The following Announcement is being issued by the Auditing & Assurance Standards Board under the Authority of the Council of ICAI.

ANNOUNCEMENT

Manner of Reporting by the Auditors In Respect of RBI's Circular on Deferred Tax Liability on Special Reserve created under Section 36(1) (viii) of the Income Tax Act, 1961

1. The Reserve Bank of India, on 20th December 2013, issued Circular No. DBOD. No.BP.BC.77/21.04.018/2013-14 for all commercial banks (excluding Regional Rural Banks) in respect of Deferred Tax Liability on Special Reserve created under Section 36(1) (viii) of the Income Tax Act, 1961.

2. RBI, in its aforesaid Circular has noted that some banks were not creating deferred tax liability (DTL) on Special Reserve as per Accounting Standard 22, '*Accounting for taxes on Income'* (AS 22) on the grounds that they do not intend to withdraw from such Reserve in the future. In many cases banks have formalised such intent by having resolutions passed by their Boards or Committees to this effect.

3. RBI, *vide* its aforesaid Circular, has required that as a matter of prudence, banks should create DTL on such Special Reserve. Further, for this purpose, banks may take the following course of action:

a) If the expenditure due to the creation of DTL on Special Reserve as at March 31, 2013 has not been fully charged to the Profit and Loss account, banks may adjust the same directly from Reserves. The amount so adjusted may be appropriately disclosed in the Notes to Accounts of the financial statements for the financial year 2013-14.

b) DTL for amounts transferred to Special Reserve from the year ending March 31, 2014 onwards should be charged to the Profit and Loss Account of that year.

4. RBI Circular also states that in view of the requirement to create DTL on Special Reserve, banks may reckon the entire Special Reserve for the purpose of computing Tier-I Capital.

5. The Council of ICAI has considered the impact of the accounting dispensation prescribed by RBI with respect to treatment of expenditure on creation of DTL as at 31st March 2013 (as referred to in paragraph 3.a above) on the report of the banks' statutory auditors.

6. On a consideration of the matter, the Council is of the view that any specific accounting treatment prescribed by a regulator, even if at variance with the Accounting Standard/s, was an integral part of the financial reporting framework applicable to the entity falling under the jurisdiction of such regulator and the entity would be required to follow such prescribed accounting treatment. Accordingly, the statutory auditors need not modify their audit opinion in respect of such prescribed accounting treatment. However, the fact may be brought out by the statutory auditors in their audit report by way of an "Emphasis of Matter" paragraph in accordance with the Standard on Audit (SA) 706, "*Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*",

issued by ICAI, provided the matter of departure from the requirements of the Accounting Standard/s pursuant to the aforesaid regulatory requirement is appropriately disclosed, with quantification, by the entity by way of the notes to the accounts in the financial statements.

7. An illustrative "Emphasis of Matter" paragraph is as follows:

> "Emphasis of Matter
>
> We draw attention to Note X to the financial statements, which describes the accounting treatment of the expenditure on creation of Deferred Tax Liability on Special Reserve under section 36(1)(viii) of the Income Tax Act, 1961 as at 31st March 2013, pursuant to RBI's Circular No. DBOD. No.BP.BC.77/21.04.018/2013-14 dated 20th December 2013. Our opinion is not qualified in respect of this matter."

8. The aforesaid disclosure in the Notes to the Accounts would normally include the following information in respect of creation of Deferred Tax Liability (DTL) on Special Reserve for the following:

- Amount of expenditure due to the creation of DTL on Special Reserve as at March 31, 2013 not fully charged to the Profit and Loss Account as adjusted directly against Reserves
- Impact on Profit & Loss Account had the amount of hitherto unprovided DTL been charged to the Profit and Loss Account instead of Reserves directly as required by the RBI Circular.

9. An illustrative Note to Accounts in this regard is as follows:

> "Pursuant to Reserve Bank of India's (RBI's) Circular No. DBOD. No.BP.BC.77/21.04.018/2013-14 dated 20th December 2013, the Bank has created Deferred Tax Liability on the Special Reserve under section 36(1)(viii) of the Income-tax Act, 1961. As required by the said RBI Circular, the expenditure, amounting to Rs. XXXX due to the creation of DTL on Special Reserve as at March 31, 2013, not previously charged to the Profit and Loss Account, has now been adjusted directly from the Reserves. Had this amount been charged to the Profit & Loss Account in accordance with the generally accepted accounting principles in India, the amount of Profit for year had been lower/ amount of Loss for the year higher[1] by such amount."

[1] As the case may be.