

## ***Query No. 11***

***Subject: Non-recognition of deferred tax assets on provision for warranty, replacement, inventory and doubtful debts & claims.<sup>1</sup>***

### **A. Facts of the Case**

1. A Company (hereinafter referred to as ‘the Company’) is an Indian state owned aerospace and defence Company. The Company is engaged in the design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of products including aircrafts, helicopters, aero engines, avionics, accessories and aerospace structures. Manufacture of the Company’s products involve a substantial period of time and are subject to high precision and stringent quality control measures and Inspection procedures.

*Accounting treatment in the books of account of the Company:*

2. The querist has stated that in terms of the contracts entered into with Defence customers, the contracts typically provide for:

- (a) Product warranties
- (b) Liquidated damages for supply beyond the contractual delivery date

The Company in compliance of Indian Accounting Standard (Ind AS) 37, ‘Provisions, Contingent Liabilities and Contingent Assets’, recognises provision for liabilities in respect of replacement or future charges, onerous contracts, wage revision due to revision in salary, raw materials to take care of redundancy, doubtful debts / claims in respect of dues from parties other than Government in addition to warranties and liquidated damages. The nature and method of provision in respect of each item is detailed below:

#### *a) Warranty Provision*

- The Company offers warranty for the supplies of various platforms and services given to Defence services as per the terms and conditions of the warranty governed by the Government of India (GOI) policy letter.
- The warranty obligation depends on the nature of activities like manufacturing, overhaul, repair and spares and is for specific period or flying hours.
- The approved price for supply of the Company’s products/services to defence customers includes warranty as a separate element of cost.
- As on date, the warranty percentage applicable for various products is as tabulated:
  - Aircraft & Helicopters - 1.75%
  - Engine - 4%
  - Accessories - 3.5%
- The warranty liability is recognised in the books based on actuarial valuation by independent actuary. The basis of the ascertainment of the warranty liability is done after considering the date from which warranty starts, period of warranty outstanding, warranty percentage, warranty expenditure incurred etc.
- The provision is created/withdrawn for the reporting period based on the

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<sup>1</sup> Opinion finalised by the Committee on 4.6.2020.

actuarial valuation. When the closing liability (after adjustment of actual expenditure) assessed as per actuarial valuation is more than available liability, provision is made towards warranty. In case closing liability as per actuarial valuation is less than available liability, unutilised liability is withdrawn and accounted for as operating revenue.

*b) Provision for Liquidated Damages (LD)*

- Provision for liquidated damages is recognised for the period of delay between due date of supply of goods/services as per contractual delivery and the actual date of delivery in respect of the contracts, repair & overhaul task and spares supplies.
- Liquidated damages are payable upto 5% (maximum) for supplies under various manufacturing contracts and upto 10% (maximum) for repair & overhaul and supply of services.
- The provision created/withdrawn for the reporting period is arrived at as follows :
  - The opening liability at the beginning of the year is reduced by actual LD paid during the reporting period.
  - Closing balance of liability required at the end of reporting period is determined considering the delay between due date and actual date of delivery.
- When the closing liability is more than available liability, provision is made towards LD. In case closing liability is less than available liability, unutilised liability is withdrawn and accounted as operating revenue.

*c) Provision for Replacement & Future Charges*

- Provision for replacement and future charges outstanding at the close of each financial year is made towards:
  - Material taken on loan from customer, which needs to be replaced subsequently.
  - Maintenance expenditure from acceptance of products by customer till physical delivery.
- The provision to be created/withdrawn for the reporting period is arrived at as follows:
  - The opening liability at the beginning of the year is reduced by the expenditure incurred during the reporting period and net liability is arrived at the end of reporting period.
  - When the closing liability is more than available liability, provision is made towards replacement or future charges. In case closing liability is less than available liability, unutilised liability is to be withdrawn and accounted for as other Operating Revenues.

*d) Onerous Contract*

- A provision for onerous contract is recognised when the expected benefits to be derived by the Company are less than the unavoidable cost of meeting its obligations under the contract.

- Prior to the creation of provision, the Company recognises any impairment loss on the assets associated with that contract.

e) *Wage Revision*

Pending settlement of negotiations with workmen, based on the past settlement, provision is made for wage revision.

f) *Provision for Redundancy of Materials*

Redundancy provision is recognised in the books of account based on the available balance of inventories @ 1.5% of the total inventories and 100% of the shelf-life expired items, non-moving items for more than 5 years, closed projects etc.

Provision is assessed at the close of accounting period and required provision is created and excess, if any, is reversed in the books of account.

g) *Provision for Doubtful Debts*

In respect of dues from customers other than Government, provision is made if the debts are due for more than three years on case to case basis.

h) *Provision for Doubtful Claims*

Claims on suppliers / underwriters / carriers towards loss / damages, claim for export subsidy, duty drawback and claims on Customs Department for refunds are accounted for when claims are preferred and are carried forward till such time the Company has a legal right to recover such amounts.

3. The querist has referred to the following requirements of Ind AS 12, 'Income Taxes':

***“Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.***

***Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:***

- (a) deductible temporary differences;
- (b) the carryforward of unused tax losses; and
- (c) the carryforward of unused tax credits.

***Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:***

- (a) ***taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or***
- (b) ***deductible temporary differences, which are temporary differences that will results in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.***

**“24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be**

**available against which the deductible temporary difference can be utilized. ...”**

(Emphasis supplied by the querist.)

4. The querist has given the reasons for not accounting for deferred tax assets (DTA) by the Company in respect of the following provisions as follows:

<b>S. No.</b>	<b>Description</b>	<b>Certainty/Uncertainty</b>	<b>Treatment in deferred tax computation</b>
1	<p><b><i>Provision for Warranty:</i></b> Provision for warranty is created by the Company for an estimated amount that may have to be spent to repair or replace a product during its warranty period.</p> <p>The Company recognises the provision on the basis of actuarial valuation in respect of warranty for manufacturing, repair and overhaul of aircraft/helicopter/engine/ rotables and spares.</p>	It is uncertain that the provision created for warranty by the Company will be utilized fully or the utilization of the provision will be at the amount of provision created.	Even though it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, DTA was not created for provision for warranty, redundancy, replacement and other charges, doubtful debts and claims since the following was not certain:
2	<p><b><i>Provision for redundancy:</i></b> Provision for redundancy is assessed by the Company on ageing at a suitable percentage / level of the value of closing inventory of raw material and components, stores and spare parts and construction material. Besides, wherever necessary, the Company provides adequate provision for the redundancy of such materials in respect of completed / specific projects and other surplus / redundant material pending transfer to salvage stores.</p>	The provision for redundancy will never be recovered or settled by the Company in full.	<p>(1) <i>amount of provision</i> and</p> <p>(2) <i>whether the provision will be settled fully in future (i.e. there will be no reversal)</i></p> <p>(Emphasis supplied by the querist.)</p>
3	<p><b><i>Provision for replacement and other charges:</i></b> It represents provision created by the Company for expenditure which may be incurred from the date of acceptance of products by customer till physical delivery and loan items taken from the customer which need to be replaced, etc.</p>	It is uncertain that whether the provision by the Company will be required or if required, whether it will be sufficient or deficient for the expense to be incurred between the date of acceptance of products by customer till	

		physical delivery.
4	<b>Provision for doubtful debts:</b> Debts from the Government departments are generally treated as fully recoverable by the Company and hence the Company does not recognise credit risk of such financial assets. Impairment on account of expected credit loss is being assessed by the Company on a case to case basis in respect of dues outstanding for a significant period of time.	As per the recent past history of the Company, there was no trade receivable which was written off as bad debts for receivable from Government. Therefore, it is highly uncertain that the provision created will be treated as bad debts.
5	<b>Provision for Doubtful claims:</b> <i>Claims which are not likely to realise are provided as doubtful claims.</i>	There is no certainty that the doubtful claims would be reversed.

5. In view of the above, the Company has not recognised deferred tax assets (DTAs) of Rs.1,14,360 lakhs as on 31.03.2019. The break-up of which is given below:

Rs. in lakhs

Sl. No.	Description	As on 01.04.2018	For the year 2018- 2019	Utilisation/ Reversal during the year	As on 31.03.2019
1	Provisions for Replacement and Other Charges	101577	51323	8245	144655
2	Provision for warranty	43056	22186	8779	56463
3	Provision for Raw Materials and Components, Stores and Spares, Construction Material and Loose Tools	77314	9638	8698	78254
4	Provision for Doubtful Debts	18122	719	2108	16733
5	Provision for Doubtful Claims	29831	2153	822	31162
	<b>Total</b>	<b>269900</b>	<b>86019</b>	<b>28652</b>	<b>327267</b>
	<b>Tax @34.944%</b>				<b>114360</b>

6. *Issue raised by the Auditors:*

The querist has informed that during the audit of the financial statements for the year ended 31.03.2019, the statutory auditors appointed by the Comptroller and Auditor

General of India (C&AG) have raised an issue that in terms of Ind AS 12, 'Income Taxes', deferred tax shall be recognised as these are all deductible temporary differences. The relevant paragraphs have been referred as follows:

**“24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:**

- (a) is not a business combination; and**
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).**

**However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.**

25 It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the entity of resources embodying economic benefits. When resources flow from the entity, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to deferred tax asset in respect of the income taxes that will be recoverable in future periods.”

“26 The following are examples of deductible temporary differences that result in deferred tax assets:

- (a) retirement benefit costs may be deducted in determining accounting profit as service is provided by the employee, but deducted in determining taxable profit either when contributions are paid to a fund by the entity or when retirement benefits are paid by the entity. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset as economic benefits will flow to the entity in the form of a deduction from taxable profits when contributions or retirement benefits are paid;
- (b) preliminary expenses are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period(s). The difference between the tax base of the preliminary expenses, being the amount permitted as a deduction in future periods under taxation laws, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset;
- (c) with limited exceptions, an entity recognises the identifiable assets

acquired and liabilities assumed in a business combination at their fair values at the acquisition date. When a liability assumed is recognised at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 66); and

- (d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.”

“27 The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reduction in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.”

The statutory auditors are of the view that all these provisions, when made, affect the accounting profit but are not allowed for income tax purposes (paragraph 24 (b)). The tax base and accounting base are different. The actual expenditure on warranty gets debited to the respective heads of expenditure and there is outflow of economic resources embodying economic benefits and further gets allowed in income tax. The incremental provisions are based on actuarial report which is based on the warranty expenditure incurred and the warranties expired. Therefore, it cannot be said that provision for warranty does not get allowed or not capable of reversal. Further, provision in respect of warranties though disallowed for the purpose of computation of income tax will get allowed in the year in which the liability gets crystallized and therefore, they partake the character of deductible temporary differences and it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. No doubt, the period over which the reversal takes place may be longer which is true in the case of depreciation (paragraph 26 of Ind AS 12) also. Further, provisions for employee benefits like gratuity made based on actuarial valuation in books gets allowed only in tax assessments when the same is paid and deferred tax assets are recognised. The Company is a profit-making Company and paying income tax under normal computation; and therefore, does not get covered under paragraph 27 of Ind AS 12 also. The basis of provision and accounting for replacements are identical to provision for warranties and therefore, deferred tax assets are to be recognised.

In respect of provision for doubtful debts, the provision gets reversed when the actual write off takes place leading to deduction under income tax assessments. When provisions are reversed when no longer required, the reversal is not subject to tax and the provision as well as reversal affects both accounting and tax profits and the base is also different requiring recognition of deferred tax. However, the statutory auditors are in agreement with the Company in respect of provision for raw materials redundancy as the same is a mere provision and the deduction will be available only when the inventories are sold.

## **B. Query**

7. In view of the above facts, the opinion of the Expert Advisory Committee (EAC) has been sought by the querist on the following:

- (i) Whether the stand taken by the Company is in order that deferred tax assets are not to be recognised on provision for warranties, replacements, redundancy, doubtful debts and doubtful claims as they are mere provisions and are not likely to be available for set off against future taxable profits.
- (ii) If the answer to the above is in the negative, i.e. deferred tax assets ought to be recognised on the above items, whether the recognition of the same would be a change in an accounting estimate in terms of paragraph 32 of Indian Accounting Standard (Ind AS) 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'; or would it be an error/omission and therefore, a prior period item and the Company has to comply with paragraphs 42 to 49 of Ind AS 8 and accordingly, restate the financial statements, i.e. recognising the deferred tax asset for the financial year 2018-2019 by restatement of the financial statement for the year 2018-2019 or adjusting the deferred tax assets as on 01.04.2019 to the opening equity and give suitable disclosures.

## **C. Points considered by the Committee**

8. The Committee notes that the basic issue raised by the querist relates to creation/recognition of DTA in respect of provision for warranties, replacements, redundancy, doubtful debts and doubtful claims. The Committee has, therefore, considered only this issue and not examined any other issue that may arise from the Facts of the Case, such as, appropriateness of creation, measurement and write-back of the above-mentioned provisions; recognition of DTA in respect of other provisions, such as, provisions for wage revision, other employee benefits, onerous contract, etc.; computation of deferred tax asset; interpretation of Companies Act, 2013 with regard to restatement/revision of financial statements in respect of prior period items/errors (if any); etc. Further, the opinion expressed is purely from accounting perspective and not from the perspective of Income-tax Act. The Committee also wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified by the Companies (Indian Accounting Standards) Rules, 2015 as amended/revise from time to time. At the outset, the Committee notes from the Facts of the Case that the provisions referred by the querist are not deductible for income tax purposes in the year when these are recognised in the books of account but in subsequent years and therefore, the opinion expressed hereinafter, is on the said premise.

9. The Committee notes from the Facts of the Case that the Company is recognising provision in respect of warranties, replacements, future charges, etc.; however, at the same time, it is also stated that the liabilities in respect of such provisions are uncertain and may or may not settle to the extent of the provision created. In this regard, the Committee wishes to point out that a provision is always created for such liabilities whose timing or amounts are uncertain and therefore, a judgement would necessarily need to be exercised with regard to the probability/possibility of the events giving rise to the obligation/liability and the amount of cash flows required to settle that obligation.

The Committee is of the view that certainty or uncertainty of an event/contingency in respect of a provision should be taken into consideration while recognising or measuring the provision rather than while creating/recognition deferred taxes in respect of them.

Hence, once a provision is recognised considering the due requirements of various standards dealing with such provisions, the Committee is of the view that the application of another standard, for example, Ind AS 12 in the extant case should not be questioned due to the uncertain nature or amount of the provision. The Committee, therefore, without going into the correctness of the judgement of the Company with regard to the above-mentioned provisions, has presumed that the same have been made in accordance with the requirements of the relevant standards, viz., Ind AS 37, Ind AS 115, etc.

10. With regard to the creation of the deferred tax asset, the Committee notes the following requirements of Ind AS 12:

**“Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:**

- (a) deductible temporary differences;**
- (b) the carry forward of unused tax losses; and**
- (c) the carry forward of unused tax credits.**

**Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:**

- (a) taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or**
- (b) deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.**

**The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.”**

#### **“Tax base**

- 7 The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

#### **Examples**

- 1 A machine cost Rs. 100. For tax purposes, depreciation of Rs. 30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. *The tax base of the machine is Rs. 70.*
- 2 Interest receivable has a carrying amount of Rs. 100. The related interest revenue will be taxed on a cash basis. *The tax base of the interest receivable is nil.*
- 3 Trade receivables have a carrying amount of Rs. 100. The related revenue

has already been included in taxable profit (tax loss). *The tax base of the trade receivables is Rs. 100.*

...”

- “8 The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

### **Examples**

- 1 Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense will be deducted for tax purposes on a cash basis. *The tax base of the accrued expenses is nil.*
- 2 Current liabilities include interest revenue received in advance, with a carrying amount of Rs. 100. The related interest revenue was taxed on a cash basis. *The tax base of the interest received in advance is nil.*
- 3 Current liabilities include accrued expenses with a carrying amount of Rs. 100. The related expense has already been deducted for tax purposes. *The tax base of the accrued expenses is Rs. 100.*

...”

- “9 Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. For example, preliminary expenses are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period(s). The difference between the tax base of the preliminary expenses, being the amount permitted as a deduction in future periods under taxation laws, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset.

- 10 Where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this Standard is based: that an entity shall, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences. Example C following paragraph 51A illustrates circumstances when it may be helpful to consider this fundamental principle, for example, when the tax base of an asset or liability depends on the expected manner of recovery or settlement.”

- “24 **A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised,**

...

- 25 It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the entity of resources embodying economic benefits. When resources flow from the entity, part or all of their amounts may be deductible in determining taxable profit of a period

later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. ...

### **Example**

An entity recognises a liability of Rs. 100 for gratuity and leave encashment expenses by creating a provision for gratuity and leave encashment. For tax purposes, any amount with regard to gratuity and leave encashment will not be deductible until the entity pays the same. The tax rate is 25%.

*The tax base of the liability is nil (carrying amount of Rs. 100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable profit by an amount of Rs. 100 and, consequently, reduce its future tax payments by Rs. 25 (Rs. 100 at 25%). The difference between the carrying amount of Rs. 100 and the tax base of nil is a deductible temporary difference of Rs. 100. Therefore, the entity recognises a deferred tax asset of Rs. 25 (Rs. 100 at 25%), provided that it is probable that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.*

26 The following are examples of deductible temporary differences that result in deferred tax assets:

- (a) retirement benefit costs may be deducted in determining accounting profit as service is provided by the employee, but deducted in determining taxable profit either when contributions are paid to a fund by the entity or when retirement benefits are paid by the entity. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset as economic benefits will flow to the entity in the form of a deduction from taxable profits when contributions or retirement benefits are paid;
- (b) preliminary expenses are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period(s). The difference between the tax base of the preliminary expenses, being the amount permitted as a deduction in future periods under taxation laws, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset;
- (c) with limited exceptions, an entity recognises the identifiable assets acquired and liabilities assumed in a business combination at their fair values at the acquisition date. When a liability assumed is recognised at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 66); and

- (d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.”

From, the above, the Committee notes that as per the above-reproduced requirements of Ind AS 12, deferred tax asset is required to be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. Further, Ind AS 12, inter alia, provides that deductible temporary differences are the temporary differences (viz., differences between the carrying amount of an asset or liability in the balance sheet and its tax base), that will result in taxable amounts in determining taxable profit/loss of future periods when carrying amount of the asset or liability is recovered or settled.

The Committee notes that the provisions referred by the querist in the extant case, will either be reflected in the financial statements as an adjustment to the related existing asset (i.e., by measuring the related asset net of such provision), for example, provision for doubtful debts/ claims and provision for redundancy will be reflected in the financial statements as an adjustment to the value of the related receivables/debts/inventory; or as a separate liability, for example, provision for warranty or provision for replacements.

The Committee is of the view that where a provision is reflected in the financial statements as a separate liability, the tax base of such liability would be nil and therefore there would be a difference between the tax base and carrying amount for accounting purposes. However, when that liability would be settled in future for its carrying amount, the same shall reduce the future taxable profit by an equivalent amount and therefore the same is a deductible temporary difference. Accordingly, deferred tax asset in respect of the same should be recognised in the financial statements to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

Similarly, where the provision is reflected as an adjustment to the value of related asset (i.e., by measuring the related asset net of such provision), it will reduce the carrying amount of the related asset, whereas tax base of the related asset would be higher than the carrying amount of that asset as these adjustments or restatement of an asset does not affect taxable profit in the period of the adjustments or restatement and, consequently, the tax base of the asset is not adjusted. However, when in future the carrying amount of the asset would be recovered, to the extent of the difference in the carrying amount and tax base, there would be less taxable profit in future leading to deductible temporary difference. Accordingly, deferred tax asset in respect of the same should be recognised in the financial statements to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

11. With regard to the issue as to whether the recognition of DTA in a period later than when such provision is recognised in the financial statements, will be considered as a change in accounting estimate or would be considered as an error, the Committee notes the following requirements of Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’:

**“A *change in accounting estimate* is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in**

**accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.”**

**“Prior period errors are omissions from, and misstatements in, the entity’s financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:**

- (a) was available when financial statements for those periods were approved for issue; and**
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**

**Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.”**

From the above, the Committee notes that a change in accounting estimate is change in value of asset or liability due to the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities, whereas errors refer to omissions in financial statements due to failure to use or misuse any information that was available when financial statements were approved. Further, changes in accounting estimates result from new information or new developments. In the extant case, DTA is required to be created in respect of the above-mentioned provisions in the period in which these provisions are recognised as per the afore-mentioned requirements of Ind AS 12 and, therefore, non-recognition of the same results in an omission in the financial statements, which constitutes as a prior period error and not a change in estimate resulting from new information or new development. Accordingly, if these prior period errors are material, the Company should rectify the same by retrospective restatement as per paragraphs 42 to 49 of Ind AS 8 and accordingly, restate the financial statements. In this context, the Committee notes paragraphs 42 and 49 of Ind AS 8 as follows:

**“42 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:**

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or**
- (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”**

**“Disclosure of prior period errors**

**49 In applying paragraph 42, an entity shall disclose the following:**

- (a) the nature of the prior period error;**
- (b) for each prior period presented, to the extent practicable, the amount of the correction:**
  - (i) for each financial statement line item affected; and**
  - (ii) if Ind AS 33 applies to the entity, for basic and diluted earnings per share;**
- (c) the amount of the correction at the beginning of the earliest prior period presented; and**

- (d) **if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.**

**Financial statements of subsequent periods need not repeat these disclosures.”**

#### **D. Opinion**

12. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 7 above:

- (i) Not recognising deferred tax asset on provisions for provision for warranties, replacements, redundancy, doubtful debts and doubtful claims is not correct and DTA should be recognised as discussed in paragraph 10 above.
- (ii) Since DTA is required to be created in respect of the above-mentioned provisions in the period in which these provisions are recognised as per the requirements of Ind AS 12, non-recognition of the same results in an omission in the financial statements, which constitutes as a prior period error and not a change in estimate resulting from new information or new development. Therefore, if these prior period errors are material, the Company should rectify the same by retrospective restatement as per paragraphs 42 to 49 of Ind AS 8 and accordingly restate the financial statements, as discussed in paragraph 11 above.

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