

Query No. 29

Subject: Accounting treatment in the financial statements of Employees Provident Fund Trust for degraded investments.¹

A. Facts of the Case

1. An Employees Provident Fund (EPF) Trust (hereinafter referred to as ‘the Trust’) is an exempted trust under the Employees’ Provident Funds and Miscellaneous Provisions Act, 1952, incorporated by A Ltd. (hereinafter also referred to as ‘the Company’). The exemption has been granted to the Trust under section 17 of the Employees’ Provident Funds and Miscellaneous Provisions Act, 1952 since inception of A Ltd. The Trust has been recognised under Rule 3(1) of Part A of Fourth Schedule of Income-tax Act, 1949.

Accounts of recognised provident funds as per Income-tax Act:

2. As per Part A of the Fourth Schedule, ‘Recognised provident funds’ of Income-tax Act, following applied for Accounts of Recognised provident fund:

“12. (1) The accounts of a recognised provident fund shall be maintained by the trustees of the fund and shall be in such form and for such period, and shall contain such particulars, as the Board may prescribe.

(2) The account shall be open to inspection at all reasonable times by income-tax authorities, and the trustees shall furnish to the Income-tax Officer such abstracts thereof as the Board may prescribe.”

3. *Contributions:*

(i) The contribution payable by the Company to the Fund shall be at the rate of 12% of the Basic Pay and Dearness Allowance payable to each employee who is eligible for membership of the Fund.

(ii) The contribution payable by an employee under these Rules shall be equal to or more than the contribution payable by the Company in respect of such employee subject to the limit laid down in the Income-tax Act. Provided, that the member's contribution shall be 12% of Basic Pay and Dearness Allowance unless the member intimates in writing the increased amount which he/she chooses to contribute as voluntary contribution.

4. *Interest:*

(i) Interest shall be credited to the account of each member at such rate as may be determined by the Board of Trustees subject to minimum as prescribed by the Employees’ Provident Fund Organisation (EPFO) (statutory interest rate declared by EPFO is 8.50% for financial year (F.Y.) 2020-21). Such interest shall be deemed to have been credited immediately on close of the year.

(ii) The aggregate amount of interest credited to the accounts of the members shall be debited to ‘interest account’.

¹ Opinion finalised by the Committee on 9.2.2022.

5. *Accounts and Audit:*

- (i) The accounts of the Trust are maintained on accrual basis of accounting and the Trust has not opted for Ind AS.
- (ii) The Secretary shall cause the accounts of the Fund to be maintained in such a manner as the Board and the Commissioner may, from time to time, decide. The Company or the Secretary shall furnish to the Commissioner such accounts relating to the Fund as the Commissioner may prescribe from time to time.
- (iii) At the end of each financial year, an Income and Expenditure Account together with a Balance Sheet of the Fund's assets and liabilities along with Audit Report shall be laid before the Board, at a meeting to be held within six months of the close of the financial year.

6. *Investment by EPF Trust:*

- (i) All the money belonging to the Fund shall be deposited in the Reserve Bank or the State Bank of India or in such other Scheduled Bank as may be approved by the Central Government from time to time or shall be invested expeditiously subject to such directions as the Central Government may from time to time give in regard to securities mentioned or referred in clauses (a) to (d) of Section 20 of the Indian Trusts Act, 1882 (II of 1882) provided that such securities are payable both in respect of capital and in respect of interest in India.
- (ii) Investment Pattern: The Trust follows the Investment pattern guidelines issued by the Government of India, Ministry of Labour and Employment vide Notification No. 1134 S.O.1433(E) Dated 29.05.2015 of Government of India, Ministry of Labour.

INVESTMENT PATTERN

Category	Percentage to be invested
1. Government Securities and Related investments -	Minimum 45% and Upto 65%
2. Debt instruments and Related Investments -	Minimum 35% and Upto 45%
3. Short-term Debt Instruments and Related Investments -	Up to 5%
4. Equities and Related Investments -	Minimum 5% and upto 15%

- (iii) All expenses incurred in respect of and loss, if any, arising from any investment shall be recouped from A Ltd.

Any money received on the maturity of earlier investments reduced by obligatory outgoing shall be invested in accordance with the investment pattern prescribed in this Notification. An Investment Sub-Committee has been formed by the Board of Trustee to analyse the current investment and market situation. As per recommendation of sub-committee, the Trust invests the surplus funds after paying all obligatory outgoing. The instrument selected by Investment sub-committee is based on prescribed instrument rating, yield of security, period of security and overall market condition, etc. In case of default in principal and interest on investment, the amount of principal and interest due but not received is provided for in the Income and Expenditure Account. For the investments, where principal is not due but Trust is not

receiving the interest on investments and ratings of the investments are degraded due to default, the Trust is only providing for interest and not for principal.

7. The querist has separately informed that due to poor financial position of few companies in which investments were made by the Trust and insolvency proceedings were also initiated, those investments were degraded from initial rating of AAA+ to A/B/C by credit rating agencies. PF Trust has made a provision for interest and principal due to non-realisation from these degraded investments (up to 31st March 2021: ₹69.68 crore). This has resulted in a net shortfall of ₹4.56 crore for F.Y. 2019-20 and ₹46.28 crore for F.Y. 2020-21 with respect to statutory minimum interest rate to be declared by PF Trust and the same was provided for by A Ltd. The investments are not due for maturity as on date and are subject to realisation through National Company Law Tribunal (NCLT).

8. The querist has stated that the following accounting is being followed by the Trust:

- i. The accounts of the Trust are maintained on accrual basis of accounting.
- ii. The investments other than Exchange Traded Funds (ETFs) are stated at cost adjusted with the premium/discount on the purchase of investments apportioned over the unexpired period thereof.
- iii. Investments made by the Trust are held till maturity except for equity based investments, which are held for long-term.
- iv. Long-term ETFs are being shown at market price as on 31.03.2021. Any difference on account of unrealised gain/loss is disclosed in the Balance Sheet as 'Unrealised Gain/Loss on Equity based Investments' and same is not being recognised in profit/loss in Income and Expenditure Account.
- v. In case of default in principal and interest on investment, the amount of principal and interest due but not paid is recognised as provision in Income and Expenditure at the time when principal and interest become due.

B. Query

9. In view of above, the querist has sought the opinion of the Expert Advisory Committee as to whether PF Trust has to make provision in its books for all the investments in the companies for which insolvency proceedings have been initiated and principal/interest is not due. If it is to be provided for, what shall be the basis of measurement of the provision?

C. Points considered by the Committee

10. The Committee notes that the basic issue raised by the querist relates to accounting treatment in the books of account of Employee Provident Fund Trust for investments in the companies for which insolvency proceedings have been initiated and principal/interest is not due and basis of measurement of the provision (if any). The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for ETFs, accounting in the books of Self-contributory Superannuation Benefit (Pension) Fund Trust, Employee Gratuity Fund Trust and Employee Post-retirement Medical Benefit Trust etc. The Committee has only examined the issue from accounting principles perspective and has not examined the regulatory or legal aspects, including those arising under Income-tax Act, Indian Trusts Act, 1882, DPE Guidelines, investment pattern guidelines issued by the Ministry of Labour, Employees' Provident Funds and Miscellaneous Provisions Act, 1952 etc. The Committee presumes from the Facts of the Case that investments under the question are long-term investments and are not ETFs.

Further, the Committee notes from the Trust's financial statements separately supplied by the querist for the perusal of the Committee, that the accounting standards issued by the Institute of Chartered Accountants of India (ICAI) are being followed by the Trust. Therefore, the Committee has based its opinion on the Accounting Standards issued by the ICAI.

11. At the outset, the Committee notes that Accounting Standard (AS) 13, 'Accounting for Investments' does not deal with the investments of retirement benefit plans. Therefore, AS 13 is not directly applicable to investments of the PF Trust; however, since no other guidance is available in respect of investments under other accounting standards, the Committee feels that the principles of AS 13 may still be applied in the extant case. Accordingly, the Committee notes the requirements of AS 13 as follows:

***“3.2 A current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.*”**

3.3 A long term investment is an investment other than a current investment.”

“Long-term Investments

17. Long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long term investment, the carrying amount is reduced to recognise the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. The type and extent of the investor's stake in the investee are also taken into account. Restrictions on distributions by the investee or on disposal by the investor may affect the value attributed to the investment.

18. Long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis.

19. Where there is a decline, other than temporary, in the carrying amounts of long term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.”

***“31. Investments classified as current investments should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment, but not on an overall (or global) basis.*”**

32. Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually.”

12. The Committee notes that as per the requirements of AS 13, the Employee PF Trust is required to classify its investments into current and long-term investments depending on readily realisability of each investment and the Trust's intention for holding beyond one year from the date on which such investment is made. Investments classified as current investments should be carried in the financial statements at the lower of cost and fair value determined either on an individual investment basis or by category of investment. Long-term investments shall be measured at cost, however, a provision for diminution is recognised if

there is a decline, other than temporary, in the value of the investments. Such a reduction is determined for each long-term investment individually.

13. The Committee notes that the Employee PF Trust follows an accounting policy under which, in case of default in principal and interest on investment, the amount of principal and interest due but not received is provided for. For the investments where principal is not due but the Trust is not receiving the interest on investments and ratings of the investments are degraded due to default, the Trust is only providing for interest and not for principal. The Committee is of the view that such an accounting policy is not consistent with the requirements of AS 13. This is so because as may be observed from paragraph 17 of AS 13, whether there is other than temporary decline in value of long-term investments is an assessment not restricted to only default in payment of interest or repayment of principal amount. In other words, there can be other than temporary diminution in value of investments even if there is no default in payment of interest or repayment of principal amount of the investments.

14. The Committee is of the view that the Trust should assess the reasons for downgrading the ratings of the investments in question and exercise its judgement to determine whether there is a decline, other than temporary, considering various factors related to the investment, including those provided by AS 13. The fact that the investments are under insolvency proceedings would generally indicate that there is other than temporary decline in the value of the investment. However, whether or not there is other than temporary decline in the value of the investment is a matter of careful assessment and judgement, that the Trust should make based on specific facts and circumstances of each investment of the Trust which are undergoing insolvency proceedings. Accordingly, in case of long-term investments, if on the basis of such assessment, it is determined that there is other than temporary decline in the value, the Committee is of the view that the Trust should provide for such diminution or decline in the value of the investments.

D. Opinion

15. On the basis of above, the Committee is of the opinion that the PF Trust should make assessment based on specific facts and circumstances of all the investments in the companies for which insolvency proceedings have been initiated, to determine whether there is diminution or decline other than temporary in the value of the investments and if so, should make provision for such diminution or decline in its financial statements, as discussed in paragraphs 12 to 14 above.