ACCOUNTING STANDARDS OF NON CORPORATE ENTITIES – AS 22 & AS 29

CA VIJAY TC, FCA, CISA

NON CORPORATE ENTITY

- All Business or Professional Entities,
- other than Companies incorporated under Companies Act and LLPs incorporated under LLP Act
- are considered to be Non-Corporate entities

NON CORPORATE ENTITY

- Sole Proprietorship firms
- Hindu Undivided Family
- Partnership firms (Registered/Un-registered)
- Association of Persons
- Society (registered under any law)
- Trusts (public or private) (registered/Un-registered)
- Statutory Corporations, Autonomous bodies and Authorities
- Any form of organisation that is engaged fully or partially in any Business or Professional activities

ACCOUNTING STANDARDS (AS) PRESCRIBED BY ICAI FOR ENTITIES OTHER THAN COMPANIES

- AS notified under Companies Act are applicable only to Corporates
- Hence, ICAI announced the scheme for applicability of AS issued by ICAI to Non-Corporate Entities.
- NCEs are classified in four levels (Level I, II, III & IV)
- Level I non-company entities are required to comply fully with all the AS. Level IV, Level III and Level II non-company entities are considered as Micro, Small and Medium Sized Entity (MSMEs) that have been granted certain exemptions/relaxations by the ICAI.

ACCOUNTING STANDARD 22 - ACCOUNTING FOR TAXES ON INCOME

OBJECTIVE

- to prescribe accounting treatment for taxes on income
- Matching concept : Taxes on Income are accrued in the same period as the revenue and expenses to which they relate
- taxable income may be significantly different from the accounting income
- divergence between taxable income and accounting income arises due to two main reasons

there are differences between items of revenue and expenses

there are differences between the amount in respect of a particular item of revenue or expense

SCOPE

- This Standard should be applied in accounting for taxes on income. This includes the determination of the amount of the **expense** or **saving related** to **taxes on income** in respect of an **accounting period** and the **disclosure of such an amount** in the **financial statements**.

DEFINITIONS

- **Accounting income (loss)** is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.
- **Taxable income (tax loss)** is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.
- **Tax expense (tax saving)** is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

DEFINITIONS

- **Current tax** is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.
- **Deferred tax** is the tax effect of timing differences.
- **Timing differences** are 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.
- **Permanent differences** are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.

TIMING DIFFERENCE VS PERMANENT DIFFERENCE

PERMANENT DIFFERENCE

- differences between taxable income and accounting income which originate in one period and do not reverse subsequently
- Example : Cash payment in excess of Rs.10,000.

TIMING DIFFERENCE

- 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
- Example : Depreciation, 43b Disallowances.

UNABSORBED DEPRECIATION / CARRY FORWARD LOSSES

- Unabsorbed depreciation and carry forward of losses which can be set- off against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence

RECOGNITION

- Standard requires recognition of deferred tax for all the timing differences. This is based on the principle that the financial statements for a period should recognise the tax effect, whether current or deferred, of all the transactions occurring in that period
- 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.
- Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only tothe extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

VIRTUAL CERTAINTY

- is a matter of judgement based on convincing evidence and will have to be evaluated on a case to case basis
- cannot be based merely on forecasts of performance such as business plans
- is not a matter of perception and is to be supported by convincing evidence
- for example, a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party.
- On the other hand, a projection of the future profits made by an enterprise based on the future capital expenditures or future restructuring etc., submitted even to an outside agency, e.g., to a credit agency for obtaining loans and accepted by that agency cannot, in isolation, be considered as convincing evidence.

MEASUREMENT

- Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws
- Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.
- Deferred tax assets and liabilities should not be discounted to their present value.
- REVIEW OF DEFERRED TAX ASSETS : The carrying amount of deferred tax assets should be reviewed at each balance sheet date

RE-ASSESSMENT VS REVIEW

REASSESSMENT

- This is a right
- Related to DTA previously UNRECOGNISED

REVIEW

- This is a Duty
- Relates to DTA previously RECOGNISED

PRESENTATION AND DISCLOSURE

- An enterprise should offset assets and liabilities representing current tax if the enterprise:
- (a) has a legally enforceable right to set off the recognised amounts; and
- (b) intends to settle the asset and the liability on a net basis.
- An enterprise should offset deferred tax assets and deferred tax liabilities if:
- (a) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and
- (b) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

PRESENTATION AND DISCLOSURE

- Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.
- For non-companies entities, Deferred tax assets (net of the deferred tax liabilities, if any, in accordance with paragraph 29) may be disclosed on the face of the balance sheet separately after the head 'Investments' and deferred tax liabilities (net of the deferred tax assets, if any, in accordance with paragraph 29) may be disclosed on the face of the balance sheet separately after the head 'Unsecured Loans.'

PRESENTATION AND DISCLOSURE

- The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.
- The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

TRANSITIONAL PROVISIONS

- On the first occasion that the taxes on income are accounted for in accordance with this Standard, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Standard as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves.
- The amount so credited/charged to the revenue reserves should be the same as that which would have resulted if this Standard had been in effect from the beginning
- On the first occasion when a non-company entity gets classified as a Micro enterprise (Level IV non-company entity), the accumulated deferred tax asset/liability appearing in the financial statements of immediate previous accounting period, should be adjusted against the opening revenue reserves.

SIMPLE MATHS

- (Accounting income/loss +/- Permanent Differences) * Tax Rate = Current Tax + Deferred Tax

Accounting Profit	1,00,000
Add :	
Cash payments in excess of Rs.10,000	12,500
43B Disallowances	17,500
Taxable Profit	**1,30,000**
Tax on the above @30%	39,000
Current Tax	39,000
Deferred Tax Asset on 43B Disallowance	-5,250
Total Tax	**33,750**
Accounting Profit + Permanent Diff	1,12,500
Tax @30%	**33,750**

SOME BASIC DEFERRED TAX CONCEPTS

- If Accounting profit > Taxable profit = Deferred Tax Liability
- If Taxable profit > Accounting profit = Deferred Tax Asset
- Carry forward losses and Unabsorbed Depreciation result in DTA (subject to virtual certainty)

SOME EXAMPLES

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

SOME EXAMPLES

- In the financial Statements of X Enterprises, the income taxes paid (current tax asset) and provision for income tax (current tax liability) were disclosed as Assets and Liability respectively. Comment.
- An enterprise should offset assets and liabilities representing current tax if the enterprise:

  (a) has a legally enforceable right to set off the recognised amounts; and

  (b) intends to settle the asset and the liability on a net basis.

HENCE should set off and disclose.

ACCOUNTING STANDARD 29 – PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

OBJECTIVE

- to ensure that appropriate recognition criteria and measurement bases are applied to
- provisions and contingent liabilities
- and that sufficient information is disclosed in the notes to the financial statements to
- enable users to understand their nature, timing and amount

SCOPE

- should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except
- (a) those resulting from financial instruments2 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 policyholders;
- (d) those covered by another Accounting Standard.

DEFINITIONS

- A **provision** is a liability which can be measured only by using a substantial degree of estimation.
- A **liability** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
- An **obligating event** is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.
- A **contingent liability** is:

(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; 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) a reliable estimate of the amount of the obligation cannot be made.

DEFINITIONS

- A **contingent asset** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non- occurrence of one or more uncertain future events not wholly within the control of the enterprise.
- **Present obligation -** an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.
- **Possible obligation -** an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

RECOGNITION - PROVISION

- 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.

PRESENT OBLIGATION

- 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 enterprise determines whether a present obligation exists at the balance sheet date 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 balance sheet date

PAST EVENT

- 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 enterprise has no realistic alternative to settling the obligation created by the event
- no provision is recognised for costs that need to be incurred to operate in the future. The only liabilities recognised in an enterprise's balance sheet are those that exist at the balance sheet date
- It is only those obligations arising from past events existing independently of an enterprise's future actions (i.e. the future conduct of its business) that are recognised as provisions

PROBABLE OUTFLOW OF RESOURCES EMBODYING ECONOMIC BENEFITS

- 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
- an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, i.e., the probability that the event will occur is greater than the probability that it will not

RELIABLE ESTIMATE OF THE OBLIGATION

- use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability – TRUE IN CASE OF PROVISIONS
- In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability

CONTINGENT LIABILITIES

- **<u>An enterprise should not recognise a contingent liability</u>**
- A contingent liability is disclosed
- Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised

CONTINGENT ASSETS

- Contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the enterprise
- Contingent assets are not recognised in financial statements
- A contingent asset is not disclosed in the financial statements

MEASUREMENT

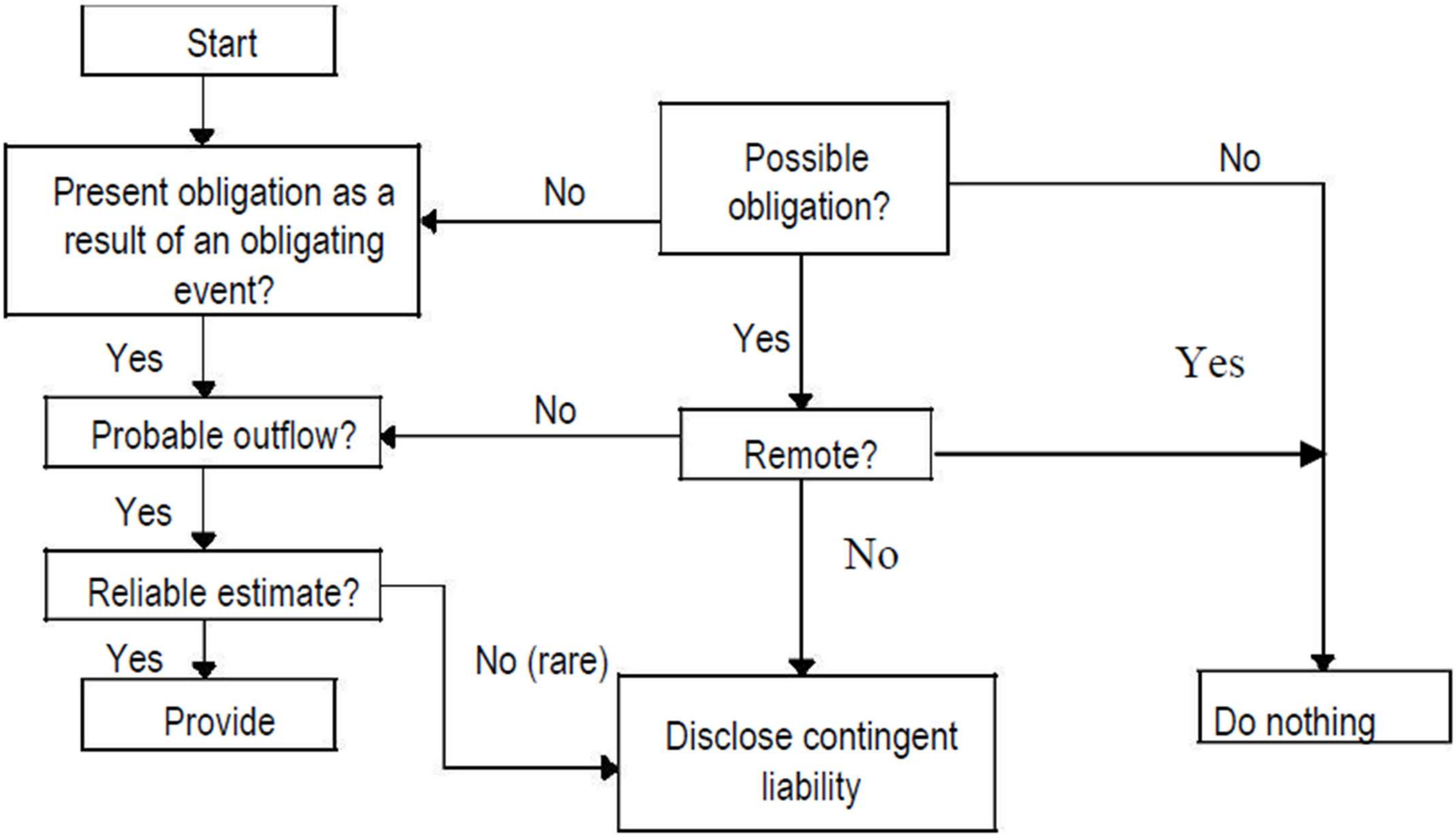
- The amount recognised as a provision should be the **best estimate** of the **expenditure required** to **settle the present obligation** at the **balance sheet date**. The amount of **a provision** should **not be discounted** to its present value **except in case** of **decommissioning, restoration and similar liabilities** that are recognised as cost of Property, Plant and Equipment.
- The **risks and uncertainties** that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision
- **Future events** that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

REIMBURSEMENTS

- Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision
- In the statement of profit and loss, the expense relating to a provision may be presented net of the amount recognised for a reimbursement

CHANGES IN PROVISIONS

- Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed


Start
Present obligation as a result of an obligating event?
No
Possible obligation?
No
Yes
Yes
Yes
Probable outflow?
No
Remote?
Yes
No
Reliable estimate?
Yes
No (rare)
Provide
Disclose contingent liability
Do nothing

DISCLOSURE

- For each class of provision, an enterprise should disclose:

(a) the carrying amount at the beginning and end of the period;

(b) additional provisions made in the period, including increases to existing provisions;

(c) amounts used (i.e. incurred and charged against the provision) during the period; and

(d) unused amounts reversed during the period.

Level IV, III and II non- company entities ARE EXEMPT

DISCLOSURE

- An enterprise should disclose the following for each class of provision:

(a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

(b) an indication of the uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 41; and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Level IV, III and II non- company entities ARE EXEMPT

DISCLOSURE

- Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect, measured under paragraphs 35-45;

(b) an indication of the uncertainties relating to any outflow; and

(c) the possibility of any reimbursement

Where any of the information required AS ABOVE is not disclosed because it is not practicable to do so, that fact should be stated.

DISCLOSURE

- In extremely rare cases, disclosure of some or all of the information required by paragraphs 66-70 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision or contingent liability. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

EXAMPLES : WARRANTIES

- A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (i.e. more likely than not) that there will be some claims under the warranties.
- Conclusion - A provision is recognised for the best estimate of the costs of making good under the warranty products sold before the balance sheet date (see paragraphs 14 and 23).

EXAMPLE : REFUNDS POLICY

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

Present obligation as a result of a past obligating event - The obligating event is the sale of the product, which gives rise to an obligation because obligations also arise from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner.

An outflow of resources embodying economic benefits in settlement - Probable, a proportion of goods are returned for refund.

Conclusion - A provision is recognised for the best estimate of the costs of refunds

EXAMPLE - PROVISION

- **Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 2023. The enterprise has not fitted the smoke filters as at the balance sheet date of 31 March 2023**

Present obligation as a result of a past obligating event - There is no obligation because there is no obligating event either for the costs of fitting smoke filters or for fines under the legislation.

Conclusion - No provision is recognised for the cost of fitting the smoke filters

EXAMPLE : PROVISION

- **Under new legislation, an enterprise is required to fit smoke filters to its factories by 30 September 2022. The enterprise has not fitted the smoke filters as on 31 March 2023**

Present obligation as a result of a past obligating event - There is still no obligation for the costs of fitting smoke filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliant operation of the factory).

An outflow of resources embodying economic benefits in settlement - Assessment of probability of incurring fines and penalties by non-compliant operation depends on the details of the legislation and the stringency of the enforcement regime.

Conclusion - No provision is recognised for the costs of fitting smoke filters. However, a provision is recognised for the best estimate of any fines and penalties that are more likely than not to be imposed

QUESTIONS?

THANK YOU

VIJAY TC

9790914074 / VIJAY.TC@GMAIL.COM