

Query No. 6

Subject: *Treatment of disputed amount (Principal and Interest) in respect of cases pending before various regulatory authorities.*¹

A. Facts of the Case

1. The company (hereinafter referred to as the ‘company’) is a central public sector undertaking under the Ministry of Petroleum & Natural Gas. The company is engaged in engineering consultancy services and execution of turnkey contracts in the field of petroleum refineries, pipelines, oil & gas processing, petrochemicals, offshore structures and platforms, ports and terminals, metallurgy, fertilizers, power, highways and bridges, airports and intelligent buildings and urban development. The company being a listed company and having net worth of more than Rs.500 crore, has prepared and presented its financial statements for the year ended 31st March 2017 as per Ind AS.

2. The querist has stated that in the note - 40 forming part of financial statements of the company for the year ended 31 march 2017, the company had disclosed the information with respect to contingent liability as on 31 March 2017 (relevant extracts have been separately supplied by the querist for the perusal of the Committee).

3. The querist has stated that the disclosure with respect to contingent liability includes:

- (a) Income Tax (IT) department is in appeal against tax demand of Rs. 373.83 Lakhs with Income Tax Appellate Tribunal, against the Commissioner of Income Tax (Appeals) orders in the company’s favour for various assessment years detailed below:

| Assessment Year | Amount (Rs. in Lakhs) 31 March 2017 | Amount (Rs. in Lakhs) 31 March 2016 | Amount (Rs. in Lakhs) 1 April 2015 |
|-----------------|-------------------------------------|-------------------------------------|------------------------------------|
| 2002-03 | 204.22 | 204.22 | 204.22 |
| 2004-05 | 76.07 | 76.07 | 76.07 |
| 2010-11 | - | 32.26 | 32.26 |
| 2011-12 | 50.82 | 50.82 | - |
| 2012-13 | 42.72 | - | - |
| Total | 373.83 | 363.37 | 312.55 |

- (b) The company has filed a writ petition before Hon’ble Andhra Pradesh High Court against the VAT assessment order of commercial tax officer dated 27 August 2016 levying tax of Rs. 6,999.17 Lakhs for the period July 2011 to March 2014.
- (c) The company has filed an appeal against the order of Additional Commissioner (Appeal), Mathura before Sales Tax Tribunal, Agra, which has been subsequently transferred to Sales Tax Tribunal, Noida, for an amount of Rs. 18.71 Lakhs (previous year 31 March 2016 and 1 April 2015 : Rs. 18.71 Lakhs) on account of entry tax for the year 1999-2000 against which the company has deposited an amount of Rs. 5.01 Lakhs (previous year 31 March 2016 and 1 April 2015 : Rs. 5.01 lakhs).

¹ Opinion finalised by the Committee on 4.1.2018.

4. The querist has informed that during the course of audit of accounts of the company for the year ended 31 March 2017, Office of the Director General of Commercial Audit and Ex-officio Member Audit Board-II, New Delhi has raised observations with respect to contingent liabilities disclosed as per 3(a, b & c) above.

5. The observations raised by the Comptroller and Auditor General office (CAG) on 3(a, b & c) are as under:

(a) This includes an amount of Rs. 373.83 Lakhs payable to IT department for different financial years 2001-02 to 2011-12 pertaining to the disallowance as commission paid to foreign agents, short grant of advance tax, short grant of Tax Deducted at Source (TDS) and excess levy of interest. The company has not included the interest payable of Rs. 548.49 Lakhs on this disputed amount up to March 2017.

(b & c) Similarly, the above head includes 7012.87 Lakhs payable to Sales Tax (ST) Department pertaining to entry tax (Rs. 13.70 Lakhs) for the financial year 1999-2000 relating to job work and VAT payable to Andhra Pradesh ST department for the period July 11 to March 2014. The company has not included the interest payable of Rs. 4859.02 Lakhs on this disputed amount up to March 2017.

Hence, this has resulted in understatement of contingent liabilities by Rs. 5407.51 Lakhs and by the same extent in the disclosure of the dues of IT department and sales tax department which was disputed and shown in Annexure A, point VII(b) of Independent Auditors' Report.

6. The querist has also informed that management replies with respect to above observations of CAG are as under:

(a) It is submitted that in these cases, the Commissioner of Income Tax (CIT Appeals) has given order in the favour of the company and against the order of CIT Appeals, IT department has referred these cases before the Income Tax Appellate Tribunal (ITAT).

(The copies of assessment order, order of commissioner (appeals) and notices for referral of cases to ITAT by IT department for assessment years 2002-03, 2004-05, 2011-12 & 2012-13 have been separately supplied by the querist).

Although, the case has been decided in favour of the company, since IT department has moved to ITAT, the company has disclosed an amount of Rs. 373.83 Lakhs as contingent liability.

Since the cases have already been decided in favour of the company by the CIT appeals, based on facts and circumstances of the case, the incurrance of any interest liability on the above account is very remote and as such is not considered as contingent liability. However, since, the case is pending in ITAT, the amount of Rs. 373.83 Lakhs has been disclosed as contingent liability.

(b) With respect to contingent liability on account of VAT assessment order of Commercial Tax Officer, Kakinada for an amount of Rs. 6999.17 Lakhs, it is submitted that based on orders passed by VAT authorities, the company has disclosed the order amount as contingent liability. (The copy of assessment order of commercial tax officer is separately supplied by the querist). However, the company has filed a writ petition before Hon'ble High Court of Andhra Pradesh against the

assessment orders. Since the judgment is yet to be delivered by the Hon'ble High Court of Andhra Pradesh, the contingent liability, if any, on account of interest etc. is not ascertainable and as such the assessment order demand amount has been disclosed as contingent liability.

It is further submitted that transit sales have been allowed in all other states except Andhra Pradesh and Karnataka, where the company has executed these types of projects and, as such, it is expected that there is remote possibility of fructifying the demand.

Regarding the inclusion of interest as contingent liability, it is submitted that the same shall be reviewed including an opinion of experts shall be taken based on facts and circumstances of the case in the year 2017-18.

- (c) In respect of entry tax demand order of Rs. 13.70 Lakhs by Additional Commissioner (Appeal) Mathura, the company has filed an appeal before Sales Tax Tribunal. (The Copies of order of Dy. Commissioner Commercial Tax, Mathura and Additional Commissioner (Appeal), Grade-2 have been separately supplied by the querist).

In this regard, it is submitted that in earlier years, there were two cases involved, wherein the company was in appeal with the tribunal against the orders of the Commissioner (Appeals), Mathura.

In one of the cases, the ST department was disallowing the transit sales made by the Company to the project owner. The said cases for the years 1999-2000 and 2000-2001 have been decided by the commercial tax tribunal in the favour of company (relevant extract have been separately supplied by the querist). Since, as per the decided case of sales tax, the sales tax liability is on account of project owner and, as such, liability for entry tax as per the provision of law shall be borne by the project owner. The company, based on the demand order, has disclosed amount of Rs. 13.70 Lakhs as a contingent liability, although based on decided case for sales tax, no liability shall fall on the company.

In view of above, it is submitted that there has been no understatement of contingent liabilities by Rs. 5407.51 Lakhs and as such, audit is requested to drop its observations.

7. According to the querist, in terms of Ind AS 37, a contingent liability is a possible obligation that arises from the past events and whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of entity.

On the basis of above, the company, on the basis of orders, etc. passed by the respective statutory authorities, has made disclosure in the financial statements of the company. The levy of interest, if any and quantum thereof shall fructify only on the basis of decision made by the tribunal/court, etc. as these are not a part of orders passed by statutory authorities. As of date, the company has in its possession only the order passed by the statutory authorities and the same has been disclosed as contingent liability in the financial statements of the company.

8. The company has further assured the office of Director General of Commercial Audit and Ex-officio Member Audit Board-II, New Delhi that independent expert opinion shall be taken from the Expert Advisory Committee of the Institute of Chartered Accountants of India.

B. Query

9. Considering the facts as stated above, the company has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India in respect of the following:

- (a) (i) Whether the amount of Rs. 373.83 Lakhs disclosed as contingent liabilities is correct, although CIT (Appeals) has given the orders in favour of the company but IT department has referred these cases to Income Tax Appellate Tribunal (ITAT).
- (ii) If the above disclosure is correct, then :
 - (1) Whether interest liability on the above amount of Rs.373.83 Lakhs is required to be computed and disclosed as contingent liability as on balance sheet date, although, as such, there is no demand for it; or
 - (2) Since, there is no demand for interest on the company, whether the fact that above amount of Rs.373.83 Lakhs does not include interest, if any, is required to be disclosed; or
 - (3) None of above (1) or (2) is required to be disclosed.
- (b) (i) Whether disclosure of VAT assessment order of Commercial Tax Officer, Kakinada levying tax of Rs. 6999.17 Lakhs on the company as contingent liability is correct, although the company has filed writ petition against the order before Hon'ble Court of Andhra Pradesh.
- (ii) If the above disclosure is correct, then:
 - (1) Whether the interest liability on above amount of Rs.6999.17 Lakhs is required to be computed and disclosed as contingent liability as on balance sheet date, although as such, there is no demand for it; or
 - (2) Since there is no demand for interest on the company, whether the fact that above amount of Rs.6999.17 Lakhs does not include interest, if any, is required to be disclosed; or
 - (3) None of above (1) or (2) is required to be disclosed.
- (c) (i) Whether disclosure of entry tax demand order of Rs.13.70 Lakhs by the Additional Commissioner (Appeals), Mathura as contingent liability is correct, considering that as per decided cases of sales tax by the commercial tax tribunal, the sales tax liability in respect of transit sales made by the company shall be on account of project owner and, as such, liability for entry tax as per provision of law shall also be borne by the project owner.
- (ii) If the above disclosure is correct, then:
 - (1) Whether the interest liability on above account is required to be computed and disclosed as Contingent Liability as on balance sheet date, although as such, there is no demand for it; or
 - (2) Since there is no demand for interest on the Company, whether the fact that above amount of Rs.13.70 Lakhs does not include interest, if any, is required to be disclosed; or
 - (3) None of above (1) or (2) is required to be disclosed.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised by the querist relates to whether the disclosure of demand raised in respect of cases pending before various tax authorities as contingent liability is correct. Further, whether interest liability that may arise in respect of said cases is also required to be computed and disclosed as contingent liability. The Committee has, therefore, considered only these issues and has not examined any other issue that may be contained in the Facts of the Case such as calculation of demand and interest thereon in respect of cases pending before various regulatory authorities, adjustments on transition to Ind ASs, etc. Further, the Committee wishes to point out that its opinion is expressed purely from accounting point of view and not from any legal perspective. The Committee also wishes to point out that the opinion expressed hereinafter, is in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Accounting Standards) Rules, 2015 and not in the context of Accounting Standards, notified under the Companies (Accounting Standards) Rules, 2006.

11. The Committee notes the following terms as defined in paragraph 10 of Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets':

“A *provision* is a liability of uncertain timing or amount.

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.

An *obligating event* is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

A *legal obligation* is an obligation that derives from:

- (a) a contract (through its explicit or implicit terms);**
- (b) legislation; or**
- (c) other operation of law.**

A *constructive obligation* is an obligation that derives from an entity's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and**
- (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.**

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.”

12. The Committee further notes the following paragraphs of Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’:

“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.

15 In rare cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period.

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).”

“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).”

“27 An entity shall not recognise a contingent liability.

28 A contingent liability is disclosed, as required by paragraph 86, unless the possibility of an outflow of resources embodying economic benefits is remote.”

“86 Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the

reporting period a brief description of the nature of the contingent liability and, where practicable:

- (a) an estimate of its financial effect, measured under paragraphs 36–52;**
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; and**
- (c) the possibility of any reimbursement.”**

13. The Committee notes from the above that an element of judgement is required to determine whether the demand raised in respect of cases pending before ITAT, Honourable High Court of Andhra Pradesh and Sales Tax Tribunal should be provided for in the accounts or treated as contingent liability and disclosed by way of a note to the accounts. It is for the management of the enterprise to decide and for the auditor to assess, considering the circumstances of each case, whether the demand raised warrants recognition of provision or disclosure of contingent liability. The Committee is of the view that while making such judgement, all facts and circumstances available on the balance sheet date, including for example, legal opinion of an expert on the possibility and extent of outcome (success or failure) of the company's cases in the court of law, experience of the company or other enterprises in similar cases, decisions of appropriate authorities, etc. should be considered. The Committee is further of the view that mere expert opinion should not be considered in isolation; other factors prevailing on the balance sheet date, as suggested above should also be considered while making the judgement. Further, the Committee is also of the view that in determining whether the demand raised should be provided for in the accounts or treated as contingent liability and disclosed by way of notes to the accounts at the balance sheet date or not, events occurring after the balance sheet date but, before the date of finalization of accounts, should also be taken into consideration.

14. Further, the Committee is of view, the interest liability that may arise on demands raised in respect of cases pending before ITAT, Honourable High Court of Andhra Pradesh and Sales Tax Tribunal, will depend on the decision taken by respective authorities i.e. whether interest needs to be paid in addition to the principal amount or not in case the outcome does not result in favour of the company (which itself is uncertain). The Committee also wishes to clarify that the fact that no demand has been raised by the authorities does not necessarily indicate that demand cannot be raised. Accordingly, whether interest liability that may arise in respect of cases pending before various authorities requires to be disclosed as contingent liability or not, requires an element of judgement and should be decided by the management of the company on the basis of all facts and circumstances available on the balance sheet date such as the past decisions taken by the taxation and judicial authorities in similar cases etc.

D. Opinion

15. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 9 above:

- (a) The company should, based on all the available evidence, assess whether there is a present or possible obligation towards the demand raised in respect of cases pending before ITAT, Honourable high Court of Andhra Pradesh and Sales Tax Tribunal. If it is considered probable that a present obligation exists at the balance sheet date and the said obligation will be settled, of which a reliable estimate can be made, the company should recognise a

provision for the demand raised. If, however, it is considered that the recognition criteria for making a provision are not met, then, the company should instead, disclose the same as a contingent liability , unless the possibility of an outflow of resources embodying economic benefits is remote.

- (b) Further, the Committee is of the opinion that based on all facts and circumstances available on the balance sheet date such as the past decisions taken by the taxation and judicial authorities in similar cases etc., it should be decided by the management of the company as to whether the interest liability that may arise in respect of cases pending before various authorities is required to be computed and disclosed as a contingent liability or not.
