for last 3 years in case of the company is negative, benefit of salary revision cannot be implemented/extended to executive employees of the company as per the conditions specified in clause 3 of DPE Guidelines dated 3.8.2017 and that the current pay scales of some grades of non-executive employees are already higher than the pay scales of certain executive employees.

The Committee is of the view that the company should also consider other factors/evidences available as on the reporting date to determine the existence of an obligation (legal or constructive) in respect of pay revision, such as, legal enforceability and applicability of OM dated 24.11.2017, issued by DPE, any negotiations with trade unions, terms of any agreement with NCJS which is in force, any past experience of the company with regard to the possibility of retrospective pay revision once the affordability and financial stability factor is fulfilled in future, possibility of wage revision in part in respect of non-executive employees whose pay scales are lower than that of executive employees, any legal opinion in this regard, any past informal practice of the company which may give rise to any constructive obligation etc. Accordingly, if it is determined that a present obligation (legal or constructive) exists and other conditions as per paragraph 14 of Ind AS 37 are met, provision should be recognised. However, where it is determined that 'present obligation' does not exist or due to any other reason, provision could not be recognised, then, the company should also consider whether there is any need for disclosure as a 'contingent liability' (unless the possibility of an outflow of resources embodying economic benefits is remote), as per the requirements of Ind AS 37.

## D. Opinion

13. On the basis of the above, the Committee is of the opinion on the issue raised in paragraph 9 above that as per the requirements of Ind AS 19, employee benefits which are expected to be paid in

exchange for the employee services during a period are required to be provided for as liability. Further as per the requirements of Framework, liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits and a provision should be recognised where liability can be measured by using a substantial degree of estimation. However, in the absence of detailed guidance for application of these requirements in Ind AS 19 and the Framework, as discussed in paragraph 12 above, the requirements of Ind AS 37 in this regard should be applied. Accordingly, the company should determine whether there exists a present obligation and therefore whether a provision needs to be recognised or not in the specific facts and circumstances, considering all the evidences/factors available as on the reporting date, as discussed in paragraph 12 above. If it is determined that a present obligation (legal or constructive) exists and other conditions as per paragraph 14 of Ind AS 37 are met, provision should be recognised. However, where it is determined that 'present obligation' does not exist or due to any other reason, provision could not be recognised, then, the company should also consider whether there is any need for disclosure as a 'contingent liability' (unless the possibility of an outflow of resources embodying economic benefits is remote), as per the requirements of Ind AS 37.

1.	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2.	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on October 17, 2018. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3.	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty five volumes. A CD of Compendium of Opinions containing thirty five volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4.	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5.	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to <a href="mailto:eac@icai.in">eac@icai.in</a> . ■