

No.F&A/CIR/010/Mar-04

23rd March, 2004

**Re.: General Insurance Officers' Special Voluntary
Retirement Scheme (VRS), 2004**

Attention is drawn to the Notification of the General Insurance Officers' Special Voluntary Retirement Scheme, 2004 one for the officers and the other for Class III/IV employees (F.No. 2(3)2003-Ins. III) dated 01.01.2004 notified by the Insurance Division, Deptt. of Economic Affairs, Ministry of Finance, Government of India.

The Authority has, keeping in view the revision to the AS – 26 issued by the Institute of Chartered Accountants of India (ICAI) in March, 2004, examined the accounting treatment of the VRS expenditure. The following guidelines are issued for adoption by the public sector general insurance companies:

1. **The VRS related expenditure would consist the following:**

- Ex-gratia payment is required to be recognized as the liability in respect of VRS in the accounting year in which the decision to accept the VRS of an employee is taken and communicated.
- Termination Benefits in respect of VRS: The insurer should normally have made the provision towards such benefits as gratuity, pension, and encashment of accumulated leave on actuarial basis. However, in view of the early retirement under the VRS, it is possible that the amount of termination benefits payable may be more than the provision made in this respect in the past for that employee. The excess of termination benefits payable over the provision held in this regard would form part of the VRS expenditure which will be considered for treatment as deferred expenditure.
- Leave Encashment Expenditure: The insurers should have made the provision on an actuarial basis. Payment made for encashment of leave salary for employees who have opted for VRS must be treated as expenditure for the year and cannot be treated as Deferred Revenue Expenditure. The excess of the payment over the actuarial liability provided for can be treated as Deferred Revenue Expenditure.

2. **Period of Deferment:**

The period of deferment would be restricted to a maximum of five years including the year of acceptance of VRS.

3. **Allocation of Expenditure**

While allocating the deferred revenue expenditure, it should be recognized that the tax benefits for the whole expenditure would arise in the first year itself. Therefore, the basis of allocation should be as under:

- (i) For the first year the charge should be equal to the sum of the tax benefit obtained + $\frac{1}{5}$ th of the balance; and
- (ii) In each of the subsequent four years, the charge should be equal to the $\frac{1}{5}$ th of the balance amount (the gross amount less the tax benefit obtained for the first year) as computed at (i) above.

An illustrative example of the treatment is given at Annexure.

4. **Disclosure**

The disclosure pertaining to the accounting policies followed in respect of VRS expenditure should be made in the Notes to the Accounts. Further, if VRS applications are accepted subsequent to closure of the accounting year 2003-04, disclosure of the same should be made in the Directors' Report along with the details of the likely impact of the said VRS expenditure in the subsequent financial year.

All public sector insurers who have offered the VRS to their employees during the financial year 2003-04 are required to ensure compliance with the guidelines.

(C. S. RAO)
Chairman

Illustrative Example on allocation of Expenditure

If the deferred revenue expenditure is 100 and spread over a period of five years, taking into account the tax savings, the amount to be charged off in each year should be as under:

Year	Gross Charge	Tax Savings	Net Charge
2003-04	36.75	36.75	---
	12.65	---	12.65
	49.40	36.75	12.65
2004-05	12.65	---	12.65
2005-06	12.65	---	12.65
2006-07	12.65	---	12.65
2007-08	12.65	---	12.65
	100.00	36.75	63.25

In case the insurer does not have adequate taxable income to fully absorb the deduction for the VRS in the first year, the charge in the first year may be lower and in the later years higher than in the above example. For example, if the insurer's taxable income is Rs.80/-, the charge for each year will be as under:

Year	Gross Charge	Tax Savings	Net Charge
2003-04	29.40	29.40	---
	12.65	---	12.65
	42.05	29.40	12.65
2004-05	7.35	7.35	
	12.65	---	12.65
	20.00	7.35	12.65
2005-06	12.65	---	12.65
2006-07	12.65	---	12.65
2007-08	12.65	---	12.65
	100.00	36.75	63.25

Note: The tax has been computed at the prevailing 35% corporate tax rate + 5% surcharge.