

## ***Query No. 30***

***Subject: Measurement of provision for degraded investments of Employee Benefit Trusts and accounting treatment thereof.<sup>1</sup>***

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

1. A company (hereinafter referred to as 'the Company') is a Government of India enterprise incorporated under the Companies Act and is engaged in the business of transmission of power from the generating units to different State Electricity Board (SEBs) through its transmission network. The Company prepares its financial statements in compliance of Indian Accounting Standards (Ind ASs) from financial year (F.Y.) 2016-17. The equity shares of the company are listed in NSE and BSE.

2. The Company has the following trusts for the post-retirement benefits to its employees for funded benefits:

- Employees Provident Fund Trust (Exempted Trust under Employees' Provident Funds and Miscellaneous Provisions Act, 1952)
- Self-Contributory Superannuation Benefit (Pension) Fund Trust
- Employees Gratuity Fund Trust
- Employees Post-Retirement Medical Benefit Trust

In addition to above, there are unfunded benefits namely, leave encashment, long service award and baggage allowance. All the above four trusts are exempted by the Income-tax Act, 1961 and are separate entities. Separate set of books of account are maintained for the same.

3. The funding of the trusts is done by the Company through statutory contributions limited to a ceiling limit of 30% of Basic Pay and Dearness Allowance (DA) by the employers as per DPE Guidelines. Out of the said 30% contribution, the contribution towards employer's share for Provident Fund (PF) is 12%. Balance 18% is utilised for other funded/unfunded benefits. PF Trust is mandatorily required to declare interest rate not below the rate announced by the Employees' Provident Fund Organisation (EPFO). If the Trust is not able to meet such interest rate, the employer has to make good the shortfall. To declare such interest, PF Trust invests the amount contributed by employees and employers after providing for its present obligation of separated employees as per the prescribed guidelines issued by the Ministry of Labour from time to time.

4. Pursuant to paragraph 57 of Ind AS 19, 'Employee Benefits', accounting by an entity for defined benefit plans, inter-alia, involves determining the amount of the net defined benefit liability (asset) which shall be adjusted for any effect of limiting a net defined benefit asset to the asset ceiling prescribed in paragraph 64. As per paragraph 64 of Ind AS 19, in case of surplus in a defined benefit plan, an entity shall measure the net defined benefit asset at the lower of actual surplus or the value of the assets ceiling determined using the discount rate. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

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<sup>1</sup> Opinion finalised by the Committee on 9.2.2022.

5. As per the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, the Company has no right to the benefits either in the form of refund from the plan or lower future contribution to the plan towards the net surplus of ₹41.57 crore as on 31<sup>st</sup> March 2021 (31<sup>st</sup> March 2020: ₹90.22 crore) (refer note 63 to standalone financial statements for F.Y. 2020-21) determined through actuarial valuation. Accordingly, the Company has neither recognised the surplus as an asset nor the remeasurement loss /gains in 'Other Comprehensive Income', as these pertain to the Provident Fund Trust and not to the Company.

6. However, the Company has recognised the surplus/deficit as well as remeasurement loss /gain in 'Other Comprehensive Income' in respect of Gratuity, Post-Retirement Medical Benefit, Leave Encashment, Long Service Award and Baggage Allowance based on actuarial valuation. The Company has accounted for 'Self-Contributory Superannuation Benefit (Pension)' as defined contribution plan.

7. The querist has referred to the following requirements of Appendix B to Ind AS 19:

**“When a minimum funding requirement may give rise to a liability**

23 If an entity has an obligation under a minimum funding requirement to pay contributions to cover an existing shortfall on the minimum funding basis in respect of services already received, the entity shall determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan.

24 To the extent that the contributions payable will not be available after they are paid into the plan, the entity shall recognise a liability *when the obligation arises*. The liability shall reduce the net defined benefit asset or increase the net defined benefit liability so that no gain or loss is expected to result from applying paragraph 64 of Ind AS 19 when the contributions are paid.”

(Emphasis supplied by the querist.)

8. The querist has stated that as per clause 28 of Appendix A to paragraph 27AA of Employees' Provident Funds Scheme, 1952, 'Revised Conditions for Grant of Exemption under Section 17 of Employees' Provident Funds and Miscellaneous Provisions Act, 1952', “in the event of any loss to the trust as a result of any fraud, defalcation, wrong investment decisions etc. the employer shall be liable to make good the loss”.

9. Further, as per paragraph 3 of the Accounting Policy No. 2.12.2, 'Defined benefit plans' of the Company, “The Company pays fixed contribution to Provident Fund at predetermined rates to a separate trust, which invests the funds in permitted securities. The contributions to the fund for the year are recognised as expenses and are charged to the Statement of Profit and Loss. The obligation of the Company is limited to such fixed contributions and to ensure a minimum rate of interest on such contributions to the members as specified by the Government of India”.

10. Due to poor financial position of few companies in which investments were made by above all trusts 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 31<sup>st</sup> 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 the Company.

11. As the investments are not due for maturity as on date and further, they are subject to realisation through National Company Law Tribunal (NCLT), there is no present obligation on the Company to pay to Trusts entire principal and interest of degraded investment. Since the amount to be provided was not ascertainable and fair value of plan assets is more than present value of defined benefit obligations, therefore, provision was made by the Company to the extent of shortfall in case of PF Trust and others through actuarial valuation rather than for full amount of degraded investments.

During the audit, the Comptroller and Auditor General of India (CAG) auditors advised to obtain opinion of the Expert Advisory Committee (EAC) on measurement of provision and accounting treatment thereof.

## **B. Query**

12. In view of above, the opinion of the Expert Advisory Committee is sought regarding accounting treatment for surplus/deficit in fair value of plan assets over present value of obligation of Provident Fund, remeasurement loss/gains of Provident Fund, interest surplus/deficit in Provident Fund in the books of the Company.

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

13. The Committee notes that the basic issue raised by the querist relates to the accounting treatment of the Employees Provident Fund benefit scheme of the Company and accounting treatment for investments made by the Employees PF Trust in the companies for which insolvency proceedings have been initiated and principal/interest is not due, in the separate financial statements of the Company. 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, classification under Ind AS 19 as defined benefit or defined contribution plan of employee PF benefits, accounting for other employee benefit schemes, such as, gratuity benefits, post-retirement medical benefit, superannuation, pension benefit, baggage allowance, etc., accounting in the books of various trusts formed by the Company, etc. The Committee has only examined the issue from Ind AS perspective and has not examined the regulatory or legal aspects, including those arising under Income-tax Act, PF Act, Gratuity Act, DPE Guidelines, Employees' Provident Funds and Miscellaneous Provisions Act, 1952, Employees' Provident Funds Scheme, 1952, etc.

14. The Committee notes the following requirements of Ind AS 19:

**“Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113, Fair Value Measurement.)”**

**“The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.”**

**“61 An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity’s informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change**

**in the entity's informal practices would cause unacceptable damage to its relationship with employees.**

- 62 The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to terminate its obligation under a plan (without payment) if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an entity that is currently promising such benefits will continue to do so over the remaining working lives of employees.

#### **Balance Sheet**

- 63 An entity shall recognise the net defined benefit liability (asset) in the balance sheet.**

- 64 When an entity has a surplus in a defined benefit plan, it shall measure the net defined benefit asset at the lower of:**

- (a) the surplus in the defined benefit plan; and**
- (b) the asset ceiling, determined using the discount rate specified in paragraph 83.**

- 65 A net defined benefit asset may arise where a defined benefit plan has been overfunded or where actuarial gains have arisen. An entity recognises a net defined benefit asset in such cases because:

- (a) the entity controls a resource, which is the ability to use the surplus to generate future benefits;
- (b) that control is a result of past events (contributions paid by the entity and service rendered by the employee); and
- (c) future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit. The asset ceiling is the present value of those future benefits.”

“113 The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus.”

- “120 An entity shall recognise the components of defined benefit cost, except to the extent that another Ind AS requires or permits their inclusion in the cost of an asset, as follows:**

- (a) service cost (see paragraphs 66–112 and paragraph 122A) in profit or loss;**
- (b) net interest on the net defined benefit liability (asset) (see paragraphs 123–126) in profit or loss; and**
- (c) remeasurements of the net defined benefit liability (asset) (see paragraphs 127–130) in other comprehensive income.”**

**“122 Remeasurements of the net defined benefit liability (asset) recognised in other comprehensive income shall not be reclassified to profit or loss in a subsequent period. However, the entity may transfer those amounts recognised in other comprehensive income within equity.”**

“127 Remeasurements of the net defined benefit liability (asset) comprise:

- (a) actuarial gains and losses (see paragraphs 128 and 129);
- (b) the return on plan assets (see paragraph 130), excluding amounts included in net interest on the net defined benefit liability (asset) (see paragraph 125); and
- (c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset) (see paragraph 126).”

Further, Appendix B to Ind AS 19 states the following:

“7 An entity shall determine the availability of a refund or a reduction in future contributions in accordance with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan.”

“23 If an entity has an obligation under a minimum funding requirement to pay contributions to cover an existing shortfall on the minimum funding basis in respect of services already received, the entity shall determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan.

24 To the extent that the contributions payable will not be available after they are paid into the plan, the entity shall recognise a liability when the obligation arises. The liability shall reduce the net defined benefit asset or increase the net defined benefit liability so that no gain or loss is expected to result from applying paragraph 64 of Ind AS 19 when the contributions are paid.”

From the above, the Committee notes that, in case of a defined benefit plan, paragraphs 64 and 65 of Ind AS 19 state that an asset may arise (that is, an asset measured on the basis of Ind AS 19) where a defined benefit plan has been overfunded or when actuarial gains have arisen. The Standard permits the recognition of an asset in such cases, only when:

- (a) the entity controls a resource, which is the ability to use the surplus to generate future benefits;
- (b) that control is a result of past events (contributions paid by the entity and service rendered by the employee); and
- (c) future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit; the present value of those benefits is described as the asset ceiling.

When there is a surplus in a defined benefit plan, the Standard requires the net asset recognised to be restricted to the lower of the surplus in the plan and the asset ceiling discounted using the same discount rate used for determining the defined benefit obligation.

15. In the extant case, the Committee is of the view that the Company should assess the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 so as to determine, whether these render any right to the Company to the benefits of surplus in plan asset either in the form of refund from the plan or lower future contribution to the plan towards the net surplus. As noted earlier, when there is a surplus in a defined benefit plan, Ind AS 19 requires the net asset recognised in the balance sheet to be restricted to the lower of the surplus in the plan and the asset ceiling. In the extant case, if these legal provisions provide for restrictions that would preclude the Company to have control over the resource, i.e., the ability to use the surplus to generate future benefits in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit, the Committee is of the view that the Company should not recognise any net surplus in plan asset.

The Committee further notes that as per the requirements of Ind AS 19, an entity shall recognise the components of defined benefit cost in the form of service cost in profit or loss; net interest on the net defined benefit liability (asset) in profit or loss; and remeasurements of the net defined benefit liability in other comprehensive income. Remeasurement also includes any changes in the asset ceiling, excluding amounts in net interest on the defined benefit liability. The Committee is of the view that in the extant case, although remeasurement loss is to be recognised in full in other comprehensive income, remeasurement gain should be recognised in other comprehensive income, restricted to the asset ceiling restriction that precludes any net surplus from being recognised by the Company.

16. Further, the Committee notes that paragraphs 23 and 24 of Appendix B to Ind AS 19 state that if there is an obligation under a minimum funding requirement to pay contributions to cover an existing shortfall on the minimum funding basis in respect of services already received, the entity should determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan; and to the extent the contributions payable will not be available after they are paid into the plan, the entity should recognise a liability when the obligation arises.

17. In the extant case, the querist has submitted that the Company has minimum funding requirements of at least 12% of the employees' basic pay and dearness allowance as per the Employees' Provident Funds and Miscellaneous Provisions Act, 1952. Further, the querist has submitted that clause 28 of Appendix A to paragraph 27AA of EPF Scheme, 1952, 'Revised Conditions for Grant of Exemption under Section 17 of Employees' Provident Funds and Miscellaneous Provisions Act, 1952', requires the employer to make good the loss in the event of any loss to the Employees PF Trust as a result of any fraud, defalcation, wrong investment decisions, etc. The Committee is of the view that whether or not there is a loss to the PF Trust due to such an instance is a matter of careful assessment and judgement, that the Company should make based on specific facts and circumstance of each investment of the trust which are undergoing insolvency proceedings.

18. The Committee further notes that the querist has submitted that the Employees PF Trust's investments are not due for maturity as on date, are subject to realisation through NCLT, and there is no present obligation on the Company to pay to the Trust the entire principal and interest of degraded investment. The Committee is of the view that the obligation, as stated in paragraph 24 of Appendix B to Ind AS 19, would arise on the Company, if the loss can be attributed to any instance such as, fraud, defalcation and wrong

investment decisions, as discussed above. Therefore, the above contention of the querist would not hold good.

Furthermore, interest deficit on the net defined benefit liability (asset) would also create a net defined benefit plan obligation, since the Company is required to contribute towards any deficit in the corpus of the PF Trust and, therefore, would have to be included in the measurement of plan obligation. Recognition of interest surplus, if any, would however be subjected to the asset ceiling restriction as stated in the earlier paragraphs and would be eligible for recognition only if the asset ceiling criteria are fulfilled.

19. The querist has also submitted that the amount to be provided was not ascertainable and fair value of plan assets is more than present value of defined benefit obligations, therefore, provision was made by the Company to the extent of shortfall in case of PF Trust and others through actuarial valuation rather than for full amount of degraded investments. The Committee notes that Ind AS 19 requires plan assets to be measured at fair value. For this purpose, fair value is determined based on the principles and guidance in Ind AS 113. Therefore, the fair value of the plan assets, including the degraded investments, of the employee PF trust shall be made as per the requirements of Ind AS 113 as per the management's best estimates, which may include, recoveries from past insolvency proceedings, information provided by the administrators/insolvency professionals, etc. Merely because the investments are subject to insolvency proceedings, it cannot be stated that the fair values are not ascertainable.

The Committee further notes that Ind AS 113 specifies that fair value is a market-based measurement. If market participants would consider adjustments for the inherent risk of the asset or consider the risk in the valuation technique used to measure fair value, then such risk adjustments should be considered in the fair value assumptions. Further, the Committee notes that the actuarial valuation report submitted by the querist does not contain any reason why the fair values of the investments in question are not ascertainable.

**D. Opinion**

20. On the basis of above, the Committee is of the opinion that the accounting for the obligation of Employees Provident Fund defined benefit plan, remeasurement gain/loss and interest surplus/deficit should be in accordance with the requirements of Ind AS 19, as described in paragraphs 15 to 19 above.