केन्द्रीय भण्डारण निगम
(भारत सरकार का उपक्रम)
CENTRAL WAREHOUSING CORPORATION
(A Govt. of India Undertaking)
जन-जनकेलिएभण्डारण/ Warehousing for Everyone

No. CWC-FD/CA-Accounts Circular/20-21 **1st June, 2021**

ACOOUNTING CIRCULAR NO.# 45

Sub: Accounting of write off of bad debts by routing it through Profit & Loss A/c in cases where the provision against the recoverable amount exists in the books.

1.0 The existing accounting treatment being followed by the Corporation for writing off the irrecoverable debts of the corporation **(where the provision against the recoverable amount exists in the books)** has been reviewed in consultation with the Tax Consultants of the Corporation.

2.0 Accordingly, based on above and in supersession of any earlier instructions issued on the above subject, the following accounting entries are advised to be passed for creation of Provision for doubtful recoveries & their write offs:

a. At the time of creation of Provision for Bad & Doubtful debts:

Bad & Doubtful Debt Provision (Expense A/c)-44000(Dr.)
To Reserve for doubtful debt (Liability A/c)-10750 (Cr.)

(Creation of provision of Doubtful Recovery)

b. At the time of writing off the irrecoverable debts of the Corporation against which the provision for Bad & doubtful debt already exists in the books.

(i) Bad debts written off (Expense A/C) - 42000(Dr.)
To Sundry debtors (Cr.)-29800 (Cr)

(Writing off the irrecoverable debts through Profit & Loss A/c)

(ii) Reserve for doubtful debt (Liability A/c)-10750 (Dr.)
To Bad & Doubtful Debt Provision (Expense A/c)-44000(Cr.)

(write back of provision created by the amount of debt to be written off)

Note: In no case the accounting entry for writing off of bad debts is to be passed outside the Profit & Loss A/c. The same is required to be routed through Profit & Loss A/c. only.

c. For writing off the irrecoverable debts of the Corporation against which no provision for Bad & doubtful debt exists in the books.

Bad debts written off Expense's a/c-42000(Dr.)
To Sundry debtors (Cr.)-29800 (Cr)

(Writing off the irrecoverable debts through Profit & Loss A/c)

निगमितकार्यालय :4/1, सीरीइंस्टीट्यूशनलएरिया,अगस्तक्रांतिमार्ग, हौज़खास,नईदिल्ली-110016. CO: 4/1, Siri Institutional Area, August Kranti Marg, HauzKhas, New Delhi-110016. टेलिफोन/Landline:011-40810544, ईमेल-/Email: puri.amit@cewacor.nic.in

3.0 In case, there is only write back off the earlier recognized provision and no provision is created, the write back should be recognized as income in the Profit & loss A/c in Ledger Code 31403 i.e. EXCESS RESERVE FOR BAD & DOUBTFUL DEBTS WRITTEN BACK.

4.0 The Income tax Act also does not provide deduction for the provision made for bad and doubtful debts, but allows the actual bad debts written off during the year under consideration provided the amount of the debt must be taken into account while computing the Income of the previous year in which the amount of such debt or part thereof is written off. Accordingly, for the amount written off, the following details are required to be maintained to enable the corporation to claim deduction as expense for Income Tax purposes of the amount written off as irrecoverable in the books:

(a) Name of customer/depositor
(b) PAN of customer/depositor
(c) Address of customer/ depositor(with PIN Code)
(d) Amount written off

In case PAN is not available, complete name, address and PIN code is required.

Opinion given by the Tax Consultants of the Corporation "M/s Ved Jain & Associates" is also enclosed for reference.

The above mechanism is advised to be followed w.e.f. F.Y. 2021-22.

Encl: As above.

भवदीय,

Digitally signed by Amit Puri
Date: 2021.06.01 14:47:15 +05'30'

(अमित पुरी)
महा प्रबंधक (कर एवं लेखा)

Distribution to:
1. All Regional Managers of CWC.
2. All DGMs/AGMs/Managers/ (Sr.) Asstt. Managers in-charge of the Finance, Accounts & Internal Audit Wings of all ROs.

Copy for information to:
1. All DGM/AGMs/Managers/(Sr.) Asstt. Managers/Accountants in Finance, Accounts & Internal Audit Cadre at CWC, Corporate Office, New Delhi.
2. Consultant to Director (Fin), CWC, CO, New Delhi.
3. PPS to GGM (F&A), CWC, Corp. Office, New Delhi.
4. PPS to GGM (Systems), CWC, CO, New Delhi place this Circular on CWC's Website.

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November 04th, 2020

OPINION

Central Warehousing Corporation

1.0 Central warehousing Corporation (hereinafter referred to as the "querist") has sought our opinion on whether the accounting treatment currently followed by the querist with regard to the provisions for bad debts and bad debts actually written off, during the year is in line with the general accounting practice or not. The facts stated by the querist are as under:

2.0 **Facts:**

"May please note CWC is creating the provision for bad and doubtful debts as and when the same is doubtful of recovery and following accounting entry is passed on creation of provision for Bad Debts :

Ledger name	*Debit*	*Credit*
Bad & Doubtful Debts Provision- P & L (Expense A/c)	*100000*	
Reserves for Bad & Doubtful Debts (Liability A/c)		*100000*

It can be seen from the above entry that as and when any debt is doubtful for recovery, the impact of same is charged as expense in the profit and loss account of the Corporation.

Later on as and when the debt actually becomes irrevocable/ beyond recovery and is to be written off, following accounting entry is passed:

Ledger name	*Debit*	*Credit*
Reserves for Bad & Doubtful Debts (Liability A/c)	*100000*	
Sundry Debtors		*100000*

The above accounting entry is not passed through the profit and loss a/c and both the heads as balance sheet items.

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Corporation has been consistently following this practice and does not route the bad debt again through profit and loss a/c as the same had already hit the P & L A/c at the stage of creation of provision itself.

May like to see the above accounting treatment and suggest if the same is in line with the accounting practices."

3.0 ANALYSIS:

3.1 As per the facts stated, the querist is creating the provision for bad and doubtful debts as and when the same is doubtful of recovery, the impact of same is charged as expense in the profit and loss account of the Corporation and the following accounting entry is passed on creation of provision for Bad Debts :

Bad & Doubtful Debts Provision - P & L (Expense A/c)	100000	
To Reserves for Bad & Doubtful Debts (Liability A/c)		100000

3.2 Thereafter, when the debt actually becomes irrevocable/ beyond recovery and is to be written off, the querist does not route the bad debt again through profit and loss a/c as the same had already hit the P & L A/c at the stage of creation of provision itself and the following accounting entry is passed:

Reserves for Bad & Doubtful Debts (Liability A/c)	100000	
To Sundry Debtors		100000

3.3 Further, it has been stated by the querist that, it has been consistently following this practice and does not route the bad debt again through profit and loss a/c when the debt becomes irrecoverable as the same had already hit the P & L A/c at the stage of creation of provision itself.

3.4 In the above backdrop, the querist has sought our opinion on whether the accounting treatment currently followed by it with regard to the provisions for

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bad debts and bad debts actually written off, during the year is in line with the general accounting practice or not.

Accounting Entry passed at the time of creating Provision for Doubtful Debts

3.5 In this regard, at the very outset it is pertinent to refer to Accounting Standard-1 'Disclosure of Accounting Policies' issued by the Institute of Chartered Accountants of India (ICAI). Para 17 of the said standard prescribes the major considerations regarding the selection and application of accounting policies. The relevant extract of the Standard is reproduced hereunder for the sake of ready reference:

"17. For this purpose, the major considerations governing the selection and application of accounting policies are:—

a. Prudence

In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. ***Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information."***

3.6 The above Para of the Accounting Standard 1 clearly states that one of the major consideration governing the selection and application of accounting policies is prudence, according to which Provision is to be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

3.7 Further, it is also pertinent to refer to Accounting Standard-29 'Provisions, Contingent Liabilities and Contingent Assets' issued by the Institute of Chartered Accountants of India (ICAI). Para 14 of the said standard prescribes that a provisions should be recognized when the mentioned conditions are fulfilled. The relevant extract of the Standard is reproduced hereunder for the sake of ready reference:-

"14. A provision should be recognised when:

(a) an enterprise has a present obligation as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised."

3.8 The above Para of the Accounting Standard 29 clearly states that a provision should be recognized when an enterprises has a present obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If these conditions are fulfilled, provision should be recognised.

3.9 We have not analyzed whether all the conditions prescribed in Para 14 are getting fulfilled or not but assuming that all the conditions prescribed in the present case are getting fulfilled. The querist is creating the provision for bad and doubtful debts as and when the same is doubtful of recovery and consistently following the same practice over the years.

At the time of actually writing off debts

3.10 Now, coming to the second aspect of the entries passed by the querist. The querist has mentioned that when the debt actually becomes irrevocable/ beyond recovery and is to be written off, the same is adjusted with the provision made in the books of accounts without passing it through the Profit and Loss account. The following entry has been passed at the time of writing off the debts:-

Ledger name	*Debit*	*Credit*
Reserves for Bad & Doubtful Debts (Liability A/c)	*Xxxx*	
Sundry Debtors		*Xxxx*

3.11 On the perusal of the aforementioned journal entry, it has been noticed that the querist has written off the debts without routing it through the Profit and Loss Account. It is noted that querist is consistently following the accounting policy to adjust the amount of bad debts with the balance of provision created for bad and doubtful debts.

3.12 In this regard, it is pertinent to refer to Accounting Standard-1 'Disclosure of Accounting Policies' issued by the Institute of Chartered Accountants of India (ICAI). Para 17 of the said standard prescribes the major considerations regarding the selection and application of accounting policies. The relevant extract of the Standard is reproduced hereunder for the sake of ready reference:

"*17. For this purpose, the major considerations governing the selection and application of accounting policies are:—*

c. Materiality Financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions ofthe user ofthe financial statements."

3.13 The above Para of the Accounting Standard 1 clearly states that one of the major consideration governing the selection and application of accounting policies is 'materiality', according to which financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.

3.14 Now we may mention that, by writing off the debts with the amount of provision created for bad and doubtful debts in the balance sheet and not routing it through the profit and loss account, the actual figure of bad debts would not be disclosed in the financial statements. In view of the same, when a decision is to be taken to write off the debts, the querist should route it through the profit and loss account and should not adjust it with the amount of Provision for Bad and Doubtful debts. Also, the querist may write back the provisions created for the bad and doubtful debts.

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3.15 Further, the querist shall review its provision at the end of each reporting period. In this regard, it is of utmost importance to refer to Accounting Standard-29 'Provisions, Contingent Liabilities and Contingent Assets' issued by the Institute of Chartered Accountants of India (ICAI). Para 52 of the said standard prescribes that provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. The relevant extract of the Standard is reproduced hereunder for the sake of ready reference:-

"Changes in Provisions

52. Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed."

3.16 The above Para of the Accounting Standard 29 clearly states provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision should be reversed. It is evident that the querist should review the provisions at each balance sheet dates to reflect the current best estimates. The querist should not directly adjust the amount of bad debts with the amount of provision created for the bad and doubtful debts. The querist needs to review its provision at the end of each reporting date and write back/or create further provision as the case may be.

3.17 In view of the aforesaid discussion, it can be said that the accounting policy followed by the querist seems to be not correct as per the Accounting standards issued by the ICAI. The correct accounting entries should be:-

i. **At the time of creating the provision for bad and doubtful debts**

Ledger name	*Debit*	*Credit*
Bad & Doubtful Debts Provision- P & L (Expense A/c)	*XXXX*	

Reserves for Bad & Doubtful Debts (Liability A/c)		*XXXX*

ii. **<u>At the time of debt actually becomes irrevocable</u>**

Ledger name	*Debit*	*Credit*
P&L (Expenses A/c)	*XXXX*	
Sundry Debtors		*XXXX*

iii. **<u>At the time of review of the provision for bad and doubtful debts (In case additional Provision in required at the Balance sheet date)</u>**

Ledger name	*Debit*	*Credit*
Bad & Doubtful Debts Provision- P & L (Expense A/c)	*XXXX*	
Reserves for Bad & Doubtful Debts (Liability A/c)		*XXXX*

iv. **<u>At the time of review of the provision for bad and doubtful debts (In case Provision already made is required to reverse at the Balance sheet date)</u>**

Ledger name	*Debit*	*Credit*
Reserves for Bad & Doubtful Debts (Liability A/c)	*XXXX*	
Bad & Doubtful Debts Provision- P & L (Expense A/c)		*XXXX*

3.18 In view of the aforesaid discussion, we are of the considered opinion that the accounting policy adopted by the querist needs to be change and a proper disclosure of the same is required to be made in the Financial Statements.

<u>Taxability under the Income Tax Provisions</u>

3.19 It is also relevant to mention that the provisions made for bad and doubtful debts are not allowable expenditure under the Income Tax Act. In this regard, we may refer to explanation 1 to the clause (vii) of section 36(1) of the Income Tax Act,1961 which reads as under:-

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"Explanation 1.—For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee; "

3.20 On the plain reading of above explanation to the section, it becomes clear that Act does not provide the deduction for the provision for bad and doubtful debts made during the year under consideration while computing the total income of the assessee. Thus, the querist needs to add back the provisions for bad and doubtful debts made during the year under consideration while computing the total income as per the provisions of the Income Tax Act.

3.21 In this regard, it will also be relevant to take note of section 36(1)(vii) of Income Tax Act, 1961 which provides the deduction while computing profit and gains of business which reads as under:-

*"(vii) **subject to the provisions of sub-section (2),** the **amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee** for the previous year:"*

3.22 As per the above cited provision, any amount of bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year can be claimed as deduction under the said section while computing the total income for the year under consideration **subject to the provisions of sub section 2 of the section 36 of the Income Tax Act, 1961.**

3.23 In this regard, it is relevant to take note of subsection 2 of section 36 of the Act which is reproduced here as below:-

"(2) In making any deduction for a bad debt or part thereof, the following provisions shall apply—

*(i) **no such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year,** or represents*

money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee;"

3.24 On the conjoint reading of section 36(1)(vii) and section 36(2) of the Act, it can be said that while computing the business profit, an assessee is entitled to claim the deduction of bad debts written off in the books if the following two conditions are being fulfilled:-

- The debt in question must be written off as irrecoverable in the books of accounts for the relevant previous year **and**
- The amount of the debt must be taken into account while computing the income either during the previous year or during the earlier years.

3.25 Thus, it is clear that if the aforementioned two conditions get fulfilled then the querist can claim the expense of actual bad debts written off during the year under consideration.

3.26 It can be said that the Income Tax Act does not provide deduction for provisions made for bad and doubtful debts but allows the actual bad debts written off during the year under consideration. In view of the same, the querist shall add back the provisions for bad and doubtful debts and claim actual bad debts written off during the year under consideration at the time of calculation total income as per the provisions of Income Tax Act.

4.0 OPINION:

Query 1) Whether the accounting treatment currently followed by the it with regard to the provisions for bad debts and bad debts actually written off, during the year is in line with the general accounting practice or not.

Ans. As analyzed hereinabove, we are of the opinion accounting treatment currently followed by the querist with regard to the provisions for bad debts and bad debts actually written off, during the year is not in line with the general accounting practice. As analysed hereinabove, the querist needs to charge actual bad debts written off in the Profit and Loss account instead of adjusting it with the provision for bad and doubtful debts. Further, the querist need to review its provision at the end of each reporting date and write back/or create further provision as the case may be.

5.0 DISCLAIMER:

This is only a personal opinion on facts and on the basis of the facts stated in the query and our interpretation of law as applicable at the relevant time of our opinion. User may take its own decision before acting on this opinion. There is no contractual obligation whatsoever. In no event, shall we be liable for direct or indirect or consequential damages, if any, arising out of or in any way connected with the use of the above opinion or information.

Yours Faithfully,
For **Ved Jain and Associates**
Chartered Accountants

Partner