COMPENDIUM OF OPINIONS

Volume XXXVIII

Expert Advisory Committee
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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(This thirty eighth volume contains opinions finalised between February 12, 2018 and February 11, 2019. The opinions finalised upto September 1981 are contained in Volume I. The opinions finalised thereafter upto February 11, 2018 are contained in Volumes II to XXXVII.)

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Foreword

The principal objective of financial reporting is to report the financial performance and position of any enterprise to provide for the information needs of various stakeholders especially to those who provide various resources to the enterprise such as creditors and investors. To ensure consistency and uniformity, financial reporting should be carried out in accordance with Generally Accepted Accounting Principles (GAAPs) comprising of Accounting Standards, Guidance Notes, etc. The continuous updation in these GAAPs is indispensable to make the accounting more robust. However, while following and implementing these GAAPs, both the preparers and the auditors may face several questions; and only an independent yet authoritative guidance can solve these queries.

The Expert Advisory Committee was established almost four decades ago by the Council of the Institute to examine the accounting/auditing principles related issues faced by our members and to provide pertinent guidance. Since then, the Committee has been regularly providing opinions on complex issues referred to it by the members of the Institute. The Committee has also earned a reputation amongst various Regulatory and Government authorities who rely on the views given by the Committee when they face intricate accounting issues.

To disseminate the comprehensive guidance contained in various opinions, the Volumes of Compendium of Opinions are published regularly by the Committee. These Volumes may be referred to while dealing with an accounting issue for quick and in depth guidance. It gives me enormous joy to acknowledge the efforts put in by CA. Babu Abraham Kallivayalil, Chairman and CA. M.P. Vijay Kumar, Vice-Chairman for steering the Committee and bringing out this Volume.

I am completely optimist about the fact that this Volume is going to be another addition to the wealth of knowledge offered by the Committee in the field of accounting.

New Delhi
February 02, 2021

CA. Atul Kumar Gupta
President

Preface

We are delighted to present another magnificent volume of the Compendium of Opinions, viz., Thirty Eighth Volume. The opinions in this volume were finalised by the Expert Advisory Committee (EAC) during the Council year 2018-19 under the dynamic leadership of CA. Nilesh Vikamsey, Chairman of the EAC who was earlier the President of Institute of Chartered Accountants of India (ICAI). It is a matter of great pride for me to chair the Committee for the current Council Year – 2020-21.

This Volume contains opinions on some of the most sought-after issues and some of the remarkable topics are as follows:

- Accounting treatment of license fees (lease rentals) paid for use of licensed land for the development of new integrated fuel farm facility;
- Accounting for discontinuance of service concession arrangement during first-time adoption of Ind AS;
- Presentation of deferred tax recoverable from beneficiaries (customers) accounted as 'Deferred Asset for Deferred Tax Liability' under Ind AS;
- Accounting for funded interest term loan (FITL) subsequent to restructuring of a loan taken from a shareholder;
- Accounting for Agreement for sale of electricity generated under Ind AS;
- Treatment of 'prepayment penalty' incurred for foreclosure of existing loan and availing new loan/borrowings;
- Accounting treatment for the funds/contribution received from the State Government for acquisition of land and the land so acquired;
- Deferred tax under Indian Accounting Standard (Ind AS) 12, 'Income Taxes' on fair value changes of investments under section 112A of Income-tax Act;
- Issues related to first time adoption (Ind AS 101 and Ind AS 20);
- Accounting for provision to be created for onerous contract;
- Presentation of provision for crossflow claim;
- Accounting treatment of R&D expenditure as capital work-in-progress and treatment of grants-in-aid received as liability.

It may be noted that the opinion or views expressed by the EAC represent the opinion or views of the Expert Advisory Committee and not the official opinion of the Council of the ICAI. The opinions are finalised by the Committee based on the facts and circumstances of the query as supplied by the querist, the relevant laws and statutes, and the applicable accounting/auditing principles prevailing on the date on which a particular opinion is finalised. The date of finalisation of each opinion is specified along with the respective opinion. The opinions must, therefore, be read in the light of any amendments and /or developments in the applicable laws/statutes and accounting/auditing principles subsequent to the date of finalisation of the opinions.

The Committee answers all the queries as per the Advisory Service Rules framed by the Council which are available on the website (https://www.icai.org/post/advisory-service-rules-of-the-expert-advisory-committee) of the Institute and also published in the Compendium of Opinions.

We are glad to inform that all the Opinions contained in volumes I to XXXVII have also been hosted on Digital Learning Hub on the website (https://learning.icai.org/iDH/icai/) of the ICAI for convenient and quick access by the members of the Institute.

We are extremely overwhelmed by the continuous support offered to the Committee by CA. Atul Kumar Gupta, President, ICAI and CA. Nihar N. Jambusaria Vice-President, ICAI. I would like to acknowledge the uncountable efforts put in by CA. M. P. Vijay Kumar Vice-Chairman EAC by generously devoting time and sharing his immense knowledge and wisdom with the members. We would like to acknowledge the unswerving efforts, expertise and involvement of all members and special invitees of the Expert Advisory Committee both past and present in finalization of opinions. I wish to sincerely thank Council Colleagues in the Committee, viz., Ms. Ritika Bhatia (Government Nominee), Shri Chandra Wadhwa (Government Nominee), CA. Tarun Jamnadas Ghia, CA. G. Sekar, CA. Anuj Goyal, CA. Dheeraj Kumar Khandelwal, CA. (Dr.) Debashis Mitra, CA. Prakash Sharma, CA. Prasanna Kumar D., CA. Satish Kumar Gupta, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, CA. Hans Raj Chugh and CA. Dayaniwas Sharma.

We are also thankful to the Co-opted members of the Committee, namely, CA. Nilesh S. Vikamsey (Past President, ICAI), CA. (Dr.) Girish Ahuja, CA. Vivek Newatia, CA. Piyush Agrawal, CA. Venkateswarlu S. and CA. Siddharth Jain; and Special Invitees, namely, CA. Mohit Bhuteria, CA. Navneet Mehta, CA. Venugopal C. Govind and CA. K. Vishwanath for their whole-hearted support and expertise contributed in the opinions of the Committee.

I would also like to acknowledge the consistent efforts and committed support of CA. Parul Gupta - Secretary EAC for formulating and presenting drafts for consideration of the Committee in timely manner, ably assisted by CA. Khushboo Bansal, Sr. Executive Officer and thereafter finalising the same as per the decisions of the Committee.

I am completely optimistic that this volume will be beneficial for the members and other accounting professional colleagues while tackling tricky issues.

New Delhi
February 02, 2021

CA. Babu Abraham Kallivayalil
C*hairman*
Expert Advisory Committee

Contents

PART I:
Opinions on Indian Accounting Standards

Query No. 1

Subject: Netting off of trade receivable and advances received from customers.[1]

A. Facts of the Case

1. A company (hereinafter referred to as the 'company') is a Government of India (GoI) undertaking under the Ministry of Defence. It manufactures a wide range of products, like super alloys, titanium alloys, maraging steel, etc. for strategic sectors like space, defence, nuclear power, etc. The products manufactured are sold in the form of ingots, forged billets, sheets, plates, strips, rods, rings, etc. The company's turnover in the financial year 2016-17 was to the tune of Rs. 809.71 crore.

2. The querist has stated that as the products are niche products, made only against specific orders, the company receives advances from various customers on agreed percentages of sale value of an order for supply of goods and services. While raising the sale invoice on supply of ordered goods or services, advances to the extent of proportionate value of invoice to the total sales value of the order is adjusted. The balance amount of the invoice is included in the trade receivable schedule and the balance amount of advance is included in the advances from customer schedule. Above practice is being followed by the company for the past several years.

3. Under the normal course, on the reporting date, there may be both receivables as well as advances appearing against the same party which is shown under 'Trade Receivables' and 'Other Current/Non-Current advances' in the notes to the balance sheet.

4. Complete party-wise, voucher-wise details against each of the receivable and advances are maintained at subsidiary ledger level. The company is of the view that such advances and receivable for the same customer may be netted-off in the balance sheet either

- At customer level (or)
- At customer's purchase order i.e. at contract level

Above depiction provides better clarity in respect of net balances of trade receivables/advances at customer level or contract level as compared to showing both the receivables and advances separately against the same customer.

5. It is observed by the Government audit during audit of annual accounts for the financial year 2016-17 that trade receivables are financial assets in nature

[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

as they give rise to contractual right to receive cash or another financial asset from another entity. On the other hand outstanding advances received form customer are non-financial liability in nature as the same are to be discharged by supply of goods or services to the customer and does not involve discharge of liability through payment of cash or exchange of other financial asset. While presenting the trade receivables and outstanding advances from the customers in the balance sheet, even if trade receivables are due from the customer whose advances are outstanding after the adjustment of proportionate value of supplies with reference to each specific order, they are to be disclosed separately as these assets and liabilities pertain to different classes of financial and non-financial category.

6. However, the company is of the view that, as per the provisions of Indian Accounting Standard (Ind AS) 32, 'Financial Instruments: Presentation', offsetting is permissible for a financial assets and a financial liability. This is to present the net realisable value of a transaction at the reporting date to give a fair view to the users. Drawing a simile from Ind AS 32 which speaks of off-setting of financial assets and financial liability, it would be appropriate to consider the principles of Ind AS 32, for setting-off the customer's dues and advances at customer levels to reflect the net receivable / net payable of a customer instead of showing them separately in the financial statements.

7. It may be noted that as far as trade receivables are concerned, they are a financial asset. In case of advances from customers, as they are liable to be returned in cash in case of company's failure to supply the contracted material as per contract, the same are also classifiable as financial liabilities.

8. The querist has separately provided the query of the Comptroller and Auditor General (C&AG) auditors and management's reply thereto.

9. The querist has also submitted following example for easy understanding of the issue:

<u>*Customer: XYZ*</u>

Contract No. XYZ-001:
For supply of material Qty. 100 MT @ 1000, value Rs.1,00,000
Payment terms – Advance 30%, thus paid an amount of Rs. 30,000
During the year 40MT Qty supplied to the customer, invoice raised for Rs.40,000 and advance adjusted for Rs.12,000 (40,000 x 30%) at the invoice level

Contract No. XYZ-002:
For supply of material Qty. 200 MT @ 1000, value Rs.2,00,000
Payment terms – Advance 30%, thus paid an amount of Rs.60,000

During the year 90MT Qty supplied to the customer, invoice raised for Rs.90,000 and advance adjusted for Rs.27,000 (90,000 x 30%) at the invoice level

Contract No. XYZ-003:
For supply of material Qty. 50 MT @ 1000, value Rs.50,000
Payment terms – Advance 30%, thus paid an amount of Rs.15,000
As on the reporting date, no supplies made against this order

Customer-XYZ

	Contract: 001	Contract: 002	Contract: 003	Total	
A. Receivables					
Invoice	Rs.40,000	Rs.90,000	Rs.0	Rs.1,30,000	
Less: Advance adjusted	Rs.12,000	Rs.27,000	Rs.0	Rs.39,000	
Balance (A)	Rs.28,000	Rs.63,000	Rs.0	Rs.91,000	A
B. Customer Advances					
Advance Received	Rs.30,000	Rs.60,000	Rs.15,000	Rs.1,05,000	
Less: Adjusted on Supplies	Rs.12,000	Rs.27,000	Rs.0	Rs.39,000	
Balance (B)	Rs.18,000	Rs.33,000	Rs.15,000	Rs.66,000	B
C. Order Level Balance (A - B)					
C1. Trade Receivables	Rs.10,000	Rs.30,000	-	Rs.40,000	C1
C2. Customer Advances			Rs.15,000	Rs.15,000	C2
D. Customer Level Balance (Total A - Total B)				Rs.25,000	D

a) Presentation at Customer Level
   - Trade receivable — Rs.25,000 (Ref. D of above table)
   - Customer Advances — NIL

b) Presentation at Customer Order Level
   - Trade receivable — Rs.40,000 (Ref. C1 of above table)
   - Customer Advances — Rs.15,000 (Ref. C2 of above table)

c) Presenting Receivables and Advances on Proportionate adjustments
   - Trade receivable — Rs.91,000 (Ref. A of above table)
   - Customer Advances — Rs.66,000 (Ref. B of above table)

As per the Accounting Standard, netting-off is permissible when there is a legal right to do so. When the company prepares a customer statement, all dues and advances will be shown in the statement and the net balance, i.e., net due/advance is arrived at (a) above. As such, the company is of the view that disclosing only net trade receivables/ advance (as the case may be) at customer level in the balance sheet is perfectly acceptable.

10. The querist has separately informed that in normal circumstances, advance of one purchase order is not adjusted against dues of another purchase order. In the event of termination of contract, customer may recover outstanding advance from the dues of some other order or they may ask for refund of same. Further, there are incidents where customer has recovered the outstanding advance of short closed/ closed purchase order from the dues of another purchase order (one settlement bill where customer has mentioned the recovery of advance of one short closed purchase order from the dues payable against another purchase order has also been separately supplied by the querist for the perusal of the Committee).

B. Query

11. On the basis of above, the querist has sought the opinion of the Expert Advisory Committee as to whether the company is right in netting-off trade receivable and advances of the same customer at customer level or at customer's purchase order level in presenting the financial statements at the balance sheet date (considering that sub-ledgers of dues and advances are maintained by the company separately at transaction level with full details).

C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to whether the company is right in netting of trade receivable and advances of the same customer, either at customer level or at customer's purchase order level while presenting the financial statements at the balance sheet date. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case.

13. The Committee notes the following paragraphs of Ind AS 32, Financial Instruments: Presentation:

"A *financial asset* is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

…

A *financial liability* is any liability that is:

(a) a contractual obligation :

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is: …"

"42 A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:

(a) currently has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see Ind AS 109, paragraph 3.2.22)."

"46 The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

47 An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 36 of Ind AS 107."

From the above definitions of 'financial asset' and 'financial liability', the Committee notes that a financial asset is any asset that is a contractual right to receive cash or another financial asset from another entity and financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another entity. Further, it is also noted from paragraph 42, 46 and 47 reproduced above that an entity can offset a financial asset and financial liability in the balance sheet when it currently has a legally enforceable right to set off and it intends to either set off on net basis or to realise the asset and settle the liability simultaneously. Legal right of set-off in the event of bankruptcy or cancellation of contracts by parties, etc. are not currently enforceable right of set-off but are contingent rights also. The existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. Further, an intention by one or both parties to settle on a net basis without the legal right to do so is also not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered. Paragraph 47 also states that entity's intention to settle particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously.

15. The Committee notes that in the extant case, trade receivable is a financial asset as it represents a contractual right to receive cash. With regard to advance received, the Committee notes that in normal circumstances, there is no contractual obligation to pay cash/financial asset but the obligation is for providing goods and services and therefore, cannot be classified as financial liability. Accordingly, in such circumstances, the question of set-off of financial asset and financial liability does not arise. However, where the contract specifically provides for the refund of the advance resulting in contractual obligation to pay cash or another financial asset in respect of advance received then the same will be considered as financial liability. In such case, the set-off is possible if the requirements of paragraphs 42, 46 and 47 are fulfilled. In this regard, the Committee notes from the Facts of the Case that in normal circumstances, advance received and which is pending for adjustment from future invoices/billings on the customer cannot be set-off against the outstanding trade receivables either at contract/purchase order level or at customer level (two contracts with same customer). Therefore, in the extant case, such a set-off cannot be made.

D. Opinion

16. On the basis of above, the Committee is of the opinion that the company is not right in offsetting trade receivables and entire advances received either at customer level or at contract/ purchase order level in normal circumstances while presenting the financial statements at the balance sheet date; set-off is possible only if the requirements of paragraphs 42, 46 and 47 of Ind AS 109 are fulfilled, as discussed in paragraphs 14 and 15 above.

Query No. 2

Subject: Disclosure of impairment loss on long-term investments as exceptional item.[1]

A. Facts of the Case

1. A company was incorporated on 16th August 1984 for procuring, transmission, processing and marketing of natural gas. The company has an

[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

authorised share capital of Rs. 2,000 crore, out of which Rs. 1,691.30 crore is paid-up share capital. The Government of India holds 54% equity of the company at present. The securities of the company are listed on National Stock Exchange, Bombay Stock Exchange and London Stock Exchange. At present, the company owns over 11,000 Kms of pipeline and currently transmits about 206 MMSCM per day of natural gas. The company operates six LPG manufacturing plants in different parts of the country with an installed capacity of 1.04 Million MT of LPG per annum. The company has an integrated petrochemical plant at Pata, Uttar Pradesh for manufacturing polymers. The company has world's longest pipeline from Jamnagar to Loni for transmission of LPG. The company has integrated its business activities and operates the City Gas Distribution, Exploration of Natural Gas, Wind Power & Solar Power Plant and Telecom Businesses.

2. The company has prepared its accounts as per Indian Accounting Standards (Ind ASs) w.e.f. 1st April 2016. In compliance with the Companies (Indian Accounting Standards) Rules, 2015, the company has prepared its financial statements for F.Y. 2016-17 with comparative figures for F.Y. 2015-16. The company has adjusted the impact of transition from Indian Generally Accepted Accounting Principles to Ind ASs in the opening reserve as on 1st April 2015 and in the statement of profit and loss for F.Y. 2015-16. Further, the holding company, subsidiaries, joint ventures, or associate companies of the company have also made transition to Ind ASs w.e.f. 1st April 2016.

3. As per the provisions of Indian Accounting Standard (Ind AS) 36, 'Impairment of Assets', the company is conducting impairment test for investments in subsidiaries, associates and joint ventures that are accounted for at cost in the standalone financial statements. In line with the provisions of Ind AS 36, an impairment test is conducted, when internal and external indicators of potential impairment exist.

4. The company has an equity investment amounting to Rs. 974.31 crore, in a joint venture company, 'R', which is equivalent to 25.51% of the paid up equity capital of 'R' as on 31st March 2017. 'R' is in the process of restructuring its business by way of de-merger of its LNG business into a separate company effective from 1st January 2016. New company, viz., 'K' has been incorporated in 2015-16. The scheme of demerger w.e.f. 01.01.2016 has been approved by the Board of 'R', all the shareholders including the company and 'N', as well as by the majority of lenders and has been filed with National Company Law Tribunal for approval. 'R', along with its promoters, viz., the company and 'N', has carried out an assessment of impairment of 'R' as on 31st March 2017, considering the accumulated losses and restructuring of the business.

5. The impairment study of 'R' has been conducted on the basis of value in use, arrived at through the sum of present value of expected future cash flows of 'R' (both Power and LNG Block). Impairment study has been conducted over the economic life of assets. Based upon the impairment study, the company has provided Rs. 783 crore in the books of account towards impairment loss in respect of carrying amount of equity investment in 'R' for the FY 2016-17.

6. The company also has an equity investment amounting to Rs. 8.10 crore in an associate company, 'F', an Egyptian company, which is equivalent to 19% of the paid up equity capital of 'F' as on 31st March 2017. In November 2016, Egyptian Government devalued the Egyptian Pound (EGP) which resulted in erosion of about 50% value of EGP vis-à-vis US Dollar. Considering the same, the company has carried out an assessment of impairment of its investment in 'F' as on 31st March 2017 and made provision of Rs. 5.04 crore in the books of account towards impairment loss in respect of the carrying amount of the investment in 'F' for the FY 2016-17.

7. The company has disclosed impairment loss on long-term investments as "Exceptional Item" on the face of the statement of profit and loss, considering the transaction as exceptional in nature as it is

a) not the ordinary business activity;
b) not being an item occurring on regular basis in due course of business; and
c) not temporary in nature

Further, it has also materially affected or substantially reduced the profit of the company.

8. Although the term "Exceptional Item" has not been defined in Ind ASs, however, paragraph 97 of Ind AS 1, 'Presentation of Financial Statements', requires that when items of income or expense are material, an entity shall disclose their nature and amount separately, either in the statement of profit and loss or in the Notes to Accounts.

9. Considering the above aspects and transaction not being the ordinary business activity and also not temporary in nature, the company has disclosed impairment loss on equity investment of long-term nature as "Exceptional Item" on the face of the statement of profit and loss for FY 2016-17.

10. The Comptroller & Auditor General of India ('C&AG') has conducted supplementary audit on the accounts of the company for FY 2016-17 under section 143(6) of the Companies Act, 2013. The C&AG, while conducting supplementary audit under section 143(6) of the Companies Act for the financial year 2016-17, has made observation on disclosure of impairment loss on long-term equity investments as an "Exceptional Item" on the face of statement of profit and loss. The C&AG was of the opinion that the impairment loss should be

treated as an ordinary item and should not be considered as an "Exceptional Item" and disclosed as such.

11. It was submitted to the C&AG that the Institute of Chartered Accountants of India has issued Educational Material on Ind AS 1 and in response to Question No. 32 on treatment of "Exceptional Item", the educational material states that as per Ind AS 1, materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. Considering the same and transaction not being the ordinary business activity, and also not temporary in nature, the Company has disclosed impairment loss on long-term investment as an "Exceptional Item" on the face of statement of profit and loss.

12. The C&AG, however, has not accepted company's/joint statutory auditors' replies. According to the C&AG, Accounting Standards categorically state that only the actual losses, which are permanent in nature and relate to ordinary activities, can be classified as "Exceptional Item", whereas the provision for impairment losses can be reversed in future as and when the financial condition of the entity is improved.

13. The provisional comment of the C&AG and the reply submitted by the company are as follows:

Provisional Comment	Reply
<u>Exceptional Items:</u> **<u>Impairment of investment: Rs.788.04 crore</u>**	
The above includes Rs.788.04 crore on account of provision for impairment loss against the equity investments in 'R' and 'F', Egypt. In this regard, it was observed that para 14 of AS-5 states that "Exceptional items are defined as those items which relate to entity's ordinary activities or permanent in nature like (i) abnormal losses on long term contract, (ii) litigation settlement, (iii) write off of expenditure capitalised on intangible assets other than	It is submitted that 'Exceptional items' have not been defined in Ind AS. However, paragraph 97 of Ind AS 1 requires that when items of income or expense are material, an entity shall disclose their nature and amount separately. Institute of Chartered Accountant of India has also issued Educational Material on Ind AS 1 on Presentation of Financial Statements. In response to Question No 32 on treatment of exceptional items, the educational material states that as per Ind AS 1, materiality depends on the size and

amortisation and (iv) disposal of long-term investment. However, the above said impairment loss, as provided by the company, neither relates to its ordinary activities nor is permanent in nature; hence, does not qualify as an exceptional item. Management/Joint Statutory Auditors replied that impairment is an incident which is rarer than disposal, hence is surely in nature of exceptional item. Management's/Joint Statutory Auditors' replies are not acceptable as AS categorically stated that only the actual losses, which are permanent in nature and relate to its ordinary activities, can be classified as exceptional items whereas the provision for impairment losses can be reversed in future as and when the financial condition of the entity will be improved. Thus, it has resulted into overstatement of exceptional items (impairment loss) and profit before exceptional items and understatement of expenses (Depreciation and amortisation expenses) by Rs.788.04 crore each.	nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. As per paragraph 12 of existing Accounting Standard (AS) 5, Net profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies, when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. As referred in AS-5 and pointed by the audit, profit / loss on disposal of Investment should be shown as exceptional item. In this regard, it is submitted that impairment is an incident which is rarer than disposal, hence is surely in nature of exceptional item. Generally, items of income or expense fulfilling the above mentioned criteria are classified as exceptional items and are disclosed separately. Thus, exceptional items are those items which meet the test of 'materiality' (size and nature) and the test of 'incidence'. The provision for impairment loss on equity investment disclosed as exceptional item includes provision against 'R' (Rs. 783 crore) and 'F' (Rs. 5.04 crore). It is further submitted that the Company has an equity investment amounting to Rs. 974.31 crore, in a joint venture company, 'R', which is equivalent to 25.51% of the paid up equity capital of 'R' as on 31st March 2017. 'R' is in the process of

	restructuring its business by way of de-merger of its LNG business into a separate company effective from 1st January 2016. New company namely 'K' has been incorporated in 2015-16. The scheme of demerger has been approved by the Board of 'R', all the shareholders including the company and 'N', as well as by the majority of lenders and has been filed with NCLT for approval. 'R', the company and 'N' (co-promoter) have carried out an assessment of impairment of 'R' as on 31st March 2017, considering the restructuring of the business. The impairment study of 'R' has been conducted on the basis of value in use, arrived through sum of present value of future cash flows of 'R' (Power Block) for 22 years and LNG block for 20 Years. Impairment study has been conducted over the economic life of assets. Based upon the impairment study, the company has provided Rs. 783 crore in the books of account towards impairment loss on carrying value of investment in 'R' for the financial year 2016-17. Hence, the transaction is of exceptional nature not being an item occurring on regular in due course of business and substantially reduced the profit. The impairment study has been done covering substantial periods and it's not likely that the company will reverse the impairment losses in near future. Considering the same and transaction not being the ordinary business activity, and also not temporary in nature, it has been disclosed as Exceptional Item. Further, the Company has an equity investment amounting to Rs. 8.10 crore, in an Associate company, 'F', Egypt, which is

	equivalent to 19% of the paid up equity capital of 'F' as on 31st March 2017. In November 2016, Egyptian Government devalued the Egyptian currency which resulted in erosion of about 50% value of EGP vis-à-vis US Dollar. Considering the same, the company has carried out an assessment of impairment of its investment in 'F' as on 31st March 2017 and made provision of Rs. 5.04 crore in the books of account towards impairment loss on carrying value of investment in 'F' for the financial year 2016-17. The provision for impairment loss against investment in 'F' has been made due to devaluation of the Egyptian currency by Egypt Government and permanent in nature. Since, it is not the ordinary business activity and also permanent in nature, it has been disclosed as Exceptional Item. Without prejudice, it is also submitted that in the similar case, another Public Sector Undertaking ('N') has also disclosed the provision for loss on impairment as Exceptional item in financial statement. Thus, there is no overstatement of exceptional items (impairment loss) and profit before exceptional items and understatement of expenses (Depreciation and amortisation expenses) by Rs. 788.04 crore each. Considering above, Provisional Comment may please not be pursued further.

14. It may be mentioned that there is no specific guidance available on the matter in Ind AS 1 towards disclosure of "Exceptional Item", particularly of the nature described in general and herein above.

B. Query

15. In view of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) Whether the disclosure of Rs.788.04 crore towards impairment loss of long-term equity investments as an "Exceptional Item" on the face of the statement of profit and loss for FY 2016-17 by the company for the reasons mentioned in paragraphs 7-9 above is correct as per Ind AS 1.

(ii) In case the answer to (i) above is not in the affirmative, what should be the form and manner of disclosure for impairment loss of long-term equity investments in the financial statements of such nature and materiality.

C. Points considered by the Committee

16. The Committee notes that the basic issue raised by the querist relates to disclosure of impairment loss on long-term equity investments in the joint venture company 'R' and the associate company 'F' as exceptional item on the face of the statement of profit and loss for the financial year 2016-17 in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as 'the Rules'). The Committee has, therefore, considered only this issue in the light of the Rules and has not examined any other issue that may be contained in the Facts of the Case, such as treatment under Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, adjustments on transition to Ind ASs, etc.

17. The Committee notes that Part II of Division II of Schedule III to the Companies Act, 2013 (hereinafter referred to as the 'Ind AS Schedule III'), which prescribes the format of statement of profit and loss applicable for companies adopting Ind ASs, requires presentation of 'Exceptional Items' as a separate line item in the statement of profit and loss. Further, Note 7 of the 'General Instructions for Preparation of Statement of Profit and Loss' applicable for companies adopting Ind ASs requires that a company should disclose by way of notes, additional information regarding aggregate expenditure and income on some items. One of the items to be disclosed in this regard is 'details of items of exceptional nature'. However, the term 'exceptional item' is not defined in 'Ind AS Schedule III'. Further, the term 'exceptional item' is neither defined nor used in Ind ASs.

18. Before proceeding to address the issue raised by the querist, the Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements', notified under the Rules:

''31 Some Ind ASs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an Ind AS if the information resulting from that disclosure is not material except when required by law. This is the case even if the Ind AS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

"82 In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:

…

(ba) impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of Ind AS 109;

…"

"85 An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance."

"86 Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement of profit and loss, and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense. For example, a financial institution may amend the descriptions to provide information that is relevant to the operations of a financial institution. An entity does not offset income and expense items unless the criteria in paragraph 32 are met."

"97 When items of income or expense are material, an entity shall disclose their nature and amount separately.

98 Circumstances that would give rise to the separate disclosure of items of income and expense include:

(a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;

(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

(c) …

…"

Further, the Committee notes that the term 'material' is defined in paragraph 7 of Ind AS 1 as below:

> ***"Material*** **Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor."**

Further, the Committee notes that while paragraphs 97 and 98 are placed under the caption 'Information to be presented in the statement of profit and loss or in the notes' 'Ind AS Schedule III' requires presentation of 'exceptional items' as a separate line item in the statement of profit and loss with disclosure of individual items in the notes.

19. From the above, the Committee notes that subject to legal requirements, only material items need be presented as line items and/or disclosed in financial statements and this principle is applicable even for

items mentioned in paragraph 82 of Ind AS 1 (as evident from paragraph 31 of Ind AS 1). The Committee notes that the querist has drawn attention to the Educational Material on Ind AS 1 issued by the Institute of Chartered Accountants of India on the meaning of 'Exceptional items' as per which it appears that all material items are not exceptional items and exceptional items are those items which meet the test of 'materiality' and 'incidence'. Definition of the term 'Material' as per paragraph 7 of Ind AS 1 is reproduced in paragraph 18 above. The Committee is of the view that 'incidence' refers to frequency of occurrence. Further, the Committee notes that 'Guidance Note on Division II-Ind AS-Schedule III to the Companies Act, 2013' (hereinafter referred to as 'the Guidance Note') issued by the Institute of Chartered Accountants of India deals with 'exceptional items'. While noting the absence of definition of the term 'exceptional items' in Ind ASs as well as 'Ind AS Schedule III', paragraph 9.6 of the Guidance Note states that Ind AS 1 has reference to such items in paragraphs 85, 86, 97 and 98 of that Standard.

20. Now the Committee addresses the issue of presentation/ disclosure of impairment loss on the long-term equity investments. In the extant case, the investments in the joint venture and associate are accounted for at cost in the standalone financial statements of the company, which is permitted by paragraph 10 of Ind AS 27, 'Separate Financial Statements', notified under the Rules. Hence, these investments are outside the scope of Ind AS 109, 'Financial Instruments', notified under the Rules. Consequently, the impairment of such investments is covered by Ind AS 36, 'Impairment of Assets', notified under the Rules, since, paragraph 2 of Ind AS 36 scopes out financial assets, only if they are within the scope of Ind AS 109. The Committee notes that Ind AS 36 does not deal with presentation of impairment loss in the statement of profit and loss. The Committee notes that paragraph 126 of Ind AS 36 states as follows:

> **"126 An entity shall disclose the following for each class of assets:**
>
> **(a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are included.**
>
> **..."**

Therefore, Ind AS 36 merely requires, inter alia, disclosure of the line item(s) of the statement of profit and loss in which the impairment losses are included. The

Committee notes that while paragraph 82 of Ind AS 1 requires, inter alia, presentation of impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of Ind AS 109 as a line item, it does not specify a similar requirement for presentation of impairment losses determined in accordance with Ind AS 36. Further, the Committee notes that 'Ind AS Schedule III' does not specify impairment loss either as a separate line item in the statement of profit and loss or as part of any other line item. Hence, it is clear that only if the impairment loss on long-term investments is material, it is required to be disclosed separately as per paragraph 97 of Ind AS 1 (either on the face of the statement of profit and loss or in the notes) or is required to be presented as a separate line item in the statement of profit and loss in accordance with paragraph 85 of Ind AS 1. The Committee notes that item (a) cited in paragraph 98 of Ind AS 1 (reproduced in paragraph 18 above) represents impairment of inventories and property, plant and equipment and also reversals of such write-downs. These items are examples only. The Committee is of the view that impairment of long-term investments should also be disclosed, if material, as required by paragraph 98 of Ind AS 1. The issue whether such impairment loss can be presented as exceptional item is discussed in paragraph 21 below.

21. As stated in paragraph 19 above, an issue arises as to whether material items without any additional criteria can also be described as exceptional items. The Committee is of the view that this issue need not be examined, since, the querist's argument is that impairment loss in the extant case is *both* material and expected not to occur regularly. As stated by the querist in paragraph 7 above, in the extant case, the impairment loss has materially affected or substantially reduced the profit of the company. Assuming the correctness of these features, both the materiality and incidence tests are met. Consequently, based on the discussion so far made, the Committee is of the view that in the extant case impairment loss on the long-term equity investments can be presented as 'exceptional item' or part of exceptional items, if there is any other exceptional item, on the face of the statement of profit and loss, with disclosure of individual items in the notes to accounts in the latter case. The Committee also viewed that the disclosures as required by paragraph 126 of Ind AS 36, Impairment of Assets should be given.

22. The Committee does not agree with the views that the impairment loss is not related to ordinary activities. Further, an exceptional item can be an estimated amount (gain or loss) also and it need not be permanent. Mere possibility that the provision for impairment losses can be reversed in future as and when the financial condition of the entity will improve does not prevent it from its classification as an exceptional item. This is evident from the example of reversal of write-downs given in the Educational Material on Ind AS 1 and the

Guidance, which is also found in paragraph 98 of Ind AS 1, reproduced in paragraph 18 above.

D. Opinion

23. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 15 above:

(i) The disclosure of impairment loss of long-term equity investments as an "Exceptional Item" on the face of the statement of profit and loss for F.Y. 2016-17 by the company in this case, appears to be appropriate, assuming that the querist's claim on materiality and incidence aspects and quantification of impairment loss are correct and if the disclosures as required by Ind AS 36, Impairment of Assets are appropriately given.

(ii) See (i) above.

Query No. 3

Subject: Disclosure in standalone financial statements of contingent liability in respect of Corporate Guarantee (Deed of Guarantee) issued by the parent company to the bank for furnishing Performance Bank Guarantee on behalf of wholly owned subsidiary company towards its performance obligation.[1]

A. Facts of the Case

1. A company was incorporated on 16th August 1984 for procuring, transmission, processing and marketing of natural gas. The company has an authorised share capital of Rs. 2,000 crore, out of which Rs. 1,691.30 crore is paid-up share capital. The Government of India holds 54.43% equity of the company at present. The securities of the company are listed on National Stock Exchange, Bombay Stock Exchange and London Stock Exchange.

2. At present, the company owns over 11,000 Kms of pipeline and currently transmits about 206 MMSCM per day of natural gas. The company operates six LPG manufacturing plants in different parts of the country with an installed capacity of 1.30 Million MT of LPG per annum. The company has an integrated petrochemical plant at Pata, Uttar Pradesh for manufacturing polymers. The company has world's longest pipeline from Jamnagar to Loni for transmission of LPG. The company has integrated its business activities and operates the City

[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

Gas Distribution (CGD), Exploration of Natural Gas, Wind Power & Solar Power Plant and Telecom Businesses. The company has formed subsidiaries/associates/ joint ventures companies for CGD, Petrochemicals, LNG, Gas Trading, Power Generation and Shale Gas.

3. The company has prepared its accounts as per Indian Accounting Standards (Ind ASs) w.e.f. 1st April 2016. In compliance with the Companies (Indian Accounting Standards) Rules, 2015, the company has prepared its financial statements for F.Y. 2016-17 with comparative figures for F.Y. 2015-16. The company has adjusted the impact of transition from Indian Generally Accepted Accounting Principles to Ind ASs in the opening reserve as on 1st April 2015 and in the statement of profit and loss for F.Y. 2015-16. Further, the holding company, subsidiaries, joint ventures, or associate companies of the company also need to make transition to Ind ASs w.e.f. 1st April 2016.

4. The company has a wholly owned subsidiary company 'GG' which was incorporated in the year 2008 for the smooth implementation of CGD projects. 'GG' has been authorised by the Petroleum and Natural Gas Regulatory Board ('PNGRB') for implementing CGD Projects in Dewas (Madhya Pradesh), Kota (Rajasthan), Sonipat (Haryana), Meerut (Uttar Pradesh), Taj Trapezium Zone (Uttar Pradesh) and Bengaluru (Karnataka).

5. 'GG' was authorised in February 2015 (F.Y. 2014-15) through a bidding process to set up CGD business in Bengaluru Rural and Urban Districts (Karnataka) by PNGRB as per the 'Petroleum and Natural Gas Regulatory Board (Authorizing Entities to Lay, Build, Operate or Expand City or Local Natural Gas Distribution Networks) Regulations, 2008' ('the Regulations'). The said authorisation entails submission of Performance Bank Guarantee ('PBG') of Rs. 5,199.99 crore to PNGRB for timely commissioning of the project as per the prescribed target in the bid and for meeting the service obligations during the operating phase of the project. 'GG' contacted State Bank of India ('SBI') for issue of PBG of Rs. 5,199.99 crore. SBI agreed to issue PBG to 'GG' on the basis of guarantee of the company.

6. 'GG' issued a counter guarantee of Rs. 5,199.99 crore in favour of the company for the purpose of giving Corporate Guarantee (Deed of Guarantee), in favour of SBI for issuance of PBG. Accordingly, the company (as Guarantor) signed Corporate Guarantee (Deed of Guarantee) in favour of SBI (as lender) to make available the PBG facility for an aggregate principal amount of Rs. 5,199.99 crore up to a period of five years to 'GG' (Borrower) on 16th February 2015. 'GG' submitted the PBG to the PNGRB (Beneficiary) as a guarantee for timely commissioning of CGD project in Bengaluru as per the Minimum Work Programme (MWP) prescribed by the PNGRB. (Copies of counter guarantee,

Corporate Guarantee (Deed of Guarantee) and PBG have been furnished by the querist for the perusal of the Committee).

7. As per the Regulations, an authorised entity shall abide by all the terms and conditions specified in these regulations and any failure in doing so, except *force majeure*, shall be dealt with as per the following procedure, namely:

(a) the Board shall issue a notice to the defaulting entity allowing it a reasonable time to fulfil its obligations under the Regulations;

(b) no further action shall be taken in case remedial action is taken by the entity within the specified period to the satisfaction of the Board;

(c) in case of failure to take remedial action, the Board may encash the performance bond of the entity equal to percentage shortfall in meeting targets of inch-kms and/or domestic connections. Provided that, the value so encashed would be refunded, if the entity achieves the cumulative targets at the end of exclusivity period for exemption from the purview of common carrier or contract carrier. In case of failure to abide by other terms and conditions specified in these Regulations, performance bond shall be encashed as under:

(i) 25% of the amount of the performance bond for the first default; and

(ii) 50% of the amount of the performance bond for the second default:

Provided that the entity shall make good the encashed performance bond in each of the above cases within two weeks of encashment failing which the remaining amount of the performance bond shall also be encashed and authorisation of the entity terminated.

(iii) 100% of the amount of performance bond for the third default and simultaneous termination of authorisation of the entity.

(Relevant extract of the Regulations with reference to encashment of PBG in case of failure to meet the performance target has been furnished by the querist for the perusal of the Committee). It may be noted that there is no specific clause for PBG encashment in case of failure in a particular year. The performance obligation is to be completed by the 5th year.

8. The MWP as per the bid has to be completed during a period of five years commencing from February 2015. During the last two years i.e., up to 17th February 2017, 'GG' has timely completed the yearly MWP's target of the PNGRB. The actual work executed by 'GG' during last two years is given below.

(a) Pipeline to be laid

Description	**Year I [18.02.2015 to 17.02.2016]**	**Year II [18.02.2016 to 17.02.2017]**
MWP (in Inch-KM)	316	475
Actual Work Done (in Inch-KM)	347	1,011

(b) PNG Domestic Connections

Description	**Year I [18.02.2015 to 17.02.2016]**	**Year II [18.02.2016 to 17.02.2017]**
MWP (in Numbers)	----	19,673
Actual Work Done (in Numbers)	1,308	23,568

9. As per the querist, during the FY 2016-17, no liability either actual or contingent, has arisen on account of non-fulfilment of MWP by the subsidiary company ('GG'). Accordingly, the company has not included the amount of Corporate Guarantee (Deed of Guarantee) given to SBI on behalf of 'GG' for its business performance, as part of contingent liabilities in the Notes to standalone financial statements. Considering the above, the Company has also not disclosed Corporate Guarantee (Deed of Guarantee) issued to SBI for issue of PBG on behalf of 'GG' for its business performance, as a separate note in the Notes to standalone financial statements. The company has followed this practice on consistent basis as was done in previous financial years. Further, the Comptroller and Auditor General of India ('C&AG') had not given any observations on non-disclosure of Corporate Guarantees (Deed of Guarantee) in the audited financial statements for F.Y. 2014-15 and F.Y. 2015-16.

10. The C&AG has conducted supplementary audit on the accounts of the company for F.Y. 2016-17 under section 143(6) of the Companies Act, 2013. The

C&AG, while conducting the supplementary audit, has made observation on non-inclusion of Corporate Guarantee (Deed of Guarantee) given by the company to SBI on behalf of 'GG' under the head 'Contingent Liabilities and Commitments'' in its standalone financial statements.

11. The company replied to audit query and submitted that as on 31st March 2017, there is no liability, either actual or contingent, towards non-performance of MWP under Regulations, in the books of the subsidiary company ('GG'). Further, as per the querist, the said position is dealt with in more detail in an earlier Guidance Note on 'Guarantees & Counter-Guarantees Given by Companies (Revised 1976)'[2] issued by the Institute of Chartered Accountants of India, which states that the mere possibility or chance of such an event taking place in the future would not involve any question of contingent liability on the balance sheet date.

There is no reason to believe that 'GG' will commit a default or that it will fail or has failed to comply with its obligations. In any case, this is a matter which is in the control of 'GG' itself and the mere chance of a commission of a default by 'GG' in the future cannot be said to involve the existence of a contingent liability as on the balance sheet date.

Considering that no liability, either actual or contingent, has arisen on account of non-fulfilment of MWP by 'GG', the company has not included the amount of Corporate Guarantee (Deed of Guarantee) under the head "Contingent Liabilities and Commitments". The company is also of opinion that inclusion/ disclosure of Corporate Guarantee (Deed of Guarantee) in its Notes to standalone financial statements will depict misleading information towards liabilities of the company to the investors and may affect the credit rating of the company.

12. However, the C&AG has not accepted the views of company/joint statutory auditors considering that as per paragraph 8.8.7.2 of the erstwhile 'Guidance Note on the Revised Schedule VI to the Companies Act,1956', issued by the Institute of Chartered Accountants of India, "A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to *guarantee the loan given to a subsidiary* or to another company *or gives a guarantee that another company will perform its contractual obligations"*.

(Emphasis supplied by querist.)

13. The provisional comment of the C&AG and the reply submitted by the company are as follows:

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[2] The Guidance Note on Guarantees & Counter-Guarantees Given by Companies (Revised 1976) has been withdrawn from April 1, 2009 as AS 30 became mandatory.

Provisional Comment	Reply
Contingent Liabilities and commitments	
The above does not include Rs. 5,199.99 crore being the value of Guarantee Deed as signed (Feb. 2015) by the company in favour of State Bank of India (as lender) to make available the bank guarantee for the similar value for a period of five years to its wholly owned subsidiary viz. 'GG' towards submission of the same to PNGRB against the Bengaluru CGD MWP commitment. Management / Joint Statutory Auditors accepted the above said fact and also stated that as on 31st March 2017, there is no liability - either actual or contingent, in the books of 'GG' towards non-performance of minimum work plan under PNGRB. Management's/Joint Statutory Auditors' replies are not acceptable as Guidance Note on Revised Schedule VI (Para 8.8.7.2) explicitly states that "*A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to* ***guarantee the loan given to a subsidiary*** *or to another company* ***or gives a guarantee that another company will perform its contractual obligations***".	It is submitted that 'GG', wholly owned subsidiary of the company, undertook the authorisation for City Gas Distribution business in Bengaluru Geographical Area. The said authorisation requires submission of Performance Bank Guarantee of Rs. 5,199.99 crore to Petroleum and Natural Gas Regulatory Board (PNGRB), backed by Counter Guarantee of the company. The company (as Guarantor) signed deed of guarantee in favour of State Bank of India (as lender) to make available a Bank Guarantee facility for an aggregate principal amount of Rs.5,199.99 crore up to a period of five years to 'GG' on 16th February 2015. Further, 'GG' submitted Performance Bank Guarantee to PNGRB as a guarantee for timely commissioning of city gas distribution project in Bengaluru as per the minimum work plan prescribed by PNGRB. It is submitted that 'GG' has submitted Performance Bank Guarantee and as on 31st March 2017, there is no liability - either actual or contingent, in the books of 'GG' towards non-performance of minimum work plan under PNGRB. The above position is dealt in more detail in an earlier Guidance Note on 'Guarantees & Counter-Guarantees Given by Companies' issued by the Institute of Chartered Accountants of India, which states that the mere possibility or chance of such an event taking place in the future would not involve any question of contingent liability on the balance sheet date. There is no reason to believe that

Hence, the Company is contingently liable in case of non-timely commissioning of the CGD Project at Bengaluru by its wholly owned subsidiary and the guarantee deed signed by the Company also falls under the purview of contingent liability and needs disclosure. Thus, contingent liabilities are understated by Rs. 5,199.99 crore and Note No.29 (I) (b) – "Corporate Guarantee" is also deficient to that extent. (Emphasis supplied by querist.)	'GG' will commit a default or that it will fail to comply with its obligations. In any case, this is a matter which is in the control of the Company itself and the commission of a default by the Company in the future cannot be said to involve the existence of a contingent liability. It is pertinent to mention that 'GG' has decent track record for completion of projects and there is no default in performance of minimum work plan for timely commissioning of city gas distribution project in Bengaluru prescribed by PNGRB. In view of above, no disclosure is made – either of the possible future liability or of the guarantee which has been given in order to cover such possible future liability. Thus, contingent liabilities are not understated by Rs. 5,199.99 crore. Considering above, Provisional Comment may please not be pursued further.

14. It is further mentioned that there is no specific Guidance Note issued by the Institute of Chartered Accountants of India/Ministry of Corporate Affairs towards inclusion and disclosure of Corporate Guarantees (Deed of Guarantee) furnished by the company on behalf of its subsidiary company ('GG') for its business performance on which no liability, either actual or contingent, has arisen on account of non-fulfilment of MWP. As per the querist, Ind AS 37, 'Provision, Contingent Liabilities and Contingent Assets', also does not provide any specific guidance on the subject.

B. Query

15. In view of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) In the absence of any default by the subsidiary company ('GG') and any claim or action by the PNGRB (Beneficiary) for payment of part or full of the PBG amount, whether the company has to disclose Corporate Guarantee (Deed of

Guarantee) issued to SBI for issue of PBG on behalf of its subsidiary company for its performance, as a separate note in the Notes to standalone financial statements of the company.

(ii) In the absence of any default by the subsidiary company ('GG') and any claim or action by the PNGRB (Beneficiary) for payment of part or full of the PBG amount, whether the company has to include the amount of Corporate Guarantee (Deed of Guarantee) issued to SBI for issue of PBG on behalf of its subsidiary company for its performance, in the amount mentioned under the head "Contingent Liabilities and Commitments" in its standalone financial statements of the company.

(iii) In case the answers to (i) and (ii) above are not in the affirmative, whether any other disclosure and/or inclusion of amount of Corporate Guarantee (Deed of Guarantee) issued to SBI is required in the Notes to standalone financial statements of the company and if so, what is the manner and form of such disclosure, etc.

C. Points considered by the Committee

16. The Committee notes that the basic issue raised by the querist relates to disclosure, in the standalone financial statements of the company, of contingent liability in respect of the corporate guarantee given to State Bank of India (hereinafter referred to as 'the bank') in the context of Indian Accounting Standards ('Ind ASs') notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as 'the Rules'). The Committee has, therefore, considered only this issue in the light of the Rules and has not examined any other issue that may be contained in the Facts of the Case, such as treatment under Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, adjustments on transition to Ind ASs, treatment in the consolidated financial statements of the company, treatment of counter guarantee received, initial measurement of the corporate guarantee etc. The Committee notes from paragraph 5 above that performance obligations of the subsidiary cover not only timely commissioning of the CGD project but also service obligations during the operating phase, which is also evident from the copy of the Performance Bank Guarantee ('PBG') furnished by the querist for the perusal of the Committee. However, at other relevant places, in particular in paragraphs 6 and 13 above, there is no reference to service obligations during the operating phase. This apparent inconsistency, however, does not affect the opinion of the Committee.

17. Before examining the issue raised by the querist, the Committee wishes to point out that not all the contingent liabilities are within the scope of Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets', notified under the Rules. As per paragraph 1 of Ind AS 37, contingent liabilities covered by another Standard are outside the scope of Ind AS 37. Based on this scope exclusion, paragraph 2 of Ind AS 37 reads as follows:

> "2 This Standard does not apply to financial instruments (including guarantees) that are within the scope of Ind AS 109, *Financial Instruments*."

Thus, while the corporate guarantee issued by the company may give rise to a contingent liability, first it has to be examined whether any other Ind AS covers the same before considering the applicability of Ind AS 37.

18. The Committee notes that in the extant case, the company has given a corporate guarantee to the bank on the basis of which the bank has issued a PBG to Petroleum and Natural Gas Regulatory Board ('PNGRB'), which is the beneficiary, on behalf of the company's wholly owned subsidiary (hereinafter referred to as 'the subsidiary'). For this purpose, the company has received a counter guarantee from the subsidiary. On perusal of the documents furnished by the querist, the Committee notes that, in effect, the purpose of the PBG issued by the bank is to guarantee performance obligations of the subsidiary and to pay the beneficiary against any breach in this regard by the subsidiary. As per clause 2.1 of the corporate guarantee, the company guarantees that it will pay the 'guaranteed obligations' upon issue of 'demand certificate' by the bank. As defined in the counter guarantee, the guaranteed obligations, *in simple terms*, means guarantee by the company for due payment by its subsidiary due to the bank under the 'Facility' (under which the PBG was given by the bank). As per clause 2.2 of the corporate guarantee, the company will compensate the bank for any loss that might be suffered under the 'Facility'. As per clause 8 of the corporate guarantee, the company may be treated as a principal debtor.

19. The Committee now examines whether having regard to the discussion in paragraph 18 above, the corporate guarantee given by the company is a financial guarantee. In this regard, the Committee notes the definition of the term 'financial guarantee contract' given in Ind AS 109, 'Financial Instruments', notified under the Rules, reproduced below:

> "A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument."

The Committee notes that the term 'debt instrument' is neither defined in Ind AS 109 nor in Ind AS 32, 'Financial Instruments: Presentation', notified under the Rules. The Committee is of the view that the term implies a contractual right to receive cash arising on account of a debtor-creditor relationship. In case the PBG issued by the bank is encashed by the beneficiary, the bank has a right to recoup the loss suffered by it from the subsidiary. In such an eventuality, the subsidiary is indebted to pay the bank towards the loss incurred by it, thereby establishing a debtor-creditor relationship between the subsidiary and the bank. Under the terms of the corporate guarantee, the company guarantees that it will pay 'guaranteed obligations' specified therein in order to reimburse the bank for the loss it incurs because of encashment of the PBG by the beneficiary due to non-performance by the subsidiary of its contractual obligations to the beneficiary. The Committee is, therefore, of the view that the corporate guarantee issued by the company to the bank meets the definition of financial guarantee contract given in Ind AS 109. In this context the Committee notes the following clause from the deed of guarantee entered between the company and the bank:

> "2.1 The Guarantor hereby irrevocably, absolutely and unconditionally guarantees to the Lender that it shall, upon issuance of the Demand Certificate and no later than 5 (Five) days of the date of issuance of the Demand Certificate, pay to the Lender, without demur or protest, the Guaranteed Obligations of an amount as stated in the Demand Certificate."

The Committee further notes that assumption by the company of its subsidiary's liability to the bank towards reimbursement of loss incurred by the bank itself is sufficient to treat the corporate guarantee issued by the company as a financial guarantee. Consequently, the Committee is of the view that the corporate guarantee issued by the company falls within the scope of Ind AS 109 and, consequently, is outside the scope of Ind AS 37. In this regard, the Committee also observes from the company's financial statements that the company has neither previously nor on transition to Ind ASs in the financial year 2016-17, asserted explicitly that it regards financial guarantee contracts as insurance contracts and uses accounting that it is applicable to insurance contracts. Consequently, the irrevocable option to treat the corporate guarantee as an insurance contract available under paragraph 2.1(e) of Ind AS 109 is not applicable.

20. The Committee notes that Division II of Schedule III to the Companies Act, 2013 (hereinafter referred to as 'Ind AS Schedule III') is applicable for companies adopting Ind ASs. As per Note 6 of the 'General Instructions for Preparation of Balance Sheet' companies are required to disclose certain

information in the Notes. Note 6(H) of the said Instructions requires the following information to be disclosed in the Notes:

> **"H. Contingent Liabilities and Commitments:**
> (to the extent not provided for)
>
> (i) Contingent Liabilities shall be classified as-
>
> (a) claims against the company not acknowledged as debt;
>
> (b) guarantees excluding financial guarantees; and
>
> (c) other money for which the company is contingently liable.
>
> (ii) …"

From the above, the Committee is of the view that corporate guarantee issued by the company, being of the nature of financial guarantee, should not be disclosed under the head 'Contingent liabilities and Commitments (to the extent not provided for)'. Further discussion is made in paragraphs 21 and 22 below.

21. The Committee notes that the Guidance Note on 'Guarantees & Counter-Guarantees', issued by the Institute of Chartered Accountants of India ('ICAI') has already been withdrawn from 1st April 2009 and, in any case, is not relevant in the context of Ind ASs. Further, the Committee notes that ICAI has issued the 'Guidance Note on Division II-Ind AS-Schedule III to the Companies Act, 2013' (hereinafter referred to as 'the Guidance Note'). Paragraph 8.2.14.1 and 8.2.14.2 of the Guidance Note reads as below:

> "**8.2.14.1.** A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations. However, …"
>
> **"8.2.14.2.** Ind AS Schedule III requires guarantees other than financial guarantees to be disclosed as a part of contingent liabilities, since financial guarantees are recognized on the balance sheet in accordance with Ind AS 109. Ind AS 107 specifies certain disclosure in respect of the exposure to credit risk on financial guarantee contracts as a part of the disclosures on 'credit risk exposures', which an entity should provide in its Notes to Accounts."

Thus, it is clear that the purpose of the first sentence of paragraph 8.2.14.1 of the Guidance Note is to give instances of contingent liabilities whereas the treatment of financial guarantee contract should be in accordance with the relevant Standard, which is Ind AS 109 in the extant case.

22. Based on the above discussion, the Committee is of the view that the requirements of Ind AS 109 and Ind AS 107, 'Financial Instruments: Disclosures', notified under the Rules, to the extent relevant, should be met in accounting and disclosure of the corporate guarantee issued by the company. In particular, Ind AS 109 contains measurement requirements of financial guarantees while paragraph B10 of Ind AS 107 requires disclosure of maximum exposure of the financial guarantee to credit risk, which is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognised as a liability.

D. Opinion

23. On the basis of paragraphs 18 to 22 above, the Committee is of the following opinion on the issues raised by the querist in paragraph 15 above:

(i) The recognition /disclosure of corporate guarantee is required to be made in accordance with the requirements of Ind AS 109 and Ind AS 107, as discussed in (iii) below.

(ii) The corporate guarantee provided will be recognised/disclosed in accordance with the requirements of Ind AS 109 and Ind AS 107, as discussed in (iii) below.

(iii) Corporate Guarantee (Deed of Guarantee) issued to SBI being in the nature of financial guarantee is to be recognized and measured in accordance with the requirements of Ind AS 109 and has to be disclosed considering requirements of paragraph B 10 of Ind AS 107, Financial Instruments: Disclosures as discussed in paragraph 22 above. The Company, if so desires, may give reference of such disclosures under the head "Contingent Liabilities and Commitments" for better understanding of the users of the financial statements.

Query No. 4

Subject: Accounting treatment to recognise interest earned on advance fee as its income as per the provisions of Ind AS 18.[1]

A. Facts of the Case

1. A company (hereinafter referred to as the 'company') has undertaken various metro projects for other states also on cost plus basis named as "External Projects". As per contract agreement signed for these projects, the company is entitled to fixed percentage of fees on cost plus basis. In terms of contract agreement, two types of advances are received by the Company:

(i) *Advance against project cost* (Advance I): As per contractual provisions interest earned on this advance is payable to the concerned state agency.

Accounting Treatment: The advance received from the concerned agency is kept in separate bank account and shown as advance from client. Simultaneously, interest earned on this account, if any, is also shown as payable to the concerned agency in line with the provisions of contract agreement.

(ii) *Advance received against fee for execution of Projects* (Advance II): As per terms and conditions of Contract Agreement, fee is also received in advance. The fee is primarily meant for discharging liabilities related to project set up expenses and to meet day-to-day overhead & establishment expenses. The invoice for fees is raised on quarterly basis as given in the contract. This fee money which is received in advance is also kept in a separate bank account.

Accounting treatment: The amount received on account of fees received in advance is also shown as advance from the client. At the year end, the invoice is raised for total expenditure incurred during the year plus fee amount at fixed percentage as defined in the contract agreement. On the basis of invoices which are raised for the work done the turnover is booked and advance from client both on account of project fund and fee is reduced to that extent. Remaining amount of advance fee continues to be shown under the head of account 'Advance Received from Client'. However, interest earned during the year on fee received in advance booked as income of the company as there is no obligation on the company, to refund of interest income earned on it.

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[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

2. *Observation raised by Resident Audit Party of C&AG:* On the above accounting treatment during the year 2016-17, Resident Audit Party of C&AG has issued Half Margin which is reproduced below:

> "The accounting policy no. 10.8.1 relating to Revenue from External Projects, interalia stipulates that in cost plus contracts, revenue is recognized by including eligible contractual items of expenditure plus proportionate margin as per contract.
>
> During 2016-17, significant fees was primarily received from four projects viz, Greater Noida, Kochi, Vijayawada and Mumbai. The fees is received quarterly in advance and a portion out of the same is recognized as revenue on the basis of accounting policy. The balance fee along with project fund received in advance is booked in Advance Customers (External) Projects and consultancy, which is shown as a current liability. However bank interest received on the above account relating to fees is treated as interest income. Recognition of income on amount which has been shown as a liability is not correct as income cannot arise from a liability.
>
> Accounting of bank interest in above manner has resulted in overstatement of income from bank interest and understatement of current liability to that extent".

3. *Management Reply as stated by the querist:*

"The company has undertaken various external projects including construction of Metro projects of Noida-Greater Noida, Kochi, Vijayawada, and Mumbai on cost plus basis as external project works. As per agreement signed with these agencies the company is entitled to charge fixed percentage of fee on the cost.

Further, the agreement clearly states that these agencies shall pay 5% mobilization fee in advance and balance fee will be released on quarterly basis to meet out project set up expenses and day to day overhead and establishment expenses. Accordingly, the company raised quarterly invoices from these agencies for claiming project fee. At the year end the bill is raised as per accounting policy No. 10.8.1 and the due fees is booked to revenue.

Since, there is no clause in the agreement regarding refund of interest on project fee received in advance, hence, interest income on advance fee is also recognized as income as per terms and conditions of the contract agreement.

Further, the accounting for interest earned on project fee has been made as per provisions of Indian Accounting Standard (Ind AS) 18, Revenue. The relevant paragraphs of Ind AS 18 in relation to booking of interest revenue are reproduced below:

“29. Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases given below:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.”

“34. Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity ...”

From the above it is clear that interest revenue shall be recognized only when it is probable that the economic benefit of the transaction will flow to the entity. As there is neither any clause in the agreement which requires refund of interest earned on advance fee nor claimed from the company, hence, it is probable that the economic benefit of this interest income will flow to the company only. This practice is consistently followed by the company in previous years also.

Further, accounting of interest on advance fee is also in line with the opinion given by the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) in respect of accounting treatment of interest on deposits made out of equity share capital and interest free subordinated debt funded by Government. As per the opinion, accounting treatment of interest earned on these surplus fund is treated as interest income in the statement of profit and loss (Query No. 44, Volume No. 34 of the Compendium of Opinions).”

4. The querist has submitted following points for consideration of the Expert Advisory Committee:

(i) Advance fee is provided by external project agencies for the purpose of providing liquidity to meet out project set up expenses and day to day overhead and establishment expense. However, the fee is recognized as per accounting policy of the company and remaining fund is recognized as liability in books of accounts.

(ii) There is no specific clause in agreements which require refund of interest earned on advance fee.

(iii) As per Audit, income cannot arise on liability. However, as per Expert Opinion given by the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) vide query No. 44, Volume No. 34 of the Compendium of Opinions, interest earned on deposits made out of equity share capital and interest free subordinate debt funded by Government is to be recognized as income in the Statement of Profit & Loss.

B. Query

5. In view of the facts explained above opinion of the Expert Advisory Committee is required on the following queries:

(i) Whether the company's accounting treatment to recognize interest earned on advance fee as its income is correct as per the provisions of Ind AS 18?

(ii) If not, what is the correct accounting treatment?

C. Points considered by the Committee

6. The Committee notes that the basic issue raised in the query relates to accounting treatment of interest income earned on advance fee received for execution of project (Advance II). 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 treatment of advance received, accounting treatment of interest earned on advance received against project cost (Advance I) etc. Further, the opinion expressed, hereinafter, is purely from accounting perspective and not from any legal perspective or interpretation of terms of contracts agreement.

7. The Committee notes from the facts of the case that the advance received against fee for execution of project is kept in a separate bank account and thus interest income is generated on the same. Therefore, the Committee consider paragraph 29 of Ind AS 18, Revenue which states as follows:

> **"29 Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases given below:**
>
> **(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and**
>
> **(b) the amount of the revenue can be measured reliably."**

The Committee notes from above that revenue arising from use by others of entity's assets yielding interest shall be recognized when it is probable that the economic benefits associated with the transaction will flow to the entity and the amount of revenue can be measured reliably. In the extant case, it is probable that the interest income will flow to the entity and the same can be measured reliably. Therefore, the same should be recognized as revenue of the entity.

8. The Committee further notes the contention as made in the query that recognition of income on amount which has been shown as liability is not correct.

In this regard, the Committee noted that the interest is earned on the amount held with bank (out of the advance received) and therefore, the same is income for the company.

D. Opinion

9. On the basis of the above, the Committee is of the view that the accounting treatment to recognise interest earned on advance fee as its income is proper.

Query No. 5

Subject: Accounting treatment of license fees (lease rentals) paid for use of licensed land for the development of new integrated fuel farm facility.[1]

A. Facts of the Case

1. A company had been incorporated by ABC Private Limited (also referred to as the Airport Operator) as a private company limited by shares under the Companies Act, 1956, as its wholly owned subsidiary. Thereafter, on 6th March 2014, ABC Private Limited along with three other promoter companies entered into a Shareholders' Agreement cum Share Purchase Agreement so as to effectively form a joint venture company amongst the four parties (herein referred to as "the company"). The company was to achieve the following objective:

- To take-over existing aviation fuelling facilities and businesses including without limitation aviation fuelling stations, tankage, hydrant infrastructure.
- To create, establish, design, construct, develop, upgrade, modernise, integrate, optimise and modify, fuelling facilities for the airport.
- To operate, manage and maintain and to provide services in relation to the fuelling facilities for the airport, on an Open Access basis.

2. The company is in the process of creating a modern and efficient aviation fuel facility to cater to the needs of airlines operating from the International Airport. The company has also undertaken the development of the Integrated Facility and linking thereof to the Hydrant System.

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[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

The company has executed a License Agreement with the Airport Operator for two locations, i.e. at Location 1 & Location 2 (A and B). The fuel farm operations are being carried out at Location 1 and the project of development of integrated fuel farm facility is carried out at Locations 2 (A and B).

3. Prior to the formation of Joint venture company, three of the promoter companies had constructed aviation fueling stations, hydrant infrastructure and allied facilities on the land licensed by the airport operator to the respective three promoter companies to enable each of them to supply aviation turbine fuel (ATF) at the airport.

Further, the Airport Operator was in the process of developing a new integrated fuel farm facility at the airport.

4. For the purposes of establishing an integrated aviation fueling facility at a single location, the Airport Operator and the other three promoter companies formed the Joint venture company. These three promoter companies transferred to the company the existing fueling facilities and the Airport Operator (also a promoter) granted to the company the right to use the licensed land on which the fueling stations were erected.

5. The total license fee is Rs. 46,901,329 for the year ended 31 March 2017, out of which:

(A) License fee of Rs. 24,784,597 paid for the licensed land (Location 1) used for the existing fuel farm facility being of revenue nature have been charged to the Statement of Profit & Loss for the financial year 2016-17. This facility is being used for operational purpose until the new integrated fuel farm facility is commissioned.

(B) The license fees of Rs. 22,116,732 paid for the use of licensed land (Location 2) admeasuring 37947 sq. mtrs. being directly attributable expenses for the development of the new integrated fuel farm facility under construction have been capitalised in the books of account for the financial year 2016-17 and have been included in cost of Work in Progress (CWIP) as per Ind AS 16, 'Property, Plant & Equipment'.

6. As per the querist, the above treatment is also based on EAC Opinion dated 24 January 1990 (published as Query no. 1.3 of Volume X of the Compendium of Opinions). Further, the same treatment is also emphasized in Ind AS 16 and the detailed analysis is given below by the querist:

In accordance with Ind AS 16, 'Property, Plant & Equipment', all directly attributable expenses incurred by the company for development of the integrated fuel farm facility are capitalised as a part of CWIP. The key question is whether the license fees paid by the company for usage of land/additional land can be considered as being directly attributable to the construction cost. The company has considered these license fees as directly attributable expenses for construction and thus capitalised these costs as a part of CWIP.

As per paragraphs 16 and 17 of Ind AS 16, 'Property, Plant & Equipment':

"16 The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17 Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in Ind AS 19, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) …"

The cost of the license fee during the construction period is an unavoidable cost of constructing the integrated facility because without the lease, no construction could occur. Hence the license fee paid for land during the construction period should be considered as a directly attributable cost and consequently capitalised.

7. Further, paragraph 19 of Ind AS 16 lays down the examples of costs that **are not** costs of an item of an acquired or constructed property, plant and equipment. They are:

(a) costs of opening a new facility;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(d) administration and other general overhead costs.

License fees paid for the use of the land in question do not get covered in the type of expenses illustrated in this paragraph 19. (Emphasis supplied by the querist.)

8. The querist has mentioned that this view (i.e. the appropriateness of capitalisation) is also supported by an earlier EAC opinion issued on 24 January, 1990, where the querist had raised an issue pertaining to capitalisation of interest and ground rent payable till the completion of construction of the office building. According to the querist, in this opinion, the ground rent was payable for the land on which the office building was being constructed. In the instant case, the Committee was of the opinion that interest accruing during construction period on the instalments of land *together with the ground rent payable* during the construction period of the building should be capitalised. Further, the Committee also referred to 5.1 of the 'Guidance Note on Treatment of Expenditure During Construction Period', and recommended the following in connection with indirect expenditure incidental and related to construction:

> *"This paragraph deals with the bulk of the indirect expenditure which would be incurred by a project during its construction period. A characteristic of this type of expenditure is that, for a running concern, it would be of a revenue nature. However, because the expenditure is incurred during the construction period and because, during that period, the expenditure is indirectly related to construction and is incidental thereto, it should be capitalised as part of the construction cost."*

Though this opinion was issued under Indian GAAP, the core principle of what are directly attributable expenses to be capitalised, is similar under both Ind AS and Indian GAAP.

(Emphasis supplied by the querist).

9. As per note 2.5(iv) of the Notes to Accounts forming part of the Financial Statements for the year ended 31 March 2017, "Cost comprises cost of acquisition or cost of construction and any directly attributable cost of bringing the asset to its working condition for its intended use."

10. As per note 2.12 of the Notes to Accounts forming part of the unaudited Financial Statements for the six months ended 30 September 2017, the company

signed License Agreements with the lessor-promoter as contextually summarized below:

Title of Agreement	Location	Area (sq. metre)	License Period
Short Term Agreement	1	38,890.00	Effective Date to 30 November, 2017 or such later date as may be mutually agreed between the Parties.
Long Term Agreement	2(part A)	30,163.32	Effective Date to 2 May, 2036 subject to any extension in accordance with the Agreement.
Long Term Agreement	2(part B)	7,783.68	Effective Date to 2 May, 2036 subject to any extension in accordance with the Agreement.

11. During the audit by the Comptroller and Auditor General (CAG), the CAG expressed their opinion (see extract below) that the treatment of capitalisation of license fees of Rs. 22,116,732 is not in accordance with Ind AS 16:

> "The License Fee paid to the lessor for the period from 1st April 2016 to 31st March 2017 for the land area of 37,947 sq. mtrs. of the project site is an operating lease for Integrated Fuel Farm facility at (the airport) for the period from 30th December 2014 to 2nd May 2036. Considering the nature of lease and in accordance with Ind AS 17 the amount of lease rental should have been charged to Profit and Loss account. This has resulted in understatement of Other Expenses and overstatement of profit."

B. Query

12. The company has sought the opinion of the Expert Advisory Committee as to whether the license fees/lease rentals paid for the project site (used for the development of the integrated fuel farm facility- Location 2) has been correctly capitalised as per Ind AS 16.

C. Points considered by the Committee

13. The Committee notes that the basic issue raised in the query is whether certain lease rentals qualify for capitalisation in accordance with Ind AS 16, 'Property, Plant & Equipment'. 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 treatment of any other expenditure incurred by the company, nor has the Committee verified the factual accuracy of the data and information presented by the querist, including but not limited to the numerical data. The Committee has also not examined whether the lease rentals have been measured in accordance with Ind AS 17 or not. The Committee would further like to mention that the terms "license fees" and "lease rentals" are used interchangeably in this document but are intended to mean lease rentals, considering the substance of the arrangement as outlined by the querist. At the outset, the Committee wishes to point out that the opinion expressed hereinafter, is in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015.

14. The Committee also wishes to clarify that with regard to the references made by the querist to the earlier ICAI opinions and guidance note during the AS era, the same may not be relevant in the context of Ind AS and accordingly, the Committee has not considered the same.

15. The Committee notes paragraph 16(b) of Ind AS 16, 'Property, Plant & Equipment' which states that the cost of "an item of property, plant and equipment comprises **any costs directly attributable** to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management" (emphasis added by the Committee).

16. The Committee is of the view that "directly attributable" costs are generally such costs which are necessary, to enable the construction activity, i.e. these costs are directly related to the construction activity and without the incurrence of which the asset cannot be brought to the location and condition necessary for it to be capable of operating in the manner intended by management.

17. In the extant case, the construction activity is on the leased land that, considering the facts as presented, is rented only for the purpose of creating (and subsequently operating) the integrated facility. As such, there appears to be a direct relation between the land and the construction activity, leading to the conclusion that the lease rentals of such land are directly attributable to the construction activity.

18. To address the point made by the CAG auditors, i.e. that *"Considering the nature of lease and in accordance with Ind AS 17 the amount of lease rental should have been charged to Profit and Loss account",* the Committee believes that, while in the current context, Ind AS 17 *Leases* does deal with the accounting for lease rentals, Ind AS 16 provides more specific and relevant guidance to the issue under consideration.

19. In addition, it is important to note that the lease rental costs should be considered for capitalisation only until the point of "**bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management"**, and should stop at that point (highlighted section extracted from paragraph 16(b) of Ind AS 16).

20. Finally, the Committee wishes to highlight that the lease rental costs that require capitalisation should be suitably allocated to the unit or units of measure of the property, plant and equipment. For example, it might be that the querist's capitalisation unit comprises of two separate assets, i.e. Location 2A and Location 2B. If so, then the lease rentals that require capitalisation should be allocated to these two assets on a reasonable basis using appropriate judgment. In this context, the following extract from paragraph 9 of Ind AS 16 is relevant:

> "This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances …"

D. Opinion

21. On the basis of the facts as presented by the querist, it is apparent that there is a direct relation between the leased land and the construction activity thereon. As a result, the rental cost of such land, upto the time as mentioned in paragraph 19 above, can be said to be directly attributable to the construction activity, as envisaged in paragraph 16(b) of Ind AS 16, 'Property, Plant & Equipment'. Therefore, the Committee is of the opinion that the accounting policy adopted by the querist, i.e. the capitalisation of the lease rentals of the under-construction integrated facility, is appropriate.

Query No. 6

Subject: Provisioning for expected credit loss on the amount due in the course of business from Government organisations.[1]

A. Facts of the Case

1. A company is a listed Government of India Navratna Enterprise under the Ministry of Housing and Urban Affairs, Government of India. The company operates in three business segments viz., (a) Project Management Consultancy

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[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

(PMC); (b) Real Estate and (c) Engineering, Procurement and Construction ('EPC'). Under the PMC segment, the company executes cost plus contracts obtained on either nomination basis or through competitive bidding. The projects are executed by contractors appointed by the company through transparent tendering process. Under the Real Estate segment, the company works as a developer, procures land, gets the works executed by entering into contractual engagements with contractors and the project is sold in pre-construction and post-construction stages. Marketing is done by the company only. Under the EPC segment, the company takes contracts at fixed prices and the work is executed through sub-contractors.

2. Indian Accounting Standards (Ind ASs) are applicable for the company w.e.f. 01.04.2016. The accounts of the F.Y. 2016-17 were prepared in accordance with Ind ASs with comparatives for 2015-16 and opening Ind AS balance sheet as on 01.04.2015. For implementing Ind ASs, M/S XYZ & Co., LLP were appointed as consultants. As per their advice and suggested methodology, provision for expected credit loss ('ECL') was calculated. The accounts were audited by both statutory auditors and Govt. auditors and, as per the querist, the methodology was acceptable to them also.

3. The historical pattern of the company shows the debtors' age profile as follows:

(Rs. in Crore)

Age as on	0 – 1 year	1 – 2 years	2 – 3 years	< 3 years	Total
01.04.2015	1198.62	238.19	138.27	73.84	1648.92
31.03.2016	1449.34	193.36	126.98	170.13	1939.81
31.03.2017	1796.25	176.68	91.99	248.17	2313.09
31.03.2018 (Expected)	1850.00	390.04	161.75	328.41	2730.20

4. In accordance with the principles set out in Ind AS 109, 'Financial Instruments', the following provision for ECL has been made:

(Rs. in Crore)

(i)	Provision upto 01.04.2015 (Adjusted in retained earnings)	75.66
(ii)	Provision charged in the year 2015-16	28.65
(iii)	Provision charged in the year 2016-17	21.97
(iv)	Provision charged in the year 2017-18 (upto 30.09.2017)	44.34

5. The company's accounting policy on provision for ECL is as follows:

"IMPAIRMENT OF FINANCIAL ASSETS

In accordance with Ind AS-109, the Company applies Expected Credit Loss (ECL) model for measurement and recognition of impairment loss for Financial Assets.

ECL is the difference between all contractual cash flows that are due to the company in accordance with the contract and all the cash flows that the Company expects to receive. When estimating the cash flows, the Company considers the following –

- All contractual terms of the Financial Assets (including prepayment and extension) over the expected life of the assets.
- Cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms.

Trade Receivables

As a practical expedient the Company has adopted 'simplified approach' using the provision matrix method for recognition of expected loss on trade receivables. The provision matrix is based on three years rolling average default rates observed over the expected life of the trade receivables and is adjusted for forward-looking estimates. These average default rates are applied on total credit risk exposure on trade receivables and outstanding for more than one year at the reporting date to determine lifetime Expected Credit Losses."

6. The company, being a Government company, is mainly engaged in business with Central Govt. / State Govt. / Autonomous Bodies/ Public Sector Undertakings. Generally, it takes long time to liquidate the debt such entities. Hence, the company is of the view that the requirement to make provision for ECL should not be applied in general.

B. Query

7. The querist has sought the opinion of the Expert Advisory Committee as to whether any exemption is available from making provision for expected credit loss under Ind ASs / other guidelines issued as on date where the clients are Central Govt. / State Govt. / Autonomous Bodies/ Public Sector Undertakings.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised by the querist relates to availability of any exemption from making provision for expected credit loss under Ind AS 109. The Committee has, therefore, considered only this issue and

has not examined any other issue that may be contained in the Facts of the Case, such as, text of the Accounting Policy, propriety of making provision for expected credit loss in respect of credit risk exposure on trade receivables and outstanding for *more than one year* at the reporting date, etc. The Committee notes that the company in the extant case is a Government company.

9. The Committee notes that section 5.5 of Indian Accounting Standard (Ind AS) 109, 'Financial Instruments', notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as the 'Rules'), deals with impairment recognition of expected credit losses on financial instruments. Related application guidance is given in paragraphs B5.5.1 to B5.5.55 of Appendix B to Ind AS 109. Further, the Committee notes paragraph 2.2 of Ind AS 109, reproduced below:

> **"2.2 The impairment requirements of this Standard shall be applied to those rights that Ind AS 11 and Ind AS 18 specify are accounted for in accordance with this Standard for the purposes of recognising impairment gains or losses."**

The Committee also notes that Ind AS 11, 'Construction Contracts', and Ind AS 18, 'Revenue', notified under the Rules, make cross-reference to Ind AS 109 for recognition of impairment losses in respect of rights arising from the application of these Standards. Relevant paragraphs of these Standards are reproduced below:

Ind AS 11

> "1A The impairment of any contractual right to receive cash or another financial asset arising from this Standard shall be dealt in accordance with Ind AS 109, *Financial Instruments.*"

Ind AS 18

> **"1B The impairment of any contractual right to receive cash or another financial asset arising from this Standard shall be dealt in accordance with Ind AS 109, *Financial Instruments.*"**

Further, the Committee notes the following paragraphs of Ind AS 109:

> **"5.5.15 Despite paragraphs 5.5.3 and 5.5.5, an entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:**
>
> **(a) trade receivables or any contractual right to receive cash or another financial asset that result from transactions that are within the scope of Ind AS 11 and Ind AS 18.**
>
> **(b) …"**

"5.5.17 An entity shall measure expected credit losses of a financial instrument in a way that reflects:

(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

(b) the time value of money; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions."

Further, the Committee notes that paragraph B5.5.35 of Ind AS 109 permits use of practical expedients when measuring expected credit losses if they are consistent with the principles in paragraph 5.5.17 of that Standard, reproduced above. Paragraph B5.5.35 of Ind AS 109 cites calculation of the expected credit losses on trade receivables using a provision matrix as an example of a practical expedient.

10. From the above, the Committee notes that impairment requirements of Ind AS 109 are mandatory. In particular, receivables arising from the application of Ind AS 11 and Ind AS 18, if measured at amortised cost, are subject to the impairment requirements of Ind AS 109. No exemption is given in Ind AS 109 from compliance with impairment requirements of that Standard for *any* entity.

D. Opinion

11. On the basis of the above, the Committee is of the opinion that no exemption is available from making provision for expected credit loss under Ind ASs / other guidelines issued as on date where the clients are Central Govt. / State Govt. / Autonomous Bodies/ Public Sector Undertakings.

Query No. 7

Subject: Accounting for discontinuance of service concession arrangement during first-time adoption of Ind AS.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a wholly owned subsidiary of ABC Infrastructure Developers Limited and is engaged in the business of toll collection and maintenance under a concession agreement for a stretch of national highway on Operate, Maintain and Transfer (OMT) basis for a period of 9 years starting from 22nd September, 2013.

2. Under the terms of concession agreement, the company needs to pay Rs. 11.08 crore concession fee in 12 equal monthly instalments to National Highways Authority of India (NHAI) with an escalation of 10% every year.

3. The company also has an obligation to create project facilities such as toll plaza, medical aid post, traffic aid post, etc., and also has an obligation to do an overlay of the entire stretch (resurfacing of the road) on or before 31.03.2017.

4. Being the subsidiary of a listed entity having networth of Rs. 500 crore and above, the company was required to and has adopted Indian Accounting Standards (Ind ASs) for the first time for the financial year ending 31st March, 2017. The Group and all subsidiaries had presented comparative Ind AS financial statements for the year ended 31st March, 2016. Thus, the transition date was 1st April, 2015.

5. The querist has stated that obligation to pay concession fee over the concession period as specified in the concession agreement is considered as constructive obligation. The company is of the view that as per Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets', when an entity has constructive obligation ('obligating event') provision is required to be created, if other criteria for recognition of provision are also met. However, the company has not recognised the provision over the concession period under previous Indian GAAP (viz., Accounting Standards) and hence, this has been considered as a GAAP difference, on first time adoption of Ind ASs.

6. The querist has further stated that the toll collection rights over the concession period as specified in the concession agreement may be recognised as an intangible asset to be amortised over the concession period. The company is of the view that as per Indian Accounting Standard (Ind AS) 38, 'Intangible Assets', paragraph 7AA: intangible asset arising from service concession arrangement, i.e., the toll collection rights should be recognized as an intangible

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

asset. The company has not recognised the intangible asset of toll collection right under Indian GAAP and drawing an analogy from the discussion in Issue 6 of Ind AS Transition Facilitation Group (ITFG) Clarification Bulletin 5, (which discussion pertains to Property, Plant and Equipment) the fair valuing of the intangible asset has been considered as a GAAP difference, on first time adoption of Ind ASs.

7. In view of the above, the company has made a provision as per Ind AS 37, by applying for the first time, the Ind ASs at the time of preparing interim financial statements for the quarter and six months ended 30th September, 2016 (Q2 reporting date). Accordingly, on the Q2 reporting date, in regard to the constructive obligation, the financial statements record the said obligation as mentioned below:

a. Provision, on the transition date (i.e. 1st April, 2015) has been created by debiting 'Retained Earnings' as per paragraph 11 of Indian Accounting Standard (Ind AS) 101, 'First-time Adoption of Indian Accounting Standards' and crediting to 'Provision for Concession Fees Payable A/c'.

b. Intangible asset for toll collection has been recognised by debiting 'Toll Collection Rights A/c' as per paragraph 7AA of Ind AS 38 and crediting 'Provision for Concession Fees Payable A/c'. These effects have been given in the previous year column of the presentation in the prescribed format.

This has been done in all subsidiaries of the Group.

8. On 25th August 2016, the company has handed over (by way of discontinuance of the OMT) the project to the NHAI as per the amicable settlement between the company and NHAI.

9. At the time of preparing interim financial statements for the quarter and six months ended 30th September, 2016 (Q2 reporting date), an issue arose about the creation of an obligation (in the previous year column) under the Ind AS (as mentioned in paragraph 7 above) and its reversal on the same date as at the 'Q2 reporting date' (in the quarter 2 financials).

10. As the obligation to pay concession fee ceased to exist on account of handing over the project back to the authority, under paragraph 59 of Ind AS 37, the company had reversed the 'Provision for Concession Fee Payable' and credited the whole provision back to profit and loss account as an exceptional item with a detailed note explaining the accounting treatment in the profit and loss account. This was done in the interim financial statements for the quarter and six months ended 30th September, 2016 ('reporting date') (i.e., liability no longer required -written back). Similarly, the entire intangible asset for toll

collection rights has been debited to the profit and loss account as an exceptional item with the note to the profit and loss account explaining the accounting treatment.

11. This has resulted in the following accounting treatment in the preparation and finalisation of one single financial statement, i.e., for the quarter and six months ended 30th September, 2016:

a. For opening balance sheet (i.e., 1st April, 2015) Rs. 66,43,12,069 is debited to 'Retained Earnings' and 'Intangible Assets (Toll collection Rights A/c)' is debited by Rs.703,82,18,187 as per paragraph 11 of Ind AS 101, and 'Provision for Concession Fees Payable A/c' is credited by Rs. 770,25,30,256.

b. For F.Y. 2015-16, revenue based amortization of intangible assets is made by debiting Rs. 56,98,14,658 to 'Amortization A/c' and crediting 'Toll collection Rights A/c'. Further, interest cost on unwinding of trade payable is debited by Rs. 107,77,51,528, 'Provision for Concession Fees Payable A/c' debited by Rs. 20,03,21,335 and credited to operating cost (Concession Fees A/c) Rs. 127,80,72,863.

c. Aggregate of the two amounts stated in points (a) and (b) being the 'Provision for Concession Fees Payable' no longer required, and impaired the full value of Toll Collection Rights and credited the net impact Rs. 103,38,05,392, of the 2 items, back to profit and loss account as an exceptional item of income.

The querist has also furnished to the Committee, the numerical workings to derive the above figures.

12. The company is of the view that this accounting treatment is justified on a plain reading of Ind AS 101 as, on first time adoption of Ind AS, 'hindsight' is not permitted. Therefore, the obligation not earlier recognised as per the then applicable accounting standards, results in a reduction in retained earnings in the previous year column on first time application of Ind ASs. On the very same date however, an equal amount is credited in the current period (Q2) as income as mentioned in paragraph 11(c) above.

B. Query

13. Based on the above, the querist has sought the opinion of the Expert Advisory Committee as to whether the accounting treatment followed is in line with the requirements of Ind AS.

C. Points considered by the Committee

14. The Committee notes that the basic issue raised in the query relates to the company's recognition and derecognition of the toll collection right (intangible asset) and obligation towards the fees payable to NHAI, and the consequential gain recognised in the statement of profit and loss during the quarter ended 30th September 2016. 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, appropriate classification of the OMT concessions agreement as intangible asset in accordance with Appendix A to Ind AS 11, rather than as financial asset; appropriateness of revenue-based amortisation of toll collection rights; presentation of writing back of 'Provision for Concession Fee Payable' and impairment of full value of 'toll collection right' in the statement of profit and loss as an exceptional item; applicability of Ind AS 105, 'Non-current Assets Held for Sale and Discontinued Operations'; appropriateness of the company's accounting under previous GAAP (Accounting Standards notified under Companies (Accounting Standards) Rules, 2006); and the regulatory aspects of the discontinuance of concession agreement and handing over the same to NHAI. The Committee has also not verified the accuracy or the appropriateness of the calculations separately shared by the querist. Further, the Committee presumes that the OMT concession arrangement in the extant case is within the scope of Appendix A, Service Concession Arrangements to Indian Accounting Standard (Ind AS) 11, 'Construction Contracts'. The Committee also wishes to point out that since the financial year referred to in the query is F.Y. 2016-17, the Committee has considered the issue in the light of the Indian Accounting Standards applicable for that period.

15. At the outset, the Committee notes that the querist has described in the Facts of the Case, the obligation towards the NHAI fee payable as a constructive obligation. In this regard, the Committee notes that the term, 'constructive obligation' has not been defined under Accounting Standard (AS) 29, 'Provisions, Contingent Liabilities and Contingent Assets', however paragraph 10 of Ind AS 37 defines the term as follows:

> **"A *constructive obligation* is an obligation that derives from an entity's actions where:**
>
> **(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and**
>
> **(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities."**

From the above, the Committee is of the view that the obligation towards fee payable to NHAI is not a constructive obligation as it is not an obligation arising from the action of the company by an established pattern of past practice; rather, the obligation towards NHAI fee payable emanates from the OMT concession agreement and is therefore a legal binding contractual obligation on the company.

16. The Committee further notes, based on the facts provided, that the company is getting toll collection right against multiple obligations under the concession arrangement, including:

1. Obligation to create Project facilities such as Toll plaza, Medical Aid post, Traffic Aid Post, etc., and also has an obligation to do an overlay of the entire stretch (resurfacing of the road) on or before 31.03.2017.

2. Obligation to pay Rs. 11.08 crore concession fee in 12 equal monthly instalments to NHAI with an escalation of 10% every year.

In the above context, the Committee notes the following paragraphs of Appendix A to Ind AS 11:

> "12 Under the terms of contractual arrangements within the scope of this Appendix, the operator acts as a service provider. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.
>
> 13 The operator shall recognise and measure revenue in accordance with Ind AS 11 and Ind AS 18 for the services it performs. …"
>
> "21 The operator may have contractual obligations it must fulfil as a condition of its licence (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement. These contractual obligations to maintain or restore infrastructure, except for any upgrade element (see paragraph 14 of this Appendix), shall be recognised and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period."

From the above, the Committee notes that the Appendix A to Ind AS 11 requires an operator to recognise contractual obligations towards maintenance of the infrastructure in accordance with Ind AS 37 and in case of any upgrade element, account for revenue and costs in accordance with Ind AS 11. However, the Committee has not looked into these aspects in the opinion as the same is not the issue raised by the querist in the extant case.

17. With regard to obligation to pay Rs. 11.08 crore concession fee in 12 equal monthly instalments to NHAI, the Committee notes the definition of 'financial liability' from Indian Accounting Standard (Ind AS) 32, 'Financial Instruments: Presentation' as follows*:*

> **"A *financial liability* is any liability that is:**
>
> **(a) a contractual obligation :**
>
> **(i) to deliver cash or another financial asset to another entity; or**
>
> **(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or**
>
> **…"**

18. The Committee notes that the company has an obligation to pay concession fee over the concession period as specified in the concession agreement. This obligation, being a contractual obligation towards NHAI payable in cash terms, would meet the above definition of financial liability. Accordingly, in the extant case, a financial liability should be recognised at fair value at the date of initial recognition of the obligation (refer paragraph 5.1.1 of Ind AS 109) and subsequently should be measured in accordance with Ind AS 109, 'Financial Instruments'. Under previous GAAP, the Committee notes that the company did not recognise any liability towards the contractual obligation payable to NHAI.

19. The Committee further notes from the Facts of the Case that the company has made a provision towards the aforesaid obligation by applying for the first time, the Ind ASs at the time of preparing interim financial statements for the quarter and six months ended 30th September, 2016 ('Q2 reporting date'). In this regard, the Committee wishes to point out that the Ind AS transition adjustments should be made as of the date of transition to Ind ASs, i.e., 1st April, 2015 by making adjustments or passing entries on that date in the first reporting period of its Ind AS financial statements and assumes that the same has been followed by the company in the extant case.

20. With regard to the toll collection right, the Committee notes the following guidance in Appendix A to Ind AS 11 and Ind AS 38, 'Intangible Assets' for determining the initial cost of an intangible asset:

Appendix A to Ind AS 11

"17 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service."

"26 Ind AS 38 applies to the intangible asset recognised in accordance with paragraphs 17 and 18 of this Appendix. Paragraphs 45–47 of Ind AS 38 provide guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets."

Ind AS 38

"25 Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets.

26 In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.

27 The cost of a separately acquired intangible asset comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

(b) any directly attributable cost of preparing the asset for its intended use.

28 Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in Ind AS 19) arising directly from bringing the asset to its working condition;

(b) professional fees arising directly from bringing the asset to its working condition; and

(c) costs of testing whether the asset is functioning properly."

"32 If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with Ind AS 23, *Borrowing Costs*."

"Exchanges of assets

45 One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

46 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (ie risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

47 Paragraph 21(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident."

21. From the above, the Committee is of the view that the initial recognition of the financial liability at fair value will be part of the cost of the toll collection right (intangible asset) at the point of initial recognition. The Committee is further of the view that the intangible asset so recognised should be subsequently amortised using an appropriate method considering the requirements of Ind AS 38 and Ind AS 101. Further, the financial liability should also be subsequently amortised in accordance with Ind AS 109.

22. The Committee further notes that Ind AS 101, 'First-time Adoption of Indian Accounting Standards' sets out the following requirements with regard to first time adoption of Ind ASs:

"10 Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind ASs;

(b) not recognise items as assets or liabilities if Ind ASs do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and

(d) apply Ind ASs in measuring all recognised assets and liabilities.

11 The accounting policies that an entity uses in its opening Ind AS Balance Sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind ASs. Therefore, an entity shall recognise those adjustments directly in

retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs."

23. Based on the above, the Committee is of the view that the net impact of the recognition and subsequent measurement of the financial liability and toll collection right (intangible asset) should be recognised in retained earnings at the date of transition to Ind AS, i.e., 1st April 2015 in the first reporting period of its Ind AS based financial statements.

24. The Committee also notes that subsequent to the transition date, on 25th August 2016, the company has handed over (by way of discontinuance of the OMT) the Project to the NHAI as per the amicable settlement between the company and NHAI. In this regard, the Committee notes that as per the requirements of Appendix A of Ind AS 11, after initial recognition, the subsequent measurements of the respective assets and liabilities shall be in accordance with the applicable Ind ASs. Accordingly, the Committee notes that Ind AS 38 provides the following requirements with regard to derecognition of intangible assets:

> **"112 An intangible asset shall be derecognised:**
>
> **(a) on disposal; or**
>
> **(b) when no future economic benefits are expected from its use or disposal.**
>
> **113 The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised (unless Ind AS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue."**

The Committee also notes that Ind AS 109 provides the following requirements with regard to derecognition of financial liability:

> "B3.3.1 A financial liability (or part of it) is extinguished when the debtor either:
>
> (a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or
>
> (b) is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met.)"

25. The Committee notes that the intangible asset and the financial liability are derecognised when the above conditions are respectively met and in both the cases, the consequential gain or loss is recognised in the statement of profit and loss. The Committee is of the view that the discontinuance of the OMT and the settlement with NHAI is effectively a legal release of the financial obligation towards NHAI and also disposal of the toll collection right (intangible asset).

26. The Committee notes that Ind AS 101 provides the following requirements with regard to use of estimates and hindsight while first time adoption of Ind ASs:

> **"14 An entity's estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.**
>
> 15 An entity may receive information after the date of transition to Ind ASs about estimates that it had made under previous GAAP. In accordance with paragraph 14, an entity shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with Ind AS 10, *Events after the Reporting Period*. For example, assume that an entity's date of transition to Ind ASs is 1 April 2015 and new information on 15 July 2015 requires the revision of an estimate made in accordance with previous GAAP at 31 March 2015. The entity shall not reflect that new information in its opening Ind AS Balance Sheet (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 March 2016."

On the basis of the above, the Committee is of the view that a first time adopter of Ind AS is prohibited from using hindsight while preparing first Ind AS financial statements. The toll collection right (intangible asset) and the obligation towards NHAI (financial liability) existed as at the Ind AS transition date and, therefore, should be recognized in the opening Ind AS balance sheet as at 1st April, 2015, notwithstanding the fact that subsequently, there was a discontinuance of the OMT agreement. The discontinuance of the OMT agreement is a subsequent event, which cannot be considered while preparing the opening Ind AS balance sheet at the date of transition.

27. Incidentally, the Committee notes that the querist has raised two separate queries for the different obligations (viz., obligation for major maintenance and the obligation to pay concession fee to NHAI) arising from the same concession agreement.

The Committee further notes that in this query, the querist has stated that the company has recognized the provision for concession fee payable for the first time, by applying Ind AS 37 at the time of preparing interim financial report/statement for the quarter/six months ending 30th September, 2016 (Q2 reporting date), whereas in the other query, the querist has stated that the company has recognized the provision for resurfacing (major maintenance) for the first time, by applying Ind AS 37 at the time of preparing interim financial report/statement for the quarter ending 30th June, 2016 (Q1 reporting date). Thus, there is an apparent contradiction in the two queries as to when the company has applied Ind ASs for the first time, viz., Q1 or Q2 reporting date. Moreover, if the Ind ASs compliant financial statements were prepared for the quarter ending 30th June, why the company did not make provision for concession fee payable in the first quarter itself is not clear.

Further, the Committee notes that in the other query, the querist has stated that the adjustment relating to reversal of provision for resurfacing was made in the first quarter itself as the financials for that quarter were adopted on 2nd September, 2016 and the OMT was discontinued on 25th August, 2016; whereas in this query, in respect of obligation of payment of concession fee arising under the same concession agreement, the provision for concession fee payable was recognized for the first time in the second quarter ending 30th September, 2016.

However, the Committee has examined these two queries separately and independently without examining the consequential effects or impact that the one issue may have on the other from accounting perspective.

D. Opinion

28. On the basis of the above, the Committee is of the opinion that the toll collection right (intangible asset) and the obligation towards NHAI (financial liability) should be recognised and measured in accordance with the requirements of Appendix A of Ind AS 11, Ind AS 38 and Ind AS 109 respectively (as discussed in afore-mentioned paragraphs) as of the date of transition to Ind ASs, i.e., 1st April, 2015, notwithstanding the fact that, subsequently, there was a discontinuance of the OMT agreement. The discontinuance of the OMT agreement resulting in derecognition of the toll collection right (intangible asset) and the obligation towards NHAI financial liability should be accounted for during the period in which the handover of the OMT and the settlement between the company and NHAI were legally effective. The consequential gain or loss should

be recognized in the statement of profit and loss during that period (i.e., during quarter ended 30 September 2016).

Query No. 8

Subject: Accounting for discontinuance of obligation under service concession arrangement during first-time adoption of Ind AS.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a wholly owned subsidiary of ABC Infrastructure Developers Limited. The company is engaged in the business of toll collection and maintenance of a stretch of a national highway on Operate, Maintain and Transfer (OMT) basis for a period of 9 years starting from 22nd September, 2013.

2. Under the terms of concession agreement, the company needs to pay Rs. 11.08 crore concession fee in 12 equal monthly installments to National Highways Authority of India (NHAI) with an escalation of 10% every year.

3. Under the concession agreement, the company also has an obligation to create project facilities, such as Toll plaza, Medical Aid post, Traffic Aid Post, etc., and also has an obligation to do an overlay of the entire stretch (resurfacing of the road) on or before 31.03.2017.

4. The querist has stated that being the subsidiary of a listed entity having networth of Rs. 500 crore and above, the company was required to and has adopted Indian accounting Standards (Ind ASs) for the first time for the financial year ending 31st March, 2017. The group and all the subsidiaries had chosen to present comparative Ind AS financial statements for the year ended 31st March, 2016. Thus, the transition date was 1st April 2015.

5. The querist has further stated that the major maintenance obligation as specified in the concession agreement is considered as constructive obligation. The company is of the view that as per Indian Accounting Standard (Ind AS) 37,'Provisions, Contingent Liabilities and Contingent Assets', when an entity has constructive obligation ('obligating event'), provision is required to be created, if other criteria for recognition of provision are also met. However, the company has not recognized the provision under previous Indian GAAP and hence, this has been considered as a GAAP difference, on first time adoption of Ind ASs. In view of the above, the company has made a provision as per Ind AS 37, by

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[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

applying for the first time, the Ind AS at the time of preparing interim financial statement for the quarter ended 30th June, 2016 (Q1 reporting date). Accordingly, on the 'Q1 reporting date', in regard to the constructive obligation, the financial statements record the said obligation as mentioned below:

a. Provision, prior to the transition date (i.e. 1st April, 2015) has been created by debiting 'Retained Earnings A/c' as per paragraph 11 of Ind AS 101, 'First-time Adoption of Indian Accounting Standards' and crediting to 'Provision for Resurfacing A/c'.

b. Provision post April 2015 by debiting 'Road Repairing and Maintenance expenses' in the statement of profit and loss and crediting to 'Provision for Resurfacing A/c'.

These effects have been given in the previous year column of the presentation in the prescribed format.

This has been done in all subsidiaries of the Group where such a major maintenance obligation was specified in the respective concession agreement.

6. On 25th August 2016, the company has handed over (by way of discontinuance of the OMT) the project to the NHAI as per the amicable settlement between the company and NHAI.

7. According to the querist, this was the only project where the adjustments discussed in the following paragraphs were felt necessary because of the handing over of the project post the reporting date but before adoption of the financials in the Audit Committee meeting held on 2nd September, 2016 (hereinafter referred to as 'Adoption of Financial Statements Date').

8. At the time of preparing interim financial statements for the quarter ended 30th June, 2016 (Q1 reporting date), an issue arose about the creation of an obligation (in the previous year column) under the Ind ASs (as mentioned in paragraph 5 above) and its reversal on the same date as at the 'Q1 reporting date' (In the 1st quarter financials).

9. As the maintenance obligation ceased to exist on account of handing over the project back to the authority, under paragraph 59 of Ind AS 37, the company had reversed the 'Provision for Resurfacing' and credited the whole provision back to profit and loss account as an exceptional item with a detailed note explaining the accounting treatment in the profit and loss account. This was done in the interim financial statements for the quarter ended 30th June, 2016 ('reporting date') as an 'Event occurring after Balance Sheet Date' (i.e., liability no longer required – written back).

10. This has resulted in the company, using the following accounting treatment in the preparation and finalisation of one single financial statement, i.e. for the quarter ended 30th June, 2016:

(a) Debiting Rs. 30,23,10,084 to 'Retained Earnings' as per paragraph 11 of Ind AS 101 and crediting to Provision for Resurfacing A/c for Provision prior to April 2015.

(b) Provision post April 2015 by debiting Rs. 24,32,19,407 to 'Road Repairing and Maintenance expenses' in the statement of profit and loss and crediting 'Provision for Resurfacing A/c'.

(c) Reversed Rs. 54,55,29,491 aggregate of the two amounts stated in points (a) and (b) being the Provision for Re-surfacing no longer required and credited the whole provision back to profit and loss account as an exceptional item of income.

11. The company is of the view that this accounting treatment is justified on a plain reading of Ind AS 101 as, in first time adoption of Ind ASs, 'hindsight' is not permitted. Therefore, the obligation not earlier recognised as per the then applicable AS, results in a reduction in (debited to) retained earnings in the previous year column on first time application of Ind AS. Further, as mentioned in paragraph 10(c) above, an equal amount is credited in the current period (Q1) as income.

B. Query

12. The Committee's opinion is sought on the accounting treatment given by the company.

C. Points considered by the Committee

13. The Committee notes that the basic issue raised in the query relates to the company's recognition and derecognition of the company's obligation towards the NHAI for major maintenance under the concession agreement and the consequential gain recognised in the statement of profit and loss during quarter ended 30th June, 2016. 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 toll collection right; accounting for obligation to pay concession fee to NHAI under the OMT concession agreement; disclosure of writing back of provision for resurfacing as an exceptional item of income; applicability of Ind AS 105, 'Non-current Assets Held for Sale and Discontinued Operations' appropriateness of the company's accounting under previous GAAP (Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006); and the regulatory aspects of the discontinuance of concession agreement and handing over the same to NHAI. The Committee has also not

verified the accuracy or the appropriateness of the calculations shared by the querist. Further, the Committee presumes that the OMT concession arrangement in the extant case is within the scope of Appendix A, Service Concession Arrangements to Indian Accounting Standard (Ind AS) 11, 'Construction Contracts'. The Committee also wishes to point out that since the financial year referred to in the query is F.Y. 2016-17, the Committee has considered the issue in the light of the Indian Accounting Standards applicable for that period.

14. At the outset, the Committee notes that the querist has described in the Facts of the Case the obligation for major maintenance under the concession agreement as a constructive obligation. In this regard, the Committee notes that the term, 'constructive obligation' has been defined under paragraph 10 of Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets' as follows:

> **"A *constructive obligation* is an obligation that derives from an entity's actions where:**
>
> **(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and**
>
> **(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities."**

From the above, the Committee is of the view that the obligation for major maintenance is not a constructive obligation as it is not an obligation arising from the action of the company by established pattern of past practice; rather, it is an obligation that emanates from the OMT concession agreement and is therefore a legal binding contractual obligation on the company.

15. With regard to obligation of major maintenance, the Committee notes the following paragraphs of Appendix A to Ind AS 11:

> "12 Under the terms of contractual arrangements within the scope of this Appendix, the operator acts as a service provider. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.
>
> 13 The operator shall recognise and measure revenue in accordance with Ind AS 11 and Ind AS 18 for the services it performs. …"

"21 The operator may have contractual obligations it must fulfil as a condition of its licence (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement. These contractual obligations to maintain or restore infrastructure, except for any upgrade element (see paragraph 14 of this Appendix), shall be recognised and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period."

From the above, the Committee notes that the Appendix A to Ind AS 11 requires an operator to recognise contractual obligations towards maintenance of the infrastructure in accordance with Ind AS 37 and in case of any upgrade element, account for revenue and costs in accordance with Ind AS 11. In this context, the Committee notes the requirements from Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' as follows*:*

***"*A *provision* is a liability of uncertain timing or amount.**

A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

An *obligating event* is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation."

"14 A *provision* shall be recognised when:

(a) an entity has a present obligation (legal or constructive) 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 shall be recognised."

"36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period."

"45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation."

"59 Provisions shall be reviewed at the end of each reporting period 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 shall be reversed.

60 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost."

16. The Committee notes that the company has an obligation to do an overlay of the entire stretch (resurfacing of roads) on or before 31.03.2017 as specified in the concession agreement. This obligation, being a contractual obligation towards NHAI, would meet the above definition of 'provision'. Accordingly, in the extant case, a provision should be recognised, at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period and where the effect of the time value of money is material, the amount of provision shall be the present value of the expenditures expected to be required to settle the obligation at the date of initial recognition of the obligation. The Committee also notes that as per paragraph 60 of Ind AS 37, the provision so recognized should be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. Further, where discounting is used, the carrying amount of a provision should be increased in each period to reflect the passage of time and such increase is recognised as borrowing cost in the financial statements.

17. The Committee further notes from the Facts of the Case that the company has made a provision towards the aforesaid obligation by applying for the first time, the Ind ASs at the time of preparing interim financial statements for the quarter ended 30th June, 2016 (Q1 reporting date). In this regard, the Committee wishes to point out that the Ind AS transition adjustments should be made as of the date of transition to Ind AS, i.e., 1st April, 2015 by making adjustments or passing entries on that date in the first reporting period of its Ind AS financial statements and assumes that the same has been followed by the company in the extant case.

18. The Committee further notes that Ind AS 101, 'First-time Adoption of Indian Accounting Standards' sets out the following requirements with regard to first time adoption of Ind ASs:

"10 Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind ASs;

(b) not recognise items as assets or liabilities if Ind ASs do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and

(d) apply Ind ASs in measuring all recognised assets and liabilities.

11 The accounting policies that an entity uses in its opening Ind AS Balance Sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind ASs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs."

19. Based on the above, the Committee is of the view that the net impact of the recognition of the provision should be recognised in retained earnings as of the date of transition to Ind AS, i.e., 1st April, 2015 in the first reporting period of its Ind AS based financial statements.

20. The Committee also notes that subsequent to the transition date, on 25th August 2016, the company has handed over (by way of discontinuance of the OMT) the Project to the NHAI as per the amicable settlement between the company and NHAI. In this regard, the Committee notes that paragraph 59 of Ind AS 37 provides that if it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision shall be reversed. Accordingly, the Committee is of the view that on discontinuance of the OMT, the provision recognised in respect of major maintenance/resurfacing obligation should be reversed through the statement of profit and loss.

21. The Committee notes that Ind AS 101 provides the following requirements with regard to use of estimates and hindsight while first time adoption of Ind ASs:

"14 An entity's estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with

previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

15 An entity may receive information after the date of transition to Ind ASs about estimates that it had made under previous GAAP. In accordance with paragraph 14, an entity shall treat the receipt of that information in the same way as non-adjusting events after the reporting period in accordance with Ind AS 10, *Events after the Reporting Period*. For example, assume that an entity's date of transition to Ind ASs is 1 April 2015 and new information on 15 July 2015 requires the revision of an estimate made in accordance with previous GAAP at 31 March 2015. The entity shall not reflect that new information in its opening Ind AS Balance Sheet (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 March 2016."

On the basis of the above, the Committee is of the view that a first time adopter of Ind AS is prohibited from using hindsight while preparing first Ind AS financial statements. The major maintenance obligation towards NHAI existed as at the transition date and, therefore, should be recognized in the opening Ind AS balance sheet as at 1st April, 2015, notwithstanding the fact that subsequently, there was a discontinuance of the OMT agreement. The discontinuance of the OMT agreement is a subsequent event, which cannot be considered while preparing the opening Ind AS balance sheet at the date of transition. However, since before the adoption of interim financial statements for the quarter ended 30th June, 2016, the concession agreement was discontinued on August 25, 2016, the same should be analysed as to whether it is an adjusting event after the reporting period or non-adjusting event as per the requirements of Ind AS 10, 'Events after the Reporting Period' while preparing and presenting interim financial reports for the period ending 30th June, 2016. Accordingly, the company should consider making appropriate adjustments in the provision recognised and also consider impairment of the related intangible asset (viz., toll collection right) under service concession agreement. Further, the company should also bear in mind the requirements of Ind AS 34 if it prepares and presents its 30th June, 2016 financial statements in accordance with Ind AS 34.

22. Incidentally, the Committee notes that the querist has raised two separate queries for the different obligations (viz., obligation for major maintenance and the obligation to pay concession fee to NHAI) arising from the same concession

agreement. The Committee further notes that in this query, the querist has stated that the company has recognised the provision for resurfacing (major maintenance) for the first time, by applying Ind AS 37 at the time of preparing interim financial report/statement for the quarter ending 30th June, 2016 (Q1 reporting date), whereas in the other query, the querist has stated that the company has recognised the provision for concession fee payable for the first time, by applying Ind AS 37 at the time of preparing interim financial report/statement for the quarter/six months ending 30th September, 2016 (Q2 reporting date). Thus, there is an apparent contradiction in the two queries as to when the company has applied Ind ASs for the first time, viz., Q1 or Q2 reporting date. Moreover, if the Ind ASs compliant financial statements were prepared for the quarter ending 30th June, 2016, why the company did not make provision for concession fee payable in the first quarter itself is not clear.

Further, the Committee notes that in this query, the querist has stated that the adjustment relating to reversal of provision for resurfacing was made in the first quarter itself as the financials for that quarter were adopted on 2nd September, 2016 and the OMT was discontinued on 25th August, 2016; whereas in the other query, in respect of obligation of payment of concession fee under the same concession agreement, the provision for concession fee payable was recognised for the first time in the second quarter ending 30th September, 2016.

However, the Committee has examined these two queries separately and independently without examining the consequential effects or impact that the one issue may have on the other from accounting perspective.

D. Opinion

23. On the basis of the above, the Committee is of the opinion that the major maintenance/resurfacing obligation should be recognised as of the date of transition to Ind ASs, i.e., 1st April, 2015, notwithstanding the fact that, subsequently, there was a discontinuance of the OMT agreement. The discontinuance of the OMT agreement resulting in reversal of provision should also be accounted for through the statement of profit and loss in the period of such discontinuance, however, it should also be analysed as to whether it is an adjusting event after the reporting period or non-adjusting events as per the requirements of Ind AS 10 for the interim financial statements for the quarter ended 30th June, 2016 and accordingly, adjustments to provision recognised and impairment of related intangible asset should be considered by the company, as discussed in paragraph 21 above.

Query No. 9

Subject: Presentation of deferred tax recoverable from beneficiaries (customers) accounted as 'Deferred Asset for Deferred Tax Liability' under Ind AS.[1]

A. Facts of the Case

1. A company (hereinafter referred to as the 'company') is a central public sector enterprise (CPSE) incorporated with an objective to plan, promote and organise an integrated and efficient development of hydroelectric power. The company has extended its objective to include development of power in all aspects through conventional and non-conventional sources in India and abroad. The company's shares are listed in BSE and NSE. The company has adopted Indian Accounting Standards (Ind ASs) during the 1st Phase, i.e., from April 1, 2016.

2. The company constructs hydropower projects and operates them on build, own, operate & maintain (BOOM) basis. Electricity being a regulated product, tariff for each power station is determined by the Central Electricity Regulatory Commission (CERC) based on the CERC Tariff Regulations issued for a period of five years at a time. The currently applicable tariff period is 2014-15 to 2018-19, i.e. 2014-19.

3. Tariff is fixed by the CERC based on the capital cost incurred for the power station. Tariff Regulations provide for recovery of costs incurred on running and maintenance of the power station, depreciation of property, plant & equipment, interest on loans & borrowings for construction of the plant and interest on working capital, plus a specified pre-tax rate of return on equity invested in the plant. Annual Fixed Charges (AFC) i.e. tariff, for a hydropower station is the sum of the following items:

(a) Return on Equity (ROE): ROE is allowed @ 15.5% for run-of-the-river type power stations and @ 16.5% for storage-type power stations grossed up at the effective tax rate. Normative Debt: Equity ratio of capital cost allowed by the CERC after prudence check is 70:30.

(b) Interest on loan capital: calculated on the normative average loan of the year by applying the weighted average rate of interest.

(c) Depreciation: depreciation is allowed at the rates prescribed in the tariff regulations on Straight Line Method (SLM) for the first 12 years from commercial operation date. The balance depreciation

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

upto 90% of capital cost of the asset is spread over the balance life of 23 years. Total life of a hydro-power station is considered as 35 years.

(d) Interest on working capital: Provided on normative basis @ bank rate prevailing as on 1st April of the relevant year on the following items:

(i) Receivables equivalent to two months of annual fixed charges + (ii) Maintenance spares @ 15% of operation and maintenance expenses + (iii) Operation and maintenance expenses for one month.

(e) Operation and Maintenance expenses (O&M Expenses): Provided on the basis of normalized actual O&M expenses after escalation @ 6.64% in case of existing power stations and @ 2% of capital cost for new power stations.

4. The AFC so arrived at is recovered in two parts: A) Capacity Charges and B) Energy Charges. Capacity charges amounting to 50% of the AFC is recovered on the basis of Plant Availability Factor (PAF) which is defined as the average of the daily declared capacities (DCs) for all the days during the period expressed as a percentage of the installed capacity in MW less the normative auxiliary energy consumption. Energy charges amounting to 50% of the AFC are recovered on the basis of energy scheduled to be supplied to the beneficiary, excluding free energy.

5. *Provisions of Central Electricity Regulatory Commission (CERC) for recovery of tax on Income:* Income tax on core business, i.e. generation and sale of power is allowed as a component of tariff for recovery from beneficiaries. However, the method of recovery of income tax has undergone change in the various tariff periods. The relevant regulations for recovery of income tax as a component of tariff under the various tariff periods have been reproduced by the querist as under:

CERC (Terms and Conditions of Tariff) Regulations, 2004 (For tariff period 2004-09):

Regulation 7: Tax on Income:

(1) Tax on the income streams of the generating company or the transmission licensee, as the case may be, from its core business, shall be computed as an expense and shall be recovered from the beneficiaries.

(2) Any under-recoveries or over-recoveries of tax on income shall be adjusted every year on the basis of income-tax assessment under the Income-Tax Act, 1961, as certified by the statutory auditors.

Provided that tax on any income stream other than the core business shall not constitute a pass through component in tariff and tax on such other income shall be payable by the generating company or transmission licensee, as the case may be.

Provided further that the generating station-wise profit before tax in the case of the generating company and the region-wise profit before tax in case of the transmission licensee as estimated for a year in advance shall constitute the basis for distribution of the corporate tax liability to all the generating stations and regions.

Provided further that the benefits of tax-holiday as applicable in accordance with the provisions of the Income-Tax Act, 1961 shall be passed on to the beneficiaries.

Provided further that in the absence of any other equitable basis the credit for carry forward losses and unabsorbed depreciation shall be given in the proportion as provided in the second proviso to this regulation.

Provided further that income-tax allocated to the thermal generating station shall be charged to the beneficiaries in the same proportion as annual fixed charges, *the income-tax allocated to the hydro generating station shall be charged to the beneficiaries in the same proportion as annual capacity charges* and in case of interstate transmission, the sharing of income-tax shall be in the same proportion as annual transmission charges.

Regulation 10- Recovery of Income-tax and Foreign Exchange Rate Variation:

Recovery of income-tax and foreign exchange rate variation shall be done directly by the generating company or the transmission licensee, as the case may be, from the beneficiaries without making any application before the Commission.

Provided that in case of any objections by the beneficiaries to the amounts claimed on account of income-tax or foreign exchange rate variation, the generating company or the transmission licensee, as the case may be, may make an appropriate application before the Commission for its decision.

CERC (Terms and Conditions of Tariff) Regulations, 2009 (For tariff period 2009-14):

Regulation 15: Return on Equity:

(1) Return on equity shall be computed in rupee terms, on the equity base determined in accordance with regulation 12.

(2) Return on equity shall be computed on pre-tax basis at the base rate of 15.5% to be grossed up as per clause (3) of this regulation.

(3) *The rate of return on equity shall be computed by grossing up the base rate with the normal tax rate for the year 2008-09* applicable to the concerned generating company or the transmission licensee, as the case may be.

Provided that return on equity with respect to the actual tax rate applicable to the generating company or the transmission licensee, as the case may be, in line with the provisions of the relevant Finance Acts of the respective year during the tariff period shall be trued up separately for each year of the tariff period along with the tariff petition filed for the next tariff period.

(4) Rate of return on equity shall be rounded off to three decimal points and be computed as per the formula given below:

Rate of pre-tax return on equity = Base rate / (1-t)

Where 't' is the applicable tax rate in accordance with clause (3) of this regulation.

Illustration:

(i) In case of the generating company or the transmission licensee paying Minimum Alternate Tax (MAT) @ 11.33% including surcharge and cess:

Rate of return on equity = 15.50/ (1-0.1133) = 17.481%

(ii) In case of generating company or the transmission licensee paying normal corporate tax @ 33.99% including surcharge and cess:

Rate of return on equity = 15.50/ (1-0.3399) = 23.481%

Regulation 39: Tax on Income.

Tax on the income streams of the generating company or the transmission licensee, as the case may be, shall not be recovered from the beneficiaries, or the long-term transmission customers, as the case may be.

Provided that the deferred tax liability, excluding Fringe Benefit Tax, for the period up to 31st March, 2009 whenever it materializes, shall be recoverable directly from the beneficiaries and the long-term customers.

CERC (Terms and Conditions of Tariff) Regulations, 2014 (For tariff period 2014-19):

Regulation 25. Tax on Return on Equity:

(1) The base rate of return on equity as allowed by the Commission under Regulation 24 shall be grossed up with the effective tax rate of the respective financial year. For this purpose, the effective tax rate shall be considered on the basis of actual tax paid in respect of the financial year in line with the provisions of the relevant Finance Acts by the concerned generating company or the transmission licensee, as the case may be. The actual tax income on other income stream (i.e., income of non-generation or non-transmission business, as the case may be) shall not be considered for the calculation of "effective tax rate".

(2) Rate of return on equity shall be rounded off to three decimal places and shall be computed as per the formula given below:

Rate of pre-tax return on equity = Base rate / (1-t)

Where "t" is the effective tax rate in accordance with Clause (1) of this regulation and shall be calculated at the beginning of every financial year based on the estimated profit and tax to be paid estimated in line with the provisions of the relevant Finance Act applicable for that financial year to the company on pro-rata basis by excluding the income of non-generation or non-transmission business, as the case may be, and the corresponding tax thereon. In case of generating company or transmission licensee paying Minimum Alternate Tax (MAT), "t" shall be considered as MAT rate including surcharge and cess.

Illustration:

i) In case of the generating company or the transmission licensee paying Minimum Alternate Tax (MAT) @ 20.96% including surcharge and cess:

Rate of return on equity = 15.50/(1-0.2096) = 19.610%

ii) In case of generating company or the transmission licensee paying normal corporate tax including surcharge and cess:

a) Estimated Gross Income from generation or transmission business for F.Y. 2014-15 is Rs. 1000 crore.
b) Estimated Advance Tax for the year on above is Rs. 240 crore.
c) Effective Tax Rate for the year 2014-15 = Rs. 240 Crore/Rs. 1000 Crore = 24%
d) Rate of return on equity = 15.50/ (1-0.24) = 20.395%

(3) *The generating company or the transmission licensee, as the case may be, shall true up the grossed up rate of return on equity at the end of every financial year based on actual tax paid together with any additional tax demand including interest thereon, duly adjusted for any refund of tax including interest received from the income tax authorities pertaining to the tariff period 2014-15 to 2018-19 on actual gross income of any financial year.* However, penalty, if any, arising on account of delay in deposit or short deposit of tax amount shall not be claimed by the generating company or the transmission licensee as the case may be. Any under-recovery or over-recovery of grossed up rate on return on equity after truing up, shall be recovered or refunded to beneficiaries or the long term transmission customers/DICs as the case may be on year to year basis.

Regulation49. Deferred Tax liability with respect to previous tariff period:

The deferred tax liability before 1.4.2009 shall be recovered from the beneficiaries or the long term transmission customers/DICs as the case may be, as and when the same gets materialised. No claim on account of deferred tax liability arising from 1.4.2009 upto 31.03.2014 shall be made from the beneficiaries or the long term transmission customers/DICs as the case may be.

(Emphasis supplied by the querist.)

6. Accounting for tax on income by the company:

i) The company accounts for tax on income (including deferred tax) as per applicable Accounting Standard (AS) 22 'Accounting for Taxes on Income'/Ind AS 12 'Income Tax'. Tax expense of the company consists of current tax and deferred tax.

ii) As per CERC regulation 2004-09, tax on income computed as an expense shall be recovered from the beneficiaries. Accordingly, an asset towards Deferred Tax 'Recoverable for tariff period up to 2009' has been created against deferred tax expenditure charged to profit and loss account upto 31st March, 2009 as the same is recoverable from the beneficiaries when the same becomes a part of current tax during any subsequent year.

iii) As per CERC Regulation 2009-14, beneficiaries were not liable to pay the income tax on the income streams of the generating companies or the transmission licensees unlike the provisions under 2004 Tariff Regulations and the liability of the beneficiaries was only limited to paying a rate of return grossed up at the applicable tax rate. Consequently, the generating companies were not allowed to recover the deferred tax liabilities created during the period 2009-14. Accordingly, during F.Y. 2009-10 to F.Y. 2013-14, the company has not created deferred tax recoverable (asset) against deferred tax expenditure. In other words, since return on equity was grossed up at the applicable tax rate (i.e. normal tax rate / MAT), no additional recovery towards deferred tax was required to be made.

iv) The tariff norms for the period 2014-19 notified by the CERC provide for grossing up of the return on equity with the effective tax rate of the financial year based on the actual tax paid during the year on income from generation of power. Accordingly, deferred tax provided during the year on income from generation and further recoverable from beneficiaries in future periods is accounted for as 'Deferred tax adjustment against Deferred Tax Liability'. The 'Deferred tax adjustment against Deferred Tax Liability' so created for the year is netted off from the 'Deferred Tax expense' in the profit & loss account and from deferred tax liability in the balance sheet. The asset so created during the tariff period 2014-19 will be reversed in future years (including tax holiday period) when the related deferred tax liability forms a part of current tax and becomes recoverable from beneficiaries by way of grossing up of the Return on Equity.

v) Accordingly, the balances appearing under 'Recoverable for tariff period up to 2009' and 'Deferred tax adjustment against Deferred Tax Liabilities' for tariff period 2014-19 have been reduced from the deferred tax liabilities in the financial statements and presented as under:

Presentation in the Balance Sheet as at 31st March 2017

Deferred Tax Liability (Net)	(Rs. In Crore)	
Deferred Tax Liabilities	XXXX	
Less: Recoverable for tariff period up to 2009	XXXX	XXXX
Less: Deferred tax adjustment against Deferred Tax Liabilities (For tariff period 2014-19)	XXXX	

Presentation in the Profit & Loss for the year ended 31st March 2017

Provision for Taxation	(Rs. In Crore)	
(i) Current Tax	XXXXX	
(ii) Deferred Tax	XXXX	
Less: Recoverable for tariff period up to 2009	(XXXX)	XXXX
Less: Deferred tax adjustment against Deferred Tax Liabilities (For tariff period 2014-19)	XXXX	

7. *Comments by the Office of the C&AG during the Phase-II audit of accounts for the F.Y. 2016-17*

i) C&AG had issued a half margin to the company on the presentation of deferred asset for deferred tax liability in the financial statements. Similar half margin was issued to another power sector CPSU. The replies by both companies were considered and it was decided in the review meeting by the C&AG that opinion from the Expert Advisory Committee of the Institute of Chartered Accountants of India should be obtained on the presentation of 'Deferred asset for deferred tax liability' in the financial statements of the company. Accordingly, the half margin was dropped on the basis of assurance on the above lines.

Though there are certain variations in the queries raised by the C&AG to the CPSUs, the basic observation of the C&AG regarding presentation of 'Deferred asset for deferred tax liability' as per Ind AS

114, 'Regulatory Deferral Accounts' and the reply to the same provided to C&AG are as under:

ii) Observation of the C&AG

"The Company has recognised Rs. XXXX crore as Deferred Assets for Deferred Tax Liability and the same has been presented as a deduction from Deferred Tax Liability, as detailed below:

Note on Deferred Tax Liabilities (Net)

Deferred Tax Liability	Rs. XXXX crore
Less: Deferred Assets for deferred tax liability	Rs. XXX crore
Net deferred tax liability	Rs. XXXX crore"

Observation of the C&AG is based on the following paragraphs of Ind AS 114- Regulatory Deferral Account Balances (as quoted by Audit):

"Indian Accounting Standard (Ind AS) 114, Regulatory Deferral Accounts emphasizes primarily on the presentation and disclosure requirements for regulatory deferral account balances. The Standard permits an entity within its scope to continue to account for regulatory deferral account balances in its financial statements in accordance with its previous GAAP (in this case Guidance Note issued by ICAI on Rate Regulated Activities) when it adopts Ind ASs, subject to the limited changes referred to in paragraph 2. However, Ind AS stipulates that the presentation and disclosure of these accounts shall be according to the requirements of Ind AS 114.

Important stipulations of Ind AS 114 are narrated below:

Paragraph 8 of the Standard says that an entity that is within the scope of, and that elects to apply, this Standard shall apply all of its requirements to all regulatory deferral account balances that arise from all of the entity's rate-regulated activities.

Paragraph 11 re-emphasises that the presentation of such amounts shall comply with the presentation requirements of this Standard, which may require changes to the entity's previous GAAP presentation policies.

Paragraph 18 under 'Presentation-Changes in presentation' says that this Standard introduces presentation requirements, outlined in paragraphs 20–26, for regulatory deferral account balances that are recognised in accordance with paragraphs 11–12. When this Standard is applied, the regulatory deferral account balances are recognised in the balance sheet in addition to the assets and liabilities that are recognised in accordance with other Standards. These presentation requirements separate the impact of recognising regulatory deferral account balances from the financial reporting requirements of other Standards.

Paragraph 20 says that an entity shall present separate line items in the balance sheet for: (a) the total *of all regulatory deferral account debit balances; and (b) the total of all regulatory deferral account credit balances*.

Paragraph 23 says that an entity shall present, a separate line item in the profit or loss section of the statement of profit and loss, for the remaining net movement in all regulatory deferral account balances for the reporting period, excluding movements that are not reflected in profit or loss, such as amounts acquired. This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total, which is drawn before the net movement in regulatory deferral account balances.

Appendix B to Ind AS 114

Application Guidance

"Application of Ind AS 12 Income Taxes

B9 Ind AS 12 requires, with certain limited exceptions, an entity to recognise a deferred tax liability and (subject to certain conditions) a deferred tax asset for all temporary differences. A rate-regulated entity shall apply Ind AS 12 to all of its activities, including its rate regulated activities, to identify the amount of income tax that is to be recognised.

B10 *In some rate-regulatory schemes, the rate regulator permits or requires an entity to increase its future rates in order to recover some or all of the entity's income tax expense. In such circumstances, this might result in the entity recognising a regulatory deferral account balance in the balance sheet related to income tax, in accordance with its accounting policies established in accordance with paragraphs 11–12.* The recognition of this regulatory deferral account balance that relates to income tax might itself create an additional temporary difference for which a further deferred tax amount would be recognised.

B11 Notwithstanding the presentation and disclosure requirements of Ind AS 12, when an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances, the entity shall not include that deferred tax amount within the total deferred tax asset (liability) balances. Instead, the entity shall present the deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances either:

(a) with the line items that are presented for the regulatory deferral account debit balances and credit balances; or

(b) as a separate line item alongside the related regulatory deferral account debit balances and credit balances.

B12 Similarly, when an entity recognises the movement in a deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances, the entity shall not include the movement in that deferred tax amount within the tax expense (income) line item that is presented in the statement of profit and loss in accordance with Ind AS 12. Instead, the entity shall present the movement in the deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances either:

(a) with the line items that are presented in the statement of profit and loss for the movements in regulatory deferral account balances; or

(b) as a separate line item alongside the related line items that are presented in the statement of profit and loss for the movements in regulatory deferral account balances."

Continuation of existing accounting policies

"B3 For the purposes of this Standard, a regulatory deferral account balance is defined as the balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers…"

From the above extracts of Ind AS 114 and a review of the implementation of this Ind AS by the company, Audit observed the following:

a) The Company needed to present the Regulatory Deferral Account created in the form of 'Deferred Assets against Deferred Tax Liability' in the face of the Balance Sheet itself against the line item "Regulatory Deferral Account Balances". Instead the Company *showed the same as deduction from Deferred Tax Liabilities which is against the principles set out in Ind AS 114.*

b) *As a result of deviation from the Ind AS 114 requirements, Balance Sheet- Regulatory Deferral Account Balances is understated by Rs. XXXX crore with corresponding understatement of Balance Sheet- Deferred Tax Liabilities (Net) by an equal amount. Total of the Balance Sheet is also understated by Rs. XXXX crore.*

c) *Similarly in the Statement of Profit and Loss, "Profit for the period before Regulatory Deferral Account Balances) is overstated by Rs. XXXX crore with corresponding understatement of Tax Expense. This has also resulted in understatement of "Net movement in Regulatory Deferral Account Balances-Income / (Expenses)" by Rs. XXXX crore."*

(Emphasis supplied by the querist)

iii) *Reply to the comments of C&AG as per 7(ii) above were as under:*

"The company has recognized Deferred Tax Liability as per Ind AS 12 to recognize tax effect of timing differences. Such Deferred Tax Liability would reverse in future years. The company has recognized a Deferred Asset for Deferred Tax Liability which would also reverse in future years along with the deferred tax liability. The Deferred Asset against Deferred Tax Liability is thus not a regulatory asset as per the definition of the Regulatory Asset given in the Guidance Note.

Paragraphs B10 and B11 referred by audit are not applicable in the instant case for the following reasons:

Paragraph B10 of Ind AS 114 provides a background explaining the circumstances when an additional temporary difference might arise on recognizing a regulatory deferral account balance that relates to income tax. If a regulatory deferral account balance that relates to income tax gives rise to a temporary difference, then para B 11 provides the disclosure guidance. B11 is applicable when "an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances".

Deferred Tax Liability has been recognized by the Company in accordance with requirements of Ind AS 12. Since Deferred Tax Liability is not arising from a regulatory deferral account balance, the "Deferred Asset for Deferred Tax Liability" also does not meet the requirement of paragraph B11.

Reference of Audit is invited to provisions of paragraph 33 of Ind AS 1- Presentation of Financial Statements which permits offsetting of income and expense, assets and liabilities when it reflects the substance of the transaction or other event or when separate disclosure detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. In the present case, the Deferred Tax Liability and Deferred Asset against Deferred Tax Liability are closely related, as such separate disclosure thereof would not reflect the substance of the transaction. Accordingly, the Deferred Asset for Deferred Tax Liability has been deducted from the Deferred Tax expense with adequate disclosure on the face of the profit and loss account as well as the notes to the Balance Sheet.

It may also be seen that similar provisions for netting are available in Ind AS 18 Revenue which provides that the entity may net any income with related expenses when it reflects the substance of the transaction.

It is also submitted that under Ind AS 12 also, the netting of deferred tax assets and deferred tax liabilities is permitted to reflect the substance of the underlying asset/liability.

In view of above, it is submitted that presentation of the deferred asset for deferred tax liability in the financial statements is in order."

B. Query

8. Keeping in view the above, opinion of the Expert Advisory Committee is solicited as to whether in terms of Ind AS 114, 'Regulatory Deferral Accounts',

a) 'Deferred Asset for Deferred Tax Liability' created during the year (pertaining to 2014-19 period) and reversal of 'Deferred Asset for Deferred Tax Liability' pertaining to earlier periods (tariff period 2004-09) are to be presented as an adjustment to expenditure on deferred tax in the statement of profit and loss or to be presented as a movement in regulatory deferral account balance (as a separate line item in the statement of profit and loss), and

b) Balance in 'Deferred Asset for Deferred Tax Liability A/c' pertaining to tariff period 2004-09 and 2014-19 is to be presented as an adjustment to deferred tax liability in the balance sheet or to be presented as a regulatory deferral account balance (as a separate line item in balance sheet).

C. Points considered by the Committee

9. The Committee notes that the company in the extant case has applied Indian Accounting Standards (Ind ASs) notified under Companies (Indian Accounting Standards) Rules, 2015 for accounting periods commencing from 1 April, 2016 onwards. The Committee further notes that the querist has opted to apply Ind AS 114 in its first Ind AS financial statements for financial year 2016-17.

10. The Committee notes that the basic issue raised in the query relates to whether the presentation of regulatory deferral asset on deferred tax liability balance, recognised as per the requirements of Ind AS 114, is appropriate and in line with the requirements contained in Ind ASs. 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, recognition of deferred tax liability, etc. Further, this opinion is restricted to the financial reporting requirements under Ind AS and does not deal with the regulatory aspects of the CERC tariff regulations or any other related regulations. The Committee also presumes that the 'Deferred Asset for Deferred Tax Liability' has been appropriately recognised as per the requirements of Ind AS 114/Guidance Note on Accounting for Rate Regulated Activities.

11. The Committee notes from the above that the CERC tariff norms for the period 2004-2009 provides for recovery of income tax directly from beneficiaries and tariff norms for the period 2014-19 provides for grossing up of the return on equity with the effective tax rate for the financial year based on the actual tax paid during the year on income from generation of power, rather than the applicable tax rate. Considering these norms the company has recognised an asset balance referred to as 'Deferred Tax Adjustment against Deferred Tax Liability'/'Deferred Asset for Deferred Tax Liability'/ 'Recoverable for tariff period up to 2009' (which is hereinafter referred to as 'Deferred Tax Adjustment against Deferred Tax Liability'. The Committee presumes that these terminologies referred to by the querist and the Office of C&AG are used interchangeably and refer to the same account balance in question. The Committee further notes that the company has presented deferred tax liability in the balance sheet after netting of 'Deferred Tax Adjustment against Deferred Tax Liability', which has been disclosed in the deferred tax schedule in the financial statements. Similarly, the deferred tax expense presented in the statement of profit and loss is net of the 'Deferred Tax Adjustment against Deferred Tax Liability', which has been disclosed under 'Provision for Taxation' heading in the financial statements.

12. With regard to the nature of the 'Deferred Tax Adjustment against Deferred Tax Liability', the Committee notes that Appendix A to Ind AS 114 defines 'regulatory deferral account balance' as a 'Regulatory Asset' or a

'Regulatory Liability' as defined in the Guidance Note on Accounting for Rate Regulated Activities. Paragraph 21 of the Guidance Note states that a regulatory asset is an entity's right to recover fixed or determinable amounts of money towards incurred costs as a result of the actual or expected actions of its regulator under the applicable regulatory framework. The Committee further notes that paragraph 5 of Ind AS 12, 'Income Taxes' defines deferred tax assets and liabilities as follows:

> ***"Deferred tax liabilities*** **are the amounts of income taxes payable in future periods in respect of taxable temporary differences.**
>
> ***Deferred tax assets*** **are the amounts of income taxes recoverable in future periods in respect of:**
>
> **(a) deductible temporary differences;**
>
> **(b) the carryforward of unused tax losses; and**
>
> **(c) the carryforward of unused tax credits.**
>
> ***Temporary differences*** **are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:**
>
> **(a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or**
>
> **(b) *deductible temporary differences*, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled."**

13. The Committee notes that 'Deferred Tax Adjustment against Deferred Tax Liabilitythat the company has recognised in the extant case would reverse in future by way of tariff adjustment. The Committee further notes that future reversals of 'Deferred Tax Adjustment against Deferred Tax Liability' balance would affect the tariff recoverable from the beneficiaries in future periods and therefore fulfills the definition of regulatory deferral account balance under Ind AS 114. The Committee further notes that such deferral account balance would not be recoverable through adjustment in future income tax liabilities arising on the company as assessed under Income Tax Act and is, therefore, not a deductible temporary difference resulting into deferred tax asset under Ind AS 12. Rather, it

is a regulatory deferral account balance, as mentioned in paragraph B10 of Ind AS 114.

14. The Committee notes that Ind AS 12 does not allow deferred tax liabilities to be offset with assets other than deferred tax assets under Ind AS 12 and as discussed in paragraph 13 above, 'Deferred Tax Adjustment against Deferred Tax Liability' balance is not a deferred tax asset under Ind AS 12. Accordingly, the Committee is of the view that 'Deferred Tax Adjustment against Deferred Tax Liability' cannot be offset with deferred tax expense or liability in the financial statements.

15. Further, with regard to presentation of 'Deferred Tax Adjustment against Deferred Tax Liability', the Committee notes paragraphs 20, 22 and 23 of Ind AS 114, which provide as follows:

> **"20 An entity shall present separate line items in the balance sheet for:**
>
> **(a) the total of all regulatory deferral account debit balances; and**
>
> **(b) the total of all regulatory deferral account credit balances."**
>
> **"22 An entity shall present, in the other comprehensive income section of the statement of profit and loss, the net movement in all regulatory deferral account balances for the reporting period that relate to items recognised in other comprehensive income. Separate line items shall be used for the net movement related to items that, in accordance with other Standards:**
>
> **(a) will not be reclassified subsequently to profit or loss; and**
>
> **(b) will be reclassified subsequently to profit or loss when specific conditions are met.**
>
> **23 An entity shall present a separate line item in the profit or loss section of the statement of profit and loss, for the remaining net movement in all regulatory deferral account balances for the reporting period, excluding movements that are not reflected in profit or loss, such as amounts acquired. This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total, which is drawn**

before the net movement in regulatory deferral account balances."

Accordingly, the Committee is of the view that the company should follow the above- reproduced requirements of Ind AS 114 in respect of 'Deferred Tax Adjustment against Deferred Tax Liability' in its financial statements.

16. Incidentally, the Committee wishes to point out that in view of paragraph B10 of Ind AS 114, the company should also examine as to whether or not the recognition of regulatory deferral account balance in the extant case, viz., 'Deferred Tax Adjustment against Deferred Tax Liability' is creating an additional temporary difference for which a further deferred tax amount needs to be recognised. Further, if a deferred tax/deferred liability (as the case may be) is created considering the requirements of B10, the same should also be presented as per the requirements of Ind AS 114 and not Ind AS 12.

D. Opinion

17. On the basis of the above, the Committee is of the opinion that the nature of the 'Deferred Tax Adjustment against Deferred Tax Liability' is in the nature of regulatory deferral account balance under Ind AS 114 and not in the nature of deferred tax asset for reasons mentioned in paragraphs 12 and 13 above. The presentation by the entity of deferred tax liabilities balance in balance sheet and deferred tax expense in statement of profit and loss, each net of 'Deferred Tax Adjustment against Deferred Tax Liability' is not in compliance with the requirements of Ind AS 114 and Ind AS 12. The same should be in accordance with paragraphs 20, 22 and 23 of Ind AS 114, as discussed in paragraphs 14 and 15 above.

Query No. 10

Subject: Accounting for funded interest term loan (FITL) subsequent to restructuring of a loan taken from a shareholder. [1]

A. Facts of the Case

1. XYZ Ltd. (hereinafter referred to as 'the company') is a pharmaceutical manufacturing unit, which is a subsidiary of A Ltd. (74% share) and B Ltd. (26% share). Annual turnover of XYZ Ltd. for the financial year (F.Y.) 2016-17 is INR 77.66 crore and it is not listed on any recognised stock exchange. However, XYZ

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

Ltd. is required to adopt Indian Accounting Standards (Ind ASs) from F.Y. 2016-17 onwards, with the date of transition to Ind AS being 1st April 2015.

2. XYZ Ltd. had taken loans from B Ltd. (which is also a financial institution) from 2002-03 to 2007-08. During this period, the company was unable to pay interest on the loan amount. So after discussion with B Ltd., an agreement dated 14th September 2009 (the agreement) was signed with B Ltd., as per which, B Ltd. had converted the unpaid interest into a funded interest term loan (interest-free loan) of amount INR 2,77,40,554.

3. The total loan related to this interest was INR 3,75,32,873.44 detailed as below:

Principal Loan	Interest Rate
2,00,00,000.00	12.50%
1,25,00,000.00	12.50%
18,00,000.00	12.00%
13,36,586.00	10.00%
11,92,128.97	10.00%
7,04,158.47	12.00%
3,75,32,873.44	

4. Interest amounting to INR 2,77,40,554 on the above loans was converted into a Funded Interest Term Loan (FITL) which was interest-free and had to be repaid in instalments as per the schedule stipulated in the agreement (a copy of which has been supplied by the querist for the perusal of the Committee).

5. According to the querist, the effective interest rate was determined as per Ind AS and the requisite adjustments were made in the financial statements for the F.Y. 2016-17. (A copy of the working of the effective interest rate and summary of treatment given in the financial statements have also been supplied by the querist separately for the perusal of the Committee.)

6. The auditors of the Comptroller and Auditor General of India (CAG) observed in their review of the company's financial statements, that the interest-free loan should be fair valued by discounting all future cash flows at the market interest rate as per Ind AS 113 and the resultant gain should be recognised in the profit and loss account for the F.Y. 2015-16 along with the imputed interest cost on the discounted loan amount.

7. The company's contention was that though the FITL is separated from the main term loan, for calculation of effective interest rate, it should be taken as a part of the original term loan and effective interest rate should be determined accordingly.

8. The company has provided an undertaking to the CAG that it would seek an expert opinion from the Expert Advisory Committee for determination of the correct accounting treatment for the transaction as per the requirements of Ind ASs.

B. Query

9. Accordingly, the company has sought the opinion of the Expert Advisory Committee as to whether the accounting treatment followed by the company is in consonance with Ind ASs and if not, the company has requested the Committee to suggest the correct accounting treatment for the aforesaid transaction.

C. Points considered by the Committee

10. At the outset, the Committee notes the following relevant information from the agreement dated 14th September 2009, between the company and B Ltd. and other documents supplied by the querist:

(i) XYZ Ltd. had taken various loans from its shareholder, B Ltd., which is a financial institution and a Government of Goa undertaking, as follows:

a. Term loan of INR 2,00,00,000 vide agreement dated 02.02.1995
b. Term loan of INR 5,00,00,000 vide agreement dated 09.12.2005
c. Various unsecured loans to meet financial requirements from time to time; outstanding amount was INR 1,75,32,873.44 as on 31.03.2009
d. New term loan towards settlement of XYZ Ltd.'s bank loan and for implementation of a voluntary retirement scheme (VRS) for its employees. This new term loan of INR 2,00,00,000 at an interest rate of 12.5% per annum was sanctioned vide letter dated 23.03.2009 and was disbursed in two instalments of INR 1,22,66,000 on 14.09.2009 and INR 77,34,000 pursuant to a financial restructuring package for XYZ Ltd.'s existing liabilities to B Ltd.

(ii) The company was unable to pay interest on its outstanding term loans and unsecured loans and was granted a financial restructuring package by B Ltd. vide agreement dated 14th September 2009 as follows:

a. The outstanding unsecured loan of INR 1,75,32, 873.44 merged with the outstanding (old) term loan of INR

2,00,00,000, making a total of INR 3,75,32,873.44 (known as the 'first outstanding amount') would be payable in 12 quarterly instalments from 01.04.2010 to 01.01.2013. This outstanding amount would carry an interest of 10% per annum with effect from 01.04.2009 to be paid quarterly along with the instalments.

b. The outstanding interest on the unsecured loan amounting to INR 92,82,749.23 as on 31.03.2004 and interest of INR 1,84,57,804.77 on the old term loan referred to in 10(i) above, calculated at 10% per annum from 01.04.2004 until 31.03.2009; totalling to INR 2,77,40,554 (known as the 'second outstanding amount') was converted into a Funded Interest Term Loan (FITL). B Ltd. agreed not to charge any further interest on this FITL with effect from 01.04.2009. The FITL would be repaid in 9 quarterly instalments with effect from 01.04.2013 until 01.04.2015.

c. The outstanding (old) term loan of INR 5,00,00,000 (known as the 'third outstanding amount') would be repaid in 11 quarterly instalments from 01.07.2015 to 01.01.2018. Interest on this outstanding amount would not be remitted by the company until the same is being reimbursed by the Government of Goa to B Ltd. However, in the event, the reimbursement of the interest is not received from the Government, the company would be required to pay interest at 12.5% per annum in 11 quarterly instalments on the third outstanding amount from the last date of reimbursement of interest received from the Government.

(iii) The repayment schedule agreed in the financial restructuring package mentioned in point (ii) above, was further revised on 19.03.2011 to extend the repayment timelines for the first, second and third outstanding amounts, as well as reduce the interest rate applicable to the third outstanding amount from 12.5% per annum to 10% per annum. The revised schedule also reduced the interest rate applicable to the new term loan to 10% per annum, however, it provided for earlier repayment of this new term loan.

(iv) On transition to Ind ASs, the company has computed the effective interest rate (EIR) under Ind AS 113, 'Fair Value Measurement' for the first outstanding amount of INR 3,75,32,873 and the FITL of INR 2,77,40,554, considering the cash inflows and outflows under the revised repayment schedule. Further, the company has adjusted the loan balance outstanding in its financial statements on transition to Ind ASs to reflect the amortised cost based on the EIR computed as per this method. This adjustment resulted in an increase in the loan balance of INR 15,81,314 as on 1st April 2015, with similar consequential adjustments being made to the loan amount as on 31st March 2016.

(v) The CAG auditors observed that the interest-free loan (being the FITL) should be fair valued by discounting all future cash flows at the market interest rate as per Ind AS 113 and the resultant gain should be recognised in the profit and loss account for the F.Y. 2015-16. Accordingly, the CAG observed that the company's borrowings and other income and profit for the F.Y. 2015-16 were overstated by an amount of INR 64,69,313, being the difference between the FITL amount and its present value at a discount rate of 10%.

(vi) The querist's contention was that the FITL is not a loan sanctioned by B Ltd. Rather, it is the unpaid interest on a term loan, which the company has defaulted on. On restructuring, the interest accrued until the date of restructuring was converted into the FITL in a manner similar to that of banks or financial institutions assisting borrowers with stressed cash flows. Therefore, this was a modification of the terms of repayment with a change in the timing of cash flows. Ind AS 109, 'Financial Instruments', specifically deals with such cases. The company has, therefore, viewed the FITL as a part of the term loan and computed the EIR based on the combined revised cash flows of the term loan as well as the FITL.

11. The Committee notes that the main issue raised in this query relates to the measurement of the FITL (being the second outstanding amount) from B Ltd. at amortised cost on the date of transition to Ind AS. Specifically, whether the company's approach to determining the EIR and the resulting amortised cost based on the combined, revised repayment schedule relating to the first and second outstanding amounts, is appropriate. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, including the measurement of the third outstanding amount and the new term loan from B Ltd. Accordingly, the querist should separately determine the appropriate accounting treatment for the other outstanding loan amounts based on relevant considerations under Ind AS. The Committee has also not considered whether 10% discount rate used by the company for calculating fair value is appropriate. The same should be estimated by the company in accordance with Ind AS 113 principles.

12. The Committee further notes that the borrowing from B Ltd. is a financial liability of XYZ Ltd. It is assumed that the same is not held for trading nor it otherwise meets criteria for designation at fair value through profit or loss under Ind AS 109. Hence, it should be subsequently measured at amortised cost. Appendix A to Ind AS 109 defines the amortised cost of a financial instrument as the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance. The effective interest rate is "the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the **gross carrying amount of a financial asset** or to the **amortised cost of a financial liability**."

The amount at which a financial liability (classified at amortised cost) is to be initially recognized under Ind AS 109 is its fair value plus or minus any transaction costs that are directly attributable to the issue of the financial liability. (Refer paragraph 5.1.1 of Ind AS 109)

13. XYZ Ltd. has obtained the loan from B Ltd. prior to its date of transition to Ind ASs. Hence, Ind AS was not applicable at the time of initial recognition of the borrowing. Therefore, the Committee considers that a key issue is to determine the appropriate recognition and measurement requirements for this liability on transition to Ind ASs. Ind AS 101, 'First-time adoption of Indian Accounting Standards' provides guidance on transition to Ind ASs. Paragraph 10 of Ind AS 101 states that "Except as described in paragraphs 13-19 and Appendices B-D, an entity shall, in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind ASs;
(b) not recognise items as assets or liabilities if Ind ASs do not permit such recognition;
(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and
(d) apply Ind ASs in measuring all recognised assets and liabilities."

14. XYZ Limited entered into a financial restructuring agreement with B Ltd. in 2009, in which it converted the interest accrued and due to B Ltd. into a funded interest term loan. Further, it has extended the repayment term of its first outstanding amount. As a result of this restructuring transaction, under previous GAAP, the company derecognised the interest accrued and recognised the FITL as an unsecured term loan, under 'long term borrowings' in its financial

statements. Based on the terms given including different interest rates and repayment terms, they continue to be separate loans and cannot be treated as one loan. The Committee notes that under Ind AS 109, the company would have been required to assess whether the modification in the terms of the borrowings would result in their derecognition and the recognition of a new liability. However, paragraph 13 and Appendix B of Ind AS 101 prohibit retrospective application of some aspects of other Ind ASs. The Committee notes that paragraphs B2 and B3 of Ind AS 101 provide as follows:

> "B2 Except as permitted by paragraph B3, a first-time adopter shall apply the derecognition requirements in Ind AS 109 prospectively for transactions occurring on or after the date of transition to Ind ASs. For example, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before the date of transition to Ind ASs, it shall not recognise those assets and liabilities in accordance with Ind ASs (unless they qualify for recognition as a result of a later transaction or event).
>
> B3 Despite paragraph B2, an entity may apply the derecognition requirements in Ind AS 109 retrospectively from a date of the entity's choosing, provided that the information needed to apply Ind AS 109 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions."

15. From the above and assuming that the company in the instant case has not exercised the option under B3, the Committee is of the view that since the company had already derecognised the interest liability and recognised the borrowing pursuant to the FITL under previous GAAP, on transition, the company should not reassess whether the derecognition of accrued interest on the old loans and recognition of the new loans (including the FITL) would have been appropriate under Ind AS. Further, the company's approach to determining the EIR and the resulting amortised cost based on the combined, revised repayment schedule relating to the first and second outstanding amounts, is not appropriate. This is because various facilities continue to be separate loans with their own interest and repayment terms.

16. However, paragraph 10(d) of Ind AS 101 requires an entity to apply Ind ASs retrospectively in measuring all *recognised* financial assets and liabilities on transition. All financial liabilities as per Ind AS 109 are initially recognised at their fair value plus transaction costs, if any. Since the FITL is an interest-free loan, the Committee notes that the company would have to determine its fair value on

initial recognition (i.e., at the time of the financial restructuring), being its discounted present value based on the prevailing market interest rate (for a similar instrument as to currency, term, type of interest rate and other factors with a similar credit rating) at the time of initial recognition. An issue which therefore arises is the nature of, and appropriate accounting treatment under Ind AS for the difference between the nominal amount of the FITL and its initial recognition amount (i.e. its fair value). In this regard, the Committee notes paragraph B 5.1.1 of Appendix B of Ind AS 109, which states as follows:

> "B5.1.1 The fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also paragraph B5.1.2A and Ind AS113). However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset."

17. From the above, the Committee is of the view that based on reading of paragraph B 5.1.1 of Appendix B of Ind AS 109, the difference between the amount lent and the fair value of an interest-free loan is generally recognised as a gain or loss unless it qualifies for recognition as an asset or liability or some other element. The Committee further notes that in the present instance, the loan is from a shareholder, B Ltd. (which is also a financial institution), to its associate, XYZ Ltd. If the querist determines that, in substance, B Ltd. is acting in its capacity of a shareholder by providing financial support in the form of interest-free funding (due to financial difficulty of its associate), the difference between the FITL amount and its fair value may be recognized in equity by the company. This is because, in substance, the interest-free element may be construed as a contribution by a shareholder to the company. The interest-free element of the loan may, in such a case, be considered as a non-reciprocal capital contribution by B Ltd., acting in its capacity as a shareholder. However, if the querist determines based on the specific facts and circumstances that B Ltd. is acting as a lender (i.e., similar to an unrelated lender) providing financial restructuring package to its borrower due to financial difficulty, then under Ind AS 109, the difference between the FITL amount and its fair value would generally be recognised in profit or loss, unless it qualifies for recognition as an asset or liability.

18. The amortised cost on the date of transition would then be determined by unwinding the discount for the period from the date of initial recognition to the transition date. The resultant adjustment, related to the unwinding of the discount, should be recognised in retained earnings on transition.

19. The Committee notes that another issue to consider in the extant case is whether the loan provided by B Ltd. may be considered a government loan as B Ltd. is a government entity, i.e., whether B Ltd. is acting in its capacity as Government. In this regard, the Committee notes that paragraph B10 of Ind AS 101, inter alia, states that "Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in Ind AS 109, *Financial Instruments*, and Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to Ind ASs and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant. Consequently, if a first time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind ASs as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind ASs".

20. The Committee further notes that paragraph 3 of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', *inter alia* states that ***"Government grants* are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity".** The Committee notes that the FITL is an interest-free loan extended by B Ltd. to the company as a consequence of a financial restructuring package due to financial difficulty. The interest-free benefit is therefore not in the nature of government assistance or benefits provided to similar entities in general. There are no further terms or conditions attached to the receipt of this benefit that need to be complied with by the company. These factors indicate that B Ltd. is not acting in its capacity as Government in providing the interest-free FITL to the company. Hence, the FITL does not meet the definition of a government grant. Therefore, the Committee is of the view that the interest-free element of the loan extended by B Ltd. to the company is not in the nature of government assistance or a government grant and the exemption from fair valuation of government loans under Ind AS 101 would not apply in the extant case.

D. Opinion

21. On the basis of the above, the Committee is of the following opinion on the issue raised by the querist, relating to the measurement of the FITL (being the second outstanding amount) in paragraph 9 above:

a. The company is not required to reassess whether its derecognition of the old term loan and the interest accrued and due thereon and the recognition of a new term loan (including the interest-free FITL) on modification of the contractual terms is appropriate under Ind AS, due to the first-time adoption exemption, as discussed in paragraph 15 above. Further, the company's approach to determining the EIR and the resulting amortised cost based on the combined, revised repayment schedule relating to the first and second outstanding amounts, is not appropriate.
b. Considering the requirements of Ind AS 109, the company is required to determine the fair value of the FITL on the date of the financial restructuring, as its initial recognition amount, as discussed in paragraph 16 above.
c. If the querist determines that B Ltd. was acting in its capacity as a shareholder when providing interest-free financial support to the company, the difference between the nominal amount and the initial recognition amount of the FITL should be recognised in an appropriate component of equity on transition to Ind AS. However, if the querist determines that B Ltd. is acting as a lender, then the difference between the nominal amount and the initial recognition amount of the FITL would generally be recognised in the statement of profit or loss, as discussed in paragraph 17 above.
d. The amortised cost of the FITL on the date of transition to Ind AS should be determined by unwinding the discount from the date of initial recognition to the transition date. The unwinding of the discount should be recognised as an adjustment in retained earnings on transition.
e. The benefit of an interest-free loan provided by B Ltd., a government undertaking, is not in the nature of a government grant or government assistance, since B Ltd. is not acting in its capacity as Government in this case. Therefore, the exemption from fair valuation of a below-market rate government loan on first-time adoption of Ind ASs would not apply to the FITL, as discussed in paragraph 20 above.

Query No. 11

Subject: Accounting for Agreement for sale of electricity generated under Ind AS.[1]

A. Facts of the Case

1. The querist is a public sector undertaking (hereinafter referred to as 'the company'), engaged mainly in extraction and sale of manganese ore from its mines in Madhya Pradesh and Maharashtra. It has also diversified into production of electrolytic manganese di-oxide, ferro alloys and generation of wind power. The company having decided to venture into wind energy generation project had entered into agreement on Build, operate, and transfer (BOT) basis, with a developer, who has the expertise in designing, construction, commissioning, operating and maintaining the wind energy generators (WEGs). Incidentally, the developer had already obtained lease for the land required for the project in its favour from the State Government. The developer has agreed to transfer the lease in favour of the company for the consideration alongwith cost of design, construction, installation and commissioning the WEGs. Further, it is agreed to pay to the developer annually the operation and maintenance charges at the agreed rate with 5% escalation p.a. The operation and maintenance charges were applicable from 3rd year to 20th year.

2. Power generated from this WEG is sold to the State's electricity distribution company (hereinafter referred to as 'the EDC') at the rates fixed by Madhya Pradesh Electricity Regulatory Commission (MPERC) for a period of twenty years. As per agreement with the EDC, which is the sole customer for this line of business at present, the consideration is solely dependent on the number of units generated and there is no stipulation for any guaranteed generation or minimum amount payable. The company raises invoices on monthly basis at the MPERC determined rates for total electricity generated from the WEGs. Thus, generation from individual WEG is of no relevance for this purpose and monthly invoice can be (a) Nil if no electricity is generated from the WEGs or (b) for any amount even though, hypothetically, entire quantity is generated from a single WEG, the rest of WEGs generating Nil quantity. The agreement with the EDC contains termination clause, which is operative in case the EDC fails in making timely payments to the company for three consecutive months. In case of termination of the agreement, the company is free to sell power to any other entity. Given the power situation in the country, sale of power to some other entity(ies) by entering into Power Purchase Agreement (PPA) is not at all difficult.

3. The company has entered into a separate agreement with WEG developer for supply, construction, operation and maintenance of WEGs. The

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[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

agreement specifies minimum guaranteed availability of each of the WEGs and deductions from operation and maintenance charges (OMC) in case of failure in maintaining minimum availability. The company has also made one-time lumpsum payment to the WEG developer for leasehold rights of the land used for the WEGs for twenty-five years. The payment has been made at the beginning of the contract period.

4. In view of the foregoing, the company is accounting for the transactions as under:

(a) Although the revenue generated from the project is not substantial in relation to the total turnover of the company, the investment in the project is more than 10% of its gross block of assets. In view of this and the fact that the risks and rewards of the new venture are different from that of its main business, the company considers WEGs as a separate reportable segment.

(b) Lumpsum one-time consideration paid for obtaining leasehold rights over land is treated as leasehold land in accounts and is depreciated over the 20 years.

Cost of WEGs is treated as plant and machinery and is depreciated over its useful life, which is 22 years as specified in Schedule II to the Companies Act, 2013. In addition, the company has also claimed allowable tax benefits under Income-tax Act, 1961, i.e., 80-IA benefits and accelerated depreciation.

(c) Monthly invoices towards generation of electricity are accounted for and treated as revenue from the sale of electricity.

OMCs are accounted for as expenditure of the WEG division. Besides this, administrative expenses, like rates and taxes, inspection fees, insurance charges, etc., are borne by the company and, hence, are also accounted for likewise.

(d) The querist has stated that during audit of annual accounts, the Government audit team has contended that the agreement entered into with the EDC is in the nature of finance lease wherein the company is a lessor and the EDC is a lessee and, hence, the assets are to be treated accordingly in accounts. However, the company has given an assurance to the Government auditors that opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India will be sought on this point and that accounting treatment will be given accordingly in accounts for/from the next financial year, i.e., 2017-18.

5. The querist has also clarified that:

(a) The WEGs are owned by the company and there is no transfer of risks/rewards to the EDC at any point of time, even after termination of the agreement,

(b) Maintenance of the WEGs is the responsibility of the company and the EDC is not in any way concerned about operation and maintenance of the assets,

(c) Payment by the EDC is dependent entirely on total number of electricity units generated and can be Nil, if no electricity is generated,

(d) The company is at liberty to terminate the contract with EDC and sell the electricity generated from the project to another entity, if the EDC makes default in payment of electricity bills for three consecutive months, and

(e) In view of the foregoing, the agreement is essentially for sale of electricity and does not fall in the category of any lease arrangement.

Analysis by the company

6. As per the stand taken by the company, accounting treatment accorded with regard to the agreement with EDC does not attract Indian Accounting Standard (Ind AS) 17, 'Leases'. With reference to Ind AS 17, the company's contentions are as under:

(i) A lease is defined in the Ind AS as an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. In the instant case, the right to use the WEGs lies with the company and the same are in full control of the company. EDC has not been given in any manner, the right to use of WEGs, whatsoever, relating to the control or custody of the WEG. Hence, it is a normal sale-purchase transaction instead of a lease wherein right to use of assets is involved.

(ii) The plant was conceived, designed, developed and commissioned well before the contract with EDC. As the plant has started generating electricity units, the same needs to be sold, as it is not a product to be stored. Due to location of the plant being in the State of Madhya Pradesh (MP) the most preferred, efficient and convenient way of sale of the electricity units, is with the EDC in MP State.

The sale of electricity to EDC is not as per any customized rate but the same is as per the rates specified by the Madhya Pradesh Electricity Regulatory Commission (MPERC), an independent regulatory authority. These rates are applicable to all wind energy producers in the State of Madhya Pradesh. These tariffs of MPERC are applicable to all the plants commissioned on or after the order date of 21.11.2007 and intended for sale of electricity to the MP EDC. Thus the tariff arrangement between the company and EDC is not exclusive one and the same is common for all the wind energy producers in MP.

(iii) A finance lease is defined in the Ind AS as a lease that transfers substantially all the risks and rewards incidental to ownership of an asset; title may or may not eventually be transferred. In the instant case, no risk incidental to the ownership is transferred; this is evident from the fact that (a) in case of Nil generation from any WEG either on account of low wind velocity or machine breakdown, nothing is payable by the EDC to the company, (b) in case of complete damage to the WEGs, the resultant loss is loss of the company (not of the EDC), (c) excessive generation of electricity gets paid fully by the EDC to the company.

(iv) As per the agreement with EDC, the company will be fully responsible for the design, construction, testing, inspection and maintenance of WEGs in accordance with the standard utility practices, relevant technical standards and specifications. Thus, the EDC has no right to any assets or interferences as far as operation and maintenance is concerned.

(v) As per the agreement with EDC (clause No.1.c), the licensee (EDC) cannot deny the company to inject additional power at the point of interconnection near to the site in future on any account except on technical ground. This clearly shows that EDC does not have the right to use the assets as it wants and hence, the arrangement does not qualify to be a lease.

(vi) As per clause 13, the company is required to intimate the number of WEGs connected to common metering point. Any subsequent addition or reduction in the number can be done by giving 30 days notice. Thus, the company has liberty to add/reduce the number of WEGs which clearly gives freedom to the company to exploit the assets in a manner it wishes. Consequently, the EDC has no right to restrict the use of assets in any manner.

(vii) Examples of situations indicated in paragraph 10 of Appendix C to Indian Accounting Standard (Ind AS) 17, 'Leases' include cases where the lessor transfers the ownership of the asset to the lessee by the end of lease term or the lessee has an option to purchase the asset. In the instant case, there is no stipulation to this effect in the agreement with the EDC. Further, the paragraph also includes cases where leased assets are of such specialised nature that only the lessee can use them without major modifications. This is also not applicable in the instant case; In fact, as pointed out above, EDC is not at all operating or using the assets and the use of assets in case of other entities by terminating the present agreement is very much possible.

The additional indicators given in paragraph 11 of Appendix C like bearing of losses by lessee in case of cancellation of agreement or continuing the operations by the lessee for secondary period are also not present in the agreement with the EDC.

(viii) The Ind AS also points out to cases where the purchaser has the ability or right to operate the asset in the manner it determines while obtaining or controlling significant output of the asset. There is no clause in the agreement with the EDC, which enables it to operate or control the asset.

From the above, the querist is of the view that it is quite evident that the arrangement between the company and the EDC does not give rise to any doubt regarding right to use of the WEG assets by the company. The right to use of assets rests solely with the company. Further, the PPA does not grant right to receive series of payments from EDC. In case the company fails to generate the wind energy units, there will not be any payment by EDC. The agreement between the company and EDC is purely buy and sell commercial agreement wherein EDC pays only when it receives the supply of electricity units.

7. In nutshell, the arrangement with the Electricity Distribution Company (EDC) is not one of 'finance lease' for the reasons that are nowhere in the realm of the Ind AS 17 whose pre-requisites are:

(i) Transfer of right to use the assets. The Standard under the caption – 'Scope', specifically states that the same does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

In the extant case, the EDC is eligible to the products (units of electricity) emerging out of use and operation of asset owned, possessed and controlled by the other party to the agreement, i.e., the company.

(ii) In terms of the definition in the Standard, a finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset.

The arrangement with the EDC falls beyond the primary requisites of the definition which clearly delineates what exactly a finance lease means.

(iii) Minimum lease payments over the lease term is the crux of any lease arrangement, which is totally absent in the arrangement with the EDC. Their payments to the company are wholly based on the quantum of supply made by the company. If there is no supply, no payment will be made.

(iv) Under finance lease, payments made by the lessee to the lessor are essentially towards the cost of acquisition of the asset where the lessee has the option to purchase the asset at the end of the lease term. This phenomenon is conspicuously absent in the company's arrangement with the EDC.

(v) Substance of the arrangement clearly indicates how the same is in harmony with the appendices to the Standard which spell out situations which are obviously not one of leases.

B. Query

8. Whether, the agreement with the EDC, merely for sale of electricity generated by the company, denotes an arrangement, which can be treated as a finance lease or it is a normal transaction of sale and purchase of electricity units supplied by the company to EDC.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to whether the agreement to sell electricity to the EDC can be treated as a finance lease under Ind ASs or it is a normal transaction of sale and purchase of electricity units between the company and EDC. The Committee has, therefore, considered only this issue and not examined any other issue that may arise from the Facts of the Case, such as, accounting for the OMC, accounting for land lease arrangements with the developer, revenue recognition by the company, accounting for WEGs, appropriateness of considering WEGs as a separate reportable segment, amortisation of leasehold rights over land, etc. Also, the Committee has not examined the applicability of Ind AS 114, 'Regulatory Deferral Accounts', to the agreement.

10. Further, the Committee notes that the company has a back-to-back arrangement with the WEG developer for supply, construction, operation and maintenance of WEGs under which the WEG developer has given a minimum guaranteed availability for each WEG. The Committee has not examined the nature of the agreement with the WEG developer.

11. The Committee notes that Appendix C to Ind AS 17, Determining whether an Arrangement contains a Lease, provides the guidance to determine when an arrangement, including sale/purchase arrangement, might contain a lease. Once a determination is reached that an arrangement contains a lease, the lease arrangement should be classified as either financing or operating, according to the principles in Ind AS 17, 'Leases'. A lease that transfers significantly all the risks and rewards incidental to ownership of an asset is a finance lease. A lease other than a finance lease is an operating lease. Accordingly, the Committee is of view that in the extant case, the company should first determine whether the arrangement is, or contains, a lease. In that context, the Committee notes that Appendix C to Ind AS 17 provides as follows:

> "6. Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:
>
> (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset); and
>
> (b) the arrangement conveys a right to use the asset."
>
> **"Arrangement conveys a right to use the asset**
>
> 9 An arrangement conveys the right to use the asset if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying asset. The right to control the use of the underlying asset is conveyed if any one of the following conditions is met:
>
> (a) The purchaser has the ability or right to operate the asset or direct others to operate the asset in a manner it determines while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
>
> (b) The purchaser has the ability or right to control physical access to the underlying asset while obtaining or controlling more than an insignificant amount of the output or other utility of the asset.
>
> (c) Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than an

insignificant amount of the output or other utility that will be produced or generated by the asset during the term of the arrangement, and the price that the purchaser will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output."

12. The Committee notes that none of the terms and conditions of the Power Purchase Agreement dated 27th June, 2008 as provided by the querist, give the EDC either the ability or the right to operate the WEG assets. Rather the WEG assets are operated by the company along with developer. Therefore, the criterion laid down in in clause (a) of paragraph 9 of Appendix C of Ind AS 17 is not met.

13. The Committee also notes that the Power Purchase Agreement does not provide the EDC the right to control the physical access to the WEG assets. Therefore, the criterion contained in clause (b) of paragraph 9 of Appendix C of Ind AS 17 is also not met.

14. As regards to the criteria laid down in paragraph 9(c) of Appendix C of Ind AS 17, the Committee notes that in the extant case, it may be considered as remote that any party other than the EDC will take more than an insignificant amount of the output, i.e. electricity generated by the WEG assets during the term of the power purchase agreement. However, the Committee notes that clause 10.1 of Annexure I to the Power Purchase Agreement (MPERC tariffs for wind energy projects commissioned after the order date of 21.11.2007) provides the tariff rates per unit of power generated and supplied during the term of the Power Purchase Agreement, as per which, the tariff per unit is Rs. 4.03, Rs. 3.86, Rs. 3.69 and Rs. 3.52 during years 1, 2, 3 and 4, respectively and thereafter, from year 5 onwards, the tariff per unit is fixed at Rs. 3.36 per unit.

15. The Committee notes that although the tariff per unit may not be equal to the current market price per unit of the electricity at the time of the supply, the tariff per unit has been pre-determined for each year of the agreement. At the inception of the arrangement, the company, i.e. the supplier, and the EDC, i.e., the purchaser, can determine what the exact price will be for every unit of electricity supplied at each point in time during the term of the arrangement. Therefore, the tariff rate per unit is fixed per unit as there is no variability in the tariff per unit depending on the volume of the electricity generated by the asset. Therefore, the criterion contained in clause (c) of paragraph 9 of Appendix C of Ind AS 17 is also not met.

16. Accordingly, the Committee notes that none of the criteria in paragraph 9 of Appendix C to Ind AS 17 are met. Resultantly, the power purchase agreement in the extant case does not contain an element of lease.

17. With regard to the issue as to whether sale of electricity generated by the company is a normal transaction of sale and purchase of electricity, the Committee wishes to state that the company should first examine whether the agreement between the company and the WEG developer is on a principal-to-principal basis or whether the company is acting merely as an agent of WEG developer. Further, the company should also examine whether the arrangement in the extant case is within the scope of Appendix A, Service Concession Arrangements to Ind AS 11, 'Construction Contracts'.

D. Opinion

18. On the basis of the above, for the reasons mentioned in paragraphs 12-16 above, the Committee is of the opinion that the power purchase agreement with the EDC cannot be classified as a lease (operating or finance) under Ind AS 17. Further, the issue, whether the sale of electricity generated by the company is a normal transaction of sale and purchase or not, should be first examined from the perspective of whether the agreement between the company and the WEG developer is on a principal-to-principal basis and whether the arrangement in the extant case is within the scope of Appendix A, Service Concession Arrangements to Ind AS 11 'Construction Contracts', as discussed in paragraph 17 above.

Query No. 12

Subject: Accounting treatment of liquidated damages (LD) recovered from suppliers/contractors as per the terms of contract, during the construction phase of the project.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a Government company under the administrative control of the Department of Atomic Energy (DAE), incorporated on 22 October, 2003 as a public limited company under the Companies Act, 1956 with the objective of constructing and commissioning the first 500 MWe Fast Breeder Reactor (FBR) and to pursue construction, commissioning, operation and maintenance of subsequent fast breeder reactors for generation of electricity in pursuance of the schemes and programmes of Government of India (GOI) under the provisions of the Atomic Energy Act,1962.

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

2. The company is currently constructing a 500 MWe prototype fast breeder reactor (PFBR). The PFBR is the forerunner of the future fast breeder reactors and is expected to provide energy security to the country. The PFBR is being built with the design and technology developed at the Indira Gandhi Center for Atomic Research (IGCAR).

3. Project cost of the company is funded by debt equity ratio of 20:80. Equity is in the form of equity share capital from the GOI and ABC limited (a CPSU) in the ratio of 95:5. Project cost of the company is Rs. 5,677 crores. Authorised capital of the company is Rs. 5,000 crores and paid up capital at the end of the financial year (F.Y.) 2016-17 is Rs. 4588.20 crores.

4. The project is nearing completion stage and expected to commission during financial year 2018-19. The PFBR is a single and indigenous project under construction, which is first of its kind in India.

5. The querist has stated that during the financial year 2016-17, the company has recovered liquidated damages (LD) amounting to Rs. 19,68,605 from various vendors/contractors, towards delayed supply/completion of contract. As per procedure, levy of LD will materialise only at the time of closure of contract. If there is a delay in supply, applicable LD for that delay will be temporarily withheld and shown as liability. The levy or refund of LD will be finalized only on closure of contract, after getting approval of competent authority. If on closure of contract, LD levy is approved, LD amount already withheld as temporary retention, will be credited to respective account, to which, the payment /expenditure of that contract is debited. *It is nothing other than reduction from the cost of the contract on the ground that, levy of LD is as per the contract condition*. This practice is being followed by the company from the inception of the project (2003), as and when the LD's levy is finalized as per the provision of adjusting the related income against indirect expenditure as envisaged in the Guidance Note on Treatment of Expenditure during Construction period, which was applicable at that time.

(Emphasis added by the querist).

6. Accounting policy relating to LD, as disclosed in the financial statements of the F.Y. 2016-17 is given below:

> *Under the Head Ind AS 18: Revenue - para B) Liquidated damages:*
>
> "Until liquidated damages are decided as recoverable, retentions made on this account, if any are shown under liabilities. During construction phase, in respect of all contracts, liquidated damages recovered from supplier/contractors are taken to the respective head of account at the time of closure of contracts."

7. Accordingly, the LD recovered as per contractual conditions are credited to the cost of that contract as reduction from the cost of contract, as it is a single project, which is under construction stage.

8. The querist has also reproduced relevant extracts of the CAG (Comptroller and Auditor General) report, along with the querist's reply as follows:

CAG's Observation	**Company's reply for the CAG's observation**
The company has opted for 3 phase audit of CAG for the financial statements. In 2nd phase of CAG audit, the observation of the auditors of CAG, regarding treatment of liquidated damages is given below: "As per accounting policy relating to revenue recognition, in respect of all contracts, liquidated damages recovered from the suppliers/contractors should be taken to the respective head of account, at the time of closure of contracts during construction phase. However since liquidated damages is of revenue nature, the same should have been accounted as income in profit and loss account as recovery of liquidated damages is on account of inefficiency on the part of the contractor to execute the work by scheduled date and hence not attributable to construction/ commissioning of PFBR. Hence the non-accountal of LD recovered to the extent of Rs. 19,68,605/- has resulted in overstatement of financial liability (Retention money O&M), understatement of income and consequent understatement of profit by Rs. 19,68,605/-. Further accounting policy	"The company is a single unit company and does not have any commercial operation. The project 'PFBR' is under construction. All expenses (directly/indirectly) have to be linked with the respective asset. Since the LD levied is as per contract condition, it can be taken as directly linked transaction. Accordingly, LD has been taken (credited) to respective assets. This has been suitably given under accounting policy and is followed consistently. However for better clarity, we propose to take expert opinion from the Institute of Chartered Accountants of India (ICAI) during 2017-18."

require modification wherein liquidated damages recovered is recognised as income.”	

According to the querist, as the company is a single unit company, all the credits/income generated out of project fund or as per the conditions of contracts awarded/executed for the construction of the project are capital in nature; hence, need not be classified as revenue expenditure during the construction phase of the project. Further, crediting LD to capital expenditure and capitalization of costs net of LD is in order in the light of the provision in the purchase/works contracts and also as per the provision of adjusting related income against indirect expenditure as envisaged in the Guidance Note on Treatment of Expenditure during Construction Period. Relevant General Conditions of Contract (GCC) in respect of LD for purchase contract and works contract have been provided by the querist for the perusal of the Committee.

B. Query

9. From the above, opinion of the Expert Advisory Committee of the ICAI is sought, as to whether the accounting treatment followed by the company is consistent with the Ind ASs. If not, it is requested to suggest the correct accounting treatment, applicable from the financial year 2017-18. In the context of the query raised, the querist has supplied the following information in respect of financial statements, that may be relevant for consideration:

(i) It is an infrastructure project by nature, having long gestation period (project construction activities started in 2003, which is under construction stage and the commissioning is expected during the F.Y. 2018-19).

(ii) The company is preparing the statement of profit and loss. Interest from employee loans and rent from the shops at township are credited to profit and loss account.

(iii) CSR expenses are debited to profit and loss account.

(iv) Interest earned from temporary deposit of project funds in bank fixed deposits (FDs) are credited to ‘Expenditure During Construction (EDC) Account’ and grouped under the ‘Capital Work in Progress (CWIP)’.

(v) Ind AS is applicable to the company from the financial year 2016-17 under the category, ‘company having net worth Rs. 500 crore or more’.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised by the querist relates to accounting treatment of liquidated damages recovered from supplier/contractors during the construction phase. The Committee has, therefore, considered only this issue and has not considered any other issue arising from the Facts of the Case, such as, accounting treatment of interest from employee loans, rent from the shops at township, CSR expenses, interest earned from temporary deposits of project funds in bank FDs, etc. The Committee notes the querist's use of the phrase 'competent authority' in the context of approvals of the liquidated damages; while the phrase is not clear, the Committee presumes that the querist is referring to 'internal approvals', though this does not affect the opinion of the Committee. The Committee also wishes to point out that Guidance Note on Treatment of Expenditure during Construction Period has been withdrawn by the ICAI in August 2008 and thus, it is no longer relevant in the extant case. Further, the opinion expressed hereinafter is purely from accounting perspective and not from legal perspective, such as, legal interpretation of purchase/works contract, etc.

11. The Committee notes paragraphs 16 and 21 of Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment', that explains the elements of cost:

> "16 The cost of an item of property, plant and equipment comprises:
>
> (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
>
> (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
>
> …"
>
> "21 Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental

operations are recognised in profit or loss and included in their respective classifications of income and expense."

From the above, the Committee notes that as per the requirements of Ind AS 16, only those items of costs which are directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management can be included in the cost of the asset. Accordingly, in the context of liquidated damages, the Committee is of the view that treatment of liquidated damages would depend upon the fact whether these are directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management and whether these are received for mitigating extra costs to be incurred on the asset which will be capitalised as part of the cost of the asset.

12. In the context of the nature of liquidated damages recovered by the company, the Committee notes the following clauses from the extracts of general conditions of contract (GCC) for works contract and purchase contracts, as provided by the querist for the perusal of the Committee:

<u>"GCC-WORKS CONTRACT</u>

Clause 35-Compensation for Delay:

35.1 If the Contractor fails to maintain the required progress in terms of Clause 13 or to complete the work and clear the site on or before the Contract or extended date of completion, the Contractor shall, without prejudice to any other right or remedy of the company, on account of such breach, pay as agreed compensation amount calculated as stipulated below or such smaller amount as be fixed by the authority mentioned in Schedule 'A' on the Contract Value of the work for every week that the progress remains below that specified in Clause 13 or that the work remains incomplete.

…

(a) Completion period (as originally @ 1% per week stipulated) not exceeding 1 year.

(b) Completion period (as originally @ ½% per week stipulated) exceeding 1 year and not exceeding 3 years.

(c) Completion period (as originally @ 1/4% per week stipulated) exceeding 3 years.

35.2 Provided always that the *total amount of compensation for delay to be paid under this clause shall not exceed 5% of the total value of the Contract Value* or of the Contract Value of the item or group of items of work for which a separate period of completion is specified.

35.3 The amount of compensation may be adjusted or set off against any sum payable to the Contractor under this or any other contract(s) with same unit or any other unit(s) of the company. For the purpose of such adjustment/set off, it shall be deemed that the Contractor has given its free consent.

GCC-PURCHASE CONTRACT

Clause no. 15 DELIVERY SCHEDULE AND LIQUIDATED DAMAGES:

15.1 Time and date of delivery of the Stores stipulated in the Contract, shall be essence of the contract and delivery must be completed by the dates specified therein. Unless otherwise agreed, the contract shall be deemed to have come into force from the date of issue of priced Letter of Indent/Purchase Order and accordingly contractual delivery period shall be reckoned from that date.

15.2 Delay in Supply and Termination:

15.2.1 Should the Contractor fail to deliver the Stores or any part thereof within the period prescribed for such delivery, it shall be construed as a breach of the Contract and the Purchaser shall be entitled at his option to the following:

15.2.1.1 To receive the Stores after prescribed date of delivery with the right to recover from the Contractor agreed Liquidated Damages (LD) at the rate indicated below:

	Delivery Period	**Liquidated Damages, Rate / Week**	**Maximum Amount of LD**
1.	Delivery period (as originally stipulated) not exceeding one year.	@1% per week on the undelivered / delayed portion of supplies of Purchase Order	5% on the undelivered/delayed portion of supplies of Purchase Order
2.	Delivery period (as originally stipulated) exceeding one year	@0.5% per week on the undelivered / delayed portion of	5% on the undelivered/delayed portion of supplies of

	but not exceeding two years.	supplies of Purchase Order	Purchase Order
3.	Delivery period (as originally stipulated) exceeding two years.	@0.25% per week on the undelivered / delayed portion of supplies of Purchase Order	5% on the undelivered/delayed portion of supplies of Purchase Order
	In case of Contracts for Plant / Equipment/Machinery/Instruments which includes erection and commissioning and which could be put into use only after final acceptance, the Purchaser may levy Liquidated Damages on total Contract price, but in case of Stores which can be put to use or pro-rata deliveries are permitted in the contract, on the price of the delayed supply. The applicable terms and conditions governing the levy of liquidated damages will be specifically laid out in the Notice Inviting Tender (NIT)/Contract.		

15.2.1.2 *To purchase from elsewhere, after (thirty) 30 days notice to the Contractor, on his account and at the risk of the Contractor, the Stores, not delivered* or other items of similar description when such Stores exactly complying with the Particulars are not in the opinion of the Purchases readily procurable, such opinion being final, without cancelling the Contract in respect of the consignment(s), not yet due for delivery.

15.2.1.3 To cancel the total contract or balance portion thereof, and if so desired, to purchase or authorise the purchase of stores not so delivered or other Stores of similar description, when such Stores exactly complying with the particulars are not, in the opinion of the Purchaser, readily procurable, such opinion being final, *at the risk and cost of the Contractor*.

15.2.2 *In the event of action being taken under clause 15.2.1.2 or 15.2.1.3 above, the Contractor shall also be liable for Liquidated Damages for delay in deliveries,* which the Purchaser is entitled to recover as per 15.2 on that account provided an agreement for such alternative purchase from elsewhere, is made within (six) 6 months of the notice of failure or letter of cancellation sent to the Contractor. The Contractor shall not be entitled to any gain on such purchase made on account of default. The manner and method of such alternate purchase shall be at the entire discretion of the Purchaser, whose decision shall be final. This right shall be without

> prejudice to the right of the Purchaser, to recover the damages for breach of Contract by the Contractor as provided in the Contract or under the general law."

(Emphasis supplied by the Committee.)

From the above clauses of the contract, it appears that liquidated damages are in addition to the compensation for extra cost to be borne by the company due to delay in the delivery/contract performance schedule, for example, extra cost incurred due to purchase of the same supplies/component from some other supplier/contractor at a higher price. If this is the case, the Committee is of the view that the liquidated damages would not be on account of compensation towards extra costs due to delays; rather would be of the nature of compensation for breach of terms of contract and therefore, in that case, liquidated damages should not be capitalised as/adjusted against the part of project/contract cost and the same should be recognised in the statement of profit and loss. However, if this is not the case and the liquidated damages are received in mitigation of the extra project costs incurred on the asset/project, the same should be adjusted against the cost of the asset/project. Since the above is a matter involving exercise of the judgement in the light of the factual position and terms and conditions of the contract with the supplier/contractor, the Committee is of the view that the company in the extant case should evaluate its own facts and circumstances and accordingly, account for the liquidated damages after determining its nature, as discussed above.

D. Opinion

13. On the basis of the above, the Committee is of the opinion that whether or not the treatment followed by the company in respect of liquidated damages in the extant case is consistent with Ind ASs would depend upon the nature of liquidated damages in the extant case and since the same is a matter involving exercise of the judgement considering the factual position and terms and conditions of the contract with the supplier/contractor, the Committee is of the view that the company should evaluate its own facts and circumstances and accordingly, account for the liquidated damages, as discussed in paragraph 12 above.

Query No. 13

Subject: Presentation of 'Deferred assets for deferred tax liability' in balance sheet and statement of profit and loss.[1]

A. Facts of the Case

1. A Government of India enterprise (hereinafter referred to as the 'company') incorporated under the Companies Act, is engaged in the business of transmission of power from the generating units to different State Electricity Boards (SEBs) through its transmission network. The company is mandatorily required to comply with Indian Accounting Standards (Ind ASs) in preparation of financial statements for the accounting periods beginning on or after 1st April, 2016 with the comparatives for the periods ending on 31st March, 2016 as per the Notification dated 16th February, 2015, issued by the Ministry of Corporate Affairs (MCA). The equity shares of the company are listed in NSE and BSE.

2. The company is governed by the Electricity Act, 2003 and regulated by Central Electricity Regulatory Commission (CERC) under the Act. CERC issued Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2014 ('CERC Regulations') for determination of tariff for the block period 2014-19.

3. The querist has mentioned that as per Regulation 20 of Chapter 5 of the CERC Regulations, the tariff for transmission of electricity on inter-state transmission system shall comprise transmission charge for recovery of annual fixed cost consisting of the components specified in Regulation 21.

4. Further, as per Regulation 21 of Chapter 5, the annual fixed cost (AFC), i.e., tariff of a transmission system including communication system shall consist of the following components:

(a) Return on equity;
(b) Interest on loan capital;
(c) Depreciation;
(d) Interest on working capital; and
(e) Operation and maintenance expenses

5. Also, Regulation 24 of Chapter 6 of CERC Regulations prescribes method and rates for calculation of 'Return on Equity' as one of the component of tariff.

6. The querist further states that as per Regulation 25 of Chapter 6, tax on return on equity is allowed by grossing up the base rate of return on equity with the effective tax rate of the respective financial year. Deferred tax liability is as

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[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

per Indian Accounting Standard (Ind AS) 12, 'Income Taxes' to recognise tax effect of timing difference. Such deferred tax liability would reverse in future years. The company has also recognised deferred assets for deferred tax liability which would also reverse in future years along with the deferred tax liability and netted with the deferred tax liability for presentation in the financial statements of financial year 2016-17 as below:

Line item of Statement of Profit and Loss

Rupees in Crore

Particulars	For the Year ended 31st March 2017
Tax expense Current Tax Deferred Tax Less : Deferred Assets for deferred Tax liability	 1988.45 2680.23 2619.07
	2049.61

Note of Balance Sheet

Deferred Tax liabilities (Net) Rupees in Crore

Particulars	As at 31st March,2017
A. Deferred Tax Liability	
Depreciation difference on Property, Plant and equipment	11214.62
Finance Lease assets	90.83
Others	66.30
Sub-total (A)	11371.75
B. Deferred Tax Assets	
Income during Construction Period	18.69
Self Insurance Reserve	11.26
Provisions allowable on payment basis	236.77
Advance Against Depreciation	562.31
Others	123.98
Sub-total (B)	953.01
Deferred Tax Liability (Net) (A-B)	**10418.74**
Less: Deferred assets for deferred tax liability	**7868.20**
Net Deferred tax liability	**2550.54**

7. Government auditor has raised a query in the financial year 2016-17 that the presentation of deferred assets for deferred tax liability is not appropriate and it should be considered as regulatory assets and the presentation in the statement of profit and loss and balance sheet should be done accordingly.

Company's point of view for presentation:

8. The querist has referred to paragraph 21 of the Guidance Note on Accounting for Rate Regulated Activities, issued by Institute of Chartered Accountants of India, which states that a regulatory asset is an entity's right to recover fixed or determinable amounts of money towards incurred costs as a result of the actual or expected actions of its regulator under the applicable regulatory framework.

9. The company has recognised deferred tax liability as per Ind AS 12, 'Income Taxes' to recognise tax effect of timing differences. Such deferred tax liability would reverse in future years. The company has recognised a deferred asset for deferred tax liability which would also reverse in future years along with the deferred tax liability. The company is not expecting any action in this reference from the regulator, i.e., CERC.

10. As per the querist, the deferred asset against deferred tax liability is thus not a regulatory asset as per the definition of the 'regulatory asset' given in the Guidance Note.

11. The querist further states that paragraph B10 of Appendix B to Indian Accounting Standard (Ind AS) 114, 'Regulatory Deferral Accounts' provides a background explaining the circumstances when an additional temporary difference might arise on recognising a regulatory deferral account balance that relates to income tax. If a regulatory deferral account balance that relates to income tax gives rise to a temporary difference, then paragraph B11 of Appendix B to Ind AS 114 provides the disclosure guidance. B11 is applicable when "an entity recognises a deferred tax asset and recognising deferred asset on deferred tax liability or a deferred tax liability as a result of recognising regulatory deferral account balances".

12. The querist mentions that in the present case, DTL is recorded in accordance with requirements of Ind AS 12, 'Income Taxes'. This DTL is not a regulatory deferral account balance. Also, the DTL is not recognized as a result of recognising regulatory deferral account balance. Further, as DTL is not a regulatory deferral account balance, the 'Deferred Asset for DTL' also does not meet the requirement of paragraph B11 which, inter alia, states "…when an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances". Hence, the disclosure

requirements of paragraph B11 will not apply to 'deferred asset for deferred tax liability' line item.

13. The querist further refers to provisions of paragraph 33 of Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements' which permits offsetting of income and expenses, and assets and liabilities when it reflects the substance of the transaction or other event or when separate disclosure detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. In the present case, the deferred tax liability and deferred assets for deferred tax liability are closely related and separate disclosure thereof would not reflect the substance of the transaction. Accordingly, the deferred assets for deferred tax liability has been deducted from the deferred tax expense with adequate disclosure on the face of the statement of profit and loss as well as in the notes to the balance sheet. It may also be seen that similar provisions for netting are available in Ind AS 18, 'Revenue', which provides that the entity may net any income with the related expenses when it reflects the substance of the transaction.

14. According to the querist, as per Ind AS 12 also, the netting of deferred tax assets and deferred tax liability is permitted to reflect the substance of the underlying asset/liability. Otherwise assets as well as liabilities will increase by an equal amount in the balance sheet without any substance. Further, the practice of offsetting/deduction related to deferred asset against deferred tax liability from the deferred tax liability is being followed consistently by the company from the financial year 2014-15.

B. Query

15. In view of the above facts and the circumstances, the querist has sought the opinion of the Expert Advisory Committee as to whether the presentation of deferred assets for deferred tax liability in the statement of profit and loss and in the balance sheet, being made by the company is in compliance with the Indian Accounting Standards or it should be presented as net movement in regulatory deferral account balance in the statement of profit and loss and regulatory deferral account balances as assets in the balance sheet.

C. Points considered by the Committee

16. The Committee notes that the basic issue raised by the querist relates to whether the presentation of 'Deferred assets for deferred tax liability' in the statement of profit and loss and in the balance sheet being made by the company is in compliance with the Indian Accounting Standards. 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, recognition of deferred tax liability, etc. Further, this opinion is restricted to the financial reporting requirements under Ind AS and does not deal with the regulatory aspects of the CERC tariff regulation or any other related regulations or Electricity Act, 2003. The Committee also presumes that the 'Deferred Asset for Deferred Tax Liability' has been appropriately recognised as per the requirements of Ind AS 114/Guidance Note on Accounting for Rate Regulated Activities.

17. The Committee notes from the above, that the CERC tariff norms for the period 2014-19 provides for grossing up of the return on equity with the effective tax rate for the financial year based on the actual tax paid during the year and considering these norms, the company has recognised an asset balance referred to as 'Deferred asset for deferred tax liability'.

18. With regard to the nature of the 'Deferred asset for deferred tax liability', the Committee notes that Appendix A to Ind AS 114 defines 'regulatory deferral account balance' as a 'Regulatory Asset' or a 'Regulatory Liability' as defined in the Guidance Note on Accounting for Rate Regulated Activities. Paragraph 21 of the Guidance Note states that a regulatory asset is an entity's right to recover fixed or determinable amounts of money towards incurred costs as a result of the actual or expected actions of its regulator under the applicable regulatory framework. The Committee further notes that paragraph 5 of Ind AS 12 'Income Taxes' defines deferred tax assets and liabilities as follows:

> **"*Deferred tax liabilities* are the amounts of income taxes payable in future periods in respect of taxable temporary differences.**
>
> ***Deferred tax assets* are the amounts of income taxes recoverable in future periods in respect of:**
>
> **(a) deductible temporary differences;**
> **(b) the carryforward of unused tax losses; and**
> **(c) the carryforward of unused tax credits.**
>
> ***Temporary differences* are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:**
>
> **(a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or**

(b) *deductible temporary differences*, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled."

19. The Committee notes that 'Deferred asset for deferred tax liability' that the company has recognised in the extant case would reverse in future by way of tariff adjustment. The Committee further notes that future reversals of 'Deferred asset for deferred tax liability' balance would affect the tariff recoverable from the beneficiaries in future periods and therefore fulfills the definition of regulatory deferral account balance under Ind AS 114. The Committee further notes that such deferral account balance would not be recoverable through adjustment in future income tax liabilities arising on the company as assessed under Income Tax Act and is, therefore, not a deductible temporary difference resulting into deferred tax asset under Ind AS 12. Rather, it is a regulatory deferral account balance, as mentioned in paragraph B10 of Ind AS 114.

20. Ind AS 12 does not allow deferred tax liabilities to be offset with assets other than deferred tax assets under Ind AS 12 and as discussed in paragraph 19 above, 'Deferred asset for deferred tax liability' balance is not a deferred tax asset under Ind AS 12. Accordingly, the Committee is of the view that 'Deferred asset for deferred tax liability' cannot be offset with deferred tax expense or liability in the financial statements.

21. Further, with regard to presentation of 'Deferred asset for deferred tax liability', the Committee further notes that paragraphs 20, 22 and 23 of Ind AS 114, which requires as follows:

"20 An entity shall present separate line items in the balance sheet for:

(a) the total of all regulatory deferral account debit balances; and

(b) the total of all regulatory deferral account credit balances."

"22 An entity shall present, in the other comprehensive income section of the statement of profit and loss, the net movement in all regulatory deferral account balances for the reporting period that relate to items recognised in other comprehensive income. Separate line items shall be used for the net movement related to items that, in accordance with other Standards:

(a) will not be reclassified subsequently to profit or loss; and

(b) will be reclassified subsequently to profit or loss when specific conditions are met.

23 An entity shall present a separate line item in the profit or loss section of the statement of profit and loss , for the remaining net movement in all regulatory deferral account balances for the reporting period, excluding movements that are not reflected in profit or loss, such as amounts acquired. This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total, which is drawn before the net movement in regulatory deferral account balances."

Accordingly, the Committee is of the view that the company should follow the above-reproduced requirements of Ind AS 114 in respect of 'Deferred asset for deferred tax liability' in its financial statements.

22. Incidentally, the Committee wishes to point out that in view of paragraph B10 of Ind AS 114, the company should also examine as to whether or not the recognition of regulatory deferral account balance in the extant case, viz., 'Deferred tax asset for deferred tax liability' is creating an additional temporary difference for which a further deferred tax amount needs to be recognized. Further, if a deferred tax/deferred liability (as the case may be) is created considering the requirements of B10, the same should also be presented as per the requirements of Ind AS 114 and not Ind AS 12.

D. Opinion

23. On the basis of the above, the Committee is of the opinion that the nature of the 'Deferred asset for deferred tax liability' is in the nature of regulatory deferral account balance under Ind AS 114 and not in the nature of deferred tax asset for reasons mentioned in paragraphs 18 and 19 above. The presentation by the entity of deferred tax liabilities balance in balance sheet and deferred tax expense in statement of profit and loss, each net of 'Deferred asset for deferred tax liability' are not in compliance with the requirements of Ind AS 114 and Ind AS 12. The same should be in accordance with paragraphs 20, 22 and 23 of Ind AS 114, as discussed in paragraphs 20 and 21 above.

Query No. 14

Subject: Accounting treatment and disclosure of 'capital subsidy'.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a joint venture (JV) company of ABC Ltd., XYZ Ltd., DEF Ltd. and Government of Assam (GoA), under the administrative control of Department of Chemicals & Petrochemicals, Ministry of Chemicals & Fertilizers. As per JV agreement, ABC Ltd. holds 70% of the equity stake and XYZ Ltd., DEF Ltd. and Government of Assam (GoA) hold 10% each. The company has set up a 280 KTPA petrochemical complex at Lepetkata, district Dibrugarh, Assam and implemented the flagship project of Government of India called 'Assam Gas Cracker Project (AGCP)'. The Assam Gas Cracker Project is outcome of famous Assam accord signed on 15th August, 1985 in New Delhi between the Government of India and the leaders of the Assam movement with the motive of overall socio-economic development of the region.

2. Initially, the Cabinet Committee on Economic Affairs (CCEA) of Government of India, in its meeting held on 18th April, 2006, approved the setting up of the Assam Gas Cracker Project with a project cost of Rs. 5460.61 crore and grant of capital subsidy of Rs. 2138 crore. The project cost was again revised to Rs. 8920 crore with increase in capital subsidy to Rs. 4690 crore.

3. Finally, the Government of India has approved the final revised cost estimates (RCE) of Rs. 9965 crore with following funding pattern:

• Capital subsidy	-	Rs. 5239.45 crore
• Debt	-	Rs. 3307.88 crore
• Equity	-	Rs. 1417.67 crore
		Rs. 9965.00 crore

4. The capital subsidy of around 53% was granted by the Government of India mainly to support the huge investment requirement for a petrochemical project of sub-optimal capacity due to insufficient availability of feed stock in the region and to ensure the economic viability of the project.

5. The company was incorporated on 08th January, 2007 and in line with above funding pattern, the Government of India started disbursing the capital subsidy in tranches. The 1st tranche of capital subsidy of Rs. 30 crore was received in the financial year (F.Y.) 2007-08. The company was in construction stage until 02nd January, 2016.

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

6. The querist has stated that during the construction period, the capital subsidy received from the Government of India from time to time was treated as 'Reserves & Surplus (Capital Reserve)' under Shareholders' Fund as the capital subsidy received from the Government of India is non-refundable and is in the nature of promoters' contribution. The disbursement of capital subsidy is neither subject to any condition attached thereto nor related to any specific assets. The accounting treatment effected by the company was based on the accounting policies adopted in line with paragraph 16 of the Accounting Standard (AS) 12, 'Accounting for Government Grants', which reads as under.

> ***"16. Government grants of the nature of promoters' contribution should be credited to capital reserve and treated as a part of shareholders' funds."***

7. The plant was commissioned on 02.01.2016 and all the assets were capitalised thereafter and depreciation was provided. The company has implemented the Ind-AS accounting w.e.f. 1st April, 2016 with recasting the accounts of F.Y. 2015-16 and accordingly changed its policy with respect to treatment of the capital subsidy under Ind AS 20. Based on changed accounting policy in compliance to requirements of Indian Accounting Standard (Ind AS) 20, 'Accounting for Government Grants and Disclosure of Government Assistance', capital subsidy has been treated as deferred income and is recognised in the profit and loss statement on a systematic basis over the useful life of the plant (25 years). The balance capital subsidy (unamortised portion) has been disclosed under 'non-current liability'.

8. It is pertinent to mention here that the petrochemical project is capital intensive in nature with gross block of fixed assets of Rs. 8588 crore up to F.Y. 2016-17. In order to make it economically viable and support such huge capital investment, the capital subsidy was granted by the Government of India, which is subject to no condition and is non- refundable.

9. However, in view of above mentioned accounting treatment of capital subsidy under Ind AS, the net worth of the company has been substantially reduced as per definition under section 2(57) of the Companies Act, 2013, which as per the querist, is not correct capital investment of the company. Also the disclosure of 'un-amortised portion of the capital subsidy' under 'non-current liability' is not depicting the correct liability of the company as the capital subsidy is non-refundable and not giving the true and fair view/picture of the company.

10. The querist has stated that the normal scale of production capacity of this type of petrochemical plant is to be three times the capacity of the present plant which makes capital cost and operation economically viable. The Government of

India has therefore granted capital subsidy which is non-refundable, against the total project cost and to support this sub-optimal capacity plant, which otherwise was not viable. Keeping in view the above facts, the company intends to disclose the yearly amortisation of capital subsidy in the profit and loss statement as 'Other Operating Income' under the head 'Revenue from Operations' as against 'Other Income' being shown presently. This being not the other income of the company, its treatment should be as operating income to offset the huge depreciation, which is also considered as operating expenditure. It will lead to working out correct operating profit/loss of the company.

B. Query

11. In view of the facts deliberated above, the querist has sought the opinion of the Expert Advisory Committee that whether the following changes in the financial statements intended to be carried out with retrospective effect from the F.Y. 2015-16 are correct or not:

(i) The company intends to disclose the un-amortised portion of the capital subsidy under 'other equity' so as to depict the true nature of non-refundable subsidy and retain correct net worth of the company. At the same time, it will correctly depict the non-current liability.

(ii) The company intends to disclose the current transfer of capital subsidy to the profit and loss statement as 'Other Operating Income' under the head 'Revenue from Operations'.

C. Points considered by the Committee:

12. The Committee notes that the basic issues raised by the querist relate to disclosure of unamortised portion of 'capital subsidy' and current transfer of capital subsidy to the profit and loss statement in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as 'the Rules'). The Committee has, therefore, considered only these issues and has not examined any other issue that may be contained in the Facts of the Case, such as, nature of the grant under Ind AS 20 and under previous GAAP, viz., AS 12, amount to be recognised in the balance sheet and the statement of profit and loss, recognition and measurement of grant, viz., capital subsidy received by the company, adjustments arising on transition to Ind ASs, appropriateness of amortising government grant over the useful life of the plant, etc. Further, the Committee has not examined the issue from the perspective of Government acting in the capacity of a customer/beneficiary and the applicability of Appendix C 'Transfer of Assets from Customers' to Indian Accounting Standard (Ind AS) 18, 'Revenue'.

13. With regard to disclosure of unamortised portion of capital subsidy, viz. deferred income without examining its nature as that related to assets or related to income under Ind AS 20, the Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 20, 'Accounting for Government Grants and Disclosure of Government Assistance':

"14 Those in support of the capital approach argue as follows:

(a) government grants are a financing device and should be dealt with as such in the balance sheet rather than be recognised in profit or loss to offset the items of expense that they finance. Because no repayment is expected, such grants should be recognised outside profit or loss.

(b) it is inappropriate to recognise government grants in profit or loss, because they are not earned but represent an incentive provided by government without related costs.

15 Arguments in support of the income approach are as follows:

(a) <u>because government grants are receipts from a source other than shareholders, they should not be recognised directly in equity</u> but should be recognised in profit or loss in appropriate periods.

(b) government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate.

(c) because income and other taxes are expenses, it is logical to deal also with government grants, which are an extension of fiscal policies, in profit or loss."

(Emphasis supplied by the Committee.)

The Committee further notes that Ind AS 20, while requiring to recognise all government grants in the statement of profit and loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate, does not recognise 'Capital Approach' and is based on 'Income Approach'. Accordingly, as per paragraph 15(a) of Ind AS 20, reproduced above, since the government grants *are receipts* *from a source other than shareholders, they should not be recognised directly in equity* but should be recognised in profit or loss in appropriate periods.

14. Further, the Committee notes the definition of 'liability' as per the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards as follows:

> "49 (b) A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits."

The Committee further notes that under Ind AS 20, government grants are recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Thus, the grant is recognised over the periods that bear the cost of meeting the obligations for which grant is provided. In other words, grant is deferred/amortised over the period of fulfilment of obligations related to the grant, for example, incurrence of expenses. Accordingly, the unamortised portion of the grant represent unfulfilled obligation, the settlement of which is expected to result in outflow of resources in future (even though the same may not be refundable in future as in the extant case) and therefore, in the view of the Committee, it meets the definition of liability. Further, the Committee notes from the Facts of the Case that the grant or capital subsidy in the extant case has been given with reference to mainly the 'Assam Gas Cracker Project', which is apparently a long-term project and the liabilities in the form of fulfilment of obligations are not expected to be settled within next twelve months. Therefore, the Committee is of the view that the unamortised portion of the grant or capital subsidy in the extant case should be disclosed under the head 'Non-current Liabilities' in the balance sheet and not under 'Other Equity' as intended by the company.

15. With regard to disclosure of current transfer of 'capital subsidy' to the profit and loss statement, the Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 20 'Accounting for Government Grants and Disclosure of Government Assistance':

> "29 Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense.
>
> 30 Supporters of the first method claim that it is inappropriate to net income and expense items and that separation of the grant from the expense facilitates comparison with other expenses not affected by a grant. For the second method it is argued that the

expenses might well not have been incurred by the entity if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.

31 Both methods are regarded as acceptable for the presentation of grants related to income. Disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate."

16. Further, the Committee notes the following paragraphs of Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013, issued by the Institute of Chartered Accountants of India:

"**9.1.7.** Revenue from operations needs to be disclosed separately as revenue from

(a) sale of products,

(b) sale of services and

(c) other operating revenues.

It is important to understand what is meant by the term "other operating revenues" and which items should be classified under this head vis-à-vis under the head "Other Income".

9.1.8. The term "other operating revenue" is not defined. This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities."

"9.2. Other income

The aggregate of 'Other income' is to be disclosed on face of the Statement of Profit and Loss. As per Note 5 of General Instructions for the Preparation of Statement of Profit and Loss 'Other Income' shall be classified as:

(a) Interest Income;

(b) Dividend Income;

(c) Other non-operating income (net of expenses directly attributable to such income)."

"**6.14.** A Note below Note 9 of the General Instructions for Preparation of Financial Statements clarifies that Ind AS Schedule III sets out the minimum requirements for disclosure in the Financial Statements including notes. It states that line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to the understanding of the company's financial position or performance or to cater to industry/sector-specific disclosure requirements, apart from, when required for compliance with amendments to the Act or Ind AS.

The application of the above requirement is a matter of professional judgement. The following examples illustrate this requirement. Earnings before Interest, Tax, Depreciation and Amortization is often an important measure of financial performance of the company relevant to the various users of Financial Statements and stakeholders of the company. Hence, a company may choose to present the same as an additional line item on the face of the Statement of Profit and Loss. The method of computation adopted by companies for presenting such measures should be followed consistently over the years. Further, companies should also disclose the policy followed in the measurement of such line items."

17. The Committee also notes that 'General Instructions for Preparation of Financial Statements of a Company required to comply with Ind ASs' of Schedule III to the Companies Act, 2013 states as follows:

"**Note:** This Schedule sets out the minimum requirements for disclosure on the face of the Financial Statements, i.e., Balance Sheet, Statement of Changes in Equity for the period, the Statement of Profit and Loss for the period (The term 'Statement of Profit and Loss' has the same meaning as 'Profit and Loss Account') and Notes. Cash flow statement shall be prepared, where applicable, in accordance with the requirements of the relevant Indian Accounting Standard.

Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company's financial position or performance or to cater to industry or sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act, 2013 or under the Indian Accounting Standards."

18. On a holistic reading of above paragraphs, the Committee notes that as per the requirements of Ind AS 20, the grant related to income should be presented either separately or under a general heading such as 'Other income'. Alternatively, it can also be deducted in reporting the related expense. Further,

the Committee notes that the 'other operating revenue' includes *revenue* arising from a company's *operating activities*, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. In the extant case, the Committee notes that although the 'capital subsidy' is received in relation to the Assam Gas Cracker Project, to receive such subsidy or grant cannot be considered as revenue generated from the company's operating activities (either principal or ancillary). Therefore, it should not be disclosed as 'other operating income' in the statement of profit and loss. However, the Committee notes that considering the specific facts and circumstances of the extant case, and considering the nature of capital subsidy to support the sub-optimal capacity plant, in respect of which huge depreciation (an operating expense) is being charged in the statement of profit and loss, the Committee is of the view that it would also not be correct to disclose the capital subsidy as 'other income'. Accordingly, the Committee is of the view that considering the requirements of Ind AS Schedule III, which sets out the minimum requirements for disclosure in the financial statements including notes and as per which, line items or sub-line items can be added on the face of the financial statements when such presentation is relevant to the understanding of the company's financial position or performance, the transfer of unamortised portion of capital subsidy to the statement of profit and loss may be presented as a separate line item with appropriate nomenclature between 'Revenue from Operations' and 'other income' and with adequate disclosures as per the requirements of the Guidance Note. Alternatively, it can also be deducted in reporting the related expense if the company can relate it with specific expense in the statement of profit and loss.

19. Incidentally, the Committee notes from paragraph 11 above that the querist has stated that the company intends to carry out the required changes from retrospective effect. In this regard, the Committee wishes to point out that retrospective application should be made only as per the requirements of the Ind ASs (for example, the requirements given in Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors').

D. Opinion

20. On the basis of the above, the Committee is of the following opinion:

(i) The unamortised portion of the grant or capital subsidy in the extant case should be disclosed under the head 'Non-current Liabilities' in the balance sheet and not under 'Other Equity' as intended by the company, as discussed in paragraphs 13 and 14 above.

(ii) The company's intention to disclose the current transfer of capital subsidy to profit & loss statement as 'Other Operating Revenue' under the head 'Revenue from Operations' is not correct. The same may, however be presented as a separate line item with appropriate nomenclature between 'Revenue from Operations' and 'other income' and with adequate disclosures as per the requirements of the Guidance Note. Alternatively, it can also be deducted in reporting the related expense if the company can relate it with specific expense in the statement of profit and loss, as discussed in paragraph 18 above.

Query No. 15

Subject: Provision for un-encashable portion of Half Pay Leave (HPL) as per AS 15 / Ind AS 19.[1]

A. Facts of the Case

1. A company (hereinafter referred to as the 'company' or 'corporation') has the following policy towards provision for encashment of Privilege Leaves (PL) and Half Pay Leaves (HPL) as per Accounting Standard (AS) 15 'Employee Benefits' /Indian Accounting Standard (Ind AS) 19, 'Employee Benefits':

i. The company's employees are governed by the Industrial DA pay pattern (IDA).
ii. As per the rules of the corporation, an employee is eligible for 30 days privilege leaves (PL) in a year and 20 days half pay leaves (HPL) in a year.
iii. The privilege leaves (PL) can be accumulated up to the maximum limit of 300 days which are encashable on superannuation.
iv. The privilege leaves in excess of 300 days due to the employees are encashable during the service period which is paid to the employees and is directly charged to expenditure under the head salary, wages & benefits.
v. Half pay leaves (HPL) are un-encashable during the service period. However, the HPL are encashable on superannuation only to the extent of the privilege leaves to the credit of executives employees falling short of maximum limit of 300 days. The benefit of HPL encashment on superannuation has not been extended to the non-executives employees.

<u>**Note:**</u> As on 31-03-2017, total employees in the corporation are

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

1232 consisting of 223 executive employees and 1009 non-executives employees.

vi. Employee-wise leave balances along with other personal details (executive and non-executive employees) are shared with the actuarial valuer as below:

- In case of executive employees, PL and HPL up to the maximum limit of 300 days and
- In case of non-executive employees, only PL up to the maximum limit of 300 days.

Based on the valuation provided from the actuarial valuer, provision is created for leave encashment (PL and HPL).

2. The querist has also stated that the company has adopted Indian Accounting Standards (Ind ASs) w.e.f. 1st April, 2017.

B. Query

3. In view of the above, the querist has sought the opinion of the Expert Advisory Committee as to whether the provision for the un-encashable half pay leaves (whether executives or non-executives employees) should be created similar to the encashable portion as part of cost of services rendered during the period in which the service was rendered which resulted the entitlement.

C. Points considered by the Committee

4. The Committee, while answering the query, has considered only the issue raised in paragraph 3 above and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment for privilege leave benefits, classification of half pay leaves as 'short-term' or 'other long-term' employee benefits and their measurement etc. Further, the Committee presumes from the Facts of the Case that the half pay leaves in the extant case can be carried forward and availed upto the retirement/superannuation of the employees (both executives and non-executives employees).

5. At the outset, the Committee wishes to point out that from an accounting angle, the nature of un-encashable leave is similar to that of the encashable leave insofar as the former provides a right to an employee to receive salaries and wages for the period for which he/she avails leave as during that period he/she does not render any services to the employer. The Committee is of the view that accumulating half pay leave creates an obligation on the enterprise because any unused entitlement increases the employee's entitlement to avail leave in future periods. Thus, a provision should be recognised for all these benefits and recorded as part of the cost of service rendered during the period in

which the service was rendered which resulted the entitlement. In this regard, without examining the classification of accumulating half-pay leaves into 'short-term' and 'other long-term' employee benefits, the Committee further notes the following paragraphs of Accounting Standard (AS) 15 'Employee Benefits'/Indian Accounting Standard (Ind AS) 19, 'Employee Benefits', notified under the Companies Rules, 2006/Companies (Indian Accounting Standards) Rules, 2015 as below:

AS 15:

"Short-term Employee Benefits

8. Short-term employee benefits include items such as:

…

(b) short-term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

…"

"Short-term Compensated Absences

11. An enterprise should recognise the expected cost of short-term employee benefits in the form of compensated absences under paragraph 10 as follows:

(a) in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences; and

(b) in the case of non-accumulating compensated absences, when the absences occur."

"13. Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating compensated absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the enterprise) or non-vesting (when employees are not entitled to a cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future compensated absences. The obligation exists, and is recognised, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation."

"16. Non-accumulating compensated absences do not carry forward: they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the enterprise. This is commonly the case for maternity or paternity leave. An enterprise recognises no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit."

"Other Long-term Employee Benefits

127. Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

…"

Ind AS 19:

"Short-term employee benefits

9 Short-term employee benefits include items such as the following, if expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services:

(a) wages, salaries and social security contributions;

(b) paid annual leave and paid sick leave;

..."

"**11 When an employee has rendered service to an entity during an accounting period, the entity shall recognise the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service:**

(a) as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.

(b) as an expense, unless another Ind AS requires or permits the inclusion of the benefits in the cost of an asset (see, for example, Ind AS 2, *Inventories*, and Ind AS 16, *Property, Plant and Equipment*)."

"Short-term paid absences

13 An entity shall recognise the expected cost of short-term employee benefits in the form of paid absences under paragraph 11 as follows:

(a) in the case of accumulating paid absences, when the employees render service that increases their entitlement to future paid absences.

(b) in the case of non-accumulating paid absences, when the absences occur."

"15 Accumulating paid absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating paid absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the entity) or non-vesting (when employees are not entitled to a cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future paid absences. The obligation exists, and is recognised, even if the paid absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation."

"18 Non-accumulating paid absences do not carry forward: they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the entity. This is commonly the case for sick pay (to the extent that unused past entitlement does not increase future entitlement), maternity or paternity leave and paid absences for jury service or military service. An entity recognises no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit."

"Other long-term employee benefits

153 Other long-term employee benefits include items such as the following, if not expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service:

(a) long-term paid absences such as long-service or sabbatical leave;

..."

From the above, the Committee notes that as per the above-reproduced paragraphs of Accounting Standard (AS) 15, 'Employee Benefits'/Indian Accounting Standard (Ind AS) 19, 'Employee Benefits', obligation exists in respect of short-term accumulating compensated absences irrespective of whether these are vesting or non-vesting and is required to be recognised. Similarly, paragraph 13 of AS 15 and paragraph of 153 of Ind AS 19 require to provide for a liability in respect of other long-term compensated absences. Accordingly, the Committee is of the view that irrespective of whether accumulating half-pay leaves in the extant case can be classified as 'short-term employee benefits' or as 'other long-term employee benefits', a liability on account of compensated absences should be recognised as per the requirements of AS 15 and Ind AS 19, which should be reviewed at each reporting date to recognise the effects of changes in estimates in this regard.

D. Opinion

6. On the basis of the above, the Committee is of the opinion that irrespective of whether un-encashable accumulating half-pay leaves in the extant case can be classified as 'short-term employee benefits' or as 'other long-term employee benefits', a liability on account of these should be provided as per the requirements of AS 15/Ind AS 19, which should be reviewed at each reporting date to recognise the effects of changes in estimates in this regard, as discussed in paragraph 5 above.

Query No. 16

Subject: Treatment of 'prepayment penalty' incurred for foreclosure of existing loan and availing new loan/borrowings.[1]

A. Facts of the Case

1. A company is into the business of development of retail mall and residential real estate project. The company has constructed a retail mall in Coimbatore by taking project finance term loan of Rs. 180 crore from consortium of banks led by the Central Bank of India. Project finance carries interest rate of 13.5%. The tenor of the loan was 10 years and at this point of time balance period of loan is 6.5 years. Shops in mall are given on rent to various national and international brands. As per business model, the company avails project finance for construction of mall and once mall is completed, leasing is done. Project finance loan is refinanced by taking lease rent discounting (LRD) term loan from banks. Project finance carries

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

high rate of interest (13.5% p.a.), whereas, lease rental discounting loan is available at lower rate of interest (9% p.a.).

2. The querist has stated that the company has got sanction of LRD (lease receivable discounting) loan from bank (new bank) for Rs. 200 crore at the rate of interest 9% p.a. The objective of fresh loan is to refinance high cost current project finance debt (existing loan) taken from other banks (existing bank). The current outstanding amount of loan is around Rs. 165 crore with rate of interest 13.5% p.a. As per sanction terms with new bank, they have directly discharged outstanding amount of present loan from the existing bank. As per sanction terms with existing bank, prepayment penalty of 1%-2% is applicable on foreclosure of loan. According to the querist, b*y settlement of existing loan and paying prepayment penalty, the company gets many business benefits, such as, lower rate of interest, additional funds, enhancement of loan tenor and reduction in monthly installment.* It is the business model of the company to take project finance loan during construction of property to be leased and once property is ready to use for leasing, project finance loan (costly loan) is repaid by availing LRD loan (cheaper rate of interest loan). The company has carried out the cost-benefit analysis of the transaction and concluded that benefits received by the company by availing new loan facility outweigh the costs incurred in closing/repayment of the existing loan (i.e. the benefits of new loan are multiple times of prepayment penalty as per business model of company). *If these benefits (reduced rate) are not available, the company will not prepay the loan and pay prepayment penalty to existing banks. Commercial rationale of swapping the loan was to avail net benefit of reduced rate post prepayment penalty.* (Emphasis supplied by the querist.)

3. The querist has further stated that Indian Accounting Standard (Ind AS) 109, 'Financial Instruments' defines transaction costs as "*Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.* The company has availed the loan from its existing bank at a very high rate of interest (i.e. 13.5% p.a.), which requires the company to incur substantial amount of interest expense, while higher amount of loan based on credit rating of the company is available in the market at a lower rate of interest which has been offered by the another bank (i.e. 9% p.a.). *It is clear from the business perspective that the company has incurred the 'prepayment charges' only to avail new loan which is available at significantly reduced rate. The company would not have incurred the prepayment penalty/charges, if it would not have availed the newly available reduced rate of loan.* (Emphasis supplied by the querist.)

4. *Objective of availing loan at reduced rate was after considering the charges, if any in the form of pre-payment penalty along with reduced rate,*

hence by calculating net effective rate for the company post such loss and gain on transaction. Every prudent business entity would like to utilize its resources to the optimum level and would like to avoid all the avoidable/unnecessary expenses. Since the market lenders are willing to provide better credit facility, in the form of higher amount of loan at a substantially lower interest rate than the current borrowing terms and regulations which were provided by the existing lender / bank; as per the cost-benefit analysis carried out by the company, the benefits available after availing the borrowing from the new lender surely outweigh the cost to be incurred in foreclosure of the exiting loan (i.e., 1%-2% of outstanding loan amount). (Emphasis supplied by the querist.)

5. According to the querist, it is a known fact that accounting shall represent the language of the business, which in substance, will be post considering the business prudence including management intention and estimates under the framework of relevant laws and accounting standards applicable. Careful analysis of the definition of the transaction cost suggests that transaction cost shall only be an incremental cost (*i.e., the cost which would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument).* As discussed above, management intends to incur the 'prepayment penalty' *only* to avail the new loan facility and would not have incurred the same if the company would not have received the substantial benefits from the new loan facility. *This means that such prepayment penalty/charges may be considered as in the nature of an incremental cost which may be said to be directly attributable to the acquisition of a financial liability in the form of new loan/borrowing. This can also be demonstrated since* new bank has paid off the old loan paid directly, in substance all such cost incurred was part of the same transaction. (Emphasis supplied by the querist.)

6. Paragraph 5.1.1 of Ind AS 109 states that *except for trade receivables within the scope of paragraph 5.1.3, "***at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability"**. As per the querist, since the new loan is a financial liability; on its initial recognition it shall be measured at fair value minus the *transaction costs that are directly attributable to the acquisition of a financial liability* and subsequently measured at amortized cost as per effective interest rate (EIR) method. Paragraph B5.4.4 of Appendix B to Ind As 109 states that "When applying the effective interest method, an entity generally amortises any fees, points paid or received, *transaction costs* and other premiums or discounts that are included in the calculation of the effective interest rate over the expected life of the financial instrument ..." (Emphasis supplied by the querist.)

7. The querist has also stated that Ind AS Transition Facilitation Group (ITFG) has issued a guidance in response to similar query raised, but one needs to appreciate the facts and business rationale. This case is quite different in terms of how the company operates, and as mentioned, the company always structures its finance in such a way that the company moves from higher loan (initial stage of our business) to a lower rate by accepting pre-payment penalty, since the company, in its business, accepts the new loan rate after adjusting the penalty charges. The company's comparison of loan rate among different banks at initial stage always considers (a) coupon rate and (b) prepayment penalty, since the company is aware at the beginning itself that the company will transfer the loan at lower rate once business is developed for that project. Based on above, management believes that as per above discussion and guidance, it may be directionally guided that the prepayment penalty incurred by the company to foreclose the exiting loan facility may be treated as the transaction cost for availing the new loan facility which shall be amortized over the expected life of the financial instruments. According to the querist, if prepayment charges are recognised in the statement of profit and loss, then this accounting treatment as per matching concept of accounting may not be appropriate as the benefits of incurring prepayment charges (interest savings on new loan) will accrue over period of new loan.

B. Query

8. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee as to what shall be the accounting treatment of the 'prepayment penalty' incurred for foreclosure of existing loan and availing new loan/borrowing?

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to accounting treatment of the 'prepayment penalty' incurred for foreclosure of existing loan (from existing bank) and availing new loan/borrowing (from new bank). 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 the existing or new loan, calculation of effective interest rate, etc. Moreover, the opinion expressed hereinafter is from the perspective of Indian Accounting Standards (Ind ASs), notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended till date.

10. At the outset, the Committee wishes to highlight the following requirements of Ind AS 109 with regard to accounting for the existing/ original financial liability:

(a) Paragraph B.4.3.5(e) of Ind AS 109 states that a prepayment option embedded in a host debt contract is not closely related to the host the contract unless it meets the one of criterion (two criteria) prescribed in the paragraph. Depending on the management's assessment as to whether prepayment option is closely related to the host contract, other accounting consequences should follow. In other words, an embedded derivative which is not closely related to the host debt contract will need to be separated and accounted for as standalone derivate contract.

(b) Ind AS 109 defines the term 'effective interest rate' as "The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the **gross carrying amount of a financial asset** or to the **amortised cost of a financial liability**. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the **expected credit losses**. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1–B5.4.3), **transaction costs**, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments)." This requires that effective interest rate on a loan should be calculated considering prepayment and other related terms.

Since the company has not raised any specific issue with regard to separation of prepayment option and in the absence of detailed information on accounting for the existing loan, the Committee refrains itself from commenting further on the existing loan accounting. Rather, it is presumed that while accounting for the existing loan, the company has duly considered and ensured due compliance with the above requirements.

11. In the context of the issue raised, the Committee notes the definition of transaction costs as per Appendix A to Ind AS 109, as follows:

"Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph B5.4.8). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument."

"B5.4.8 Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs."

5.1.1 Except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability."

From the above, the Committee notes that transaction costs are the incremental costs which are directly attributable to the acquisition or disposal of a financial liability. Further, the Committee notes that at the time of initial recognition, financial liability shall include only the transaction costs that are directly attributable to the acquisition or issue of the new financial liability and not the transaction cost of disposal of the existing financial liability. The Committee is of the view that prepayment penalty in the extant case is the transaction cost of disposal of the existing financial liability (loan) which is payable to the existing loan provider rather than the incremental cost of acquisition or issue of the new financial liability (new loan) from a different new bank. The Committee is further of the view that such a penalty is incurred to extinguish the existing liability and to get the benefits due to lower cost liability (loan) and not for acquiring the new financial liability (loan). Therefore, such penalty cannot be treated as directly attributable to the acquisition of the new financial liability. Accordingly, the Committee is of the view that prepayment penalty in the extant case cannot be considered as transaction cost of the new loan; rather should be treated as transaction cost of extinguishment of existing loan, which in accordance with paragraph 5.7.2 of Ind AS 109 should be recognized as part of the gain or loss on extinguishment/derecognition of the old loan in the statement of profit and loss. In this context, the Committee notes the requirements of paragraph 5.7.2 as follows:

"5.7.2 A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship (see

paragraphs 6.5.8–6.5.14) shall be recognised in profit or loss when the financial asset is derecognised, reclassified in accordance with paragraph 5.6.2, through the amortisation process or in order to recognise impairment gains or losses. An entity shall apply paragraphs 5.6.2 and 5.6.4 if it reclassifies financial assets out of the amortised cost measurement category. A gain or loss on a financial liability that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 6.5.8–6.5.14) shall be recognised in profit or loss when the financial liability is derecognised and through the amortisation process. (See paragraph B5.7.2 for guidance on foreign exchange gains or losses.)"

D. Opinion

12. On the basis of the above and subject to any adjustment arising from paragraph 10, the Committee is of the view that prepayment penalty of an existing loan in the extant case cannot be considered as transaction cost of the new loan; rather should be treated as transaction cost of extinguishment of existing loan, which in accordance with paragraph 5.7.2 of Ind AS 109 should be recognized as part of the gain or loss on extinguishment/derecognition of the old loan in the statement of profit and loss, as discussed in paragraph 11 above.

Query No. 17

Subject: Accounting treatment of free land provided by Bangalore Metropolitan Transport Corporation (BMTC) for setting up of a CNG station at BMTC depots.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a 100% subsidiary of XYZ Ltd., a Maharatna Public Sector Undertaking (PSU) under the Ministry of Petroleum & Natural Gas, Government of India. The company was incorporated for undertaking downstream distribution of natural gas to various small/medium industrial customers and implementation of City Gas Distribution (CGD) projects in various cities/geographical areas (GA) authorized by the Government of India or Petroleum and Natural Gas Regulatory Board (PNGRB).

[1] Opinion finalised by the Committee on 23.7.2018.

Accordingly, the company is carrying out the manufacturing and sale of Compressed Natural Gas (CNG) as fuel for vehicles and distribution of Piped Natural Gas (PNG) to domestic/commercial/industrial customers in various cities authorized by the PNGRB. The company has an authorized share capital of Rs. 2,000 crores and total paid up capital of the company as on 31.03.2017 is Rs. 627 crores. Total gross revenue of the company as on 31.03.2017 is Rs. 2,800 crores.

2. XYZ Ltd. is a listed company and has implemented the Indian Accounting Standards (Ind ASs) w.e.f. 01.04.2016 as per the provisions of Companies Act, 2013. Accordingly, it is mandatory for the company, which is a 100% subsidiary of XYZ Ltd. to prepare the accounts in accordance with the requirements of Ind ASs. The company has prepared its financial statements for the financial year (F.Y.) 2016-17 as per the requirements of Ind AS which was audited by M/s ABC & Co, Chartered Accountants, statutory auditor of the company, with no adverse observation. (Copy of annual report has been provided by the querist for the perusal of the Committee).

3. For the purpose of carrying on the business of manufacture and sale of CNG, the company has set up the CNG stations for which land has been purchased or provided wherein various equipments have been installed and commissioned to operationalize the CNG stations. These CNG stations are built under Company Own Company Operated (COCO) Model in case it is built up by the company and under Dealer Owned Dealer Operated (DODO) Model in case it is built up by the dealer. Under COCO Model, the land, equipments and other facilities have to be arranged by the company and under DODO model, it is arranged by the dealer and the company pays the trading margin on the sale of CNG at the stations to the dealer.

4. To set up CNG station at one of the location of Bengaluru City, Bangalore Metropolitan Transport Corporation (BMTC) has provided the land measuring 693 sq. meter, free of cost for laying the pipelines up to the CNG station area inside the BMTC depots under CGD project at Peenya (Depot 9 & 22), Hennur (Depot-10) and Srigandakavalu (Sumanahalli) Depot – 31 of the BMTC depots with the condition of filling CNG gas only to BMTC buses. The approval of providing this land was conveyed by BMTC on 22.07.2015. (Copy of BMTC letter dated 22.07.15 has been provided by the querist for the perusal of the Committee).

5. The querist has reproduced paragraph 3 of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', which states as follows:

> **"*Government assistance* is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors."**

6. Further, the querist has reproduced paragraph 35 of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', which states as under:

> "Examples of assistance that cannot reasonably have a value placed upon them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from the normal trading transactions of the entity is a government procurement policy that is responsible for a portion of the entity's sales. The existence of the benefit might be unquestioned but any attempt to segregate the trading activities from government assistance could well be arbitrary."

7. The querist has stated further that, a book titled Indian Accounting Standard (Ind AS), Interpretation, Issues & Practical Application, Volume-1 by two eminent Chartered Accountants states that :

> "For instance, free technical or marketing advice and/or guarantees given by the government are typically considered in the nature of government assistance as against government grant. Accordingly, they are not accounted for in the financial statements of the recipient entity. Similarly, consider one more example where a government body purchases the entity's products. There is no doubt that the entity is getting some benefit from such procurement; however, it cannot be distinguished from normal trading activities of the entity. Hence, Ind AS 20 treats such transactions as government assistance and not government grant. No separate accounting is required for such assistance."

8. As per the querist, since the normal transaction of the company *inter alia* includes sale of CNG and the only purpose for which the CNG station has been put on the land belonging to M/s BMTC is for carrying out the normal trading transaction of the company, i.e., sale of CNG, therefore the same cannot be distinguished from the normal trading transactions of the company, i.e. sale of CNG and is excluded from the definition of government grants.

9. Hence, keeping in view the provisions of paragraphs 3 and 35 of Ind AS 20 as stated above, the land provided by M/s BMTC is in the form

of government assistance which cannot be reasonably have a value placed upon it (since land is situated inside the BMTC depot) and is a transaction with the government which cannot be distinguished from the main trading transaction of the entity i.e. manufacture and sale of CNG to BMTC buses and to no other entity; thus the land provided by M/s BMTC has not been considered as government grant.

10. Further, as per paragraph 36 of Ind AS 20, necessary disclosure has been made in the financial statement of the company for the financial year 2016-17 vide note 33 (e). It may also be noted that the said land is not transferable to the company and there is period mentioned by M/s BMTC for the use of such land. Accordingly, the company is also charging the depreciation on the assets installed at the land provided by M/s BMTC as per schedule-II of the Companies Act, 2013.

11. During the Comptroller and Auditor General (CAG) audit under section 143(6) (a) of the Companies Act, 2013 for the F.Y. 2016-17, the Government auditor raised the following observations on the accounts of the company:

> "As per Ind AS 20, Government Grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances the fair value of the non-monetary asset is assessed and both grant and asset are accounted for at that fair value. Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income. The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset. Audit observed that the company has constructed building on the land (693 sq. mtr) provided by the Bengaluru Municipal Transport Corporation (BMTC) at free of cost for installation of CNG station. As such, in line with the provisions of Ind AS 20, the company should have made a grant of Rs. 11.19 crore[2].
>
> Management/statutory auditor stated that ownership of the land has not been transferred and therefore BMTC remains the owner of the said land. Further, Ind AS 20 excludes those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from

[2] 693 sqrmtr=7459 sqr ft. Rate per sqt feet taken as Rs 15000. 7459*15000=Rs 111885000/-

the normal trading transaction of the entity. Since the normal transaction of the company intra-alia includes sale of CNG and the only purpose for which the CNG station has been put on the land belonging to BMTC is for carrying out the normal trading transaction of the company i.e. sale of CNG, therefore the same cannot be distinguished from the normal trading transactions of the company, i.e., sale of CNG.

Reply of the management and statutory auditors may be viewed against the fact that paragraph no. 35 of Ind AS 20 clearly states that *assistance that cannot be distinguished from the normal trading transaction of the entity is a government procurement policy that is responsible for a portion of the entity's sales.* Thus, this has resulted in understatement of deferred income (liabilities) and assets by Rs. 11.19 crore. Correspondingly, depreciation/amortisation is understated and profit is overstated by Rs. 37.30 lakh[3]."

12. The company is of the view that M/s BMTC has provided the land free of cost for installing and commissioning of CNG Stations at Peenya, Hennur, Srigandakavalu depots of M/s BMTC with a condition to filing CNG gas only to BMTC buses with no transfer of ownership right of the said land to the company. Since, ownership of the said land has not been transferred to the company as it belongs to M/s BMTC, therefore, Ind AS 20 is not applicable. Accordingly, management has submitted the following reply to the Government auditor:

"The company is in the business of city gas distribution to domestic, industrial and commercial customers and manufacture & sale of CNG. For carrying out the above activities, the company has installed various assets required for purpose of the business.

In respect of the audit observation, we would like to submit that for the purpose of putting up CNG station, the company had approached Bengaluru Metropolitan Transport Corporation (BMTC) for earmarking the area for installation of CNG station for the purpose of dispensing and sale of CNG to BMTC. Therefore, only the use of the land with specific purpose of setting up of CNG station has been provided with the condition of filling CNG only in BMTC buses with no ownership right of the said land which belongs to BMTC. Therefore ownership of the said land has not been transferred to the company and it belongs to BMTC. Further, there is no mention of period for which the use of land has been provided by BMTC for carrying out normal trading transaction of the company for sale of CNG to BMTC buses.

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[3] Useful life of factory building is 30 years as per schedule-II of the companies Act 2013. Amortisation chargeable to Profit and loss is 111885000/30= Rs 3729500/-.

Further, paragraph 3 of Ind AS 20 states as under:

"*Government assistance* is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

***Government grants* are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to operating activities of an entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.**

***Grants related to assets* are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held."**

Further, paragraphs 34 and 35 of Ind AS 20 state that:

"34. Excluded from the definition of government grants in paragraph 3 are certain forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

35. Examples of assistance that cannot reasonably have a value placed upon them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from normal trading transactions of the entity is a government procurement policy that is responsible for a portion of the entity's sales. The existence of the benefit might be unquestioned but any attempt to segregate the trading activities from government assistance could well be arbitrary."

In this regard we would like to submit that in the book titled "Indian Accounting Standard (Ind AS), Interpretation, Issues & Practical

Application, Volume -1 by two eminent Chartered Accountants, the following is stated :

"For instance, free technical or marketing advice and/or guarantees given by the government are typically considered in the nature of government assistance as against government grant. Accordingly, they are not accounted for in the financial statements of the recipient entity. Similarly, consider one more example where a government body purchases the entity's products. There is no doubt that the entity is getting some benefit from such procurement; however, it cannot be distinguished from normal trading activities of the entity. Hence, Ind AS 20 treats such transactions as government assistance and not government grant. No separate accounting is required for such assistance."

In respect of land provided by BMTC, it is submitted that BMTC has provided the use of land only for CNG Station without transfer of ownership of land to the company while title of the land still lies with BMTC. It also does not mention the period for which use of land has been provided.

Since the normal transaction of the company intra-alia includes sale of CNG and the only purpose for which the CNG station has been put on the land belonging to BMTC is for carrying out the normal trading transactions of the company, i.e., sale of CNG, therefore the same cannot be distinguished from the normal trading transactions of the company i.e. sale of CNG and is excluded from the definition of government grants."

13. Accordingly, the government auditor dropped the observations based on the assurance of the management that the company will refer the matter to ICAI during the current F.Y. 2017-18 for its opinion on the matter and will take necessary action accordingly.

14. Further, statutory auditors in their reply to CAG stated that they are also in agreement with the reply of the management.

15. The querist has separately informed that no period has been mentioned in the letter from BMTC for use of land and no rent is being paid. Further, with regard to whether any differential price being charged, the querist has informed that since the commercial operations have not commenced, no price data is available.

B. Query

16. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

(a) Whether the accounting treatment of free land provided by M/s BMTC to the company is correct in its financial statements for the financial year 2016-17.

(b) In case, accounting treatment done by the company is not correct then what would be the correct accounting treatment and disclosure thereof, if any.

(c) Whether any accounting policy (for the accounting treatment) is to be framed and disclosed in the financial statements of the company.

(d) Any other issue / guidance on the matter which ICAI wants to provide.

C. Points considered by the Committee

17. The Committee notes that the basic issue raised in query relates to accounting treatment of the land provided free of cost by the BMTC. Accordingly, the Committee while expressing its opinion has considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment under the COCO and DODO model, accounting treatment for the building / works constructed on the land and the useful life thereof, fair value measurement of the land, applicability or appropriateness of adopting Ind ASs under the Companies Act, 2013 etc. It may be noted that in this case, the company's assets (CNG station) are located at the customer's location/ land and can be used exclusively for supply of CNG to the customer' buses. The Committee has not examined whether this results into an embedded lease arrangement (if any) under Appendix C to Ind AS 17. Further, the opinion of the Committee, expressed hereinafter is only from accounting point of view and not from the angle of interpreting any legal provisions of statute, such as ownership and legal title of the land provided by BMTC and other related matters. At the outset, the Committee notes that with regard to any different price being charged by the company from BMTC, the querist has informed that since the commercial operations have not commenced, no price details are available. Accordingly, the Committee has not examined the issue from this perspective and if there would be any such differential, then this may impact the accounting treatment prescribed below. The Committee further wishes to mention that as the query pertains to financial year 2016-17, the Committee has examined the issue only in the context of Ind ASs applicable for the said financial year.

18. The Committee notes that in the extant case, BMTC has given the land to the company (although free of cost) for the exclusive purpose of setting up of gas station and the same shall be used exclusively for filling up of gas in the buses owned by BMTC. Thus, although in form, it may appear that BMTC is providing grant in the form of land to the company, the substance is that it is an arrangement from which both the parties are mutually benefitted, BMTC getting an exclusive supply of gas for its buses from the gas station set up by the company in its own premises and the company in the form of consideration for supply of gas to BMTC. The Committee is of the view that since government grant/assistance is generally non-gratuitous and non-reciprocal, the arrangement in the extant case should not be considered as that of government grant/assistance. Further, as in the extant case, BMTC is a customer for the company; the Committee examines the applicability of Appendix C, 'Transfer of Assets from Customers' to Ind AS 18 in the extant case. Accordingly, the Committee notes the following requirements of Appendix C:

"1 In the utilities industry, an entity may receive from its customers items of property, plant and equipment that must be used to connect those customers to a network and provide them with ongoing access to a supply of commodities such as electricity, gas or water. Alternatively, an entity may receive cash from customers for the acquisition or construction of such items of property, plant and equipment. Typically, customers are required to pay additional amounts for the purchase of goods or services based on usage."

"4 This Appendix applies to the accounting for transfers of items of property, plant and equipment by entities that receive such transfers from their customers.

5 Agreements within the scope of this Appendix are agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or to do both."

"7 This Appendix does not apply to agreements in which the transfer is either a government grant as defined in Ind AS 20 or infrastructure used in a service concession arrangement that is within the scope of Appendix A of Ind AS 11 *Service Concession Arrangements*."

"9 When an entity receives from a customer a transfer of an item of property, plant and equipment, it shall assess whether the transferred item meets the definition of an asset set out in the *Framework for the Preparation and Presentation of Financial*

Statements issued by the Institute of Chartered Accountants of India. Paragraph 49(a) of the Framework states that 'an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.' In most circumstances, the entity obtains the right of ownership of the transferred item of property, plant and equipment. However, in determining whether an asset exists, the right of ownership is not essential. Therefore, if the customer continues to control the transferred item, the asset definition would not be met despite a transfer of ownership.

10 An entity that controls an asset can generally deal with that asset as it pleases. For example, the entity can exchange that asset for other assets, employ it to produce goods or services, charge a price for others to use it, use it to settle liabilities, hold it, or distribute it to owners. The entity that receives from a customer a transfer of an item of property, plant and equipment shall consider all relevant facts and circumstances when assessing control of the transferred item. For example, although the entity must use the transferred item of property, plant and equipment to provide one or more services to the customer, it may have the ability to decide how the transferred item of property, plant and equipment is operated and maintained and when it is replaced. In this case, the entity would normally conclude that it controls the transferred item of property, plant and equipment.

How should the transferred item of property, plant and equipment be measured on initial recognition?

11 If the entity concludes that the definition of an asset is met, it shall recognise the transferred asset as an item of property, plant and equipment in accordance with paragraph 7 of Ind AS 16 and measure its cost on initial recognition at its fair value in accordance with paragraph 24 of that Standard."

19. From the above, the Committee notes that in the extant case, the ownership of the land is with BMTC itself and only right to use of land for limited purpose of supplying gas to BMTC buses has been transferred. Further, the company can use the land only for setting up CNG station and not for any other purpose such as, exchange, lease, use it to settle liability, or to distribute it to owners etc. Also, the company can use the CNG station set up on the land only for supplying CNG to the BMTC buses and it cannot use the same station to supply CNG to other customers. Therefore, the Committee is of the view that the company in the extant case does not control the land transferred to it by BMTC

and accordingly, the company cannot recognise the land as an asset in its financial statements. The Committee is further of the view that the substance of the transaction is that the company's assets (CNG station) are located at the customer's location to provide services exclusively to the customer and to facilitate the company in earning revenue from supply of CNG and from which BMTC is getting an exclusive availability of CNG for its buses in its own premises. Thus, this arrangement has been made for meeting the business exigencies of both the parties involved, for which an appropriate disclosure should be made in the Notes to financial statements of the company.

D. Opinion

20. On the basis of the above, the Committee is of the opinion that the transfer of land by BMTC to the company in the extant case cannot be treated as Government grant/assistance, as discussed in paragraph 18 above. Further, the transferred land in the extant case cannot be considered as an asset of the company and the company should not recognise the land transferred by BMTC in its financial statements, as discussed in paragraph 19 above. In substance, the arrangement in the extant case is that the company's assets are located at customers location which is for meeting the business exigencies of both the parties and accordingly, an appropriate disclosure should be made in the Notes to financial statements of the company.

Query No. 18

Subject: Accounting for the site restoration/mine closure obligation upon first time adoption of Indian Accounting Standards (Ind ASs).[1]

A. Facts of the Case

1. A company is a public sector undertaking and a listed company, engaged in the mining of coal with eight fully owned Indian subsidiaries and one overseas subsidiary in Mozambique. The company operates through both underground mines as well as open cast mines. The share of production from the underground mine is about 30 million tonnes whereas production from the open cast mine is approx. 537 million tonnes.

2. The querist has stated that mining of coal necessarily involves displacement of large volumes of soil and rock, resulting in various degrees of environmental degradation. Mine reclamation entails restoring these disturbed

[1] Opinion finalised by the Committee on 23.7.2018.

areas to its previous natural resource setting while minimising environmental impacts. The company and its subsidiaries have been fulfilling its obligation of restoring the mining sites as per the statutory requirements. Cost incurred for fulfilling such obligation is broadly termed as site restoration cost or alternatively, as mine closure cost. The Ministry of Coal (MoC), Government of India, has issued the Guidelines for preparation of mine closure plan (MCP) dated 7th January 2013. The Guidelines require that no project can be approved without having a mine closure plan in place. As per the Guidelines, the company is required to provide for the liability for total project area once any activity starts on land, i.e., mine closure obligation arises as soon as any activity starts on land (paragraph No. 4 of Annexure I - Mine Closure Guidelines). The Government of India monitors implementation of MCP, maintains the escrow fund related to MCP through Coal Controller, an organisation set up under the Ministry of Coal to look into, *inter alia*, conservation and development of mines. Some of the salient features of the requirements are as follows:

- All coal mine owners shall adopt a Mine Closure Plan for each of their mines comprising progressive closure plan and final closure plan duly approved by the competent authority.

- The Mine Closure Plans will have two components, viz.,
  i) Progressive or Concurrent Mine Closure Plan and
  ii) Final Mine Closure Plan.

  Progressive Mine Closure Plan would include various land use activities to be done continuously and sequentially during the entire period of the mining operations, whereas the Final Mine Closure activities would start towards the end of mine life, and may continue even after the reserves are exhausted and/or mining is discontinued till the mining area is restored to an acceptable level by the Coal Controller.

- Annual closure cost of mine closure be computed considering the total project area at the rate of Rs. 6 Lakh per hectare and Rs.1 Lakh per hectare as on 27.08.2009 in case of opencast mine and underground mine respectively and dividing the same by the entire life of mine in years for new projects and balance life of mine in years for operating/existing mines.

- An amount equal to the annual cost is deposited in escrow account each year throughout the mine life compounded @ 5% annually. (Annual cost is mentioned in Project Report.)

- An escrow account is opened separately for each mine where the aforesaid amount shall be deposited annually.

- Upto 80% of the total deposited amount, including interest accrued in the escrow account is released by Coal Controller after every five years in line with the periodic examination of the closure plan. The amount released should be equal to the expenditure incurred on the progressive mine closure in past five years or 80% whichever is less.

3. Accounting under previous GAAP:

- As per the requirement of guidelines issued by the MoC, a mine closure plan for each mine has been prepared by ABC Limited, a subsidiary of the company. (A mine closure plan for an opencast mine and an underground mine has been provided by the querist for the perusal of the Committee.)

- The plan includes calculation of estimated amount of annual closure cost, which is required to be deposited in an escrow account on yearly basis for each mine.

- A provision for mine closure is created each year by estimated annual cost calculated in mine closure plan. The same amount is deposited in escrow account on yearly basis as per the requirement of the Guidelines. Interest earned on mine closure escrow account is recognised as income. Any concurrent/progressive expenditure incurred on mine closure is recorded as receivable from escrow account. On receiving money from escrow account after five years released by Coal Controller Officer (CCO) after periodic examination, the receivable is adjusted with provision.

4. Specimen Journal Entries: (As per previous GAAP)

1. For creation of mine closure provision each year:

   Profit & Loss Account Dr.
   To Mine Closure Provision Account Cr.
   (Being mine closure provision created for the year)

2. For deposit of fund in escrow account each year

   MCP Escrow Account Dr.
   To Bank Account Cr.
   (Being mine closure provision created for the year deposited in the escrow account)

3. For interest received from escrow account of mine closure

   MCP Escrow Account Dr.
   To interest income account Cr.
   (Being interest income on MCP Escrow Account for the year)

4. For incurring actual expenditure on progressive mine closure

   Mine Closure Expenses Receivable Dr.
   To Bank Account Cr.
   (Being expenses incurred on mine closure for the year)

5. For amount released by C.C.O on progressive mine closure expenditure incurred (every five years)

   Bank Account Dr.
   To MCP Escrow Account Cr.
   (Being amount withdrawn from MCP Escrow Account (every 5 years))

6. For adjustment of provision with receivable on receipt of money from escrow account

   Mine Closure Provision Account Dr.
   To Mine Closure Expenses Receivable Cr.
   (Being mine closure provision adjusted)

5. Accounting adopted under Indian Accounting Standards (Ind ASs):

- Mine closure plan prepared for each mine separately by ABC Limited, a subsidiary of CIL as per the requirements of the Guidelines issued by MoC remains unaltered.

- Calculation of estimated annual closure cost, for deposit in escrow account yearly for each mine prepared on the basis of requirements of the Guidelines remains same.

- Under Ind ASs, the following procedure is being adopted for accounting for mine closure:

  - Total cost estimated for a mine at the end of the life of mine as per mine closure plan is discounted to present value on the date of beginning of the mine closure plan.
  - The discounted value is capitalised as ‘Site restoration asset’ and a 'Site restoration/mine closure provision' is created.
  - Mine closure/Site restoration asset is amortised over the life of mine.
  - The provision is unwound each year using the same factor used for discounting.
  - Recognising the unwinding as finance cost
  - Interest on escrow is recognised as income.
  - Concurrent expenditure on mine closure recognised as receivable when incurred and adjusted with provision in the

year in which the money is withdrawn from escrow account in respect of such expenditure.

- Based on management's assessment, discounting factor of 8% was used for this purpose and is to be reviewed every year.

(Calculation for above in case of one mine has been supplied by the querist for the perusal of the Committee.)

6. *Journal entries on date of transition, i.e., 1 April 2015*

(i) For reversal of provision as on 31.03.2015

Provision for Mine Closure A/c Dr.

To Retained Earnings

(Being provision up to 31.03.2015 under previous GAAP is reversed)

(ii) For capitalising site restoration asset as on 01.04.2015

Site Restoration Asset A/c Dr.

To Site Restoration Provision Account

(Present value of mine closure cost at the end of mine life is recognised as site restoration cost)

(iii) For recognising interest and amortisation of assets for the period 01.04.2010 to 31.03.2015

Retained Earnings Dr.

To Provision for Depreciation

To Site Restoration Provision

(Being interest costs from the date/ initial year of recognising such MCP obligation up to 31.03.2015 to be provided as Site Restoration Provision and depreciation from the date of initial capitalisation of MCP up to 31.03.2015 calculated on Site Restoration costs capitalised, adjusted through retained earnings)

Journal Entry for 2015-16

(iv) Unwinding of discount A/c Dr.

Depreciation A/c Dr.

To Provision for Depreciation A/c

To Site Restoration Provision A/c

(Being unwinding of discount recognised as finance cost and credited to MCP and amortisation of site restoration cost recognised as depreciation and credited to accumulated depreciation)

(v) For reversal of mine closure provision equivalent to interest on escrow fund

Mine Closure Provision (Liability) A/c Dr.

To Interest Income/Interest Expenses

(vi) For deposit of amount in escrow fund

Escrow Fund A/c Dr.
To Bank Account

Deposit amount will be as per original Mine Closure Plan prepared by ABC Ltd.

(Being deposit made in escrow account)

(vii) For interest earned on escrow account

Escrow Fund A/c Dr.

To Interest Income

(Being Interest on escrow deposit recognised as income)

(viii) For actual expenditure incurred on mine closure

MCP Expenses receivable A/c Dr.

To Bank

Year 2016-17 and Onwards

(ix) Unwinding of discount A/c Dr.

Depreciation A/c Dr.

To Provision for Depreciation A/c

To Site Restoration Provision A/c

(Being unwinding of discount recognised as finance cost and credited to MCP and amortisation of site restoration cost recognised as depreciation and credited to accumulated depreciation)

(x) For deposit of amount in escrow fund

Escrow Fund A/c Dr.
 To Bank Account

Deposit amount will be as per original Mine Closure Plan approved by Board.

(Being deposit made in escrow account)

(xi) For interest earned on escrow account

Escrow Fund A/c Dr.

 To Interest Income

(Being Interest on escrow deposit recognised as income)

(xii) For actual expenditure incurred on mine closure

MCP Expenses receivable A/c Dr.

To Bank/Natural heads/Liability Write back

(xiii) When amount from escrow account received

Bank A/c Dr.

 To Escrow Fund A/c

(Being amount from escrow deposit received)

(xiv) Site restoration provision A/c Dr.

Profit & Loss Account Dr. [For amount not accepted as mine closure expenses]

 To MCP Expenses receivable A/c.

(Being provision for site restoration adjusted for actual expenditure and disallowed expenditure being charged to profit & loss)

7. The querist has separately clarified that under Ind ASs, estimation of the liability was made on the original date i.e. 01.04.2010, date at which site restoration liability was recognised first as per the Mine Closure Plan guidelines of Ministry of Coal, and then the same was unwound to 01.04.2015 on which date site restoration asset and site restoration provision were recognised. Further, the company also availed the exemption of paragraph D21 under Ind AS 101, i.e., for 'decommissioning liabilities included in the cost of property, plant and equipment'. The querist has also mentioned that the mines in question include both, mines in production phase and mines in development phases. According to the querist, based on paragraph 4 of the Guidelines, mine

closure obligation arises after any activity starts on the land and therefore, recognition of obligation of site restoration is started from development stage of the mine. The querist has also stated that the costs to be incurred by the company are not in the nature of stripping cost in the production phase of a surface mine that is covered by Appendix B 'Stripping Cost in the Production Phase of a Surface Mine' to Ind AS 16 'Property, Plant and Equipment'.

B. Query

8. Based on the above, the querist has sought the opinion of the Expert Advisory Committee as to whether the company's method of accounting for site restoration/mine closure cost based on total project area of the mine is in conformity to the requirements of Ind ASs.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to accounting for the site restoration/closure obligation (decommissioning obligation) of the company upon transition to Ind ASs. 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, the appropriateness of the accounting for decommissioning obligation under previous GAAP; adequacy or appropriateness of how the company has measured/estimated the amount of provision as per the relevant MCP, or any other law, regulation or government directive in this respect; appropriateness of how the company has determined discount rate for the purpose of discounting of the provision; appropriateness of the depreciation policy; appropriateness of the accounting for the mining right; any consequential legal or regulatory aspect around site restoration or mine closure; etc. Also, the Committee has looked at the issue raised only from principle guidance perspective and has not looked at appropriateness of accounting entries passed by the querist under the previous GAAP or Ind ASs.

10. At the outset, the Committee notes from the Facts of the Case that the mines in question include both mines in production phase and mines in development phases. Further, based on the requirements of paragraph 4 of the Guidelines, mine closure obligation arises as soon as any activity starts on the land and therefore, recognition of obligation of site restoration is started from the development stage of the mine. In this regard, the Committee wishes to point out that the costs to be incurred by the company, which are in the nature of stripping costs in the production phase of a surface mine that is covered by Appendix B, Stripping Cost in the Production Phase of a Surface Mine to Ind AS 16, 'Property, Plant and Equipment' should be dealt with in accordance with the said Appendix. Since the querist has not raised any issue related to accounting for stripping costs, the accounting for such costs has not been examined by the Committee. The Committee further notes from the Facts of the Case that mine closure/site

restoration liability was recognised first on 01.04.2010 as per the Mine Closure Plan guidelines of Ministry of Coal. Ind ASs require the provision to be recognised as soon as the obligating event takes place, i.e., as soon as legal or constructive obligation for MCP arises. The determination of when such obligation arises depends on the legal provisions as well as facts and circumstances prevailing at that time. This may require significant judgement. Hence, whether the provision in respect of such an obligation was also required before that date (viz., 1.4.2010) as per the then applicable standards/legal position/ facts and circumstances has not been examined by the Committee and it has proceeded on the presumption that the same is in accordance with the applicable requirements.

11. The Committee notes that both Ind AS 16, 'Property, Plant and Equipment' and Ind AS 38, 'Intangible assets' exclude mineral reserves from their scope and Ind AS 106, 'Exploration for and Evaluation of Mineral Reserves' provides the following guidance on the classification of exploration and evaluation assets:

> "15 An entity shall classify exploration and evaluation assets as tangible or intangible according to the nature of the assets acquired and apply the classification consistently.
>
> 16 Some exploration and evaluation assets are treated as intangible (eg drilling rights), whereas others are tangible (eg vehicles and drilling rigs). To the extent that a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset. However, using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset."

On the basis of the above, the Committee is of the view that the company can treat the exploration and evaluation assets, either as property, plant and equipment or intangible assets according to the nature of assets.

12. Further, Ind AS 16 contains following guidance for initial measurement of an item of property, plant and equipment:

> "16 The cost of an item of property, plant and equipment comprises:
>
> (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
>
> (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period."

Ind AS 38 also contains the following guidance for initial measurement a separately acquired intangible asset:

"27 The cost of a separately acquired intangible asset comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and

(b) any directly attributable cost of preparing the asset for its intended use."

The Committee notes from the above that both Ind AS 16 and Ind AS 38 require costs that are directly attributable to the asset acquired or to bring the asset to the location and condition necessary for it to be capable of operating in the intended manner to be included in the initial measurement. Further, Ind AS 16 specifically provides that the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period (for purposes other than to produce inventories during that period) shall be included in the cost of an item of property, plant and equipment.

13. The Committee further notes the following paragraphs of Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', dealing with the initial measurement of a provision:

"14 A *provision* shall be recognised when:

(a) an entity has a present obligation (legal or constructive) 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 shall be recognised."

"19 It is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised."

"45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation."

"47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted."

"60 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognized as borrowing cost."

Further, Appendix A, Changes in Existing Decommissioning, Restoration and Similar Liabilities to Ind AS 16 deals with the accounting for changes in measurement of decommissioning liability and provides as follows:

"5 If the related asset is measured using the cost model:

(a) subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.

(b) the amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss.

(c) if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount, and shall account for any impairment loss, in accordance with Ind AS 36."

"8 The periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs. Capitalisation under Ind AS 23 is not permitted."

14. The Committee notes from the Facts of the Case that the mines of the company require site restoration and mine closure work for which expenditure is required to be incurred as per law and the terms of operating licenses. Therefore, based on the above guidance, the Committee is of the view that the site restoration/mine closure costs in the extant case would be in the nature of decommissioning or restoration cost to be included in the initial measurement of the related tangible or intangible asset. Further, under Ind AS 37, a provision is required to be recognised in respect of such costs since there exists an obligation to perform the site restoration and closure of the mine. However, the relevant regulations should be taken into account when determining the existence and extent of the obligation. Further, since the site restoration/mine closure costs are towards the closure activities at the end of the mine life, the obligation is a long-term obligation and, accordingly, the initial cost of the related asset should include the present value of the expenditures expected to be required to settle the obligation. Subsequently, the cost of the related asset, including the initial estimate of site restoration/mine closure costs, should be depreciated/amortised based on the pattern in which the related asset's future economic benefits are expected to be consumed in accordance with the requirements of the relevant Standards. Moreover, since discounting is used, the carrying amount of the provision will increase in each period to reflect the passage of time and this periodic unwinding of the discount should be recognised in the statement of profit and loss as finance cost. The querist has not specifically mentioned whether there are any changes in the initial estimate of MCP obligation, since its initial recognition. If there are any such changes, the querist has also not mentioned how such changes are treated in the financial statements. In the absence of such clarity, the Committee has not examined this issue in detail. The Committee believes that if there are any changes in the initial estimate of MCP obligation, the company should ensure accounting as per Appendix A to Ind AS 16. (Also refer discussion in paragraph 17 below.)

15. The Committee also notes that the company in the extant case is contributing towards an escrow account operated by the Coal Controller, under the Ministry of Coal. In this context, the Committee notes Appendix A to Ind AS 37, 'Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds' provides guidance on the accounting treatment for the contributions to a separate fund established to help fund closure and environmental obligations. The Appendix contains following requirement:

> "2 Contributions to these funds may be voluntary or required by regulation or law. The funds may have one of the following structures:
>
> (a) funds that are established by a single contributor to fund its own decommissioning obligations, whether for a particular site, or for a number of geographically dispersed sites.
>
> …"

> "7 The contributor shall recognise its obligation to pay decommissioning costs as a liability and recognise its interest in the fund separately unless the contributor is not liable to pay decommissioning costs even if the fund fails to pay.
>
> 8 The contributor shall determine whether it has control or joint control of, or significant influence over, the fund by reference to Ind AS 110, *Consolidated Financial Statements*, Ind AS 111, *Joint Arrangements*, and Ind AS 28, *Investments in Associates and Joint Ventures*. If it does, the contributor shall account for its interest in the fund in accordance with those Standards.
>
> 9 If a contributor does not have control or joint control of, or significant influence over, the fund, the contributor shall recognise the right to receive reimbursement from the fund as a reimbursement in accordance with Ind AS 37. This reimbursement shall be measured at the lower of:
>
> (a) the amount of the decommissioning obligation recognised; and
>
> (b) the contributor's share of the fair value of the net assets of the fund attributable to contributors.
>
> Changes in the carrying value of the right to receive reimbursement other than contributions to and payments from the fund shall be recognised in profit or loss in the period in which these changes occur."

16. The Committee notes that paragraph 9 of the Guidelines for Preparation of Mine Closure Plan, issued vide letter from the Ministry of Coal, Government of India dated 7th January, 2013 and as supplied by the querist for the perusal of the Committee, provide, inter alia, that "The prime responsibility of mine closure shall always lie with the mine owner, and in case these funds are found to be insufficient to cover the cost of the final mine closure … The mine owner shall undertake to provide the additional fund equivalent to the gap in funding…" Based on the above, the Committee is of the view that the company should recognise its interest in the fund separately from the liability to pay closure and environmental costs. Further, as per the above-reproduced requirements of the Appendix, the company in the extant case should determine whether it has control or joint control of, or significant influence over the escrow account, considering its own facts and circumstances and the Guidelines issued by the Ministry. If the company determines that it has control/joint control/significant influence over the escrow account, it shall account for the same in accordance with the requirements of Ind AS 110/Ind AS 111/Ind AS 28, respectively. However, if the company does not have control, joint control or significant influence over the escrow account, the contribution should be accounted for as 'right to receive reimbursement' of the company's closure obligation, at the lower of the amount of the decommissioning obligation recognised and the company's share of the fair value of the net assets of the fund. In that case, subsequent changes in the carrying value of the right to reimbursement should be recognised in the statement of profit and loss and accordingly, the company should not account for the interest income on escrow bank account separately.

17. The Committee notes that the querist has mentioned in the Facts of the Case that the exemption under paragraph D21 of Ind AS 101 has been availed by the company. In this regard, the Committee notes that paragraph D21 of Ind AS 101 states as follows:

> "D21 Appendix 'A' to Ind AS 16 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to Ind ASs. If a first-time adopter uses this exemption, it shall:
>
> (a) measure the liability as at the date of transition to Ind ASs in accordance with Ind AS 37;

(b) to the extent that the liability is within the scope of Appendix A of Ind AS 16, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and

(c) calculate the accumulated depreciation on that amount, as at the date of transition to Ind ASs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity in accordance with Ind ASs."

The Committee notes from the above that if there are changes in the initial estimate of MCP obligation, this exemption permits an entity to measure the decommissioning liability as at the date of transition (1st April 2015 in the extant case) and estimate the site restoration/mine closure obligation at the original date (1st April 2010 in the extant case) by discounting the liability based on the historical risk-adjusted discount rate for estimating the amount that would have been included in the cost of the related asset when the liability first arose (viz., 1.4.2010 in the extant case). However, in the extant case, the following are not clear:

- This exemption is relevant only if there are changes in the initial estimate of the MCP obligation. However, the querist has not specifically mentioned whether there are any changes in the initial estimate of MCP obligation, since its initial recognition. If there are any such changes, the querist has also not mentioned how such changes are treated in the financial statements. Hence, the relevance/ use of this exemption is not clear.

- The querist has also stated that under Ind AS, estimation of the site restoration/mine closure liability was made on the original date, i.e., 01.04.2010, the date at which the liability was recognised first as per the Mine Closure Plan guidelines of Ministry of Coal, and then the same was unwound to 01.04.2015, on which date site restoration asset and site restoration provision were recognised on transition to Ind ASs. This seems to suggest that the liability was also estimated on 1 April 2010, without considering any subsequent changes in estimates. If this is correct, the company has retrospectively applied the requirements of Ind AS 37, rather than the requirements of the exemption under paragraph D 21 of Ind AS 101.

The Committee is of the view that the same should be examined by the company and appropriate disclosure should be made in the notes to the financial statements of the company along with necessary adjustments (if any) required in this regard.

D. Opinion

18. On the basis of the above, the Committee is of the following opinion:

- The site restoration/mine closure cost of the mine is an essential cost that is directly attributable to the asset. The company should include an initial estimate of the site restoration/mine closure in the initial cost of the related asset as per the requirements of Ind AS 37 read with Ind AS 16 and Ind AS 38, as discussed in paragraphs 12 to 14 above.

- Any changes in the obligation amount since its initial recognition should be accounted for in accordance with Appendix A to Ind AS 16.

- Periodic unwinding of the discount on the provision for site restoration/mine closure should be recognized in the statement of profit and loss as finance cost, as discussed in paragraph 14 above.

- The company should recognise its interest in the escrow account (fund) separately from the liability to pay closure and environmental costs. The company should determine whether it has control or joint control of, or significant influence over the escrow account, considering its own facts and circumstances and the Guidelines issued by the Ministry and accordingly, account for its interest in the escrow account, as discussed in paragraph 16 above.

- As stated in paragraph 17 above, the company should examine whether it wishes to apply the requirements of paragraph D21 of Ind AS 101 or the retrospective application of requirements of Ind AS 37 and accordingly, appropriate disclosure should be made in the notes to the financial statements of the company along with necessary adjustments (if any) required in this regard.

Query No. 19

Subject: Accounting for surcharge on delayed payments from customers (beneficiaries).[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a central public sector enterprise mainly engaged in construction and operation of hydro-electric power projects. The company's shares are listed in BSE and NSE. The company has adopted Indian Accounting Standards (Ind ASs) during the 1st Phase, i.e., from April 1, 2016.

2. The company operates in a regulated environment wherein tariff to be charged for electricity generated is fixed by the Central Electricity Regulatory Commission (CERC) under applicable tariff regulations. At present, CERC (Terms and Conditions of Tariff) Regulations, 2014 are applicable for tariff period 2014-19.

3. The aforesaid tariff regulations provide, *inter alia*, regulations for billing of charges for electricity supplied by generating companies and collection thereof. Further, in order to ensure timely collection of dues to generating companies, tariff regulations also provide for levy of interest in the form of late payment surcharge at prescribed rate by the generating company if payment is delayed by customers beyond a period of 60 days from the date of billing.

Regulation 45 of the CERC Tariff Regulations for the tariff period 2014-19, which deals with levy of late payment surcharge, provides as under:

"45. Late payment surcharge: In case the payment of any bill for charges payable under these regulations is delayed by a beneficiary of long term transmission customer/DICs as the case may be, beyond a period of 60 days from the date of billing, a late payment surcharge at the rate of 1.50% per month shall be levied by the generating company or the transmission licensee, as the case may be."

4. *Billing of late payment surcharge, accounting policy and presentation in the accounts:*

(i) Paragraph 5 of Indian Accounting Standard (Ind AS) 18, 'Revenue' provides, inter alia that:

"5. The use by others of entity assets gives rise to revenue in the form of:

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[1] Opinion finalised by the Committee on 23.7.2018.

(a) Interest—charges for the use of cash or cash equivalents or amounts due to the entity;

… ”

The querist is of view that the late payment surcharge on outstanding dues is thus in the nature of interest and should, therefore, be accounted for in accordance with the principles laid down in Ind AS 18 for recognition of revenue.

(ii) Paragraph 29 of Ind AS 18 provides as under:

“29 Revenue arising from the use by others of entity assets yielding interest and royalties shall be recognised on the bases set out in paragraph 30 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.”

As per querist, revenue on account of interest should be recognised when no significant uncertainty as to measurability or collectability exists.

(iii) In line with Regulation 45 of the CERC Tariff Regulations 2014-19, the company has been raising bills for late payment surcharge also. The outstanding balances due and recoverable from beneficiaries are reconciled at regular interval. One of the major beneficiaries in default has signed such reconciliation statement including late payment surcharge, however, payments are overdue including those for supply of electricity. Further, release of payments towards surcharge in respect of a significant number of beneficiaries are outstanding and even when the same are released, the timing of such payments are uncertain. In view of significant uncertainties attached to realisability of surcharge, the same is being recognised in the books of account in accordance with the accounting policy on the subject which is reproduced as under:

“Policy No. 10.4: Interest/Surcharge recoverable from customers/Liquidated damages /interest on advances to contractors are recognised when no significant uncertainty as to measurability and collectability exists.”

(iv) The above accounting policy is uniformly followed by all major public sector entities in the power sector.

(v) Further, amount due on account of surcharge but not recognised in the books as on 31.03.2017 was disclosed as contingent assets in terms of Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets' as under:

> "***Late Payment Surcharge:***
>
> CERC (Terms and Conditions of Tariff) Regulations 2014-19 provide for levy of Late Payment Surcharge by generating company in case of delay in payment by beneficiaries beyond 60 days from the date of presentation of bill. However, in view of significant uncertainties in the ultimate collection from the beneficiaries as resolved by the management an amount of Rs. 435.20 crore as on 31.03.2017 (previous year Rs. 762.39 crore and as at 01.04.2015 Rs. 389.16 crore) has not been recognised."

5. The rationale for not accounting of such claims on accrual basis, as per the querist is as under:

(i) As is well known, the financial condition of most of the distribution companies (discoms) in the country is not healthy and they generally lag behind in timely payment of outstanding dues of electricity generators.

(ii) Past experience of dealing with such beneficiaries is that they are generally reluctant in paying late payment surcharge citing poor financial condition. During 1998, the Central Government had decided to recover the outstanding surcharge from state governments through appropriation of central plan assistance in various instalments during the next four years. Earlier, only principal was stipulated to be recovered, but subsequently, the Central Government decided to recover the interest accrued and billed upto 31.12.96/31.3.97 after allowing waiver of 60% of the total surcharge billed till that date. Based on government's decision (2000-01), the company had to waive off substantial amount of surcharge (to the extent of 60% of the total amount due).

(iii) The signing of reconciliation statement is a routine procedure which serves the purpose of measurability of amounts thus helping in dispute resolution rather than providing certainty of realisation.

(iv) Even when payment is realised towards surcharge, timing of such payments is irregular. There is significant lag between raising of bills and receipt of payment.

6. From the company's perspective, these significant uncertainties involved in the collection of surcharge get resolved only when:

a) Beneficiary gives indication directly or indirectly that it is ready to pay the amount such as issuance of letter of acceptance of claim.

b) Actual payment towards surcharge is received by the company.

c) Such surcharge is included in the appropriation of central plan assistance as was done in the past.

d) To the extent of TDS certificate on surcharge liability issued by one of the beneficiaries in the private sector.

Accordingly, bills raised for surcharge are accounted for only when any one of the above events occurs. Otherwise, the same are disclosed as contingent assets.

7. *Earlier opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on the issue:*

(i) Opinion of the EAC on the subject was obtained earlier by the company during the financial year (F.Y.) 1998-99 (opinion finalised by the EAC on 23.06.1998 and published as Query No. 2 of Volume XVIII of the Compendium of Opinions) on the following issues:

a) (i) Whether the company will be complying with the requirements of section 209(3)(b) of the Companies Act, 1956 read with Accounting Standard (AS) 9, 'Revenue Recognition' if it recognises actual receipt on account of surcharge during the year as revenue, while continuing to disclose the accounting policy, *"Revenues and expenses are generally accounted for on accrual basis except in the case of surcharge recoverable from debtors, sale of scrap, income from consultancy charges and the expenditure on account of LTC encashment."* with the additional words *"which are accounted for on actual receipt basis"*.

(ii) Whether the amount to be recognised would be shown as a 'prior period item' or would it be recognised as an ordinary activity for the year.

b) If answer to (a)(i) is in the negative, which of the amounts, i.e., actual surcharge recovered during the year, the amount of surcharge included for recovery in central appropriation or the total amount accrued as surcharge at the year-end is to be considered as revenue for the year.

(ii) Opinion of the EAC has been summarised by the querist as under:

(a) (i) According to the facts of the query, there does not seem to be any significant uncertainty regarding the recovery of the amount of surcharge included for recovery in central appropriation. Accordingly, recognition of surcharge on actual receipt basis will not be in accordance with the requirements of the Accounting Standard (AS) 9 on 'Revenue Recognition' and section 209(3)(b) of the Companies Act, 1956, even with the extended note as suggested by the querist.

(ii) The amount of surcharge recognised should not be shown as a prior period item. It should be recognised as an item of income from ordinary activities of the company. However, disclosure in accordance with paragraph 12 of AS 5 reproduced above, would be required to be made.

(b) In view of (a)(i) above, the amount of surcharge included for recovery in central appropriation should be recognised in the year 1997-98. As regards the remaining amount of surcharge accrued as at the end of the year, an assessment needs to be made as to whether there is any significant uncertainty as to its collectability. If there is no such significant uncertainty, it should be recognised. In case of significant uncertainty, the revenue recognition should be postponed and disclosures should be made in accordance with paragraph 14 of AS 9.

8. *Opinion of independent expert as obtained by the querist:*

(i) The accounting policy regarding recognition of surcharge only after resolution of uncertainty as per the opinion of the EAC (quoted above) and industry practice is being followed by the company consistently. However, during F.Y. 2015-16, the joint statutory auditors had differed with the above accounting practice. As per their opinion, the company should account for revenue on account of late payment surcharge on accrual basis due to the fact that beneficiaries had not denied the claim on account of surcharge and had in fact signed the reconciliation statement. The matter was referred to an independent expert on accounting matters.

(ii) Relevant portions of the opinion of the expert have been summarised by the querist as under:

a) The fact that a customer confirms the outstanding amount of the surcharge also acts as an acceptance of validity of the amount claimed by the company and may also be a factor to be considered in assessing reasonable certainty of its collection, but this fact does not in itself provide evidence that the ultimate collection is reasonably certain. Nor does the absence of explicit refusal of a customer to pay the outstanding surcharge provide evidence of such reasonable certainty i.e., it is not an essential requirement that the customer must refuse in writing to pay the surcharge before the company evaluates that on an overall consideration of different factors, the realisability of the surcharge is not reasonably certain.

b) As regards the point made by the joint statutory audit firm that there are no cases of waiver of surcharge in the past, the expert has noted the point made by the company regarding a waiver of 60% of the amount of surcharge in the year 2000-01 based on a decision to this effect then taken by the Central Government.

c) The expert has also noted that other major players in the industry also follow the same policy of accounting for surcharge as being followed by the company. This indicates that there is a consensus on there being a significant uncertainty about ultimate collection of the surcharge.

d) On a consideration of the various relevant factors, the company has concluded that reasonable certainty of ultimate collection is lacking at the time of raising a bill to a customer for late payment surcharge and accordingly, it postpones the recognition of the surcharge as revenue until the time that ultimate collection becomes reasonably certain. In the view of the expert, on the basis of the factors stated above (and in the absence of any other contradicting facts other than those stated above), the view of the management seems reasonable. The expert has, however, stated that as soon as the uncertainty is resolved (e.g., suppose the Government decides that the surcharge will be recovered through appropriation of central plan assistance or there is sufficient evidence that the particular Discom is going to make the payment), the credit should be recognised without waiting for the actual receipt of the amount.

e) The independent expert has also opined that the company should disclose the circumstances in which revenue recognition has been postponed pending resolution of significant uncertainties in terms of paragraph 14 of AS 9 and also report the matter separately to the Audit Committee/ Board of Directors. Further, the company should maintain a document containing reasons in support of its conclusion that the late payment surcharge billed to a customer is not reasonably certain of ultimate collection.

(Opinion of the independent expert has been supplied by the querist for the perusal of the Committee.)

(iii) On the basis of the above opinion of the independent expert, the matter was dropped by the joint statutory auditor during F.Y. 2015-16.

9. *Recent developments:*

(i) During F.Y. 2016-17 and during the 3rd quarter of F.Y. 2017-18, one of the major beneficiaries, namely M/s ABC, Jammu & Kashmir, has released substantial payment towards surcharge in lump sum. Consequently, outstanding dues on account of surcharge in respect of that beneficiary is now Rs. 31.86 crore as against surcharge of Rs. 48.43 crore billed during F.Y. 2017-18.

(ii) The joint statutory auditors have again raised the issue that surcharge billed should be recognised on accrual basis. They have submitted the following reasons in support of their stand:

a) There is no significant uncertainty in realisation of surcharge considering the release of payment by the beneficiary (refer paragraph 9(i)).

b) Surcharge is billed as per CERC Tariff Regulations.

c) Reconciliation statements are regularly being signed by the beneficiaries.

d) There have been no further instances of waiver of interest since F.Y. 2000-01.

e) The management of the company is not empowered to waive/write off the unrecovered surcharge amount without taking approval from appropriate authority/Ministry of Power (MoP)/Central Government.

f) In case of one of beneficiary, the company has filed an application in National Company Law Tribunal (NCLT) to recover the principal and surcharge. As discussed in audit committee meeting, the Chairman, audit committee has shown clear cut intentions to recover the surcharge from the beneficiary.

g) The beneficiary is providing the liability for such payments in its books of account and submitting TDS certificates showing its intention to pay the liability.

10. *Contention of management on concerns of statutory auditor:*

(i) Paragraph 34 of Ind AS 18 'Revenue' provides as under:

"34 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. …"

Accordingly, postponing revenue recognition in view of significant uncertainties regarding inflow of economic benefits is not a contravention of Ind AS 18.

(ii) Accounting treatment of late payment surcharge being followed by the company is as per the opinion of the Expert Advisory Committee dated 23.06.1998 (referred to at paragraph 7 above).

(iii) The independent expert has also concurred with the accounting treatment of late payment surcharge vide opinion dated 19.01.2016 (as referred to at paragraph 8 above).

(iv) Similar accounting policy for accounting of surcharge is being followed by major central public sector undertakings (CPSUs) in power sector.

(v) Trend of payment of surcharge in respect of M/s ABC, Jammu & Kashmir referred to at paragraph 9 above during the last 5 years is as under:

(Rs. in crore)

	2013-14	2014-15	2015-16	2016-17	2017-18 (upto 31.12.17)
Opening balance of surcharge	35.93	147.39	345.38	558.64	214.04
Add: Surcharge billed during the year	115.29	197.99	213.26	95.72	48.43
Less: Received during the year	3.83	0	0	440.32	230.62
Closing balance of surcharge	147.39	345.38	558.64	214.04	31.85

It may be seen from the above that the payment released by the beneficiary is irregular. Further, as a matter of fact, payments released during the last two years is due to funds released by the Central Government to the concerned State Government under the Ujjwal Discom Assurance Yojana (UDAY) by the MoP for financial turnaround of Discoms. Accordingly, surcharge released during F.Y. 2016-17 and 2017-18 cannot be considered as a basis for release of further payments.

(vi) As per the statement of surcharge outstanding as on 31st December 2017, out of a total of Rs. 319.74 crore, Rs. 285.66 crore is outstanding for a significant period of time as per details below:

Name of Beneficiary	**Outstanding as on 31/12/2017 (Rs. in Crore)**	**Outstanding since Financial Year**	**Last payment received during F.Y.**	**Surcharge statement signed upto**
West Bengal - State Discom (Rangit & TS-V)	1.89	2012-13 to 2016-17	Received Rs. 0.03 crore during F.Y. 2013-14	Dec-2017
West Bengal - State Discom (TLDP-III)	28.03	2015-16 to 2016-17	-	
Manipur-State Discom	14.99	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 0.14 crore during F.Y. 2016-17	Sept-2017
Meghalaya-State Discom	13.39	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 0.05 crore during F.Y. 2014-15	Sept-2017
Punjab State Electricity Board	18.70	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 1.46 crore during F.Y. 2014-15	May-2017

Uttar Pradesh - State Discom	62.90	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 28.14 crore during F.Y. 2016-17	Dec-2017
XYZ Ltd. - Private Discom	145.75	2009-10 to 2017-18 (upto Dec 17)	Received Rs. 2.23 crore during F.Y. 2017-18	Sept-2017
Total	285.66			

(vii) From the above table, it may be seen that payments, even when received recently, are not commensurate with the total amount of surcharge outstanding.

(viii) It may also be seen from the above table that upto date reconciliation statements have been signed by all the above beneficiaries. Signing of reconciliation statement is a routine procedure which serves the purpose of dispute resolution at later stage rather than providing certainty of realisation as also pointed out by the independent expert in his opinion (quoted above).

(ix) Contingent assets are being disclosed in the accounts on account of unrecognised surcharge as per requirement of paragraph 36 of Ind AS 18 since collectability may not be considered remote; however, management is of the view that probability of realisation of surcharge is of a lower threshold than that required for revenue recognition.

(x) Accounting treatment of surcharge is consistent with that followed by other power sector PSUs. This highlights that there is a consensus in the industry regarding uncertainty of realisation (as also pointed out by the independent expert).

(xi) With respect to point (e) & (f) of paragraph 9(ii) above, it is submitted that power to waive off surcharge or intention to recover the same from beneficiaries does not provide any additional assurance regarding inflow of economic benefits.

(xii) As regards point (g) of paragraph 9(ii) above, TDS certificates on outstanding surcharge is provided only by the private discoms. The same provides certainty only to the extent of TDS certificate provided by the beneficiary and not on the unpaid amounts, as may be seen in the case of XYZ Ltd. at paragraph 10(vi) above where

Rs. 145.75 crore is outstanding for the period 2009-10 to 2017-18 on account of surcharge and only Rs. 2.23 crore has been received during F.Y. 2017-18.

B. Query

11. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) Whether accounting treatment of the company relating to late payment surcharge as detailed at paragraph 6 above is proper.

(ii) If not, the alternative accounting treatment may be suggested.

C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to timing of recognition of revenue with respect to late payment surcharge, as per Indian Accounting Standard (Ind AS) 18, 'Revenue'. 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, revenue recognition with respect to principal amount of electricity supplied, discounting and impairment of receivables in respect of principal amount of electricity supplied, measurement of late payment surcharge, accounting for liquidated damages/interest on advances to contractors, disclosure of contingent asset in respect of surcharge receivables, appropriateness of billing of surcharge as per the CERC Regulations, legal interpretation of the CERC Tariff Regulations, etc. The Committee presumes from the Facts of the Case that late payment surcharge in the extant case is of the nature of interest payment and accordingly, the requirements of Ind AS 18 are applicable in the extant case. Further, the Committee further wishes to mention that as the query pertains to financial years 2016-17 and 2017-18, the Committee has expressed its opinion in the context of Ind AS 18 only and not in the context of Ind AS 115, 'Revenue from Contracts with Customers'.

13. The Committee notes the following paragraphs of Ind AS 18, 'Revenue' notified under the Companies (Indian Accounting Standards) (Amendment) Rules, 2016

"5 The use by others of entity assets gives rise to revenue in the form of:

(a) interest—charges for the use of cash or cash equivalents or amounts due to the entity;

…"

"7 **The following terms are used in this Standard with the meanings specified:**

***Revenue* is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.**

…"

"29 Revenue arising from the use by others of entity assets yielding interest and royalties shall be recognised on the bases set out in paragraph 30 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably."

"34 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility of an amount already included in revenue, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised."

From the above, the Committee notes that revenue arising from the use by others of enterprise resources yielding interest should only be recognised when *it is probable that the economic benefits associated with the transaction will flow to the entity* and the amount of revenue can be measured reliably. In other words, revenue can be recognized only when no significant uncertainty as to measurability or collectability exists. In this regard, the Committee notes that since late payment surcharge is charged at a fixed percentage of the bill amount, it is reasonably determinable and measurable.

14. Further, with regard to the uncertainty of collection of economic benefits associated with the late payment surcharge, the Committee is of the view that to assess the certainty or uncertainty of ultimate collection is a matter of judgement, which should be exercised by the company considering various factors in its own facts and circumstances of the case, such as, on the basis of past experience (for example, extent of recovery and write off of receivables in the past, etc.), TDS certificates, experience of similar companies in the similar situations, related developments, for example, relating to appropriation of central plan assistance to the customers for this purpose, etc. The Committee is also of

the view that mere overdue of payment or untimely/irregular payment of dues do not necessarily represent that there is uncertainty of collection. In this regard, the Committee also wishes to point out that mere reconciliation statements received from the customers confirming the amounts due from them or mere recognition of amount payable (liability) by the customers on account of surcharge cannot be treated as conclusive evidence of certainty of collection. Accordingly, the Committee is of the view that to the extent and till the time such uncertainty of collection exists, revenue recognition should be postponed. The revenue needs to be recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. For this purpose, events occurring after the end of the reporting period date but before the approval of financial statements by the Board of Directors may also be considered.

D. Opinion

15. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

(i) and (ii) Assessment of certainty or uncertainty of ultimate collection is a matter of judgement, which should be exercised by the company considering various factors in its own facts and circumstances, as discussed in paragraph 14 above. Accordingly, on the basis of this evaluation, if the company considers that there are significant uncertainties in the collection of revenue, then the postponement of recognition of late payment surcharge is considered appropriate.

Query No. 20

Subject: Disclosure of Government Grants.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is engaged in the business of manufacturing high-end stainless steel castings and high precision metal components for its customers across the globe. The company was founded in 1963 as a private limited company.

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[1] Opinion finalised by the Committee on 23.7.2018.

2. The company had received two grants from the Government of India:

Grant I - In the financial year (F.Y.) 2011-12, the company entered into an agreement with National Research Development Corporation (NRDC) on behalf of Department of Scientific & Industrial Research (DSIR) for development and commercialisation of rapid cast technology for manufacturing stainless steel castings of weight 5,000 kgs single piece for which the company has received grant from DSIR.

Grant II – In the F.Y. 2017-18, the company entered into an agreement with the Global Innovation and Technology Alliance (GITA) on behalf of Department of Heavy Industry (DHI) for development and commercialisation of titanium casting with ceramic shelling technology under Technology Acquisition Fund Programme (TAFP) for which the company has received grant from GITA of INR 10 crores.

3. *Grant I*: The total cost of the project mentioned above was Rs. 18 crores out of which Rs. 13 crores would be spent by the company and balance of Rs. 5 crores would be granted by DSIR. The total expenditure of Rs. 18 crores comprises of building prototypes, purchase of raw materials, mechanical tools, machineries etc.

The duration of the agreement was 12 years and the grant need not be repaid. Further, the company may need only to pay royalty @ 26% of the amount disbursed by DSIR for a period of 5 years on successful sale of products manufactured using this technology.

DSIR has the right to terminate the agreement if it is satisfied that the money released has not been properly utilised or the project is not being carried out as per the terms and conditions of the agreement. Further, DSIR has the right to recover from the company at any time, the money disbursed along with 12% simple interest only if the company abandons the project on its own without the approval of DSIR.

4. *Grant II*: The total cost of the project mentioned above was Rs. 51 crores out of which Rs. 41 crores would be spent by the company and balance Rs. 10 crores would be granted by DHI. The total expenditure of Rs. 18 crores comprises of purchase of technology, machineries etc. The duration of the agreement is 18 months and the grant need not be repaid even if the project is not successful or the company is not able to successfully commercialise the technology.

DHI has the right to terminate the agreement only if the company is unable to fulfil the terms and obligations mentioned in the agreement or if the company becomes insolvent. No repayment of the amount given by DHI is stipulated under any circumstances and the only obligation on the company is in respect of the rights to the technology developed which shall be shared between the company and DHI. In this regard, the querist has separately submitted grant sanction letter and the Memorandum of Understanding (MoU) between Global Innovation Technology Alliance (GITA) and the company for the perusal of the Committee.

5. *Technical Guidance*

As per the querist, the technical guidance is based on the disclosure and presentation of the grants received from the government under Accounting Standards (IGAAP) for Grant I which was received from DISR in the F.Y. 2012-13 and with the advent of the Indian Accounting Standards (Ind ASs), the presentation and disclosure of the grants (both Grant I and Grant II) under Ind ASs.

(i) *Definition of liability*

As per the Guidance Note on Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India (ICAI), a liability is defined as the financial obligation of an enterprise other than owners' funds.

(ii) *Presentation and Disclosure under IGAAP - Disclosure and presentation of Government grants of the nature of promoter's contribution under Accounting Standard 12 issued by the Institute of Chartered Accountants of India (the 'ICAI')*

As per paragraph 10 of Accounting Standard (AS) 12, Accounting for Government Grants issued by the ICAI:

> "Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income."
>
> *Under IGAAP, the company treated the grant received in the nature of promoters contribution and disclosed it under 'reserves and surplus'.* (Emphasis supplied by the querist.)
>
> With the advent of the Indian Accounting Standards, the company, being a phase II company, had to prepare its financial statements in accordance with Indian Accounting Standards with a transition date of 1st April 2017 and with comparative figures as at 1st April 2016.

(iii) Presentation and Disclosure requirements under Indian Accounting Standard (Ind AS) 20, Accounting for Government Grants and Disclosure of Government Assistance:

"***Grants related to assets* are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.**

***Grants related to income* are government grants other than those related to assets."**

"24. Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income."

"26 The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset."

"28 The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an entity. For this reason and in order to show the gross investment in assets, such movements are disclosed *as separate items* in the statement of cash flows." (Emphasis supplied by the querist.)

6. The querist has also explained some of the clauses of Memorandum of Understanding (MoU) between Global Innovation Technology Alliance (GITA) and the company as follows:

(i) Clause 14.4 of the MoU states that "a two year lock-in period will be allowed from the date of approval of completion of the Project(s) by the Apex Committee before opening up the Intellectual Property Rights". In this regard, the querist has explained that the rationale behind the lock-in period is that the company is making a huge amount of investment in developing a technology/project and therefore, it has exclusive right to use the technology for initial period (like any other IP rights), which in the extant case is defined for 2 years as per the MoU. The company has exclusive right on the technology for the period, whereas in case the company wishes to transfer the technology to any other party, during this lock-in period, then only it needs prior consent of DHI (clause 14.2). For its own usage, there is no restriction on the company, as IPR will be held by the company (clause 14.1). The company will consult with DHI and

GITA for appropriate dissemination of technology and other benefits only, after initial lock-in period of 2 years.

(ii) Clause 14.3 of the MoU states that "once the IP comes to public domain after the initial lock-in period, the issue of licensing and royalty will be finalized jointly by the DHI & GITA and the company". In this regard, the querist has clarified that since IPR will be with the company, there is no sharing of license fee or royalty with DHI/GITA. DHI and GITA will jointly finalise the licensing fee or royalty; and this is more from the perspective of right pricing of license fee or royalty, and nothing else.

(iii) Clause 8.4 of the MoU states that "DHI would be free to use the IPR (after two years)/ equipments/ softwares procured/ developed for any scientist work or technology Development, Acquisition & Customization/ demonstration purpose on their own or can request the company for use of this infrastructure by any other organization/agency or manufacturer for scientific technology Development, Acquisition & Customization/ demonstration/ public purpose subject to IPR lock-in period." In this regard the querist has confirmed that DHI/GITA cannot use or request usage of any of resources for initial lock-in period of 2 years but it is also reiterated that the use or request for use of resources by DHI/GITA are intended for any ancillary purpose of development, scientific purposes or demonstration only and not for commercial purposes; and also that the title and possession of all such developments or resources shall remain with the company only.

(iv) Clause 7.17 of the MoU states that "In the event of any liquidation or bankruptcy proceedings or any threatened distress action against the company or any of its assets, plants, machineries, fixtures and equipment procured for the purpose of the Project out of or with support of Grant in aid shall be outside such proceedings and the GoI may assume the control and management of the company in respect of the concerned project(s) and appoint any of its officer or authorized representative to run the Project(s)." In this regard, the querist has clarified that although for all practical purposes, the company does not see possibility of any such event, referred in clause 7.17, as the company has made huge investments and is in sound financial health; even then for theoretical purposes, the company has confirmed that there is no identification of specific assets which are acquired from the Government grant. Neither it has been a requirement as per MoU nor an intention. Government grant is 25% of the project, not exceeding Rs. 10 crores, and the grant is provided with progressive development of project and amount spent by the company. There are no identified assets to which the grant is allocated.

7. With regard to classification and presentation of the government grant II, the management believes that the grant received is not in the nature of financial obligation as no repayment is expected in case of such grants by the Government body. It is the intention of the Government to participate in these projects to develop technologies which are of 'national importance' and hence, the classification of such grants as 'liabilities' shall not be a fair representation of the intention behind the disbursement of such grants. Further under Ind AS, the classification and presentation of the grants received in the nature of promoters contribution has not been dealt with; therefore, the company intends to disclose the same as a mezzanine, different line item, between 'equity' and 'other non-current liabilities'.

B. Query

8. In view of the above facts and the circumstances, the querist has sought the opinion of the Expert Advisory Committee on the classification and presentation of the government grant (Grant II) received under Indian Accounting Standards (Ind ASs) for which no repayment obligation has been imposed by the concerned Government body.

C. Points considered by the Committee

9. The Committee notes that the issue raised by the querist relates to classification and presentation of government grant (Grant II) under Indian Accounting Standards (Ind AS) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as 'the Rules') for which, as per querist, there is no repayment obligation. The Committee has, therefore, considered only this issue and has not examined any other issue that may be contained in the Facts of the Case, such as, recognition and measurement of government grant (grant II) and accounting treatment of other government grants (Grant I) received by the company.

10. With regard to the accounting for grant of funds by the DHI/GITA, the Committee notes the following clauses from the Memorandum of Understanding (MoU) between Global Innovation Technology Alliance (GITA) and the company:

> **"3. OUTPUT: Techno-Economic-Social benefits and Technical Milestones**
>
> In case of Scheme components Technology Acquisition Fund Programme, acquisition of technologies are the output. The Project titled as **"Development & Commercialization of Titanium Casting with Ceramic Shelling Technology"** has a clear set of large Socio-economic objective from National prospective.
>
> …"

"5.1 This Project is partly funded by DHI under the CG scheme through Grant in aid. The total approved financial outlay of the project as per approved proposal is INR. **51,01,87,260/- (Fifty One Crores One Lakh Eighty Seven Thousand Two Hundred and Sixty Only)** out of which GoI grant is limited to 25% of the total project cost i.e. INR. **10,00,00,000/- (Ten Crores Only)**. The ratio of GoI's grant in aid to industry contribution will be 25:75 for the project wherein GoI grant is limited to Rs. 10 crore.
…"

"6.9 The company will ensure that assets will not be disposed-off / sold / transferred / leased / rented / transferred without prior written approval of GITA & DHI."

"6.14 … In case of loss or damage of such plant, machinery, fixtures and equipment, etc. the insurance monies will be payable to the Government of India."

"7.1 It is obligatory on the part of the company to ensure free access to AC-CG members, PMRC Members / GITA officials / DHI officials / its representatives to all facilities/assets and records relating to the project located at their works.

7.2 All research publications based on this Project shall be made jointly in the names of the scientists/investigators/GITA/innovators of DHI and the company members making scientific contributions to research project. Copy of technical papers published has to be forwarded to GITA and DHI along with Quarterly Progress Report."

"7.4 The company shall not transfer IPR/technology/process know-how or information on technology to any third party before completion of the Project without the written consent of GITA & DHI. Technology includes Technology or facility developed, expertise, knowhow etc.

7.5 The company shall hold in trust on behalf of DHI all deliverables of the project such as full documentation pertaining to Development, Acquisition & Customization, design, detailed specification of all components and material manufacturing process, sourcing of material, test results etc. to GITA & DHI.

7.6 The company shall furnish all details of documents/test reports etc. as required for registration of patent. The Intellectual Property (IP) generated from the projects shall be managed in compliance with paragraph 14 below."

"7.8 The asset acquired/created wholly or substantially by the company out of Government grants except those declared as obsolete and unserviceable or condemned in accordance with the procedure laid down in the G.F.R. shall not be disposed-off encumbered or utilized for the another purpose/project, without obtaining the prior approval of GITA & DHI. In case of winding up or dissolution of the organization all the assets acquired to that effect out of the grants-in-aid by the Ministry should be returned forthwith to the Government of India."

"7.12 No expenditure over and above the sanctioned grant shall be incurred by the company without obtaining the prior approval of GITA & DHI. Further in no case the expenditure on any scheme should exceed the approved cost of the respective scheme and quarterly targets of expenditure."

"7.17 In the event of any liquidation or bankruptcy proceedings or any threatened distress action against the company or any of its assets, plants, machineries, fixtures and equipment procured for the purpose of the Project out of or with support of Grant in aid shall be outside such proceedings and the GoI may assume the control and management of the company in respect of the concerned project(s) and appoint any of its officer or authorized representative to run the Project(s)."

"8.4 DHI would be free to use the IPR (after two years)/ equipments/ softwares procured/ developed for any scientist work or technology Development, Acquisition & Customization/ demonstration purpose on their own or can request the company for use of this infrastructure by any other organization/agency or manufacturer for scientific technology Development, Acquisition & Customization/ demonstration/ public purpose subject to IPR lock-in period."

"14. PATENT AND TECHNOLOGY TRANSFER MECHANISM

14.1 In general, IPR will be held by the company.

14.2 IP/IPR with ownership of the company will not be transferred to any other party for a period of two years from the date of completion without the consent of Department of Heavy Industry.

14.3 Once the IP comes to public domain after the initial lock-in period, the issue of licensing and royalty will be finalized *jointly* by the DHI & GITA and the company.

14.4 A two year lock-in period will be allowed from the date of approval of completion of the Project(s) by the Apex Committee before opening up the Intellectual Property Rights. After the initial lock-in period, the company will take initiative for dissemination of technology and other benefits accrued from the project(s). The company will consult with GITA

& DHI for dissemination of the technology at the earliest after the lock-in period. Declaration for the same have been enclosed as Annexure-III."

"16.2 Since the project is sanctioned to the company it shall not be transferred to any other ***Organization***. Transfer of project money within the ***Organization*** or with other Institutions under the same Management is not permitted under any circumstances."

"18 VALIDITY OF MoU

This MoU will be in force from the date of signing this MoU and is valid for a period of 4 (Four) years (First two (2) years completion of project and subsequent two (2) years for IPR) from the date of approval of by competent authority or till expiry of the lock-in period in respect of IPR after completion of the project, whichever is later."

11. The Committee notes from the Memorandum of Understanding (MoU) between the Global Innovation Technology Alliance (GITA) and the company that the basic objective of the Government behind providing funds is the development and commercialisation of 'Titanium Casting with Ceramic Shelling Technology' (hereinafter referred to as 'the project') through acquisition and customisation of technology by the company under the TAFP. Further, as per the MoU, the deliverables of the project are to be held by the company in trust on behalf of DHI and that in general, IPR will be held by the company. The MoU further states that the company shall not transfer IPR/technology/process know-how or information on technology to any third party before completing the project without the written consent of GITA & DHI. After completion of the project, IP/IPR will not be transferred to any other party for a period of two years from the date of completion without the consent of DHI. Further, after the initial lock-in period of two years and once the IP comes to public domain, the issue of licensing and royalty will be finalised jointly by the DHI & GITA and company. Also, it is stated in the MoU that DHI would be free to use the IPR (after two years) / equipments/ software procured/ developed etc. on their own or can request the company for use of this infrastructure by any other organization/agency or manufacturer for scientific technology Development, Acquisition & Customization/ demonstration/ public purpose subject to IPR lock-in period.

From the above terms, it appears that since the technology/IPR can be transferred by the company either with the consent of DHI/GITA or jointly by all the parties, there is a joint arrangement between the company and DHI/GITA, wherein both the parties are mutual beneficiaries. However, the Committee also notes that the company in the extant case has exclusive right to use the technology for initial lock-in period of 2 years as per the MoU. Further, the querist has specifically stated that there is no sharing of license fee or royalty with DHI/GITA and the clause stating that DHI and GITA will jointly finalise the licensing fee or royalty is mainly from the perspective of determining the appropriate pricing for license fee or royalty. Also, the use or request for use of assets/resources developed/procured under the project by DHI/GITA is intended only for any ancillary purpose of development, scientific purposes or demonstration and not for commercial purposes. Thus, on an overall reading of the clauses of MoU and the explanations provided by the querist with regard to these clauses, as mentioned above, the Committee is of the view that intention of the parties is that the rights of DHI/GITA in the extant case are more of the nature of protective rights for appropriate dissemination and right pricing of the technology and other benefits developed under the project rather than participating rights for commercial purposes. Accordingly, the Committee is of the view that the grant of funds by the DHI/GITA in the extant case can be considered as a government grant (as per Ind AS 20) with certain conditions attached to it.

12. With regard to the classification and presentation of government grant in the extant case, without examining its nature as that related to assets or related to income under Ind AS 20, the Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 20, 'Accounting for Government Grants and Disclosure of Government Assistance':

"14 Those in support of the capital approach argue as follows:

(a) government grants are a financing device and should be dealt with as such in the balance sheet rather than be recognised in profit or loss to offset the items of expense that they finance. Because no repayment is expected, such grants should be recognised outside profit or loss.

(b) it is inappropriate to recognise government grants in profit or loss, because they are not earned but represent an incentive provided by government without related costs.

15 Arguments in support of the income approach are as follows:

(a) *because government grants are receipts from a source other than shareholders, they should not be recognised directly in equity* but should be recognised in profit or loss in appropriate periods.

(b) government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate.

(c) because income and other taxes are expenses, it is logical to deal also with government grants, which are an extension of fiscal policies, in profit or loss."

(Emphasis supplied by the Committee.)

The Committee further notes that Ind AS 20, while requiring to recognise all government grants in the statement of profit and loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate, does not recognise 'Capital Approach' and is based on 'Income Approach'. Accordingly, as per paragraph 15(a) of Ind AS 20, reproduced above, since the government grants *are receipts from a source other than shareholders, they should not be recognised directly in equity* but should be recognised in profit or loss in appropriate periods.

13. Further, the Committee notes the definition of 'liability' as per the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards as follows:

"49 (b) A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits."

The Committee further notes that under Ind AS 20, government grants are recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Thus, the grant is recognised over the periods that bear the cost of meeting the obligations for which grant is provided. In other words, grant is deferred/amortised over the period of fulfilment of obligations related to the grant, for example, incurrence of expenses. Accordingly, the unamortised portion of the grant represents unfulfilled obligation, the settlement of which is expected to result in outflow of resources in future (even though the same may not be refundable in future as in the extant case) and therefore, in the view of the Committee, it meets the definition of liability. Further, the Committee notes from the Facts of the Case that the grant in the extant case has been given with reference to development and commercialisation of a particular technology and the same is a long-term project (as it takes around two years as stated in the MoU) and all the liabilities in the form of fulfilment of obligations are not expected to be settled within next twelve months. Therefore, the Committee is of the view that the government grant in the extant case should be classified and presented under the head 'Non-current Liabilities' and 'Current Liabilities' in the balance sheet considering the requirements of Schedule III to the Companies Act, 2013 and Ind AS 1, 'Presentation of Financial Statements' and not as a separate line item between 'equity' and 'other non-current liabilities'.

D. Opinion

14. On the basis of the above, the Committee is of the opinion that the government grant (grant II) in the extant case should be classified and presented under the head 'Non-current Liabilities' and 'Current Liabilities' in the balance sheet considering the requirements of Schedule III to the Companies Act, 2013 and Ind AS 1, 'Presentation of Financial Statements' and not as a separate line item between 'equity' and 'other non-current liabilities' as discussed in paragraph 13 above till the same is recognised in the statement of profit and loss on a systematic basis over the periods in which the company will recognise as expenses the related costs for which the grant is intended to compensate.

Query No. 21

Subject: Accounting treatment for the funds/contribution received from the State Government for acquisition of land and the land so acquired.[1]

A. Facts of the Case

1. A company is a state level undertaking incorporated under the provisions of the Companies Act 1956, to execute major and medium irrigation projects in Karnataka. 97% of the shares of the company are held by the Government of Karnataka in the name of the Hon'ble Governor of Karnataka and the balance 3% shares are held by the Karnataka State Finance Corporation, a State Finance Corporation. The bonds of the company are listed on the National Stock Exchange.

2. The company, in the course of its business, builds dams, irrigation structures and canal systems for the purpose of conveying water to the farmers' fields. These assets are owned by the company; and treated as assets of the company and disclosed in the financial statements of the company under 'Property Plant and Equipment'.

3. For the purpose of storage of water in the dams and for the canal systems, the company acquires lands under the Land Acquisition Act through the

[1] Opinion finalised by the Committee on 23.7.2018.

revenue authorities of the Government. To rehabilitate the project affected families also, the company acquires lands for creation of rehabilitation centres. Based on the requisition of the company, the revenue authorities acquire the land from the government grants released to the company for this purpose and made available to them by the company.

4. The accounting treatment in the books of account adopted by the company is that the land cost is capitalised and the related grant is disclosed under the head 'deferred revenue/deferred income' as per the company's accounting policy no. 3.3.3.(i) reproduced below:

> "3.3.3.(i) Grants allocated to LAQ, is recognized under deferred income under Non-Current Liabilities to the extent of capitalisable expenditure."

Further, paragraph 12 of Indian Accounting Standard (Ind AS) 20, Accounting for Government Grants, stipulates as under:

> **"Government Grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate."**

5. The querist has stated that the land is a non-depreciable asset, whose value increases over the time and does not depreciate. The cost of land is also not recognised in the books as an expense. Paragraph 18 of Ind AS 20, in respect of grants related to non-depreciable assets stipulates as under:

> "Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit and loss over the life of the building."

6. The statutory auditors of the company have expressed a qualified opinion in the accounts of the company for the year ended 31-3-2017 as follows:

> "To locate the dams and the canal systems Land to the extent of the land acquired out of government grants, grants having been transferred and considered under deferred revenue/income. As per Ind AS 20, in our opinion, the same needs to be systematically considered over the period of the life of the principal asset for which the land is acquired in the Profit & Loss account of the Company."

7. The qualification presumably is based on the example cited in paragraph 18 of the Ind AS 20 being that of a 'land grant' for the purpose of construction of

a building. This example may not be similar to the transaction of acquisition of land from the grant provided by the Government.

8. In the addendum to the Director's report, the company had stated that "land is not a depreciable asset and in fact instead of depreciating in value, the value always appreciates. Further, the grant is not in the nature of a 'land grant' for the project but is a 'capital grant' for the purchase of land for the project. This is not land granted for the project by the Government free of cost for use as per the condition of grant. Hence, in the opinion of the company, the land should not be recognised in the profit and loss statement concurrent with the life of the irrigation project. In the considered view of the company, such government grant being disclosed under 'Long term liability' is in order. However, the company will refer the matter to the Ind AS expert advisory group of the Institute of Chartered Accountants of India for their suggestion and guidance".

B. Query

9. In the above circumstances, the opinion of the Expert Advisory Committee (EAC) is requested on the accounting treatment of government grant for land under Ind AS 20 in respect of the following:

> Land being a non-depreciable asset, the value of which appreciates over the years and remains an asset of the company even after the useful life of the structures put on it is completed, whether it is correct to recognise the useful life of the land as equivalent to the life of the structure for the purpose of recognising cost of land as expense and corresponding government grant as income systematically in the profit and loss statement of the company.
>
> **Alternatively,**
>
> Whether it is permissible for the company to treat the grants for land acquisition as reserves as part of 'other equity' and treat the land as a non-depreciable asset under 'Property Plant and Equipment'.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query relates to accounting treatment of the funds/contribution received by the company from the State Government for acquisition of land and the land so acquired. 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 dams, canals and other irrigation structures, etc. Further, since the financial year 2016-17 has been referred to in the Facts of the Case, the Committee has not examined the effects of Companies (Indian Accounting Standards) Second

Amendment, Rules, 2018, which will be applicable for the annual periods beginning on or after April 1, 2018.

11. As regards accounting for the funds/contribution received from the State Government, the Committee notes that in the extant case, the State Government holds almost entire shares of the company (97 % of the shares directly and balance 3% through the Karnataka State Finance Corporation, which is also apparently a State controlled entity). Thus, although the amount received has been described as grant, however, there is a possibility that the State Government is contributing/providing funds in its capacity as owner/shareholder rather than as a government grant within the scope of Ind AS 20. In this context, the Committee notes that paragraph 2 of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', states as follows:

> "2 This Standard does not deal with:
>
> (a)…
>
> (c) government participation in the ownership of the entity."

From the above, the Committee notes that Ind AS 20 specifically scopes out the participation by the government in the ownership of an entity. Thus, in the extant case, accounting for the funds/contribution received by the company would depend on whether the amount received is in nature of government grant or contribution as owner, which in the view of the Committee, is a matter involving exercise of significant judgement and should be determined in the specific facts and circumstances of the company, considering various factors, such as, intention of the Government which may be clear from various communications with the Government while providing funds, etc. and considering whether these funds are provided based on a government scheme to assist entities operating in a particular sector/ industry or based on programme to provide funding in the nature of owner contribution to the government owned entities. Therefore, the company, in the extant case, should first determine whether the funds are provided as shareholders' contribution or as a government grant.

12. In case, the funds received are considered as 'government grant', the Committee notes from the Government Sanction letter (a copy of which has been provided by the querist for the perusal of the Committee) that in the extant case, the grant is provided by the State Government with the condition that "the amount released shall be used only for land acquisition, rehabilitation and resettlement". Further, it is also noted from the Facts of the Case that the grant in the extant case is used only for the purpose of land acquisition either for construction of dams and canal system or for creation of rehabilitation centres, which is also directly attributable to the aforementioned land acquisition for construction of dams/canal system. Thus, on a holistic reading of the above two

statements, the Committee is of the view that the grant in the extant case is to be used only for land acquisition (which is a long-term asset for the company). With regard to accounting for such grant, the Committee notes the following requirements from Ind AS 20:

> ***"Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.***
>
> ***Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held."***
>
> "9 The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government."
>
> "18 Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building."
>
> "23 A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, the fair value of the non-monetary asset is assessed and both grant and asset are accounted for at that fair value."

From the above, the Committee notes that the funds provided by the State Government in the extant case for acquisition of land is a Government grant related to assets. The Committee further notes from paragraph 9 of Ind AS 20 that the recognition of grant is not affected by the manner in which the grant is provided (viz., either by way of cash for acquisition of land or by providing the land itself). Thus, the Committee does not agree with the contention of the querist that since the grant in the extant case is provided by way of cash (referred to by the querist as 'capital grant') and not by way of land itself (referred to by the querist as 'land grant'), there should be difference in the accounting treatment of the grant in the extant case from that of the 'land grant'. Incidentally, the Committee may also mention that as per Ind AS 20, 'land grant' is termed as 'non-monetary' government grant as referred to in paragraph 23 of the Standard (reproduced above). The Committee further notes that in the extant case, the grant provided by the State Government is to be used only for acquisition of land, which is a non-depreciable asset. Accordingly, the Committee is of the view that the grant in the extant case should be recognised in the statement of profit and loss over the periods in which the company recognises the cost of meeting the obligation under the terms of the grant, viz., over the life of the dams/canals/irrigation project and other related structures which are created on the land acquired out of this grant.

13. With regard to the querist's contention regarding treating the grants received for land acquisition as 'reserves' as part of 'other equity', the Committee notes paragraphs 12, 14 and 15 of Ind AS 20 as follows:

> ***"12 Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate."***
>
> *"14 Those in support of the capital approach argue as follows:*
>
> (a) *government grants are a financing device and should be dealt with as such in the balance sheet rather than be recognised in profit or loss to offset the items of expense that they finance. Because no repayment is expected, such grants should be recognised outside profit or loss.*
>
> (b) *it is inappropriate to recognise government grants in profit or loss, because they are not earned but represent an incentive provided by government without related costs.*
>
> *15 Arguments in support of the income approach are as follows:*
>
> *(a) because government grants are receipts from a source other than shareholders, they should not be recognised directly in equity but should be recognised in profit or loss in appropriate periods.*

> (b) *government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate.*
>
> (c) *because income and other taxes are expenses, it is logical to deal also with government grants, which are an extension of fiscal policies, in profit or loss."*

From the above, the Committee notes that Ind AS 20 while requiring to recognise government grants on a systematic basis in the profit and loss is based on 'income approach' which does not allow recognising the grant directly in equity (reserves).

14. In case, the funds received are considered as shareholders' contribution, viz., the Government acting in the capacity of owners, the Committee notes that paragraph 70(a) of the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards (hereinafter referred to as the 'Framework'), issued by the Institute of Chartered Accountants of India (ICAI) states as follows:

> "(a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants."

From the above, the Committee is of the view that funds provided by the Government in the capacity of owners, is a contribution from an equity participant and accordingly, it should not be accounted for as 'income' or as 'liability' in the financial statements of the company; rather should be accounted for as equity only. The Committee further notes from the Facts of the Case that these funds are receipts of the company which are to be utilised by the management as per the directions of the Government for a specific purpose only, viz., acquisition of land. In this context, the Committee notes the definitions of the terms, 'reserve' and 'capital reserve' as per the Guidance Note on Terms Used in Financial Statements as follows:

> "**14.04 Reserve**
>
> The portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or a specific purpose other than a *provision* for *depreciation* or

diminution in the value of *assets* or for a known *liability*. The reserves are primarily of two types: *capital reserves* and *revenue reserves*."

"**3.10 Capital Reserve**

A *reserve* of a corporate enterprise which is not available for distribution as *dividend*."

On the basis of the above and considering the Facts of the Case, the Committee is of the view that such funds received are in the nature of 'reserve'. Further, since these receipts are used only for a specific purpose and are not available for distribution as dividend, these should be credited to 'capital reserve'.

15. With regard to the accounting treatment of the land acquired out of the grant/shareholder contribution, the Committee wishes to point out that Ind AS 16 will be applicable for the items of property, plant and equipment acquired out of grants/capital contribution. Accordingly, in the extant case, land acquired shall be dealt with as per the requirements of Ind AS 16, if it meets the definition of 'property, plant and equipment' as reproduced below:

"*Property, plant and equipment* are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period."

D. Opinion

16. On the basis of the above, the Committee is of the opinion on the issues raised in paragraph 9 above that the entity should first determine whether the funds received are provided as a shareholder contribution or as a government grant. If the funds are received as shareholders contribution then, these should be accounted for as 'capital reserve', as discussed in paragraph 14 above. If the funds are received as a government grant, then these should be recognised in the statement of profit and loss over the periods in which the company recognises the cost of meeting the obligation under the terms of the grant, viz., over the life of the dams/canals/irrigation project and other related structures which are created on the land acquired out of this grant and not as 'reserves' as part of 'other equity', as discussed in paragraphs 12 and 13 above. The land acquired out of government grant shall be dealt with as per the requirements of Ind AS 16, if it meets the definition of 'property, plant and equipment', as discussed in paragraph 15 above.

Query No. 22

Subject: Accounting of amount incurred on rehabilitation and resettlement Scheme including development of infrastructural facilities.[1]

A. Facts of the Case

1. A Government of India company (hereinafter referred to as 'the company') is engaged in the construction and operation of power plants in the country. The company has also diversified into renewable power generation, coal mining and oil & gas exploration etc. The company is registered under the Companies Act, 2013 and being an electricity generating company, is governed by the provisions of the Electricity Act, 2003. The company prepares its annual financial statements as per the provisions of the Companies Act, 2013. The company has implemented Indian Accounting Standards (Ind ASs) during the financial year 2016-17 with the transition date as 1st April, 2015. The company is listed with the BSE Ltd. and the National Stock Exchange of India Ltd. (NSE).

2. The company is functioning in the regulated environment. The tariff for sale of energy from its stations is determined by the Central Electricity Regulatory Commission (CERC) following the cost plus basis approach. Tariff for sale of energy in case of a thermal/hydro power generating station comprises of two components, namely, annual capacity (fixed) charges and energy (variable) charges. The capacity charges mainly consist of interest on loan capital, depreciation, return on equity, normative operation and maintenance expenses, interest on working capital etc. and to a large extent depend on the admitted capital cost of a generating station. The energy charges are computed on the basis of norms specified for station heat rate, auxiliary power consumption, cost of fuel etc. as applicable.

3. The company is involved in the construction of power projects. The company has ambitious expansion and diversification plans for the future and aims to be a 1,30,000 MW company by the year 2032. Further, it intends to diversify by way of providing backward and forward integration. As a part of its diversification plans, it has entered into renewable power generation, coal mining and oil & gas exploration sectors.

4. For construction of power projects, large tracts of land are required. The land is acquired from the State Governments and/or the private land owners through the concerned State Government as per the applicable provisions of the Land Acquisition Act, 1894/The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. The land

[1] Opinion finalised by the Committee on 17.10.2018.

acquired from the State Governments is normally on long term lease basis while the land acquired from the private land owners is on freehold basis. The estimated amounts payable towards acquisition of land including the estimated amount payable to the project affected persons (PAPs) under rehabilitation and resettlement (R&R) schemes are indicated in the Feasibility Report (FR) or Detailed Project Report and approved by the Board of Directors of the company before taking up the project.

5. *Land Acquisition for the Power Projects*

a) Land acquired from the State Government:

The amount paid to the State Government towards transfer of land or diversion of forest land, e.g. land premium, compensatory afforestation, cost of trees, catchment area treatment and rim plantation, etc. is treated as cost of land.

b) Land acquired from private parties:

The acquisition of private land in India is regulated through the provisions of Land Acquisition Act, 1894/The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. The acquisition of private land is to be done through the State Government of the State where the project is being set up.

As per the said Act, the compensation payable to the persons whose land has been acquired (land loser) is determined by the Land Acquisition Officer (LAO) appointed by the State Government Authorities. The possession of the land is handed over to the company by the respective LAO upon payment of the prices determined by the LAO.

c) Rehabilitation and resettlement in respect of land acquired:

In addition to the above, the company is also obliged to carry out rehabilitation and resettlement (R&R) scheme of the project affected persons (PAPs) in line with the R&R policy announced by the respective states. Several states have come out with policies on R&R. These legislations and policies are binding on the land acquisition in that particular State. As per these legislations/policies, a R&R Plan is formulated in consultation with the State or the Local Bodies of the State for the land losers and for the area where the land acquisition has taken place.

As per the R&R Plan, apart from the land compensation amount already received from the LAO, the PAPs are entitled to provision for homestead land, assistance for self-relocation, assistance for livelihood restoration, training for self-employment, infrastructural facilities, such as, education, health, other periphery development activities, etc. to provide PAPs a reasonable living standard. Further, the State Governments require various works to be undertaken by the land requisitioner to develop surrounding area where the project is proposed to be set up. State Governments sometimes make few community development activities essential and a pre-requisite to setting up of a project in their State; and agree to book the cost incurred on such activities as part of R&R Plan for capitalisation.

6. Guidance available for accounting of cost associated with acquisition of land:

a) Paragraph 16 of Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment' provides as follows:

"16. The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period."

(Emphasis supplied by the querist.)

b) Relevant Opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) (Query No. 31 of Volume XXVIII of Compendium of Opinions) on 'Provision towards resettlement and rehabilitation schemes':

"13. In the present case, as far as the obligating event for the rehabilitation/resettlement measures, such as those mentioned in paragraph 5I, 5II, and 5III are concerned, it appears to the Committee that the obligating event for the same arises as soon as the land is acquired from the project affected persons.

This is so, even if the PAPs may not have fulfilled the necessary conditions for becoming individually entitled to receive the money, because, as far as the company is concerned, upon acquisition of land from the PAPs it becomes liable to pay to the PAPs collectively. Accordingly, a provision in respect thereof, on the basis of best estimate of the expenditure required to settle the obligation, should be made on the acquisition of land from the project affected persons irrespective of fulfilment of various conditions by PAPs. *With respect to the infrastructural facilities mentioned in paragraph 5 IV also, the point of time at which the provision should be made in the books of account would depend on the obligating event, which in the view of the Committee, is the acquisition of land by the company. The event of acquisition of land from the PAPs makes the company liable to provide the infrastructural facilities even though the contracts may not have been awarded for execution of those works.…"*

(Emphasis supplied by the querist.)

c) Clarification of Ind AS Transition Facilitation Group (ITFG) - Bulletin No. 11 (Issue No. 8)

*"**Issue 8:*** ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the construction/ development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether ABC Ltd. can capitalise expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd.?

Response: Paragraph 7 of Ind AS 16 states that "the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

a) it is probable that future economic benefits associated with the item will flow to the entity; and

b) the cost of the item can be measured reliably."

Further paragraph 9 of Ind AS 16 provides that, "This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value."

Paragraph 16 of Ind AS 16, inter alia, states that the cost of an item of property, plant and equipment comprise any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. *Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.*

(Emphasis supplied by the querist.)

In view of this, even though ABC Ltd. may not be able to recognise expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

… "

7. *Accounting for land acquired by the company:*

Keeping in view the above, the amounts paid/payable towards land cost to the land owners, cost of R&R Plan including the cost of infrastructural facilities and other directly attributable expenses in relation to the acquisition of land are capitalised as land cost by the company. Similarly in the case of leasehold land acquired from the Government, compensatory afforestaion, green belt development and loss of environment value etc. are also capitalised.

8. a) The company is setting up a Super Thermal Power Project of 1,600 MW (800x2) in Odisha State. At present the project is under construction.

b) Total land required for the project was 1,814.20 acres. The land consists of 1,361.36 acres of private land, 369.71 acres of Government land and 83.13 acres of forest land. Out of the private land, about 1,361.30 acres of private land, 296.37 acres of government land and 34.47 acres of forest land has been acquired and capitalised in the books of account of the company.

c) Acquirers of the private land in the State of Odisha are required to comply with the provisions of 'Odisha Resettlement and Rehabilitation Policy, 2006' (hereinafter referred as 'Odisha R&R Policy'). Copy of the policy has separately supplied by the querist for the perusal of the Committee.

d) The important and relevant provisions of the Odisha R&R Policy have been reproduced by the querist as below:

> **Paragraph 2(ii):** "It shall apply to all those projects, for which acquisition of private land under Land Acquisition Act, 1894 or under any other laws for the time being in force or proclamation inviting objections in case of Government land is notified."
>
> **Paragraph 3(o):** "**"Rehabilitation & Periphery Development Advisory Committee (RPDAC)"** means the Committee constituted by the Government under relevant provisions of this Policy by Government to look after rehabilitation and periphery development matters."
>
> **Paragraph 8:** "**Resettlement and Rehabilitation Plan:**
> Based on the list approved by Government and option of displaced families, Resettlement and Rehabilitation Plan shall be prepared by the Collector for resettlement and

rehabilitation after due consultation with displaced communities in the manner determined by the Government. Such plan should address the specific needs of the women, vulnerable groups and indigenous communities. *The same will be placed before the RPDAC for approval….”*

Paragraph 15: “**Periphery Development:**
The Project Authorities shall be responsible for periphery development as decided by the RPDAC within the guidelines issued from time to time by the State Government.”

(Emphasis supplied by the querist).

As is clear from the above, every company acquiring land in the State of Odisha is required to prepare and implement a Rehabilitation & Resettlement Plan (R&R Plan) as per the directions of the RPDAC constituted by the Government of Odisha.

e) As per the Odisha R&R Policy, RPDAC was constituted for finalisation of R&R Plan for the Power Project. While formulating the R&R Plan for the Power Project, the Government of Odisha required the company to construct a medical college and hospital near the project. Reference is invited to the following important issues highlighted in the letter dated 10th May, 2012 of the Minister of Power, Government of India (GoI) addressed to the Chief Minister of Odisha (copy of letter has been separately supplied by the querist for the perusal of the Committee):

“(i) …

(ii) As requested by Government of Odisha, the company agreed to set up a Medical College and Hospital at Sundargarh with 400 bed which could be upgraded to 500 bed subsequently. The State Government will provide land for the same and will also run the Medical College and Hospital.

(iii) …

(iv) …

(v) Government of Odisha agreed to hand over the land expeditiously for the project of the company and also agreed to expedite the required clearances and processing of forest clearance for the plant as well as coal blocks so that the company could develop the mine along with the project.

…”

f) Further, the obligation of the company to construct the medical college and hospital was included by the RPDAC in the R&R Plan of the Project. The following was recorded in the minutes of the meeting of RPDAC held on 28th April, 2012 (copy of the minutes has been separately supplied by the querist for the perusal of the Committee):

"3) **Establishment of Medical College:**

The company reiterated its commitment to set up a Medical College at Sundargarh. It was decided that requisition of land for the Medical College will be submitted by the company to the Collector, Sundargarh by end of May, 2012. Collector indicated that suitable site has also been selected for the said purpose. The company also clarified that the management of Medical College will not be done by them and the concerned authorities should finalise modalities."

g) Based on the above, an MOU for setting up a medical college and hospital was signed between Government of Odisha and the company dated 13th December, 2013 (copy of MOU has been separately supplied by the querist for the perusal of the Committee). Paragraphs 1(b) and 2 of the MOU, inter alia, provide as under:

<u>Paragraph 1(b)</u>

"In accordance with the background, objectives and purposes, as described above both parties agreed to establish and cooperate for establishment of a Medical College & a 500 bedded Hospital and for that both parties have identified synergies in their respective objectives and are desirous of working in concert to better realize their objective in the State of Odisha."

<u>Paragraph 2(ii)</u>

"The FIRST PARTY (Government of Odisha) also agrees to allow the SECOND PARTY (the company) to *book the accrued capital expenditure on the setting of this Medical College & Hospital as part of the cost of R&R Plan for its upcoming power project in the District of Sundargarh, (Odisha).*"

(Emphasis supplied by the querist)

Paragraph 2(iii)

"The FIRST PARTY (Government of Odisha) shall provide adequate suitable land, free of cost and free of all encumbrances for the purpose of creation of infrastructure."

Paragraph 2(vi)

"The SECOND PARTY (the company), after the completion of the infrastructure shall hand over all the assets and liabilities created for the Medical College and Hospital to the FIRST PARTY (Government of Odisha)."

Paragraph 2(vii)

"The FIRST PARTY (Government of Odisha) shall take up the responsibility or run the Medical College and Hospital."

h) It is clear from the above, that the company agreed to construct the medical college and hospital in connection with the setting up of project. As clearly mentioned in the MoU, the setting up of the medical college and hospital was part of R&R plan for its upcoming Super Thermal Power Project in the district of Sundargarh, Odisha.

i) In line with the Odisha R&R Policy, R&R Plan was formulated and approved by RPDAC at its third meeting held on 3rd March, 2014. Subsequently, the expenditure for implementation of R&R plan was approved by the Board of Directors of the company.

The brief details of the R & R Plan for the Power Plant are as under:

Sl. No.	**Particulars**	**Amount (crore)**
1.	R&R Grants / Resettlement colony	136.80
2.	Community development activities in project affected villages, block and other places	46.00
3.	Medical college and hospital	417.77
4.	Polytechnic college	12.50
5.	Future miscellaneous R&R and other works provision	81.70
	Total	**694.77**

j) It is pertinent to mention here that the company agreed for construction of medical college and hospital due to its requirements of land in the state of Odisha. Had the company not set up the power plant in the state of Odisha, the company would not have agreed for constructing any such medical college and hospital. As the above expenditure on R&R plan is directly attributable to acquisition of the land for the Project of the company, the related expenditure has been capitalised as a part of land cost and the future economic benefits from such expenditure shall flow to the project in the form of return on equity.

k) During supplementary audit of accounts of the company for the year 2016-17, the Office of the Comptroller and Auditor General of India (C&AG) principally agreed with the accounting for R&R plan as part of land cost. They also desired that the accounting for the expenditure on R&R Plan capitalised as part of land cost be confirmed from the Expert Advisory Committee of the ICAI.

B. Query

9. In the facts and circumstances stated above, opinion of the Expert Advisory Committee is sought on the following issues:

(i) Whether the accounting treatment followed by the company of capitalising the expenditure on R&R Plan including construction of the medical college and hospital as part of land cost is in order.

(ii) If answer to (i) above is in negative, what should be the appropriate accounting for expenditure on R&R Plan (including construction of the medical college and hospital) for acquisition of land for the power projects considering the fact that the company is working in the regulated environment?

C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query relates to whether the accounting treatment followed by the company of capitalising the expenditure on R&R plan including construction of the medical college and hospital (MCH) as part of land cost, is in line with the requirements of Ind ASs. 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, whether the land procured from the Government on long term lease should be treated as an operating or finance lease, valuation of non-cash consideration, if any, transferred to Displaced Family (DF) or Project Affect Persons (PAPs), or issues relating to government assistance in the form of transfer of resources in return for compliance with certain conditions relating to the activities of the company,

presentation and depreciation of project related assets, etc. Further, the Committee has examined the query only from accounting perspective and not from any other perspective, such as, legal interpretation of various legal enactments, for example, whether the expenditure on R & R activities can be claimed by the company as the expenditure on Corporate Social Responsibility (CSR) activities under section 135 of the Companies Act, 2013, etc. The Committee has also not considered from the perspective of tariff or 'admitted capital cost' as considerations for determination of tariff may be different from accounting considerations, For example, Ind AS 16 requires an entity to capitalise a sum representing initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, in situations where an obligation existed. Ind AS thus envisages capitalisation of expenditure to be incurred even at a future date. However, for purposes of tariff determination, CERC may require otherwise.

11. The Committee notes that the setting up of the Power Project in the extant case is governed by the Odisha R&R Policy 2006, vital features of which are as follows:

- This shall be applicable to all projects for which land is acquired through negotiation under the provisions of this Policy.

- Two separate advisory bodies would be constituted. First is the Compensation Advisory Committee. Second is the Rehabilitation cum Periphery Development Advisory Committee (RPDAC). The objective of RPDAC is to encourage participation of displaced people and their elected representatives in (i) the implementation and monitoring of R&R package, and in (ii) overseeing and monitoring the development of the periphery.

- The types of rehabilitation assistance that can be extended to Displaced Family or Project Affect Persons (DF/PAPs) depend upon the type of the Project, for example, industrial project, mining project, irrigation projects, etc. These include (a) one-time cash assistance, (b) employment, (c) training for self-employment, (d) issue of convertible preference shares in some cases, (e) providing homestead land, (f) assistance for self-relocation, (g) house-building assistance in cash, (h) provision of shops and service units and (i) provision of agricultural land. Depending on the type of Project and the nature of displacement, one or more types of assistance could be extended. In select cases, DF/PAPs can also be granted maintenance allowance (Rs.2000 per month for one year), cash assistance for temporary shed, and transportation allowance.

Special benefits may also be extended to displaced indigenous families and primitive tribal groups in deserving cases.

- The R&R Plan has been prepared within the overall R&R Policy, which under paragraph 8(ii), specifies a condition that "no physical displacement shall be made before the completion of resettlement work as approved by the RPDAC. The certificate of completion of resettlement work will be issued by the Collector."

- The Project Authorities shall be responsible for *periphery development* as decided by the RPDAC within the guidelines issued from time to time by the State Government.

- The R&R policy defines 'periphery' as the District(s) in which a *project* is geographically situated.

The Committee further notes from the Facts of the Case that the expenditure on rehabilitation and resettlement work in the extant case is part of R & R plan of the company which has been formulated and approved by RPDAC under the R & R Policy of the State Government. Thus, apparently, it is a binding 'obligation' of the company and a necessary condition under the R&R plan to incur such expenditure.

12. From the above, the Committee notes that R & R work is closely related to the project work; had the company not incurred the cash and non-cash expenditure that is deemed as 'compensation', the resettlement work would not have been completed and certified by RPDAC and consequentially completion of project could not have been possible. For example, if physical displacement and clearance of acquired-land had not taken place, possession of land which is one of the requirements for completion of project would not have been possible. The Committee further notes from paragraph 8 (i) above that expenditure on R&R plan in the extant case consists of the expenditure on (i) R & R grants / resettlement colony, (ii) community development activities in project affected villages, block and other places, (iii) Medical college and hospital, (iv) polytechnic college and (v) future miscellaneous R & R and other works provision.

13. Now, the question that arises is whether such expenditure on R & R plan can be capitalised as part of cost of an item of property, plant and equipment (PPE). In this regard, the Committee notes the following paragraphs of Ind AS 16, 'Property, Plant and Equipment' as follows:

> **"15 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.**

16 The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period."

The Committee notes from (b) above that only 'costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management' can be capitalised as part of cost of an item of property, plant and equipment. The Committee is of the view that 'directly attributable' costs are generally such costs which are necessary and without the incurrence of which the asset cannot be brought to the location and condition necessary for it to be capable of operating in the manner intended by management. Accordingly, the Committee is of the view that the expenditure on R& R plan in the extant case can be capitalised only if it can be considered as directly attributable cost to the land or the Power Project as a whole (which can be considered as the unit of measure as per the requirements of Ind AS 16). In this context, the Committee is of the view that in the extant case, the resettlement grant/compensation payable to the land owners as a direct consequence of acquisition of land can be considered as directly attributable to the cost of land since the land cannot be acquired without incurring that expenditure and therefore, should be capitalised along with the cost of land. Further, the Committee notes from paragraphs 11 and 12 above that the other expenditure on R & R plan in the extant case is a binding obligation of the company and a necessary condition under the R&R plan approved by RPDAC under the R&R policy of the State. Therefore, such expenditure is closely related to the project work and can be considered as expenditure incurred for developmental activities associated with the Project (and not merely for acquisition of land, which is one of the requirements for the construction of the project). Accordingly, the Committee is of the view that such expenditure can be considered as directly attributable to the Project in the extant case.

14. Specifically, with regard to the expenditure incurred on Medical College and Hospital (MCH) (as the querist has specifically raised issue in this regard),

the Committee notes the relevant extracts from the communication issued by the Power Ministry to the State Government (letter dated May 10, 2012), reproduced as below:

- As requested by Government of Odisha, the company agreed to set up a Medical College and Hospital at Sundargarh with 400 bed which could be upgraded to 500 bed subsequently. The State Government will provide land for the same and will also run the Medical College and Hospital.
- Government of Odisha agreed to hand over the land expeditiously for the project of the company and also agreed to expedite the required clearances and processing of forest clearance for the plant as well as coal blocks so that the company could develop the mine along with the project.

15. From the above, although it may appear that a request has been made by the Government for setting up MCH, which is agreed by the company but a careful evaluation of this Communication reveals that the construction of MCH is linked to the Project as a whole, including forest clearances required for the Plant, as well as clearances for the coal blocks. Incidentally, the Committee notes that the Project is coal-based, and but for uninterrupted captive coal supply, the plant would not be able to operate. Accordingly, the Committee is of the view that the substance of the foregoing arrangement – though not explicit in its form -- is that construction of MCH and other developmental activities (other than resettlement grant/ compensation, as discussed in paragraph 13 above) are conditions necessary for undertaking the project as a whole; establishment of MCH and setting up of the Power Project are closely linked to each other, and it cannot be concluded that the latter would have come up independent of or without the former. Therefore, considering the principle of 'Substance over Form' as elucidated in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards, issued by the ICAI, the Committee is of the view that amounts expended towards these represent costs attributable to the power project as a whole and not merely to acquisition of land. Accordingly, the expenditure incurred on construction of the medical college and hospital (MCH) should be capitalised as part of the project cost and not as part of the cost of land.

D. Opinion

16. On the basis of the above, the Committee is of the opinion that:

(i) The accounting treatment followed by the company of capitalising the entire expenditure on R&R Plan including construction of the medical college and hospital, as part of land-cost, is not completely appropriate.

(ii) The resettlement grant/compensation payable to the land owners as a direct consequence of acquisition of land can be considered as directly attributable to the cost of land and, therefore, should be capitalised along with cost of land, as discussed in paragraph 13 above. The other expenditure on R & R plan including expenditure incurred on MCH in the extant case is a binding obligation of the company and a necessary condition of project approval, which is closely related to the project work and can be considered as expenditure incurred for developmental activities associated with the Project (and not for acquisition of land, which is one of the requirements for the construction of the project). Accordingly, such expenditure can be considered as directly attributable to the Project and should be capitalised as part of the project cost, as discussed in paragraphs 13 and 15 above.

Query No. 23

Subject: Provision for wage revision.[1]

A. Facts of the Case

1. A public sector undertaking (PSU), is a leading steel-making company in India having five integrated steel plants located at Bhilai, Durgapur, Rourkela, Bokaro and Burnpur and three special steel plants at Salem, Durgapur and Bhadravati. The company produces both basic and special steels for domestic construction, engineering, power, railways, automotive and defence industries as well as for sale in export markets. The turnover (gross) of the company in the year 2017-18 was approx. ₹58,297 crore. It provides direct employment to about 76,000 people.

2. The company also owns iron ore, flux and coal mines located in various states of the country. The entire iron ore required for the production of steel is sourced from the captive mines of the company. The mines are located close to the steel plants and ensure easy availability of iron ore, limestone, and dolomite.

3. The querist has stated that wage revision in case of non-executive employees of the company is due w.e.f. 1.1.2017 after expiry of 5 years' wage

[1] Opinion finalised by the Committee on 17.10.2018.

settlement agreement on 31.12.2016. Salary revision in case of executive employees of the company is also due w.e.f. 1.1.2017.

4. *Salary revision of executive employees:*

(i) The company, being a central public sector undertaking, is required to follow the Guidelines issued by Department of Public Enterprises (DPE) for revising the pay scales of its employees. Guidelines for 2017 salary revision in case of executives and non-unionized supervisors were issued by the Department of Public Enterprises (DPE) vide its Office Memorandum (OM) dated 3.8.2017.

(ii) Clause 3 of the DPE Guidelines dated 3.8.2017 provides as under :

"**Affordability**: The revised pay scales would be implemented subject to the condition that the additional financial impact in the year of implementing the revised pay-package for Board level executives, Below Board level executives and Non-Unionized Supervisors should not be more than 20% of the average Profit Before Tax (PBT) of the last three financial years preceding the year of implementation."

(iii) In the DPE Guidelines, it has further been provided that if the additional financial impact of revised pay package in the year of implementation is more than 20% of the average PBT of last 3 financial years, then the revised pay package should not be implemented in full but only partly as given below:

Part stages	**Additional financial impact of the full revised pay package as a % of average PBT of last 3 financial years**	**Fitment Benefit (% of BP+DA)**
I	More than 20% but upto 30% of average PBT of last 3 financial years	10%
II	More than 30% but upto 40% of average PBT of last 3 years	5%

(iv) Also it has been clearly mentioned in the Guidelines that no fitment or any other benefit of pay revision will be implemented in the central public sector enterprises (CPSEs) where the additional financial impact of the revised pay package is more than 40% of the average PBT of last 3 financial years.

(v) The financial (profit before tax (PBT)) details of the company during last three financial years prior to financial year 2017-18 are as under:

Financial year	PBT (Rs. crore)
2016-17	(-) 4851.00
2015-16	(-) 7007.50
2014-15	2358.91
Average of 3 (preceding) years	(-) 3166.53

(vi) As evident from the above, the average PBT for 3 years in case of the company is negative. Therefore, benefit of salary revision cannot be implemented/extended to executive employees of the company as per the conditions specified in clause 3 of DPE Guidelines dated 3.8.2017.

5. *Wage revision of non-executive employees:*

(i) The wage revision of non-executive employees is carried through bilateral negotiation through a Body known as National Joint Committee on Steel (NJCS) comprising representatives from management as well as trade unions. NJCS was constituted in October 1969 and its scope of work covers :

(a) Negotiations for wage agreement and its implementation;
(b) Matters pertaining to and steps to be taken for increase in production, productivity, improvement in quality, reduction of cost and wastages, etc.;
(c) Review of welfare amenities and facilities;
(d) Matters on which it is necessary to draw the attention of the Government; and
(e) Any other matter pertaining to steel industry and its employees, as may be agreed to in the NJCS, from time to time.

(ii) NJCS arrived at a Memorandum of Agreement (Bipartite Agreement) with management, covering the wage structure and other conditions of service for workers.

On expiry of Memorandum of Agreement dated 29th April, 2010, effective for a period of 5 years from 1st January, 2007 to 31st December, 2011, the NJCS arrived at, on 1st July, 2014, another Memorandum of Agreement covering the wage structure and allied matter for categories of employees covered under the said agreement. This agreement was effective from 1st January, 2012 and expired on 31st December, 2016.

(iii) DPE vide its OM dated 24.11.2017 has issued Guidelines for 8th round of wage revision for workmen in CPSEs, which inter alia, provides the following:

(a) Management of CPSEs would be free to negotiate wage revision for workmen where the periodicity of wage settlement of five years or ten years has expired generally on 31.12.2016 keeping in view the *affordability and financial sustainability* of such wage revision for the CPSEs concerned.

(b) The management of the concerned CPSEs where the five year periodicity is followed have to ensure that negotiated scales of pay for two successive *wages negotiations do not exceed the existing scales of pay of executives/officers and non-unionized supervisors of respective CPSEs for whom ten years periodicity is being followed.*

(Emphasis supplied by the querist.)

(iv) The current pay scales of some of the grades of non-executive employees in the company after wage revision effective from 01.01.2012 for 5 years are already higher than the pay scale of certain executive employees.

(v) Since no wage revision of executive employees can be effected w.e.f. 1.1.2017 due to non-fulfilment of affordability clause as discussed above, wage revision of non-executive employees w.e.f. 1.1.2017 cannot be taken up at the present time.

6. According to the querist, keeping in view the above-mentioned OMs of DPE containing Guidelines for salary/wage revision of executive and non-executive employees w.e.f. 1.1.2017, it is evident that salary/wage revision of executive and non-executives employees cannot be undertaken w.e.f. 1.1.2017 in terms of the extant Guidelines issued by DPE on the subject. The same can be done only when the criteria prescribed in the aforesaid OMs of the DPE are met.

7. Pending the issue of Guidelines of the Government, the company had made an adhoc provisions for salary/wage revision in its accounts for the period 1.1.17 to 31.03.2017 and 1.4.2017 to 31.12.2017.

8. Based on the clarifications mentioned above in paragraphs 4 (ii) and 5 (iii) above, the management of the company was of the view that provisions for salary/wage revision made in the books of account for executive and non-executive employees for the period from 01.01.2017 to 31.12.2017 are not in line with the directions issued by the Government of India, Ministry of Heavy Industries and Public Enterprises, Department of Public Enterprises. Hence, the Board of Directors of the company at its meeting held on 30th May, 2018, resolved that the provision for wage revision for executive and non-executive employees for the period 1st January, 2017 to 31st December, 2017, pending implementation of recommendations of 3rd Pay Revision Committee (PRC) and negotiations with the NJCS respectively, should be withdrawn/written back. Further, no provision should be made in respect of wage revision for the period 1st January, 2018 to 31st March, 2018.

B. Query

9. On the basis of the above, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) has been sought as to whether in view of the non-fulfillment of affordability clause and likely conflict of scales persisting vide OMs issued by DPE (dated 3.8.2017 and 24.11.2017), any provision is required to be made in the books of account towards wage revision of non-executive employees of the company.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query is whether in view of the non-fulfillment of affordability clause and likely conflict of scales persisting vide OMs issued by DPE (dated 3.8.2017 and 24.11.2017), any provision is required to be made in the books of account towards wage revision of non-executive employees of the company which as per the wage settlement agreement is due to be made w.e.f. 1.1.2017. The Committee has, therefore, considered only this issue and has not examined any other issue arising from the Facts of the Case such as, accounting treatment for salary revision (if any) of executive employees, legal interpretation of the DPE Guidelines, computation of average PBT of last three financial years as per the DPE Guidelines, etc. At the outset, the Committee wishes to point out that the opinion expressed hereinafter, is in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015.

11. The Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 19, 'Employee Benefits', notified under the Companies (Indian Accounting Standards) Rules, 2015 and the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards (Framework), issued by the ICAI:

Ind AS 19:

"4 The employee benefits to which this Standard applies include those provided:

(a) under formal plans or other formal agreements between an entity and individual employees, groups of employees or their representatives;

(b) …

(c) by those informal practices that give rise to a constructive obligation. 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.

5 Employee benefits include:

(a) short-term employee benefits, such as the following, if expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services:

(i) wages, salaries and social security contributions;

…"

"11 When an employee has rendered service to an entity during an accounting period, the entity shall recognise the undiscounted amount of short-term employee benefits *expected to be paid* in exchange for that service:

(a) as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.

(b) as an expense, unless another Ind AS requires or permits the inclusion of the benefits in the cost of an asset (see, for example, Ind AS 2, *Inventories*, and Ind AS 16, *Property, Plant and Equipment*)."

(Emphasis supplied by the Committee.)

Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards:

"49 (b) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits."

"60 An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities."

"64 Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. The definition of a liability in paragraph 49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations."

From the above, the Committee notes that when an employee has rendered service during a period, the employee benefits which are *expected to be paid* in exchange for that service are required to be provided for as liability.

Further, as per the requirements of the Framework, liability is a present obligation arising from past events, the settlement of which is *expected to result in an outflow* of resources embodying economic benefits and a provision should be recognized where liability can be measured only by using a substantial degree of estimation provided it meets the definition of liability.

12. The Committee further notes that Ind AS 19 does not provide detailed guidance as to when and in what circumstances, employee benefits should be considered to be expected to be paid and accordingly whether there is any need to provide for the same in the financial statements. Similarly, the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards also does not give detailed guidance on present obligation and when can it be considered to exist. In this regard, the Committee notes that Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets'

provides detailed guidance on present obligation and the circumstances in which liability/provision should be recognised. Accordingly, although provisions relating to employee benefits have not been addressed in Ind AS 37, the Committee notes the following paragraphs of Ind AS 37 dealing with the recognition of a provision:

"14 A *provision* shall be recognised when:

(a) an entity has a present obligation (legal or constructive) 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 shall be recognised."

"16 In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and

(b) where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86).

Past event

17 A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:

(a) where the settlement of the obligation can be enforced by law; or

(b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation."

"20 An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed—indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities."

"23 For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, ie the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86)."

"A *contingent liability* is:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability."

The Committee notes from the above that a provision is recognised when an entity has a present obligation (legal or constructive), for which it is probable that an outflow of resources will be required and a reliable estimate can be made for the same. An element of judgement is required to determine whether there exists an obligation and therefore whether a provision needs to be recognised or not. It is for the management of the entity to exercise that judgement and the auditor to assess in the specific facts and circumstances of the entity, considering all the evidences/factors available as on the reporting date.

In this regard, the Committee notes that the extracts of OM dated 24.11.2017 containing guidelines for 8th round of wage revision for workmen (paragraph 5(iii) above) states that the management would be free to negotiate wage revision for workmen keeping in view the affordability and financial stability and have to ensure that negotiated scales do not exceed the existing scales of pay of executives/officers and non-unionised supervisors of respective CPSEs. The Committee also notes from the Facts of the Case that as the average PBT for last 3 years in case of the company is negative, benefit of salary revision cannot be implemented/extended to executive employees of the company as per the conditions specified in clause 3 of DPE Guidelines dated 3.8.2017 and that the current pay scales of some grades of non-executive employees are already higher than the pay scales of certain executive employees.

The Committee is of the view that the company should also consider other factors/evidences available as on the reporting date to determine the existence of an obligation (legal or constructive) in respect of pay revision, such as, legal enforceability and applicability of OM dated 24.11.2017, issued by DPE, any negotiations with trade unions, terms of any agreement with NCJS which is in force, any past experience of the company with regard to the possibility of retrospective pay revision once the affordability and financial stability factor is fulfilled in future, possibility of wage revision in part in respect of non-executive employees whose pay scales are lower than that of executive employees, any legal opinion in this regard, any past informal practice of the company which may give rise to any constructive obligation etc. Accordingly, if it is determined that a present obligation (legal or constructive) exists and other conditions as per paragraph 14 of Ind AS 37 are met, provision should be recognised. However, where it is determined that 'present obligation' does not exist or due to any other reason, provision could not be recognised, then, the company should also consider whether there is any need for disclosure as a 'contingent liability' (unless the possibility of an outflow of resources embodying economic benefits is remote), as per the requirements of Ind AS 37.

D. Opinion

13. On the basis of the above, the Committee is of the opinion on the issue raised in paragraph 9 above that as per the requirements of Ind AS 19, employee benefits which are expected to be paid in exchange for the employee services during a period are required to be provided for as liability. Further as per the requirements of Framework, liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits and a provision should be recognised where liability can be measured by using a substantial degree of estimation. However, in the absence of detailed guidance for application of these requirements in Ind AS 19 and the Framework, as discussed in paragraph 12 above, the requirements of Ind AS 37 in this regard should be applied. Accordingly, the company should determine whether there exists a present obligation and therefore whether a provision needs to be recognised or not in the specific facts and circumstances, considering all the evidences/factors available as on the reporting date, as discussed in paragraph 12 above. If it is determined that a present obligation (legal or constructive) exists and other conditions as per paragraph 14 of Ind AS 37 are met, provision should be recognised. However, where it is determined that 'present obligation' does not exist or due to any other reason, provision could not be recognised, then, the company should also consider whether there is any need for disclosure as a 'contingent liability' (unless the possibility of an outflow of resources embodying economic benefits is remote), as per the requirements of Ind AS 37.

Query No. 24

Subject: Deferred tax under Indian Accounting Standard (Ind AS) 12, 'Income Taxes' on fair value changes of investments under section 112A of Income-tax Act.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a diversified oil and gas public sector undertaking registered under the Companies Act and is

[1] Opinion finalised by the Committee on 17.10.2018.

primarily engaged in refining and marketing of petroleum products, petrochemicals, sale of gas and exploration & production of oil and gas.

2. The company is also holding the shares of listed companies as non-current investments. At the time of implementation of Indian Accounting Standards (Ind ASs) during 2016-17, the company has designated equity investments (other than investments in subsidiaries, joint ventures (JV)/associates) at fair value through other comprehensive income (FVOCI) by exercising the irrevocable option provided under Indian Accounting Standard (Ind AS) 101, 'First-time Adoption of Indian Accounting Standards'. This designation of equity investments through other comprehensive income (OCI), as per the querist, is without any option of recycling to profit and loss (P&L) on realization. In other words, the company can never transfer gain/loss of fair value changes in equity investments in P&L even when the same are actually transferred/sold or realized.

3. The querist has stated that under Union Budget 2018-19, Government of India re-introduced Long-Term Capital Gain arising out of transfer of equity share in a company or a unit of an equity oriented fund or a unit of a business trust (referred to as specified securities) at the rate of 10 per cent on profit exceeding Rs.1 lakh from sale of specified securities held for over one year (under section 112A of Income-tax Act subject to exemptions as provided under the said section). The long-term capital gain tax is payable to the Government only on sale of equity shares on or after 01.04.2018. The brief provisions of section 112A have been provided by the querist as under:

- Long-term capital gains will be computed without giving the benefit of the first and the second proviso to section 48 of Income-tax Act, i.e., benefit of indexation of cost of acquisition and cost of improvement will not be allowed. Also, benefit of computation of capital gains in foreign currency, in case of non-resident, will not be allowed.

- The cost of acquisition (COA) in case of long-term capital asset acquired before 01/02/2018, shall be deemed to be higher of the following:
  - the actual cost of acquisition, and
  - the lower of –
    - the fair market value of such asset as on 31.01.2018; and
    - the full value of consideration received or accruing as a result of the transfer of the capital asset.

- Fair market value has been defined to mean:
  - In case of capital asset listed on any recognized stock exchange - Highest price quoted on such exchange on 31/01/2018. However, where there is no trading in such asset on such exchange on the 31/01/2018, the highest price of such asset on such exchange on a date immediately preceding 31/01/2018 when such asset was traded on such exchange shall be the fair market value;
  - in a case where the capital asset is a unit and is not listed on recognized stock exchange, the net asset value of such asset as on the 31st day of January, 2018.

4. The querist has further stated that from the above provision, it is evident that on the long-term equity shares held as capital assets before 01.02.2018 and sold on or after 01.04.2018, long-term capital gains tax is payable @10% as per the provisions of section 112A listed above.

5. As per the querist, since, the company is holding the shares of listed companies as its investments as on 31.03.2018, the newly inserted capital gain tax provisions under section 112A are applicable to these shares also whenever these shares will be sold by the company and the COA shall be the market value of these shares as on 31.01.2018 (since market value as on 31.01.2018 is more than the original cost of acquisition of these shares).

6. There is a variation in the market price of listed equity shares held as investments by the company between 31.01.2018 and 31.03.2018. During the financial year (F.Y.) 2017-18, fair value gain/ loss is recognised by the company in Other Comprehensive Income (OCI). Thus, there is a need to evaluate the tax impacts, if any, to be accounted for along with the fair value gain/loss in OCI.

7. According to the querist, after introduction of section 112A of Income-tax (IT) Act 1961, following three views are emerging for accounting of tax on fair value changes in the long-term investments held by the company in listed equity shares:

No deferred tax accounting of fair value gain/loss

Since the acquisition cost of the listed share would be considered least of the fair value as on 31.01.18 and value of actual sale thereof, and the sale of investment had not taken place upto the reporting date, the company's liability (if any) to pay long term capital gain tax as on the date of balance sheet is indeterminable. There is no tax base and thus there is no tax liability as on 31.03.2018. Consideration of deemed acquisition cost as on 31.1.2018 for working out the fair value loss/gain in equity investment and corresponding deferred tax/ liability as on 31.03.2018 or afterwards in the absence of actual sale consideration is not in line with the provision of section 112A of IT Act.

Creation of deferred tax assets and liability on fair value changes

As on 31.03.2018, any variation in the value of listed equity shares are applicable to long-term capital gain tax u/s 112A. Accordingly, deferred taxes on fair value loss/ gain in the value of the investments should also be recognised based on the requirement of Ind-AS considering the concept of accrual and matching. In this option/ view, in case there is a decrease in the fair value of investments in equity shares as on the reporting date as compared to the market value as on 31.01.2018 or actual cost price, deferred tax asset (DTA) will be created on this loss and shall be taken to OCI during the period. Similarly, in case of gain or reversal of losses, deferred tax liability (DTL) shall be created or deferred tax asset shall be reversed through OCI respectively.

Non-creation of deferred tax asset on fair value loss

Another view which is possible for accounting of taxes applicable on investments covered u/s 112A is that since, as per the provisions of section 112A, the loss on sale of listed investments shall not arise even if the investments are sold at a price less than the fair market value as on 31.01.2018, no deferred tax assets should be recognised on fair value loss unless the fair value as on reporting date is less than the actual cost of acquisition of investments. However, in case there is a fair value gain in the value of investments as on the reporting date as compared to the value as on 31.01.2018, the corresponding deferred tax liability should be created.

8. *Relevant Provisions under Ind ASs*

Relevant provisions of Ind ASs for deferred tax have been listed by the querist as below:

Ind AS 1, 'Presentation of Financial Statements'

"27 An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting."

According to the querist, in view of this provision, deferred tax needs to be recognized in the same period in which losses are shown by the company in OCI.

Ind AS 12, 'Income Taxes'

"*Deferred tax assets* are the amounts of income taxes recoverable in future periods in respect of:

(a) deductible temporary differences;
(b) the carryforward of unused tax losses; and

(c) the carryforward of unused tax credits."

"The *tax base* of an asset or liability is the amount attributed to that asset or liability for tax purposes."

"Temporary differences …

…

***(b) deductible temporary differences,* which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled."**

As per the querist, paragraph 20 of Ind AS 12 specifically deals with the recognition of deferred tax in respect of fair valuation cases. The relevant portion of this paragraph is reproduced below:

"20 Ind ASs permit or require certain assets to be carried at fair value or to be revalued (see, for example, Ind AS 16, *Property, Plant and Equipment*, Ind AS 38, *Intangible Assets* and Ind AS 109, *Financial Instruments*). In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

(a) the entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or

(b) tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets."

"24 **A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is *probable* that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:**

(a) **is not a business combination; and**

(b) **at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).**

…"

(Emphasis supplied by the querist.)

Paragraph 26 of Ind AS 12 also confirms creation of deferred tax assets on assets measured at fair value through specific example as reproduced below:

"26 The following are examples of deductible temporary differences that result in deferred tax assets:

…

(d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount."

9. *Arguments for and against creation of deferred tax:*

Arguments in favour of creation of DTA on losses in light of above Ind AS provisions are as follows:

1. Deferred tax asset should be recognised due to existence of deductible temporary differences as the losses incurred will be adjustable in future (Paragraph 5 of Ind AS 12).

2. Creation of deferred tax is required even when the tax base of the asset is not adjusted which is the case in India (Paragraph 20 of Ind AS 12).

3. Reasonable certainty is required for creation of DTA under Ind AS. The company has classified its equity investments under non-current investments as the intention is to hold them over a longer period of

time and keeping in view the past trends, the value of investment is likely to increase in future.

Arguments in favour of non-creation of DTA on losses in light of above Ind AS provisions are as follows:

1. There was no tax base and no tax liability as on 31.03.2018 since taxability u/s 112A arises after 01.04.2018 at the time of actual sale.

2. Paragraph 24 of Ind AS 12 forbids the recognition of a deferred tax asset if that asset arises from the initial recognition of an asset or liability in a transaction that at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

10. Actual trend of value of investments:

Rs. per share

	Company A	**Company B**	**Company C**	**Total**
Cost Price	**10**	**400**	**10**	**420**
Market Value as on				
- 31.01.2018	200	360	400	
- 31.03.2018	180	215	450	
- 30.06.2018	160	220	425	
Bonus in FY 2017-18 after 31.01.2018	Nil	1:2	Nil	
Gain/(Loss) on base/ original shares as on				
- 31.03.2018	(20)	(185)	50	(155)
- 30.06.2018	(40)	(180)	25	(195)
Gain/(Loss) on Bonus shares as on				
- 31.03.2018	-	107.50	-	107.50
- 30.06.2018	-	110	-	110
Total Gain/(Loss) as on				
- 31.03.2018	(20)	(77.50)	50	(47.50)
- 30.06.2018	(40)	(70)	25	(85)

B. Query

11. In view of the above, opinion of the Expert Advisory Committee (EAC) has been sought by the querist on the following:

(i) Whether accounting of deferred tax is applicable on fair value changes of equity investments covered under section 112A or tax effect to be given only at the time of sale.

(ii) In case the deferred tax is to be recognised on items covered under section 112A:

  (a) Whether deferred tax asset is to be recognised on fair value losses on investments or only the deferred tax liabilities and its reversal is to be recognised.

  (b) Whether the deferred tax needs to be computed on total net gain/loss on all investments during the period or needs to be computed separately for individual investments.

(iii) If the impact is to given at the time of sale only, whether the items covered under section 112A is an exception to general principle of Ind-AS that tax impact of items in OCI is also to be netted off in OCI itself in the same period.

(iv) Whether the bonus shares received after 31.01.2018 needs to be separately considered for computing tax u/s 112A or to be combined with original shares.

(v) Whether for financial year (F.Y.) 2017-18:

  (a) Company A – DTA needs to be created on the loss of Rs. 20 or not.

  (b) Company B - DTA needs to be created on loss of Rs. 185 on original shares or not. DTL needs to be created on the gain of Rs. 107.50 on bonus shares or not.

  (c) Company C - DTL needs to be created on the gain of Rs. 50 or not.

(vi) Whether for first quarter (Q1) of 2018-19:

  (a) Company A – DTA needs to be created on the loss of Rs. 20 or not.

  (b) Company B - DTL needs to be created on gain of Rs. 7.50 on original as well as bonus shares or DTA created in F.Y. 2017-18 needs to be reversed on gain of Rs. 5 on original shares and DTL needs to be created on gain of Rs. 2.50 on bonus shares. In other words, whether in case of bonus issue, no DTA can be created on loss incurred on original shares but DTL needs to be created on all MTM gains including bonus shares.

(c) Company C - DTL created in F.Y. 17-18 needs to be reversed on loss of Rs. 25 or not.

(vii) In other words, how taxes need to be computed and accounted for F.Y. 2017-18 and Q1 of F.Y. 2018-19 for each of the investments listed in table provided in paragraph 10 above?

C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to accounting for deferred tax arising on fair value changes in investments in equity shares of listed companies designated as at FVOCI under Ind AS 109 due to the enactment of section 112A under Income-tax Act for the financial year ended 31st March 2018 and for 3 months period ended on 30th June 2018. Accordingly, the Committee has restricted its opinion only to the accounting of deferred tax under Ind ASs and not looked into any taxation issues arising from the enactment of section 112A. At the outset, the Committee wishes to point out that the Committee has not looked into the specific numerical scenarios/trend provided by the querist in paragraph 10 above. Further, the Committee, while expressing its opinion hereinafter, has laid down the principles to be followed by the company in the extant case and has not specifically computed/calculated deferred tax impact (if any) in different scenarios provided by the querist. The Committee also notes that the investments in the extant case are investments other than investments in subsidiaries, associates and any joint venture and hence, the Committee has restricted its consideration to such investments only.

13. The Committee notes that section 112A of Income-tax Act was inserted vide Finance Bill 2018 and is applicable only on sale of equity shares on or after 1.4.2018. Therefore, an issue may arise as to whether the same should be considered while accounting for deferred taxes for the reporting period ending on 31st March, 2018. In this context, the Committee notes that Ind AS 12 contains following requirements with respect to measurement of deferred tax assets and liabilities:

"47 Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period."

The Committee notes that the Finance Act, 2018 was issued in the Official Gazette on 29th March 2018. Thus, the entire process of enactment, including the President's assent, was complete prior to the balance sheet date. Therefore, the Committee is of the view that the company should consider Finance Bill 2018 as enacted as at 31st March 2018 and should consider the requirements of section 112A for the reporting period ending on 31st March, 2018.

14. In paragraph 7 above, the company has provided one of the arguments for not recognizing DTA on account of section 112A is that the sale of investment had not taken place up to the reporting date, i.e., 31st March 2018. In this regard, the Committee notes that if the investments were sold up to the reporting date, there would have been no temporary difference since the investment would not have been there in the company's balance sheet as at 31st March 2018. The Committee further notes the requirements of Ind AS 12 as follows:

> **"*Temporary differences* are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:**
>
> **(a) *taxable temporary differences*, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or**
>
> **(b) *deductible temporary differences*, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.**
>
> **The *tax base* of an asset or liability is the amount attributed to that asset or liability for tax purposes."**
>
> "20 Ind ASs permit or require certain assets to be carried at fair value or to be revalued (see, for example, Ind AS 16, *Property, Plant and Equipment*, Ind AS 38, *Intangible Assets* and Ind AS 109, *Financial Instruments*). In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount

that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

(a) the entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or

(b) tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets."

From the above, the Committee notes that the temporary differences on the investments are based on the taxable or deductible amounts determining taxable profit or deductible loss in future periods when the carrying amounts of the investments are recovered. This is because deductible (taxable) temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base, which will result in amounts that are deductible (taxable) in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled. The temporary difference is based on the premise of future sale of the asset attracting taxable profit or tax deductible loss in future, rather than actual sale of the asset until the reporting date. Therefore, the Committee is of the view that the company's argument is not sustainable. The company should consider the provisions of section 112A while recognizing and measuring the deferred tax asset and liability on the relevant investment. The Committee is further of the view that the deferred tax liability or asset should be computed separately for individual investments since the cost of acquisition, market value at 31st January 2018 and the fair value at the reporting date for each investment may vary and, resultantly, the tax base and temporary difference for each individual investment would vary.

15. The Committee is of the view that the company should account for deferred tax liability on the investments when there is taxable temporary difference arising between the carrying amount of an investment and the tax base under Ind AS 12. In this regard, the Committee notes paragraph 15 of Ind AS 12, which, inter alia, states, "A deferred tax liability shall be recognised for all taxable temporary differences, except …" On the other hand, when there is a deductible temporary difference between the carrying amount of an investment

and the tax base under Ind AS 12, the company shall account for deferred tax asset. For recognising deferred tax asset, the Committee notes that Ind AS 12 lays down the following requirements:

> ***"Deferred tax assets*** **are the amounts of income taxes recoverable in future periods in respect of:**
>
> **(a) deductible temporary differences;**
>
> **(b) the carryforward of unused tax losses; and**
>
> **(c) the carryforward of unused tax credits."**
>
> **"24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:**
>
> **(a) is not a business combination; and**
>
> **(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).**
>
> **However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44."**
>
> "26 The following are examples of deductible temporary differences that result in deferred tax assets:
>
> …
>
> (d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount."
>
> "29 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:
>
> (a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the

deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). In evaluating whether it will have sufficient taxable profit in future periods, an entity:

…

(ii) ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised; or

(b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods."

"34 A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised."

From the above, the Committee notes that a deferred tax asset represents a future tax benefit. It is, therefore, necessary that the entity should have sufficient future taxable profits against which such benefit can be claimed. Ind AS 12 allows deferred tax asset to be recognised only to the extent that sufficient future taxable profits will be available against which the deductible temporary differences can be utilised. The sources of taxable profits against which an entity can utilize deductible temporary differences include:

- future reversal of existing taxable temporary differences;
- taxable profit in future periods; and
- tax planning opportunities.

The Committee further notes that the Companies (Indian Accounting Standards) Amendments Rules, 2018, inter alia, inserted the following paragraphs in Ind AS 12:

"27A When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, it considers whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. If tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences. However, if tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type."

From the above, the Committee notes that the assessment of the availability of taxable profits against which a deductible temporary difference can be utilised should be made considering whether the relevant tax laws restrict the sources of taxable profits or the head of income against which that deductible temporary difference can be utilised. The company should consider the relevant provisions of Income-tax Act, including with respect to set-off of the long-term capital loss under section 112A against other long-term capital gains and the time limit up to which the unabsorbed loss can be carried forward and set-off against future long-term capital gains. The company should recognize deferred tax asset on long-term capital loss under section 112A only if it has reasonable certainty about taxable income/gain that would arise in future that can be set off against the unabsorbed capital loss within the prescribed time period. For this purpose, the company should consider, amongst others, future reversal of existing taxable temporary differences (for example, future capital gains against which the long term capital loss can be set-off, existing carried forward long term capital losses) and tax planning opportunities. The Committee is also of the view that while presenting the deferred tax asset/liability, the company should also consider the criteria provided in Ind AS 12 (paragraph 74) for offsetting deferred tax assets and deferred tax liabilities.

16. The Committee notes that if investments covered under section 112A are purchased by the company after 31st January 2018, then the provisions of deemed cost of acquisition under the section do not apply. Accordingly, the Committee is of the view that determination of cost of acquisition of bonus shares, viz., whether bonus shares allotted after 31st January 2018 should be considered at nil cost of acquisition or deemed cost of acquisition is a matter of interpretation of the provisions of Income-tax Act. Therefore, the Committee has not examined the matter. The company should determine the tax base under Ind AS 12 considering the relevant provisions, interpretations and legal pronouncements. In this context, the Committee notes that in case there is uncertainty about the tax position with regard to bonus shares, Ind AS 12 provides the following disclosure requirement:

"88 An entity discloses any tax-related contingent liabilities and contingent assets in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities. Similarly, where changes in tax rates or tax laws are enacted or announced after the reporting period, an entity discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see Ind AS 10, *Events after the Reporting Period*)."

17. The Committee also notes that Ind AS 12 contains the following requirement:

> **"61A Current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:**
>
> **(a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).**
>
> **(b) directly in equity, shall be recognised directly in equity (see paragraph 62A)."**

Therefore, when the deferred tax relates to items that are recognised in other comprehensive income, the deferred tax is also recognised in other comprehensive income (OCI). Since the company has designated the investments as at FVOCI, the fair value gains and losses are also recognised in OCI. Consequently, the deferred tax arising from the investments should also be recognised in OCI.

D. Opinion

18. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

(i) As stated in paragraph 14 above, accounting for deferred tax under Ind AS 12 is applicable on fair value changes of equity investments including those covered under section 112A and the tax effect is required to be given in respect of all investments which are held as at 31st March 2018.

(ii) (a) The company should recognize deferred tax asset on long-term capital loss under section 112A only if it has reasonable certainty about taxable income/gain that would arise in future that can be set off against the unabsorbed capital loss within the prescribed time period. For this purpose, the company should consider, amongst others, future reversal of existing taxable temporary differences (for example, future capital gains against which the long term capital loss can be set-off, existing carried forward long term capital losses) and tax planning opportunities, as discussed in paragraph 15 above.

(b) The deferred tax liability or asset shall be computed separately for individual investments since the cost of acquisition, market value at 31 January 2018 and the fair value at the reporting date for each investment may vary and, resultantly, the tax base and temporary difference for each individual investment would vary, as discussed in paragraph 14 above. Further, the company should consider the relevant tax provisions, interpretations and legal pronouncements including the criteria provided in Ind AS 12 for offsetting deferred tax assets and deferred tax liabilities.

(iii) Refer (i) above. As stated in paragraph 17 above, the deferred tax charge or income resulting from fair value remeasurement of investments that are designated as at FVOCI under Ind AS 109 shall be recognised directly in OCI since the fair value remeasurement is also recognised in OCI.

(iv) Whether or not bonus shares allotted after 31st January 2018 should be considered at Nil cost of acquisition or deemed cost of acquisition is a matter of interpretation of the provisions of Income-tax Act. Therefore, the Committee has not looked in the matter. The company should calculate the tax base under Ind AS 12 considering the relevant provisions, interpretations and legal pronouncements. In case there is uncertainty regarding the tax position with regard to taxability of bonus shares or investments purchased after 31st January 2018, appropriate disclosures under Ind AS 12, as discussed in paragraph 16 above, should be provided.

(v), (vi) and (vii) The company should consider the above-mentioned principles while considering the accounting for the deferred tax asset or liability in the scenarios provided in paragraph 10 above. Also refer paragraph 12 above.

Query No. 25

Subject: Classification of consumer deposits collected for LPG connections.[1]

A. Facts of the Case

1. The querist has stated that public sector unit - oil companies, collectively referred to as Oil Marketing Companies (OMCs) are primarily engaged in the business of refining and marketing of petroleum products. Among other products, OMCs sell LPG (Liquid Petroleum Gas) to domestic as well as non–domestic customers. OMCs supply LPG (Liquid Petroleum Gas) in cylinders which are fitted with specially designed valves and regulators.

2. OMCs normally take deposits for cylinders and regulators from consumers. These deposits are taken based on the number of cylinders issued and deposit amount is uniform pan India. As per the agreement, customer can surrender the connection anytime and OMCs are obliged to repay the full deposit amount.

3. The querist has informed that in practice, not even 5% of the consumers surrender the connection and seek refund of the deposit. Due to this, the deposit balance never reduces year to year rather keeps on increasing due to business growth.

4. Guidance under Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements' and Schedule III of the Companies Act, 2013 has been reproduced by the querist as follows:

Ind AS 1, Presentation of Financial Statements:

"Current liabilities

69 An entity shall classify a liability as current when:

(a) it expects to settle the liability in its normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting period; or

(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months

[1] Opinion finalised by the Committee on 8.1.2019.

> **after the reporting period (see paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.**

An entity shall classify all other liabilities as non-current."

General Instructions for Preparation of Balance Sheet Under Division II – Ind AS Schedule III to the Companies Act, 2013:

"3. An entity shall classify a liability as current when-

(a) it expects to settle the liability in its normal operating cycle;
(b) it holds the liability primarily for the purpose of trading;
(c) the liability is due to be settled within twelve months after the reporting period; or
(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

5. As per the querist, from a reading of the above paragraphs, two views can be drawn on classification of these deposits:

First View – The OMCs do not have an unconditional right to defer the settlement of these deposits, once presented for repayment, hence the same may be treated as current liability and disclosed accordingly.

Second View – Considering that in commercial practice, these deposits are continued for years together and there is a very minimal re-payment of these deposits, these deposits against LPG connections should be considered as non-current liability, keeping in view the principle of 'Substance Over Form'.

6. The querist has mentioned that the following criteria under paragraph 10 of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' may be considered for determination of the accounting treatment/ classification of these deposits:

" ***In the absence of an Ind AS that specifically applies to a transaction,*** **other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:**

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

(i) represent faithfully the financial position, financial performance and cash flows of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects."

While emphasis is hereby drawn on the phrase –'*economic substance and not merely their legal form*', a more comprehensive paragraph on 'Substance over Form' has been included in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards (hereinafter referred to as the Framework), issued by the Institute of Chartered Accountants of India (ICAI).

(Emphasis supplied by the querist.)

7. The querist has stated that paragraphs 31-38 of the Framework talks about the 'reliability' of the information provided in the accounts. To be reliable, Framework lists out the major consideration governing the selection and application of accounting policies which are – Faithful Representation, *Substance over Form, Neutrality, Prudence & Completeness.*

Paragraph 35 therein elaborates the concept of 'Substance over Form' and states, *inter alia,* the following:

> "*If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. ...*"

(Emphasis supplied by the querist.)

8. Further, LPG deposits are taken against cylinders and regulators issued to LPG consumers at the time of granting connection to them. These cylinders and regulators are forming part of fixed assets of OMCs and are depreciated over the period of their useful lives. Practically, the company is taking these deposits to finance the fixed assets in the form of cylinders and regulators only as per its funds flow planning. Since these deposits are taken against fixed assets of the company, the basic nature of these deposits may suitably be

considered as non-current and these deposits should not form part of working capital of the company.

9. The querist has also stated that the Frequently Asked Questions (FAQs) on the Revised Schedule VI to the Companies Act, 1956[2], issued by the Corporate Laws & Corporate Governance Committee of the ICAI also addresses the same issue of classification of these kinds of deposits as current or non-current as follows:

> **"Question no. 27 - The company has received security deposit from its customers / dealers. Either the company or the customer / dealer can terminate the agreement by giving two months notice. The deposits are refundable within one month of termination. However, based on past experience, it is noted that deposits refunded in a year are not material, with 1% to 2% of the amount outstanding. The intention of the company is to continue long-term relationship with its customers / dealers. Can the company classify such security deposits as non-current liability?**
>
> Response - As per Revised Schedule VI, a liability is classified as current if the company does not have an unconditional right to defer its settlement for at least 12 months after the reporting date. *This will apply generally. However, in specific cases, based on the commercial practice, say for example electricity deposit collected by the department, though stated on paper to be payable on demand, the company's records would show otherwise as these are generally not claimed in short term. Treating them as non-current may be appropriate and may have to be considered accordingly.* (Emphasis supplied by the querist.)
>
> A similar criterion will apply to other deposits received, for example, under cancellable leases."

10. According to the querist, in the above FAQ issued, the principle of substance over form has been preferred over the general condition for classification of liability as current and non-current. Although, the FAQs have been withdrawn by the ICAI but the principle enumerated therein gives guidance in the matter and holds true even today.

11. *Practice followed by OMCs:*

In the above backdrop and emphasizing on the phrase 'economic reality and not merely their legal form', the quantum of these deposits for other OMCs during the last few years have been provided by the querist as below:

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[2] The said FAQs were subsequently withdrawn in view of issuance of Schedule III of the Companies Act, 2013.

Rs. Crore

OMC	Mar'17	Mar'16	Mar'15	Mar'14
Company A	19,790	17,093	14,322	12,633
Company B	10,763	9,183	8,062	6,989

The above table shows the increasing trend of deposits over the past few years for the 2 OMCs mentioned above. If the refunds made on account of these deposits over the last few years are considered, the data looks as follows:

(%ge of Refund Made)	Year Ending Mar'17	Year Ending Mar'16	Year Ending Mar'15	Year Ending Mar'14
Company A	2%	2%	5%	5%
Company B	1%	2%	3%	2%

The above data indicates that *the economic reality with respect to these deposits* suggests that over the past few years, OMCs have been building up its liability towards such deposits taken and the amount of refund has been minuscule as compared to the total liability towards such deposits. Also the gross block of LPG cylinders and regulators is always more than these deposits outstanding. (Emphasis supplied by the querist.)

12. Considering the fact that the company needs to take into account the relevant provisions of Accounting Standard (in this particular case Ind AS 8), these liabilities are classified as non-current by the above mentioned two OMCs taking into account the economic reality and the principle of substance over legal form as explained above. This accounting treatment is also agreed by the auditors of the company of the querist in first Ind-AS financial statements. However, since different views are possible in classification of these deposits, the company has decided to take an opinion of experts in the matter.

13. In addition to the above, given that such deposits are repayable on demand and timing of the payment cannot be estimated, the said deposits have not been discounted in accounts while classifying them as non-current liabilities.

B. Query

14. In view of the above, the querist has sought the opinion of the Expert Advisory Committee on the issue as to whether the accounting classification

made by the OMCs for deposits received by them from their LPG consumers towards supply of cylinders and regulators as non–current financial liability is correct.

C. Points considered by the Committee

15. The Committee while giving its opinion has considered only the issue raised in paragraph 14 above and has not examined any other issue that may arise from the Facts of the Case, such as, measurement and consequential discounting, if any, in respect of the said deposits and any other related matters.

16. The Committee notes that the basic issues which need to be considered are whether the deposits received by the company from their LPG customers towards supply of cylinders and regulators are to be treated as non-current liability as per the criteria for current and non-current classification of liabilities under Division II - Ind AS Schedule III of the Companies Act, 2013, Ind AS 1, 'Presentation of Financial Statements' and other applicable Indian Accounting Standards, as notified under the Companies (Indian Accounting Standards) Rules, 2015 as well as whether it meets the definition of a financial liability under Ind AS 32, 'Financial Instruments – Presentation', notified under the Companies (Indian Accounting Standards) Rules, 2015.

17. With regard to the classification of consumer deposits, as non-current liabilities, the Committee notes the following definition of 'Current Liability' as per paragraph 69 of Ind AS 1:

> **"69 An entity shall classify a liability as current when:**
>
> **(a) it expects to settle the liability in its normal operating cycle;**
>
> **(b) it holds the liability primarily for the purpose of trading;**
>
> **(c) the liability is due to be settled within twelve months after the reporting period; or**
>
> **(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period (see paragraph 73). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.**
>
> **An entity shall classify all other liabilities as non-current."**

Form the above, the Committee notes that paragraph 69(d) specifically states that if the entity does not have an unconditional right to defer the settlement of a liability beyond 12 months then the same shall be classified as current liability. The Committee also notes that paragraph 3 of General Instructions for Preparation of Balance Sheet Under Division II - Ind AS Schedule III to the Companies Act 2013 provides similar definition of the current liability. In the extant case, the OMCs are required to refund the deposits as and when the connection is surrendered by the customer and do not have an unconditional right to defer such settlement. Therefore, as per the aforesaid definition, the same should be classified as 'current liability'.

18. With regard to the contention of the querist for considering the principle of 'substance over form' in the extant case, the Committee notes the following requirements from Ind AS 8, Ind AS 1 and the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards, issued by the ICAI:

Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors':

"10 In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

(i) represent faithfully the financial position, financial performance and cash flows of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects."

Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards:

"True and fair view

46 Financial statements are frequently described as showing a true and fair view of the financial position, performance and cash flows of an entity. Although this *Framework* does not deal directly with such concepts, *the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of such information.*"

Ind AS 1, Presentation of Financial Statements:

"15 Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*. *The application of Ind ASs, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.*"

"17 *In virtually all circumstances, presentation of a true and fair view is achieved by compliance with applicable Ind ASs*. Presentation of a true and fair view also requires an entity:

(a) to select and apply accounting policies in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. Ind AS 8 sets out a hierarchy of authoritative guidance that management considers in the absence of an Ind AS that specifically applies to an item.

(b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

(c) to provide additional disclosures when compliance with the specific requirements in Ind ASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

"19 **In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS**

> **would be so misleading that it would conflict with the objective of financial statements set out in the *Framework*, the entity shall depart from that requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.”**

(Emphasis supplied by the Committee.)

From the above, the Committee notes that paragraph 10 of Ind AS 8 specifically states that in the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is reliable, in that the financial statements reflect the economic substance of transactions, other events and conditions, and not merely the legal form. Thus, the Committee is of the view that where a specific transaction or event is covered by a specific requirement of an Ind AS, the general principles, like ‘substance over form’ should not override a specific provision given in the standard. Further, the Committee notes that the Framework and Ind AS 1 also specifically state that the application of accounting standards is presumed to result in financial statements that present a true and fair view and virtually in all circumstances (except in certain extremely rare circumstances as per paragraph 19 of Ind AS 1), presentation of true and fair view is achieved by compliance with applicable Ind ASs. Accordingly, the Committee is of the view that since as per paragraph 69(d) of Ind AS 1, the consumer deposits in the extant case need to be classified as ‘current liabilities’, the same should be followed by the company in the extant case. In this regard, the Committee further notes paragraph 61 of Ind AS 1 which provides as follows:

> **“61 Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:**
>
> **(a) no more than twelve months after the reporting period, and**
>
> **(b) more than twelve months after the reporting period.”**

From the above, the Committee is of the view that for better presentation and disclosure, the company should disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability.

19. With reference to the classification of consumer deposits as a financial liability, the Committee notes the following paragraphs of Ind AS 32, ‘Financial Instruments: Presentation’:

"A *financial liability* is any liability that is:

(a) a contractual obligation :

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

…"

"13 In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

14 In this Standard, 'entity' includes individuals, partnerships, incorporated bodies, trusts and government agencies."

With regard to the classification of the deposits collected as a financial liability, the Committee notes that since as per the agreement, customer can surrender the connection anytime and OMCs are obliged to repay the full deposit amount as stated in paragraph 2 above, there exists a contractual obligation to deliver cash in terms of paragraphs 11 and 13 of Ind AS 32, reproduced above, irrespective of the type of customers in the context of paragraph 14 of Ind AS 32, reproduced above. Accordingly, the same should be classified as 'financial liability' by the company in the extant case.

D Opinion:

20. On the basis of the above, the Committee is of the opinion on the issue raised in paragraph 14 above that classification made by the OMCs for deposits received by them from their LPG consumers towards supply of cylinders and regulators as non–current financial liability is not appropriate and the same should be classified as current financial liability as discussed in paragraphs 17, 18 and 19 above, primarily since the OMC does not have the unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Query No. 26

Subject: Issues related to first time adoption (Ind AS 101 and Ind AS 20).[1]

A. Facts of the Case

1. A company (hereinafter referred to as the 'company') incorporated in 1994 is a 50:50 joint venture of the Government of India (GOI) and the Government of Karnataka (GoK) for implementation of Metro Rail Project in Bengaluru city. The GoK is responsible for providing land for implementation of Metro Rail Project in Bengaluru. As per the sanctioned funding pattern for the project, the entire cost of land is to be borne by GoK by way of subordinate debt.

2. As a part of land acquisition process, GoK, at the meeting held on 29.8.2005 under the Chairmanship of the Chief Secretary, GoK, had agreed to transfer some identified parcels of government land to the company. Accordingly, GoK issued an order on 17.4.2006 for transferring 13 parcels of land in favour of the company, free of cost. The company recognised this as government grant and shown the land under 'Fixed Assets' at a nominal value of Re.1 per land parcel and correspondingly the same value (Rs.13 for 13 land parcels) was shown under 'Reserves and Surplus'. This value has been carried in the balance sheet on year to year basis till 31st March 2015.

3. The querist has stated that the company has adopted Indian Accounting Standards (Ind ASs) on 1st April, 2016 and the date of transition is 1st April, 2015. In compliance of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', the company carried out fair valuation of the said land parcels to account for government grant. The guidance value of the land indicated in the said Government order dated 29.8.2005 as Rs. 63.29 crore has been considered as the fair value of the land for complying with mandatory provision of Ind AS 20. In doing so, the company relied upon paragraph D6 of Ind AS 101, 'First-time Adoption of Indian Accounting Standards' which reads as under:

> "D6 A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to Ind ASs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:
>
> (a) fair value; or

[1] Opinion finalised by the Committee on 8.1.2019.

(b) cost or depreciated cost in accordance with Ind ASs, adjusted to reflect, for example, changes in a general or specific price index.”

4. The accounts of the company, being a public sector undertaking (PSU), are subject to supplementary audit by the Comptroller and Auditor General of India (C&AG). The Government auditors (C&AG) have made the following observations while conducting supplementary audit of financial statements for the financial year 2016-17, which are as follows:

“*Audit Enquiry No.1*

Balance Sheet
Non-current Assets
Property, Plant and Equipment
Note No. 2.3 – Rs. 11,25,594.16 lakh.

The above includes Rs. 63.29 crore towards fair valuation of non-monetary grant in respect of 8.933 acres of land given free of cost by the Government of Karnataka to the company and its value was accounted earlier at Rs. 13 only. Due to implementation of Indian Accounting Standards (Ind AS Rules 2015) under Companies Act 2013, the fair value of land was done based on the market value as per guidance date 2/8/2005 given by Department of Stamps & Registration, Government of Karnataka instead of transition date, that is, 1st April 2015.

The fair value measurement should be done as per paragraph B2 of Ind AS 113 keeping in view the provisions of paragraph D5 of Ind AS 101 (which specifies that “An entity may elect to measure an item of property, plant and equipment at the date of transition to Ind ASs at its fair value and use that fair value as its deemed cost at that date”).

However, while making fair valuation of land, the company has not complied with the above provisions.”

5. The management has furnished the following reply to the above observation of C&AG:

“Further to our reply vide letter no. MAB/Finance/2016-17/8772 dated 12th September 2017, we submit the following:-

The company availed exemptions available under paragraph D7AA of Ind AS 101 i.e., “first-time adoption of Indian Accounting Standards which provides the option to continue with the carrying value for all of its Property, Plant and Equipment as on the date of transition”. The said option is available for the assets dealt with under Ind AS 16 as well as Ind AS 38 and Ind AS 40. Accordingly all the fixed assets have been considered at their carrying values used under IGAAP at the date of transition.

Paragraph 10(d) of Ind AS 101 states that "*Except as described in paragraphs 13 - 19 and Appendices B-D, an entity shall, in its opening Ind AS Balance Sheet: (d) apply Ind ASs in measuring all recognised assets and liabilities".* In reference to the above, Government grant received in the form of land which was presented under the head 'Reserves and Surplus' under existing Indian GAAP as on the date of transition is also required to be measured by the mandatory Ind AS 20 i.e., 'Accounting for Government Grants and Disclosure of Government Assistance'.

Audit may kindly appreciate that in Ind AS 20, there is no concept of 'Date of Transition'. Paragraph 23 of Ind AS 20 states that "*A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, the fair value of the non-monetary asset is assessed and both grant and asset are accounted for at <u>that</u> fair value. (Emphasis laid on "that").*

Further paragraphs 24 and 26 of the Ind AS 20 state that *"Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income." and that "The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset.*"

The plain reading of the above mentioned paragraphs gives an impression that the grant is required to be fair valued at the time of initial recognition only and subsequent measurement of the same is to be done by amortising the amount initially recognised on a systematic basis over the useful life of the asset. Thus, as per the company's understanding, the date for fair valuation should be the date of transaction, i.e., August 2005 as the standard nowhere mandates fair valuation of Government Grant on each balance sheet date, as required in case of Property Plant and Equipment (PPE) under Ind AS 16.

The same is in line with the requirement mentioned under the same Ind AS in regard to recognition of benefit in case of Government loan at nil or below market rate of interest, which is treated as Government grant. The benefit is measured as difference between initial fair value of loan and proceeds received.

As brought out by Audit, D5 of Ind AS 101 gives an option. Audit may refer optional exemptions from the requirements of certain Ind ASs wherein it is categorically stated that an entity may adopt as 'Deemed Cost', the fair value on or before the transition date.

> Further, according to Ind AS 16 a full retrospective restatement is one of the basis for measuring PPE on first time adoption. However to deal with practical issues in the retrospective restatement, Ind AS 101 permits first time adopter to measure items of PPE at deemed cost on the date of transition to Ind AS. Hence the company availed this exemption under Ind AS 16 and carried book value of PPE as on 31.3.2015 as 'Deemed Cost'. The company did not adopt fair value for PPE. If a first time adopter uses deemed cost exemption, subsequently depreciation / amortization of the assets is based on the deemed cost and starts from the date for which the entity established the deemed cost. In the instant case, the company received the land as grant on 02.08.2005 which was recognised at nominal value of Rs.13/- for 13 parcels of land which date is considered as an 'Event Driven'. A first time adopter may have established a deemed cost in accordance with previous GAAP for some or all of its assets and liabilities by measuring them at the fair value at one particular date. The company accordingly has considered the guidance value as on the date of the grant as 'Fair Value'."

Further, based on the assurance by the company, CAG auditors vide their letter dated 7/12/2017 communicated as under:

> "During the year, the company has elected for the option under paragraph D7AA of Ind AS 101, 'First-time Adoption of Indian Accounting Standards' which permits the adopter to continue with the carrying value for all its property, plant and equipment. The company has carried on the fair valuation of land against grant-in-aid received from Government of Karnataka as per the provisions under Ind AS 20 for Government Grants. However, as per clarification to the issue No.3 of Ind AS Transition Facilitation Group (ITFG), Bulletin-5, the option for applying fair valuation on selective basis to some of the items of property, plant and equipment is not available. Further, the fair valuation was done based on the market value as on the date of acquisition and not on the date of transition as required under the provisions of Ind AS 113 'Fair Value Measurement'."

Management of the company assured to refer the issue to the Expert Advisory Committee of the Institute of Chartered Accountants of India for an expert opinion.

6. According to the querist, from the above, it may be seen that there is a conflict between the requirements of Ind AS 20 and previous GAAP carrying value as deemed cost under first time exemption as per Ind AS 101. As a result of this conflict, the following views seem possible:

(a) PPE exemption as per Ind AS 101 overrides Ind AS 20 requirements.

(b) Ind AS 20 requirements are mandatory and hence override Ind AS 101 for PPE exemption

(c) Both PPE exemption and Ind AS 20 requirements can co-exist. Due to the use of PPE exemption, the company continues Indian GAAP carrying amount of PPE as deemed cost on the date of transition to Ind AS. To comply with the Ind AS 20 requirements, the company adopted fair value received as government grant. The resulting adjustment is made to the retained earnings based on generic principles of Ind AS 101."

7. Since there are divergent views mainly as to the date for determination of fair value, the management has given the following assurance to C&AG:

"The matter will be referred to Expert Advisory Committee of the Institute of Chartered Accountants of India for their expert opinion. Based on the opinion of the Expert Advisory Committee, necessary changes will be made in the books of account in the year of receipt.

8. The querist has also separately informed that 13 land parcels were received as grants in aid, in addition to subordinate debt. Further, in the financial statements for the year 2009-10, value of these land parcels Rs. 63.29 crore was shown under land and correspondingly as grant-in-aid under 'Reserves & Surplus' in compliance with Accounting Standard (AS) 12, 'Accounting for Government Grants'. However, in the subsequent year, based on C&AG comments, this was shown at Re. 1 per land parcel, amounting to Rs. 13/-.

B. Query

9. In the light of the above, the opinion of the Expert Advisory Committee is sought on the following issues:

(i) Whether Ind AS 16 does not have overriding effect on the mandatory provision of Ind AS 20.

(ii) Whether the date of valuation of grant as per Ind AS 20 shall be date of acquisition of the land in August 2005 (or) date of transition (1.4.2015) to Ind AS.

C. Points considered by the Committee

10. At the outset, the Committee wishes to point out that the opinion expressed hereinafter is in the context of the specific issues referred by the querist in the Facts of the Case with regard to the measurement of land received from the Government of Karnataka free of cost as grant in aid and other consequential adjustments on transition to Ind ASs and not in the context of

generic issues raised in paragraph 9 above as to the overriding effect of one Ind AS (viz. Ind AS 20) over another Ind AS (Ind AS 16). Further, since the query relates to financial year 2016-17, the Committee has expressed its views, in the context of Indian Accounting Standards (Ind ASs), notified under Companies (Indian Accounting Standards) Rules, 2015 without taking into consideration the amendment in Ind AS 20 vide Companies (Indian Accounting Standards) Amendment Rules, 2018, which is applicable for the annual periods beginning on or after April 1, 2018.

11. The Committee notes the requirements of paragraphs 10 and 12 of Ind AS 101, 'First-time Adoption of Indian Accounting Standards' as follows:

> "10 Except as described in paragraphs 13–19 and Appendices B–D, an entity shall, in its opening Ind AS Balance Sheet:
>
> (a) recognise all assets and liabilities whose recognition is required by Ind ASs;
>
> (b) not recognise items as assets or liabilities if Ind ASs do not permit such recognition;
>
> (c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind ASs; and
>
> (d) apply Ind ASs in measuring all recognised assets and liabilities."
>
> "12 This Ind AS establishes two categories of exceptions to the principle that an entity's opening Ind AS Balance Sheet shall comply with each Ind AS:
>
> (a) paragraphs 14–17 and Appendix B prohibit retrospective application of some aspects of other Ind ASs.
>
> (b) Appendices C–D grant exemptions from some requirements of other Ind ASs."

12. From the above, the Committee is of the view that in the absence of any other mandatory exception or voluntary exemption applicable in the extant case, the company should apply the requirements of Ind AS 20, 'Accounting for

Government Grants and Disclosure of Government Assistance'. In this context, the Committee notes the following paragraphs of Ind AS 20:

"18 Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building."

"23. A government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, the fair value of the non-monetary asset is assessed and both grant and asset are accounted for at that fair value."

"24 Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income."

"26 The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset."

As per the above paragraphs, the grant should be accounted for as 'deferred income' at the fair value of the non-monetary asset (land) at the acquisition date and amortised in the statement of profit and loss on a systematic basis, as per the requirements of Ind AS 20.

13. However, with regard to recognition of land, the Committee notes that the land being an item of property, plant and equipment is also governed by the requirements of Ind AS 16, 'Property, Plant and Equipment' in respect of which exemptions related to deemed cost have been provided in Appendix D to Ind AS 101. In this context, the Committee notes paragraphs D5, D6 and D7AA of Appendix D to Ind AS 101 as follows:

"D5 An entity may elect to measure an item of property, plant and equipment at the date of transition to Ind ASs at its fair value and use that fair value as its deemed cost at that date.

D6 A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to Ind ASs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) fair value; or

(b) cost or depreciated cost in accordance with Ind ASs, adjusted to reflect, for example, changes in a general or specific price index.”

“D7AA Where there is no change in its functional currency on the date of transition to Ind ASs, a first-time adopter to Ind ASs may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments in accordance with paragraph D21 and D21A, of this Ind AS. For this purpose, if the financial statements are consolidated financial statements, the previous GAAP amount of the subsidiary shall be that amount used in preparing and presenting consolidated financial statements. Where a subsidiary was not consolidated under previous GAAP, the amount required to be reported by the subsidiary as per previous GAAP in its individual financial statements shall be the previous GAAP amount. If an entity avails the option under this paragraph, no further adjustments to the deemed cost of the property, plant and equipment so determined in the opening balance sheet shall be made for transition adjustments that might arise from the application of other Ind ASs. This option can also be availed for intangible assets covered by Ind AS 38, Intangible Assets and investment property covered by Ind AS 40, *Investment Property*.”

The Committee notes from the Facts of the Case and the annual report of the company for the financial year 2016-17 that the company has elected to continue with the carrying amount for all of its property, plant and equipments and intangible assets measured as per previous GAAP and used that as its deemed cost as at the date of transition. In this context, the Committee wishes to point out that once the company elects to avail exemption under D7AA, viz., take carrying value as per previous GAAP as deemed cost at the date of transition, the other exemptions available under D5 to D7 cannot be exercised by the company. Accordingly, the contentions of the company as well as CAG in respect of D5 and D6 have not been examined by the Committee.

Further, in accordance with the requirements of paragraph D7AA of Ind AS 101, when the option of deemed cost exemption is availed for property, plant and equipment, no further adjustments to the deemed cost of the property, plant and equipment shall be made for transition adjustments that might arise from the application of other Ind ASs. However, paragraph 10 of Ind AS 101, inter alia, provides that Ind ASs will be applied in measuring all recognised assets and liabilities except for mandatory exceptions and voluntary exemptions from other Ind AS as prescribed under Ind AS 101. Accordingly, in the absence of any other mandatory exception or voluntary exemption applicable in this case, the company shall recognise the land related government grant outstanding on the transition date (viz. unamortised portion of government grant) as deferred income in accordance with the requirements of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance'. The Committee notes that in the current case, the company has initially disclosed both the land and the grant received at nominal value of Rs. 13 (Re. 1 for each of the 13 parcels of land received). As a consequence, to recognise the amount of unamortised deferred income as at the date of the transition in accordance with paragraph 10 of Ind AS 101, the corresponding adjustment should be made to the carrying amount of property, plant and equipment (i.e. land in the extant case). The Committee is of the view that this treatment would reflect the correct economic reality and result in faithful representation of the effects of these transactions on transition in accordance with the requirements of Ind ASs. Since the adjustment to the property, plant and equipment (land) is only consequential and arising because of applying the transition requirements of Ind AS 101, it would not be construed as adjustment to the deemed cost of property, plant and equipment (land) as envisaged under paragraph D7AA of Ind AS.

14. Incidentally, the Committee also wishes to point out that as the option of applying the exemption under paragraph D7AA of Ind AS 101 on selective basis to some of the items of property, plant and equipment and using fair value for others is not available, the company should apply this exemption to all the items of property, plant and equipment.

D. Opinion

15. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 9 above:

(i) Since this is a generic issue, it has not been examined by the Committee, as stated in paragraph 10 above.

(ii) The government grant should be accounted for as 'deferred income' at the fair value of the land at the acquisition date and amortised in the statement of profit and loss on a systematic basis, as per the requirements of Ind AS 20, as discussed in paragraph 12 above. Accordingly, on transition to Ind ASs, government grant outstanding on transition date (viz. unamortised portion of government grant) shall be accounted for as deferred income in accordance with the requirements of Ind AS 20, as discussed in paragraph 13 above, and to recognise such unamortised deferred income as at the date of the transition, the corresponding adjustment should be made to the carrying amount of land, as discussed in paragraph 13 above.

Query No. 27

Subject: Accounting implication of the following in relation to subsidy accounting:

(a) Recognition of Expected Credit Loss (ECL) in respect of subsidy receivables

(b) Need for discounting of subsidy receivables.[1]

A. Facts of the Case

1. The querist has stated that one of the key objectives of introduction of fertilizer subsidy in India was sustained agricultural growth and to promote balanced nutrient application. It is imperative that fertilizers are made available to farmers at affordable prices. With this objective, urea being the only controlled fertilizer, is sold at statutory notified uniform sale price, and decontrolled Phosphatic and Potassic fertilizes (P&K) are sold at indicative maximum retail prices (MRPs). The problems faced by the manufacturers in earning a reasonable return on their investment with reference to controlled prices, are mitigated by providing support under the New Pricing Scheme for urea units and the Concession Scheme for decontrolled P&K (or relevant subsidy policies from time to time). The statutorily notified sale price and indicative MRP are generally less than the cost of production of the respective manufacturing unit. The difference between the cost of production and the selling price/MRP is paid as subsidy to manufacturers as a part of total price of the product to the manufacturers. As the consumer prices of both indigenous and imported fertilizers are fixed uniformly, financial support is also given on imported urea and decontrolled P&K. In addition to this, freight on account of goods movement is reimbursed on the basis of actual rail freight/ notified rates in case of movement by road.

[1] Opinion finalised by the Committee on 8.1.2019.

2. The querist has further stated that with the objective to monitor the import, production and movement of various subsidised fertilizers and processing subsidy claims, different software systems were introduced by the Department of Fertilizers (DOF), viz., Fertilizer Management System (FMS), Mobile Fertilizer Management System (mFMS) and Integrated Fertilizer Management System (iFMS). These software systems help the manufactures/importers to file the subsidy claims from the Department of Fertilizers (DOF)/Government of India (GOI). The key thing to note here is that these claims cannot be filed in FMS etc. unless the GoI has opened the option to file the claims in the portal and generally there is a time lag between the sale of urea to distributors / farmers by the manufacturers and the time when GoI opens the portal for filing of claims of subsidy by the manufacturers.

3. The querist has given the *process/key dates for subsidy accounting, claim submission and collections in the table below:*

Revenue Accrual	Claim submission in FMS/Contractual obligation	Collections
(A)	(B)	(C)
Revenue is recorded in the books when the goods are sold to the customer (dealers) with a corresponding receivable from the GoI for the subsidy and cash (MRP amount) that is received from the dealer.	Subsidy claim is generated in FMS when the GoI gives the option in FMS for the company* to file the subsidy claim, generally after the relevant notification/policy is released (except for certain on-account payment as explained in the note below). Since there is no due date as per the contractual obligation with the GoI, the subsidy becomes due immediately on submission of subsidy claim on the portal.	Once the GoI pay for the subsidy claim, the collections are recorded in the books.

** Industry/Manufacturer/Fertilizer company (referred to as 'company' for ease of reference)*

Note to (B): The companies upload the bill on the GoI portal (for claim submission) based on last updated rates in the portal awaiting the notification from the Government for the amount of actual subsidy for the goods sold for a particular period. Generally, a provisional payment is received from the Government before the actual subsidy rates are notified for that particular period. Once the final rate of subsidy is notified, the upward/downward adjustment is made in the bill raised earlier and accordingly dues are settled with the Government.

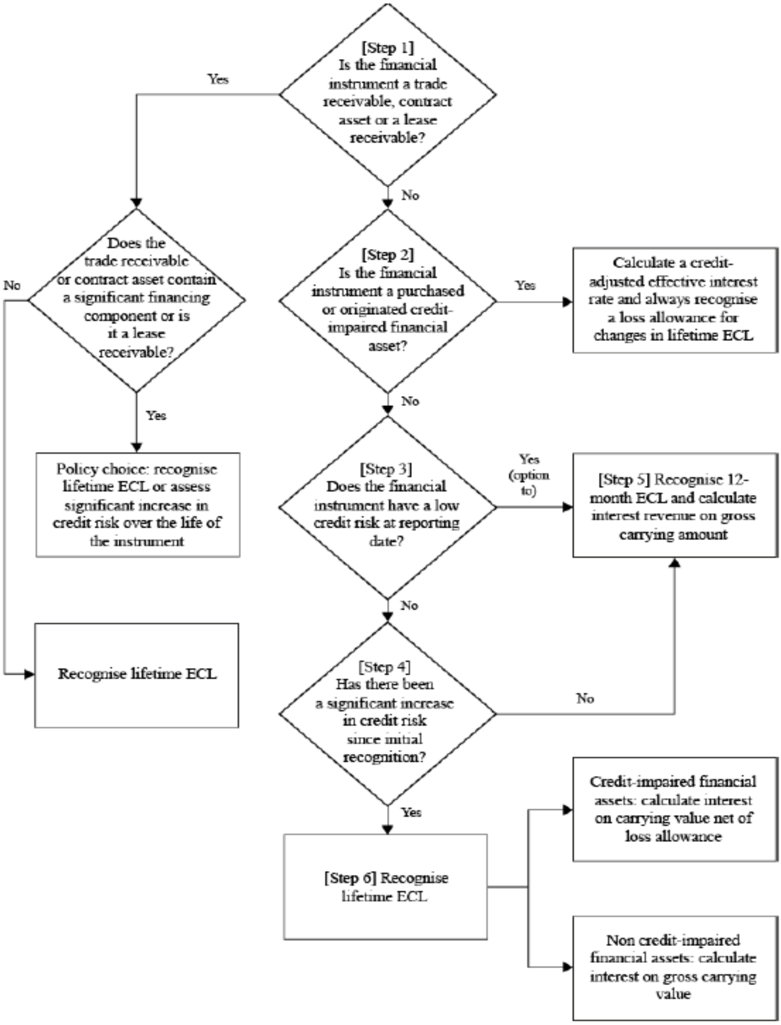
According to the querist, the GoI does not notify any credit period for payment of subsidy from the date of uploading the bill on the portal and it can be reasonably presumed that the company is contractually eligible to receive the subsidy from the Government immediately after uploading the bill claim on the portal.

4. *Direct Benefit Transfer (DBT)*

The querist has also mentioned that in the recent years, the GoI has introduced Direct Benefit Transfer (DBT) mechanism. In the Union Budget for 2016-17, it was stated that based on successful experience of DBT (Direct Benefit Transfer) in Liquefied Petroleum Gas (LPG), DBT would be introduced on pilot basis for fertilizers in few districts in the country to provide quality delivery services to the farmers. Seventeen districts were selected for the pilot project on direct transfer of fertilizer subsidy. To accomplish this objective, integrated fertilizer management system (iFMS) was developed. Fertilizer industry has been vociferously advocating for DBT of fertilizer subsidy to the bank accounts of the farmers, but the Government has said that true DBT implementation is not possible in fertilizer sector as was done in LPG, where beneficiaries are identified. Finally they implemented DBT in the form that subsidy will be given post sale of fertilizer through point of sale (POS) but to the companies and not to the farmers.

5. The pilot project was initiated from Krishna and West Godawari districts in Andhra Pradesh in October 2016. GoI started rolling out the scheme in various states in stages w.e.f. 1st September, 2017. It was rolled out in all the states by 1st March, 2018. The fertilizer industry purchased and installed the POS machines at all retail outlets across the country and provided training to the retailers about the operation of POS machines. As per the policy, the disbursement of subsidy is linked to sale of fertilizers to farmers through POS machines on weekly basis. As per the querist, there have been numerous methods of the GoI to pay subsidy to the companies at different point in time. However, over the years, GoI has implemented many ways to control the timing and mechanism of releasing payment for subsidy due to manufacturers. It is imperative to note that all of the changes are only changes in the billing / collection mechanism and no changes have been directed or implemented or proposed to be implemented which have or will cause the obligations of the parties involved in the chain to change. In essence, GoI has employed different mechanism / controls for payment of subsidy to ensure that the subsidised fertilizer reaches to the right person (i.e. farmer) and also in time.

6. The querist has analysed Indian Accounting Standard (Ind AS) 109, 'Financial Instruments' and created the following decision tree w.r.t. determining which method of recognising Expected Credit Loss (ECL) should be followed in case of subsidy receivables:



Step 1 - Is the financial instrument a trade receivable, contract asset or a lease receivable?

Response – Yes

Step 2 - Does the trade receivable or contract asset contain a significant financing component or is it a lease receivable?

Response – No

The querist has stated that as per Ind AS 18, 'Revenue' revenue shall be measured at the fair value of the consideration received or receivable. In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is determined by reference to the prevailing rate for a similar instrument of an issuer with a similar credit rating; or a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services. The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue using effective interest method as set out in Ind AS 109.

In case of fertilizer industry, once the revenue is accrued, the company expects that it will be able to realise the subsidy immediately as all the accruals are made as per the relevant applicable policy notification and notification of the rate is a procedural matter outside the control of the company. Again, it is important to emphasise that neither there is any financing component envisaged in the GoI policy/notification nor the recipient considers any financing component in the subsidy. Release of final notification / ability to raise bills in the portal are only procedural matters in the process of claiming subsidy. While historically, the time gap between revenue accrual and date of registering of claim in respect of upward/downward adjustment has been more than 365 days, it is imperative to note here that the event of opening of portal by the GoI for registering subsidy claims is entirely outside the control of the company and going forward, the time gap may be narrower than 365 days depending on availability of funds with the GoI. Thereby, at the time of recording revenue it is difficult to conclude whether the contractual due date of collection (date of claim) will be more than or less than 365 days away. Management believes that at the time of recording revenue, there is no significant financing component in the subsidy receivable from the Government and, hence, no discounting of revenue or related receivable is required.

Step 3 - Recognize lifetime ECL

Response: No

7. The querist has stated that as per paragraph 5.5.15 of Ind AS 109, the company shall always measure the loss allowance at an amount equal to lifetime expected credit losses for trade receivables that result from transactions that are within the scope of Ind AS 115, 'Revenue from Contracts with Customers'. Lifetime expected credit losses are defined in Ind AS 109 as the expected credit losses (the weighted average of credit losses with the respective risks of a default occurring as the weights) that result from all possible default events over the expected life of a financial instrument.

In accordance with Ind AS 109, credit loss is the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (ie all cash shortfalls), discounted at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). An entity shall estimate cash flows by considering all contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) through the expected life of that financial instrument. The cash flows that are considered shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. There is a presumption that the expected life of a financial instrument can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the expected life of a financial instrument, the entity shall use the remaining contractual term of the financial instrument.

Further, the querist has stated that paragraph 5.5.17 of Ind AS 109 states as follows:

> **"5.5.17 An entity shall measure expected credit losses of a financial instrument in a way that reflects:**
>
> **(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;**
>
> **(b) the time value of money; and**
>
> **(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions."**

Essentially, ECL is a probability-weighted estimate of credit losses. A credit loss is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive discounted at the original effective interest rate. ECL considers the amount and timing of payments, thus a credit loss arises even if the entity expects to be paid in full but later than when contractually due.

8. As per the querist, in manufacturer's case, there is an insignificant risk of default on the subsidy receivables, since these are recoverable from the GoI and historically, there has been insignificant defaults in the payment of subsidy by the GoI. Additionally, since the various subsidies are of similar nature from the same party (GoI) and are paid by the GoI from time to time, it is imperative to note that these subsidy receivables relate to essential commodity and are governed/administered through notified policies of the GoI and hence, are in the nature of sovereign debt.

9. However, if there is a significant gap between date of accrual and date on which the consideration is received, the time value of money shall be taken into account in order to measure the expected credit losses of a long term subsidy receivable. Considering paragraph 5.5.17 of Ind AS 109, delayed payments from the GoI indicate that a provision for expected losses shall be recognised considering that the company might be losing interest on such receipts caused due to such delayed payments. The provision for such expected loss of interest (time value of money) shall be measured by discounting the subsidy receivables outstanding from the contractual due date to the date they are expected to be recovered. According to the querist, over the past few years, there have been procedural delays due to various reasons beyond the control of the company and are dependent on Government policies which are usually influenced by:

a. financial conditions of the economy

b. Political will of the Government

Also, it is imperative to note that there is no specific trend in these delays as it majorly depends on the Government notifications, for example, the GoI has recently introduced the direct benefit transfer (DBT) for subsidies and company can claim from 2018-19, which would mean that the companies would not be able to predict the timing of the DBT.

10. The fact is that the reasons known for these delays are also of different nature. The querist has given the following analysis of significant nature of subsidy dues where there are significant delays (the list below if only indicative):

S.No.	**Nature of Subsidy**	**Nature of Delay**
1	Additional fixed cost	Subsidy is due however it is yet to be notified for years after 2014-15 by the GoI. For the year when it was notified, the GoI has not opened portal for filing of the claim.
2	Differential freight claim	Notification for this came in 2012, however portal for filing the revised claims have been opened in the recent years.
3	Escalation/De-escalation	Subsidy is due however it is yet to be notified by the GoI.
4	DBT	Subsidy is due however bills are yet to be generated from the m FMS system.
5	Freight Bill	Subsidy is due and subsidy bills are filed with the GoI, however, the GoI is yet to release the subsidy.
6.	Balance Claim (5%)	Subsidy is due to the GoI, however it is yet to be notified by the GoI.

Considering the above facts, subsidy receivable is of the same nature and from the same party, it is important to analyse the lead time taken for collection (allocation on FIFO basis since the nature of due and the party from whom it is receivable is the same) to evaluate the *'delay'* for the purpose of ECL.

(Emphasis supplied by the querist)

Analogy with Ind AS 115 as given by the querist

Further, Ind AS 115 (paragraph 63) provides a practical expedient that an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

Considering above and applying the analogy given in paragraph 63 of Ind AS 115, it is not required to account for the provision for ECL on the subsidy receivables as the lead time is less than 12 months / 365 days.

B. Query

11. In view of the above facts, the querist has sought the opinion of the Expert Advisory Committee of the ICAI on the following issues:

(i) Considering that there is no financing component in the amount of revenue booked and the manufacturer/company expects to realise the amounts with the accrual, whether it is correct to take a view that no discounting of revenue is required.

(ii) In case the historical trend for receiving the payments is less than 365 days (including the current and expected trends under the DBT regime) and applying the analogy from the practical expedient in Ind AS 115, whether there is no need to create a provision for ECL against subsidy receivable.

C. Points considered by the Committee

12. The Committee notes that the basic issue raised in the query relates to accounting for delays in the subsidy receivable from the Government. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, presentation and disclosure of subsidy receivable, timing of recognition of subsidy receivable, accounting for revenue generated from sale of fertilizers to the consumers/farmers, etc. Further, in the absence of any contrary information, the Committee presumes that the company has complied with all the applicable conditions in order to become eligible to receive the subsidy.

13. At the outset, the Committee notes that since the activities of the fertilizer company are subject to rate regulation, (viz., the price for the fertilizer to be charged from the consumers is regulated by the concerned Regulator (DoF)), the company in the extant case conducts rate-regulated activities. In this context, the Committee notes that Ind AS 114, 'Regulatory Deferral Accounts' specifies financial reporting requirements for regulatory deferral account balances that arise when an entity provides goods and services to customers at a price or rate that is subject to rate regulation. However, the Committee notes that as per the requirements of paragraph 5 of Ind AS 114, an entity is permitted to apply the requirements of Ind AS 114 in its first Ind AS financial statements if and only if it recognized amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its previous GAAP. In the absence of any information in this regard in the Facts of the Case, the Committee presumes that the company in the extant case has not recognised any regulatory deferral account balances and accordingly the requirements of Ind AS 114 shall not be applicable in the extant case.

14. The Committee notes from the Facts of the Case that to make fertilizers available to the farmers at affordable prices, it is sold at statutorily notified sale price and indicative MRP which is generally less than the cost of production. Thus, the difference between the cost of production and the selling price is paid by the Government as subsidy to manufacturers along with other financial supports and reimbursement of freight to provide support to the manufacturers. In this context, the Committee notes the following paragraphs of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance':

> "***Government grants* are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity…**"
>
> "6 Government grants are sometimes called by other names such as subsidies, subventions, or premiums."
>
> **"20 A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable."**
>
> "22 A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood."

From the above, the Committee notes that government grants are assistance by government in the form of transfer of resources in return for compliance with certain conditions. The Committee notes that in the extant case, the Government is providing subsidy to the fertilizer manufacturers in the form of compensation for the difference between the cost of production and the selling price and include compensation for expenses or losses already incurred. Accordingly, the subsidy receivable by the company in the extant case is 'Government grant' as per the requirements of Ind AS 20. In this regard, the Committee notes that the querist has made reference to Ind AS 115, 'Revenue from Contract with Customers' for subsidy receivable. However, the Committee is of the view that since the subsidy in the extant case is grant receivable from the Government and not arising from the customers or any contract with customers, the requirements of Ind AS 115 are not relevant for accounting for the subsidy receivable.

15. A question now arises is whether subsidy (government grant) receivable is a financial asset within the scope of Ind AS 32, 'Financial Instruments: Presentation' and Ind AS 109. In this regard, the Committee notes the following paragraphs of Ind AS 32:

> **"A *financial instrument* is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.**
>
> **A *financial asset* is any asset that is:**
>
> **(a) cash;**
>
> **(b) an equity instrument of another entity;**
>
> **(c) a contractual right:**
>
> > **(i) to receive cash or another financial asset from another entity; or**
> >
> > **(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or**
>
> **…"**
>
> "13 In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing."

The Committee notes from the Facts of the Case that the Government provides support to manufacturers in fertilizer industries through various relevant subsidy policies introduced from time to time. The Committee is of the view that although under such schemes/policies, there may not be a one to one agreement between the entity and the Government as to the rights and obligations but there is an understanding between the Government and the manufacturer/company that on complying with the stipulated conditions, if any, attached to the scheme/policy, the entity will be granted benefits of the scheme/policy. Accordingly, in the extant case, when the company complies with the required conditions (for example, selling the fertilizer at lower than the cost of manufacturing) then it rightfully becomes entitled to such incentive/subsidy as per the policy and the subsidy receivable will fall under the definition of 'financial instruments' and should be accounted for as a 'financial asset' as per the requirements of Ind AS 109, 'Financial Instruments'.

16. With regard to initial recognition of the subsidy receivable, the Committee is of the view that the same should be recognized at fair value of the subsidy receivable in accordance with the requirements of Ind AS 20. The Committee also notes that the determination of fair value, as per the requirements of Ind AS 113, 'Fair Value Measurement', also takes into account time value of money and expectations of timing of cash flows. Accordingly, the Committee is of the view that in the extant case, on initial recognition of subsidy receivable, the company should consider the expected timing of the cash flows while recognizing it at fair value.

17. Further, on subsequent measurement of subsidy receivable, with regard to the provision for Expected Credit Loss (ECL) to be created for subsidy receivable, the Committee further notes the following paragraphs of Ind AS 109:

> **"5.5.1 An entity shall recognise a loss allowance for *expected credit losses* on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a *contract asset* or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d)."**
>
> **"5.5.3 Subject to paragraphs 5.5.13–5.5.16, at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the *lifetime expected credit losses* if the credit risk on that financial instrument has increased significantly since initial recognition."**
>
> **"5.5.5 Subject to paragraphs 5.5.13–5.5.16, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to *12-month expected credit losses*."**
>
> "5.5.8 An entity shall recognise in profit or loss, as an *impairment gain* or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with this Standard."
>
> "5.5.10 An entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date (see paragraphs B5.5.22–B5.5.24)."

"5.5.17 An entity shall measure expected credit losses of a financial instrument in a way that reflects:

(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

(b) the time value of money; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions."

"B5.5.22 The credit risk on a financial instrument is considered low for the purposes of paragraph 5.5.10, if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk. Financial instruments are also not considered to have low credit risk simply because they have a lower risk of default than the entity's other financial instruments or relative to the credit risk of the jurisdiction within which an entity operates."

"B5.5.28 Expected credit losses are a probability-weighted estimate of credit losses (ie the present value of all cash shortfalls) over the expected life of the financial instrument. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. Because expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due.

B5.5.29 For financial assets, a credit loss is the present value of the difference between:

(a) the contractual cash flows that are due to an entity under the contract; and

(b) the cash flows that the entity expects to receive."

"B5.5.44 Expected credit losses shall be discounted to the reporting date, not to the expected default or some other date, using the effective interest rate determined at initial recognition or an approximation thereof. If a financial instrument has a variable interest rate, expected credit losses shall be discounted using the current effective interest rate determined in accordance with paragraph B5.4.5."

From the above, the Committee notes that as per the requirements of Ind AS 109, since expected credit losses consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due. Therefore, the Committee is of the view that the company in the extant case should provide for expected credit losses as per the requirements of Ind AS 109 even though as per the querist, there is an insignificant risk of default on the subsidy receivable. The Committee further notes that as per the requirements of Ind AS 109, the company in the extant case should determine whether there has been significant increase in the credit risk since initial recognition. If the credit risk has not increased significantly, 12 months ECL is to be provided for as impairment else life time ECL is to be provided. In this regard, the Committee is of the view that the past experience with the Government of honouring its commitments and the strong capacity and ability of the Government to meet its contractual cash flow obligations (as also evidenced from the past trend) should also be taken into consideration while providing for ECL.

D. Opinion

18. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

(i) and (ii) As stated in paragraphs 14 and 15 above, the subsidy receivable in the extant case is a government grant as per the requirements of Ind AS 20, which is also a financial asset and accordingly, requirements of Ind AS 115 are not relevant in the extant case. On initial recognition of subsidy receivable, the company should recognize the same at fair value of the subsidy receivable as per the requirements of Ind AS 20 and should also consider expected timing of cash flows, as discussed in paragraph 16 above. Further, as per the requirements of Ind AS 109, on subsequent measurement, the fertilizer company should provide for the expected credit loss allowance (irrespective of the fact that historical trend for receiving the payments is less than 365 days) as per the requirements of Ind AS 109 and while providing for such ECL, the past experience with the Government of honouring its commitments and the strong capacity and ability of the Government to meet its contractual cash flow obligations (as also evidenced from the past trend) should also be taken into consideration, as discussed in paragraph 17 above.

Query No. 28

Subject: Accounting for provision to be created for onerous contract.[1]

A. Facts of the Case

1. The querist has sought the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on accounting treatment of expenditure relating to onerous contract. Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets' defines an onerous contract as, "a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it". Further, as per Ind AS 37, "the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it." According to the querist, the unavoidable costs of meeting the obligations under the contract are only costs that:

- are directly variable with the contract and therefore incremental to the performance of the contract;
- do not include allocated or shared costs that will be incurred regardless of whether the entity fulfils the contract or not; and
- cannot be avoided by the entity's future actions.

2. An order for supply of 57 Nos. of 60 T dumpers was received from the customer, against which, the quantity was increased to 90 Nos., subsequently. The unit price of the equipment is Rs. 190.00 lakh. 64 Nos. equipments were supplied during the year 2017-18 and balance quantity remaining to be supplied is 26 Nos. as on 31.03.2018, which as per the querist, is an onerous contract. 5

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[1] Opinion finalised by the Committee on 8.1.2019.

Nos. of the equipment are in finished stock as on 31.03.2018, the value of which has been derated to the sale price value.

Observation raised by Resident Audit Party of Comptroller and Auditor General (CAG)

3. From the details of cost of production and cost of sales (approx.), it is seen that the cost of fulfilling the contract exceeds the economic benefits expected to be received from it. Hence, the contract is onerous and provision towards the same needs to be made as per Ind AS 37 (Provisions, Contingent Liabilities and Contingent Assets).

Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received. The unavoidable costs under a contract reflect the least net cost of exiting from the contract which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.

The company has made a provision only to the extent of cost of production incurred, but the provision has to be made with reference to cost of sales, as the cost of fulfilling the obligations under the contract will include all the costs that will be incurred upto the point of sale.

To complete the production and supply the equipments under the contract, the company has to incur further expenditure which may be fixed or variable cost. Irrespective of the nature of the cost, further costs are not avoidable and are to be provided for under onerous contract.

Management Reply:

4. The management reply to CAG is as follows:

Ind AS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligation under the contract exceeds the economic benefits expected to be received under the contract. The unavoidable costs under a contract reflect the least net cost of exiting from the contract by way of compensation or penalties.

As per the terms of the contract, if contractor failed to supply, the customer can purchase the equipment at the risk and cost of the defaulting supplier with forfeiture of security deposit as applicable. As the subject contract is ongoing contract, such exiting cost cannot be measured. As audit confirmed, the company has already made provision, considering selling price or cost of production whichever is lower for valuation of inventory.

Hence, cost upto cost of production has already been considered for valuation, which is directly variable with the contract and therefore incremental to the performance of the contract.

Unavoidable cost does not include allocated share of cost that will be incurred regardless of whether the entity fulfills the contract or not.

Moreover, other expenditure like administrative overheads, R&D, finance charges, head quarter expenditure, sales overheads etc., are of the nature of period cost and the purpose of these expenditure related to the said sales order is already completed in 2017-18 itself with receipt of sale order.

Hence, there is no non-compliance of Ind AS 37.

5. The querist has further submitted the following for consideration of the Expert Advisory Committee before issue of an expert opinion:

(i) The following are the details of costs that have been considered for creation of provision towards onerous contract:

a) Material cost – includes cost of material procured, cost of freight & insurance incurred for material procurement and handling, loading and unloading charges incurred.

b) Labour cost/ Factory Overheads – includes salaries and other expenses of direct production department; and also expenses allocated from indirect departments to direct department.

c) Material Overheads – Includes salaries and other expenses (including expenses allocated from other departments) booked under departments linked with materials like purchases, stores and quality control.

(ii) In the above referred query of CAG also, the provision has been made considering the above costs only. For example, the value of provision created for a quantity of 21 Nos. remaining to be produced is as per working shown below:

Particulars	Value (Rs.in lakhs)
Cost of production (which includes material cost, labour cost/factory overhead and material overhead)	199.00
Selling Price	190.00
Differential cost	9.00
No. of equipment remaining to be produced	21
Value of provision created	189.00

Costs incurred towards administrative overheads, finance charges, R & D expenses, sales overhead, head quarter expenditure etc., are considered as period cost and hence not considered for creation of provision.

B. Query

6. In view of the facts explained above, opinion of the Expert Advisory Committee has been sought on the following issues:

(i) Whether the company's accounting treatment of cost considered by the company for creation of provision towards onerous contracts is in line with the provisions of Ind AS 37.

(ii) If no, what are the additional costs that the company has to consider while calculating the value of provision to be created towards onerous contract?

C. Points considered by the Committee

7. The Committee notes that the basic issue raised in the query relates to elements of costs to be considered while recognition of provision in respect of onerous contract under Ind AS 37. 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, determination of whether the contract in the extant case is onerous or not, timing or amount of revenue recognition, recognition of impairment loss on assets dedicated to onerous contract, etc. Further, the Committee while expressing its opinion has laid down the principles to be followed while making the provision for the onerous contract and has not determined or calculated the actual amount to be provided for. Incidentally, the Committee notes from the Facts of the Case that the company has certain equipments lying in finished stock, which have been apparently measured (derated) to sale price value. In this context, the Committee wishes to point out that as per the requirements of Ind AS 2, 'Inventories', inventories should be measured at the lower of cost and net realisable value, which may not be necessarily equal to sale price value. Ind AS 2 defines 'net realisable value' as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

8. The Committee notes the following requirements of Indian Accounting Standard (Ind AS) 37, 'Provisions, Contingent Liabilities and Contingent Assets', notified under the Indian Accounting Standards Rules, 2015:

> **"An *onerous contract* is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it**."

"66 If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.

67 Many contracts (for example, some routine purchase orders) can be cancelled without paying compensation to the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognised. Executory contracts that are not onerous fall outside the scope of this Standard.

68 This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it.

69 Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract (see Ind AS 36)."

"36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period."

9. At the outset, the Committee notes that the querist has stated in the Facts of the Case that as per the terms of the contract, if contractor failed to supply, the customer can purchase the equipment at the risk and cost of the defaulting supplier with forfeiture of security deposit as applicable and that as the subject contract is ongoing contract, such exiting cost cannot be measured. In this context, the Committee wishes to point out that as per the requirements of

paragraph 68 of Ind AS 37, any compensation or penalties arising from failure to fulfill the onerous contract is to be compared with the cost of fulfilling such contract to determine the least net cost of exiting from the contract. Accordingly, although it may be difficult to determine the compensation/penalty payable for failure to fulfill the contract, the same should be determined/estimated on a reasonable basis considering the contract terms so as to determine whether the contract is onerous or not and in case the contract is onerous, to determine the amount of provision to be provided for such onerous contract. However, for the sake of convenience and to answer the specific issue raised in the extant case, it is assumed that the compensation/penalty payable for failure to fulfill the contract is more than the expected cost of fulfilling/meeting the obligations under the contract.

10. The Committee notes that Ind AS 37 provides that the amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation, which is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. The Committee is of the view that in case of onerous contracts, the amount that an entity would rationally pay to settle the obligation would be the lower of the compensation or penalties arising from failure to fulfill the contract and the excess of the unavoidable costs of meeting the obligations under the contract from the economic benefits expected to be received under it. Accordingly, the provision for onerous contract should be measured on this basis. Further, the Committee is of the view that unavoidable cost of meeting the obligations under the contract should be determined in accordance with paragraph 68 of Ind AS 37.

11. With regard to the specific issue raised in the extant case relating to the costs to be considered by the company for creation of provision towards onerous contracts, the Committee notes that paragraph 68 of Ind AS 37 uses the expression ‘unavoidable costs of the meeting the obligations under the contract’. The Committee is of the view that the expression ‘unavoidable costs’ means the costs that cannot be avoided due to existence of contract. These are the costs that directly relate to the contract for example, direct labour, direct material, allocations of costs that relate directly to contract activities, etc. In the context of the current issue, the Committee notes that the company has not considered administrative overheads, finance charges, R & D expenses, sales overhead and head quarter expenditure while creating provision for onerous contract. The Committee is of the view that generally such costs do not relate directly to a contract and therefore, should not be considered while creating provision for the onerous contract. Further, since Ind AS 37 requires to provide for all the costs to fulfil the obligations under the contract, the Committee is of the view that in a

contract to supply the product, the costs should include all costs till supply of the product including the cost of supplying the product.

D. Opinion

12. On the basis of the above, the Committee is of the opinion that the company's accounting treatment of costs considered by the company for creation of provision towards onerous contracts would be in line with the provisions of Ind AS 37 provided it is in accordance with the principles, as discussed in paragraphs 9 to 11 above.

Query No. 29

Subject: Recognition of interest income on delayed payment by customers.[1]

A. Facts of the Case

1. A company is a public-sector undertaking engaged in mining of coal and having a production of raw coal of about 567 million tonne during the 2017-18 fiscal year. The company is the holding company of eight Indian subsidiaries out of which seven are coal producing and one being mine planning and designing service oriented subsidiary. The company is the largest pureplay coal producer in the world and is having share of more than 80% of total coal production in India. The company operates through both underground mines as well as open cast mines. The share of production from underground mines is about 30 million tonnes whereas the production from open cast mines is 537 million tonnes. The company is also having one overseas subsidiary in Mozambique where commercial production is yet to commence. Further, it is also having a few joint ventures. The company, having a share capital of Rs. 6207.41 crore, is a listed company (in Bombay Stock Exchange and National Stock Exchange). At present, the Government of India holds 78.55% of the company's shares. All the subsidiaries are wholly owned by the company.

2. The company or its subsidiary enters into Fuel Supply Agreements (FSAs) with certain customers. (Copy of model FSA with private power utilities and copy of model Coal Supply Agreement (CSA) with State Electricity Boards have been furnished by the querist for the perusal of the Committee). Supply of

[1] Opinion finalised by the Committee on 8.1.2019.

coal to such customers is regulated through the FSAs. One of the clauses of FSA provides the following:

> **"13.0 INTEREST ON DELAYED PAYMENT**
>
> In the event of delay in payment/ adjustment of any amount payable/ recoverable pursuant to the provisions of this Agreement, the Seller/the Purchaser shall be entitled to charge interest on such sum remaining outstanding for the period after the due date till such time the payment is made. The interest charged by the Seller/ Purchaser pursuant to this Clause shall be at the Interest Rate, as per Clause 1.1(dd)."

As per Clause 1.1 (dd), "**Interest Rate**" shall mean the repo rate of Reserve Bank of India (RBI) as applicable on the due date of payment by the Purchaser plus 3% (three).

3. In some cases, payments of dues are delayed for more than the allowed period, and in some cases delays are substantial too. The company claims interest on delayed payments regularly from customers. However, recognition of claim towards interest is postponed till reasonable certainty is ascertained by way of admission of claim of interest on delayed payment by the customer. Further, in some cases, where direct information of admission of claim is not received, the company recognises interest income only when the customer deducts tax at source on interest income due to the company/subsidiaries, as it clearly indicates that claim has been accepted and accounted for by the customer. To sum up, unless certainty of realisation is assured, the company does not recognise the claim towards interest on delayed dues from debtors.

4. As per the querist, management's understanding of aforesaid accounting treatment was based earlier on paragraph 9.2 of Accounting Standard (AS) 9, 'Revenue Recognition', and subsequently on paragraph 34 of Indian Accounting Standard (Ind AS) 18, 'Revenue', which are reproduced below:

> *AS 9*
>
> "9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments."

Ind AS 18

"34 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility of an amount already included in revenue, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised."

The querist has pointed out that Ind AS 18 has been replaced by Ind AS 115, 'Revenue from Contracts with Customers'.

5. Recently, in order to speed up the recovery of past dues from customer, the company has decided the following:

(i) The company took exception about the delay in realisation of dues from the debtors and recommended the following steps for realisation of debts.

(ii) All debtors are to be analysed bill-wise and notice is to be sent to customers advising them to make payment by 30th April 2018.

(iii) A statement of up-to-date accounts indicating the interest due thereon be sent to all the parties as on 28th February 2018 and thereafter every month. The company should try and recover even previous interest.

(iv) The recovery of interest for despatches effected after 1st April 2018 will mandatorily be insisted upon and will not be waived. It shall be made clear to all the customers.

(v) FSA mandates to collect payment in advance and delivery order is to be given after that. The management should decide on 'Cash & Carry' on all despatches.

(vi)Till such time 'Cash & Carry' system is implemented, Audit Committee recommends charging interest for the delay beyond 15 days as per FSA provisions i.e., Repo rate plus 3% on monthly rest basis.

(vii) The management should take a policy decision to charge interest for the delayed payment beyond 15 days. In future, for any delay in payment, interest is to be charged mandatorily and will not be relaxed.

(viii) Due to delayed payment by the customers, the company is incurring loss and interest charged from the customers is towards compensation for the loss.

(ix) Recommended that in respect of dues which are even less than 6 months but more than 15 days, interest should be charged for all sales with effect from 1st April 2018, and recovered from the customers.

6. The querist has separately clarified that in case of advance payment by the customers, the advance is lying with coal companies till the supply is made and bills are raised. Hence, it would not be prudent to charge interest on the advance amount due but not paid for the period from the due date of each instalment till the bill date. Hence, interest may be charged to customers only to the extent of unpaid amount towards bill raised as per FSA.

7. As per the querist, a view has emerged that based on FSA between the parties, interest on delayed payment may be recognised as accrued income on each reporting date.

B. Query

8. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) Whether the recognition of interest on delayed payment from customer shall be postponed till certainty of realisation of income is reliably ensured under Ind AS 115 and whether there is any disclosure requirement in such a case. Further, how certainty of collection may be assessed where there is no past experience with the customer.

or

(ii) Whether, taking cognizance of the FSA, the company should recognise the claim towards interest on delayed payment as soon as it is raised and later test such financial asset (accrued interest) for impairment, if any.

D. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to recognition of interest income on delayed payment from customers after the revenue and related receivable from the customer has been recognised in accordance with Ind AS 115 and other applicable Indian Accounting Standards (Ind AS) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as the 'Rules') as amended till date. The Committee has, therefore, considered only this issue and has not examined any other issue that may be contained in the Facts of the Case. For example, the Committee has not examined the issues, such as, separation of financing component or other aspects, like determination of transaction price for revenue recognition/ measurement under Ind AS 115, initial recognition/ measurement of the

receivables, detailed aspects related to calculation of interest income and/ or recognition or measurement of impairment loss using the expected credit loss. Further, the Committee notes that with effect from 1st April 2018, Ind AS 18, 'Revenue' and Ind AS 11, 'Construction Contacts', notified under the Rules, have been replaced by Ind AS 115, 'Revenue from Contracts with Customers'. Though the querist has referred to both Ind AS 18 and Ind AS 115, since the querist has raised the issue in the context of Ind AS 115, while formulating its views, the Committee has considered the provisions of Ind AS 115 only and not Ind AS 18.

10. At the outset, the Committee notes the following requirements of Ind AS 32, Ind AS 109 and Ind AS 115:

Ind AS 32

"A *financial asset* is any asset that is:

(a) …

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potential favourable to the entity; or

(d) …"

"AG4 Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:

(a) trade accounts receivable and payable;

(b) …"

Ind AS 109

"2.1 This Standard shall be applied by all entities to all types of financial instruments except:

(a) …

(j) rights and obligations within the scope of Ind AS 115, *Revenue from Contracts with Customers*, that are

financial instruments, except for those that Ind AS 115 specifies are accounted for in accordance with this Standard.

2.2 The impairment requirements of this Standard shall be applied to those rights that Ind AS 115 specifies are accounted for in accordance with this Standard for the purposes of recognising impairment gains or losses."

Ind AS 115

"5 An entity shall apply this Standard to all contracts with customers, except the following:

…

(c) financial instruments and other contractual rights or obligations within the scope of Ind AS 109, *Financial Instruments*, …"

"108 A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. *An entity shall account for a receivable in accordance with Ind AS 109.* Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Ind AS 109 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss)." (Emphasis supplied by the Committee.)

From the above, the Committee notes that receivables for the coal supplied and amount billed to the customers represent a contractual right to receive cash from another entity, viz., customer. Hence, these are financial assets as defined in paragraph 11 of Ind AS 32 and their accounting post initial recognition is governed by Ind AS 109.

11. The Committee notes the following paragraphs of Ind AS 109 with regard to subsequent measurement of trade receivables:

"5.2.1 After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1.1–4.1.5 at:

(a) amortised cost;

(b) fair value through other comprehensive income; or

(c) fair value through profit or loss."

"4.1.2 A financial asset shall be measured at amortised cost if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions."

"4.1.3 For the purpose of applying paragraphs 4.1.2(b) and 4.1.2A(b):

(a) principal is the fair value of the financial asset at initial recognition. Paragraph B4.1.7B provides additional guidance on the meaning of principal.

(b) interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin. Paragraphs B4.1.7A and B4.1.9A–B4.1.9E provide additional guidance on the meaning of interest, including the meaning of the time value of money."

12. The Committee notes that paragraphs 4.1.2A and paragraph 4.1.4 of Ind AS 109 lay down criteria for measurement of financial assets as at fair value through other comprehensive income (FVTOCI) or as at fair value through other profit or loss (FVTPL). The Committee also notes that these criteria will be relevant if the amortised cost measurement criteria is not met. Hence, the Committee examines the amortised cost measurement criteria first and observes the following:

(a) From the Facts of the Case, it appears that the company holds trade receivables only for collecting the contractual cash flows on maturity and not for either selling the trade receivables or both collecting the contractual cash flows and selling the trade receivables. The Committee assumes that based on past practices, business plans and related aspects, the company will be able to demonstrate this fact. Hence, in the extant case, business model requirement for amortised cost classification as prescribed in paragraph 4.1.2(a) of Ind AS 109 is met.

(b) As far as the second criterion related to principal and interest is concerned, the Committee notes the fact that the company charges interest @ RBI Repo rate (which is generally meant for overnight borrowings by banks from RBI as benchmark rate) plus 3%. The Committee presumes that it covers the factors, such as, time value of money, credit risk associated with the principal amount outstanding and other basic lending risks and costs as well as a profit margin, as mentioned in paragraph 4.1.3 of Ind AS 109 reproduced above. Accordingly, the Committee is of the view that the requirement of paragraph 4.1.2(b) is also met.

13. Considering the above, the Committee believes that after initial recognition, trade receivable should be measured at amortised cost and interest income thereon should be recognised using the effective interest method and in accordance with the requirements of Ind AS 109. Ind AS 109 defines effective interest method as below:

"effective interest method	The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the **gross carrying amount of a financial asset** or to the **amortised cost of a financial liability**. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the **expected credit losses**. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1 – B5.4.3), **transaction costs**, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments)."

The Committee is of the view that while applying effective interest rate method, the company should determine the expected cash flows including those related to interest on delays based on the facts and circumstances of the case. Here, the expected life should be considered as expected timing of payment by the customer.

14. The Committee also notes that section 5.5 of Ind AS 109 deals with impairment recognition based on expected credit losses on certain categories of financial instruments which include trade receivables arising from Ind AS 115 (refer paragraph 2.2 of Ind AS 109, as reproduced in paragraph 10 above) measured at amortised cost. Accordingly, the Committee is of the view that recognition of expected credit loss on the trade receivable *including* interest element should be made in accordance with section 5.5 (specifically considering paragraphs 5.5.1, 5.5.3, 5.5.5 and 5.5.15) of Ind AS 109.

D. Opinion

15. Based on the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 8 above:

(i) & (ii) The trade receivables should be measured at amortised cost and interest income should be recognised in accordance with the provisions of Ind AS 109, as discussed in paragraph 13 above. Recognition of expected credit loss on the trade receivables *including* interest element should be made in accordance with the section 5.5 of Ind AS 109, as stated in paragraph 14 above.

Query No. 30

Subject: Computation of effective interest rate on borrowings.[1]

A. Facts of the Case

1. A company is a leading public sector undertaking in India operating in the power sector. To finance the capital expenditure, the company borrows term loan from multilateral/bilateral agencies such as World Bank, Asian Development Bank and KfW etc.

2. The company entered into a loan agreement (a copy of which has been supplied by the querist for the perusal of the Committee) for Euro 500 million with

[1] Opinion finalised by the Committee on 8.1.2019.

a foreign lender for financing its projects. The loan agreement with the lenders sets out the rate of interest and fees payable by the company to the lenders. This loan is guaranteed by the Government of India (GOI) for due and punctual payment of the principal, interest and other charges through separate guarantee agreement.

3. The company is required to pay an initial guarantee fee to the GOI on the sanctioned amount and thereafter subsequent guarantee fee is payable on first April of every year on the amount outstanding at the beginning of the year as per the office memorandum of Ministry of Finance, Government of India (a copy of which has been supplied by the querist for the perusal of the Committee).

4. As per the company's accounting policy, financial liabilities are recognized at fair value minus transaction costs that are directly attributable to the issue of financial liabilities. After initial recognition, financial liabilities are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate (EIR).

5. During the audit of accounts for the financial year (F.Y.) 2017-18, Government auditor made an observation that the company did not consider subsequent guarantee fee for the purpose of calculation of effective rate of interest on borrowing while the same should be considered for calculation of effective rate of interest on borrowing in line with Indian Accounting Standard (Ind AS) 109, 'Financial Instruments'. Auditor referred, inter alia, to paragraphs 5.4.1, B5.4.1, and B5.4.2 of Ind AS 109 in his audit query.

6. The querist has stated that Appendix A to Ind AS 109, inter alia, states that when calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points *paid or received between parties* to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1– B5.4.3), transaction costs, and all other premiums or discounts. (Emphasis supplied by the querist.)

7. According to the querist, a perusal of the above clearly shows that for calculating the effective interest rate, only cash flows arising under the loan agreement towards interest and fees payable to the lenders are to be considered. Since *guarantee fee is not payable to the lenders, but it is payable to the Government of India,* the same should not be considered for the purpose of computing the effective interest rate. (Emphasis supplied by the querist.)

8. Paragraph B5.4.2 of Appendix B to Ind AS 109 states as follows:

"B5.4.2 Fees that are an integral part of the effective interest rate of a financial instrument include:

(a) origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.

(b) …

(c) origination fees paid on issuing financial liabilities measured at amortised cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services."

As per the querist, the definition of origination fee as per the above-reproduced paragraph B5.4.2 of Ind AS 109 is the upfront/front-end/arrangement fee levied by lenders for providing the loan facility and is also a means to improve their overall returns on the loan. The reference to guarantee in paragraph B5.4.2 is in the context of the nature of activities performed by lender such as *"evaluating and recording guarantees, collateral and other security arrangements" and does not refer to guarantees provided by third parties.* As such, guarantee fees payable to the GOI is not the origination fee as per paragraph B5.4.2 and should not be considered for computation of the effective interest rate. (Emphasis supplied by the querist.)

9. The querist has further stated that as per paragraph B5.4.8 of Appendix B of Ind AS 109, "Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs." The initial guarantee fee is considered as a transaction cost in terms of paragraph B5.4.8 above and has been considered for computation of effective interest rate. The company pays subsequent guarantee fee on first April of every year on the loan amount outstanding at the beginning of the year. The company considers the subsequent

guarantee fee, as in the nature of *holding cost* of the loans in line with above paragraph. Subsequent guarantee fee is a periodical cost and is expensed / capitalised in the period in which it accrues. Accordingly, it is not included in the calculations of effective interest rate. (Emphasis supplied by the querist.)

B. Query

10. On the basis of above, the querist has sought an opinion from the Expert Advisory Committee of the Institute of Chartered Accountants of India as to whether subsequent guarantee fee paid to the Government of India as stated above should be considered for computation of effective interest rate in compliance with the provisions of Ind AS 109.

C. Points considered by the Committee

11. The Committee notes that the basic issue raised in the query relates to accounting for guarantee fee paid to the Government of India in relation to the loan taken from the foreign lender. 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 the loan obtained by the bank, measurement of amortised cost of the loan, EIR computation etc. At the outset, the Committee notes that the financial liability in the extant case is being subsequently measured at amortised cost using the effective interest rate method.

12. The Committee notes the following clauses of loan agreement between the company and KfW:

> "2.1 After all conditions precedent to disbursement according to Article 11 have been fulfilled, KfW will disburse the Loan in accordance with the progress of the Project and upon request of the Borrower. …"
>
> "Article 7
>
> Guarantee
>
> As security for this Loan, India, acting by its President (Guarantor) will enter into a separate guarantee agreement (Guarantee Agreement) with KfW prior to the first disbursement from the Loan."
>
> "Article 10
>
> Events of Default
>
> 10.1 KfW shall be entitled without having to resort to any legal procedure whatsoever to suspend disbursement or to terminate this Loan and to demand immediate payment of all amounts

payable under this Loan Agreement, if any event constituting an important reason under German Law ("Event of default") shall occur, such as:

a) …

c) this Loan Agreement or the Guarantee or any parts thereof cease to have a binding effect upon the Borrower or the Guarantor or ceases to be enforceable against the Borrower or the Guarantor;

…"

"Article 11

Conditions Precedent

The obligation of KfW to make disbursements of any amount under this Loan Agreement shall be subject to satisfaction of the following conditions precedent:

11.1 The following documents have been submitted to KfW not later than 2 months after the date of signing of this Loan Agreement but in any case prior to the initial disbursement date without any cost for KfW and have been accepted by it as satisfactory in form and substance:

a) …

f) original of the Guarantee Agreement mentioned in Article 7 duly executed by the Guarantor has been submitted to KfW;"

From the above, the Committee notes that guarantee provided by the GOI in the extant case is a pre-condition for obtaining and continuing with the loan facility as per the loan agreement. Hence, as long as the loan continues, guarantee will also continue and therefore, during the term of loan, the guarantee is not cancellable.

13. Further, with regard to the issue raised regarding accounting for guarantee fee, the Committee notes the following paragraphs of Ind AS 109:

"5.1.1 Except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability."

"5.3.1 After initial recognition, an entity shall measure a financial liability in accordance with paragraphs 4.2.1–4.2.2."

4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for…"

"amortised cost of a financial asset or financial liability	The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the **effective interest method** of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any **loss allowance**."
"effective interest method	The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the **gross carrying amount of a financial asset** or to the **amortised cost of a financial liability**. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the **expected credit losses**. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1–B5.4.3), **transaction costs**, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments)."

"transaction costs Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph B5.4.8). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument."

"Effective interest method

B5.4.1 In applying the effective interest method, an entity identifies fees that are an integral part of the effective interest rate of a financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Fees that are an integral part of the effective interest rate of a financial instrument are treated as an adjustment to the effective interest rate, unless the financial instrument is measured at fair value, with the change in fair value being recognised in profit or loss. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

B5.4.2 Fees that are an integral part of the effective interest rate of a financial instrument include:

(a) origination fees received by the entity relating to the creation or acquisition of a financial asset. Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument.

(b) commitment fees received by the entity to originate a loan when the loan commitment is not measured in accordance with paragraph 4.2.1(a) and it is probable that the entity will enter into a specific lending arrangement. These fees are regarded as compensation for an ongoing involvement with the acquisition of a financial instrument. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry.

(c) origination fees paid on issuing financial liabilities measured at amortised cost. These fees are an integral part of generating an involvement with a financial liability. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services."

"B5.4.8 Transaction costs include fees and commission paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and security exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs."

The Committee notes from the above that *fees paid or received between parties to the contract* that are an integral part of the effective interest rate and transaction costs are to be considered while applying effective interest method. Further, the fees that are an integral part of the effective interest rate of a financial liability include the origination fee paid on issuing such liability. Accordingly, the Committee is of the view that the origination fee referred above is applicable in the extant case if the fees is paid/received between the parties to the contract (viz., lender and the borrower in case of a loan). Since the guarantee fee (initially as well as subsequently) in the extant case is not paid between the lenders and the borrowers, the Committee is of the view that the same cannot be considered as 'fees paid or received between parties to the contract that are an integral part of the effective interest rate'. The Committee further notes that transaction costs are incremental costs that are directly attributable to the acquisition or issue of a financial liability and an incremental cost is one that would not have been incurred if the entity had not acquired or issued the financial instrument. In this context, the Committee is of the view that the guarantee fee paid (initially as well as subsequently) in the extant case is an incremental cost which is directly attributable to the acquisition of the loan facility as this cost would not have been incurred if the company had not incurred the loan liability. Accordingly, the Committee is of the view that the financial guarantee fee paid (initially as well as subsequently) by the company should be considered in the extant case for computation of effective interest rate while measuring the loan liability at amortised cost in compliance with the provisions of Ind AS 109.

D. Opinion

14. On the basis of the above, the Committee is of the opinion that the financial guarantee fee paid (initially as well as subsequently) by the company should be considered in the extant case for computation of effective interest rate while measuring the loan liability at amortised cost in compliance with the provisions of Ind AS 109.

Query No. 31

Subject: Presentation of provision for crossflow claim.[1]

A. Facts of the Case

1. A public limited company (hereinafter referred to as the 'company') which is a wholly owned subsidiary of a listed government company, is in the business of exploration and production (E&P) of oil and gas and other hydrocarbon related activities outside India.

2. The company operates overseas projects directly and/or through subsidiaries, by participation in various joint arrangements and investment in associates. Globally, E&P business is carried out by way of joint arrangements or investments in the form of subsidiaries/associates. The company has adopted Indian Accounting Standards (Ind ASs) w.e.f. 1st April 2016 (transition date 1st April 2015). The functional currency of the company is assessed as US Dollars (USD) in accordance with the provisions of Ind AS. The company presents its financial statements in its presentation currency which is Indian Rupee (INR).

3. The overseas oil and gas operations are generally conducted in joint arrangements with other partners. Main reason for holding mineral rights through jointly controlled entities/ subsidiaries is because of host country's regulations and/or various business considerations (strategic/risk management/financing etc.). The joint partners investing in an oil and gas field are individually known as consortium members and collectively as a consortium.

4. The company explores and produces hydrocarbons from different geographical areas (fields) under its mineral rights. The mineral rights license is granted on the basis of surface area divisions whereas hydrocarbon reserves are

[1] Opinion finalised by the Committee on 8.1.2019.

subsurface formations and can be conjoined in some cases. The hydrocarbon bearing fields are mostly tightly packed formations and there could be cases where two adjacent fields are operated by two separate parties having control over mineral rights of their respective fields. In such cases, there is a possibility of flow of hydrocarbons from one field to another adjacent field. Due to conjoined reserves, different pressure levels could cause oil and gas to flow from one reserve to another reserve. This phenomenon is inherent to the nature of upstream oil and gas industry and is known as 'crossflow'.

5. The querist has stated that in one such field of the consortium of which the company is a partner (consortium member), the operator of an adjacent field has claimed crossflow of oil and gas from that adjacent field to the consortium's field. On the basis of a preliminary estimate of the claim, the company has made a provision of part amount and the balance amount was shown under the contingent liability.

6. The company has classified the above-mentioned provision made against the crossflow settlement, as a separate line item in the notes under the head 'Provisions, write-off and other impairment' in the statement of profit and loss treating it as a provision in accordance with Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets'.

7. During the course of Government audit, it was highlighted by the Comptroller and Auditor General (C&AG) team that the said provision is an exceptional item and should be shown on the face of the statement of profit and loss under the head 'Exceptional Items' and profit after exceptional items would be arrived at accordingly.

8. According to the querist, the term 'Exceptional Items' is neither defined in Ind AS Schedule III to the Companies Act, 2013 nor in any Ind AS. However, Ind AS 1, 'Presentation of Financial Statements' has references to such items in paragraphs 85, 86, 97 and 98. Paragraph 85 provides for presenting additional line items in the statement of profit and loss if it is relevant for understanding of entity's financial performance and paragraph 86 stresses on materiality and nature and function of income/expense. Paragraph 97 is more relevant and states that, "*When items of income or expense are material, an entity shall disclose their nature and amount separately*". Paragraph 98 of Ind AS 1 gives an illustrative list where separate disclosure is required. The said list comprises of events that are non-recurring or at least non-frequent in nature. (Emphasis supplied by the querist.)

9. The querist has further stated that paragraph 12 of Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' states that when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their

disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.

10. Thus, from a collective reading of above provisions, it can be concluded that following ingredients should be there for an item of income/expense to be regarded as 'exceptional items':

a. The items should arise from ordinary activities;

b. They are not expected to be recurring in nature;

c. The nature and amount of such item is material to the financial statement in best judgement of the management of entity to enable the users of financial statements to understand its financial performance.

11. Crossflow of hydrocarbons from one field to another is related to the ordinary activities of the company but they are of recurring nature though the frequency of settlement of claims arising therefrom depends upon the arrangement amongst the parties. The phenomenon of crossflow is intricately linked with the core nature of upstream E&P business where fields are conjoined. *Such crossflows are therefore normal in oil and gas industry and adjustments have to be made on a regular basis.* In our case, a draft agreement has been formulated wherein the crossflow of oil and gas is proposed to be reviewed after every 5 years. Therefore, it can be reasonably concluded that this transaction will be occurring on a frequent basis in the financial statements of the company. (Emphasis supplied by the querist.)

12. As regards 'materiality', the querist has referred to paragraph 7 of General Instructions for Preparation of Financial Statements of a Company required to comply with Ind AS of Division II- Ind AS Schedule III to the Companies Act, 2013, which defines material items as the items that could individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances. According to the querist, *in the instant case, neither the size nor the nature of the transaction indicates conditions for being considered as 'material' to the financial statements of the company.* (Emphasis supplied by the querist.)

13. As per the querist, absence of a clear definition of 'exceptional items' in Ind ASs and availability of broad guiding principles only to assess the nature of any transaction, places the onus of assessing and deciding the nature of transaction on the management of the entity. Therefore, *the intent of Ind AS is to rely on the management of the entity to use its best judgement to ascertain the classification of any item as exceptional items in the financial statements as per the nature of industry in which the entity operates, size and nature of transaction*

and its impact on the user's readability of the financial statements.(Emphasis supplied by the querist.)

14. As explained above, the provisions made by the company in respect of crossflow claim of the operator of adjacent field are normal in nature and are regular phenomena of the E&P industry. Further, the amount of provision made is not also material to warrant a separate line item on the face of the statement of profit and loss. The company has shown the said provision as a separate line item under the head 'Provision, write-off and other impairment' and has also provided a disclosure note under contingent liability in respect of the said provision explaining the nature of the transaction in detail to assist the users of the financial statements to comprehend the nature of provision made.

15. Therefore, in the considered opinion of the querist, the provision made in respect of the claim for crossflow of hydrocarbons is a normal and regular feature of the E&P industry and, therefore, should be out of the purview of 'exceptional items'.

B. Query

16. In view of the above facts, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India is sought on the following issues:

(i) Whether the provision made by the company against the claim of operator of adjacent field in respect of crossflow of oil and gas has been correctly shown by the company under the head 'Provisions, write-off and other impairment' considering the intricate link of such phenomena with the E&P industry and the size and nature of amount involved;

or

(ii) Whether the said provision comes under the ambit of 'exceptional items' and is supposed to be shown as a separate and additional line item under exceptional items in the statement of profit and loss.

C. Points considered by the Committee

17. The Committee notes that the basic issue raised by the querist relates to presentation of provision for crossflow claims, viz., whether the same should be presented under the head 'Provisions, write-off and other impairment' or the same should be considered as an exceptional item and should be disclosed on the face of the statement of profit and loss under the head 'Exceptional Items'. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as,

recognition and measurement of provision for crossflow claims, accounting for inventory in respect of crossflow, appropriateness of disclosure made under contingent liability in this regard, appropriateness of inclusion of other items under the head 'Provisions, write-off and other impairment', etc. Further, the opinion has been expressed in context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as 'the Rules').

18. The Committee notes that Part II of Division II of Schedule III to the Companies Act, 2013 (hereinafter referred to as the 'Ind AS Schedule III'), which prescribes the format of statement of profit and loss applicable for companies adopting Ind ASs, requires presentation of 'Exceptional Items' as a separate line item in the statement of profit and loss. Further, Note 7 of the 'General Instructions for Preparation of Statement of Profit and Loss' applicable for companies adopting Ind ASs requires that a company should disclose by way of notes, additional information regarding aggregate expenditure and income on some items. One of the items to be disclosed in this regard is 'details of items of exceptional nature'. However, the term 'exceptional item' is not defined in 'Ind AS Schedule III'. Further, the term 'exceptional item' is neither defined nor used in Ind ASs.

19. The Committee also notes the following paragraphs of Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements', notified under the Rules:

> "31 Some Ind ASs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an Ind AS if the information resulting from that disclosure is not material except when required by law. This is the case even if the Ind AS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."
>
> **"85 An entity shall present additional line items (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance."**

"86 Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement of profit and loss, and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense. For example, a financial institution may amend the descriptions to provide information that is relevant to the operations of a financial institution. An entity does not offset income and expense items unless the criteria in paragraph 32 are met."

"97 When items of income or expense are material, an entity shall disclose their nature and amount separately.

98 Circumstances that would give rise to the separate disclosure of items of income and expense include:

(a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
(c) disposals of items of property, plant and equipment;
(d) disposals of investments;
(e) discontinued operations;
(f) litigation settlements; and
(g) other reversals of provisions."

Further, the Committee notes that the term 'material' is defined in paragraph 7 of Ind AS 1 as below:

"Material **Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor."**

20. From the above, the Committee notes that subject to legal requirements, material items need to be presented as line items and/or disclosed in financial statements, which includes the notes. Further, as per the requirements of

paragraphs 85 and 86 of Ind AS 1, events and transactions which differ in frequency should be presented as additional line items/headings when such presentation is relevant to understanding of the entity's financial performance. The Committee also notes that Question No. 32 of the Educational Material on Ind AS 1, issued by the erstwhile Ind AS Implementation Committee of the ICAI on the meaning of 'Exceptional items' states that, "it appears that all material items are not exceptional items and exceptional items are those items which meet the test of 'materiality' and 'incidence' ". Definition of the term 'Material' as per paragraph 7 of Ind AS 1 is reproduced in paragraph 19 above. The Committee is of the view that 'incidence' refers to frequency of occurrence.

21. In the above context, the Committee notes that the querist has stated in paragraph 14 and 20 above that the provision made by the company in respect of crossflow claim is a regular phenomenon of the E&P industry and the amount involved is not material. In this context, the Committee notes from the copy of the provisional comments of C&AG (separately provided by the querist for the perusal of the Committee) that the C&AG has commented that the amount of provision is 15% of the profit after tax for the year 2017-18 and therefore it is material whereas management has replied that as the provision is less than 1% of the consolidated revenue of the company, the same is not deemed material. Further, the Committee also notes from the standalone and consolidated financial statements of the company for the financial year 2017-18 that the amount of provision (Rs. 644.73 million) is 11.25% (approx) and 7.77% (approx) respectively of the profit before exceptional items and tax (Rs. 5732.91 and Rs. 8290.47 million respectively). The Committee is of the view that the impact on profit before tax is also an important factor to be considered for determination of materiality. In this regard, the Committee further notes from paragraph 7 of Ind AS 1, reproduced above, that an item should be considered material if it can influence the economic decisions of the users and that materiality depends on both size and/ or nature of an item. Thus, considering the size of this expense item in relation to profit before exceptional items and tax, the Committee is of the view that it is material and the company should comply with the disclosure requirements of paragraphs 97 and 98 of Ind AS 1. However, both the materiality and incidence tests are required to evaluate whether an item is exceptional or not and in this case, even though the item is material, same is regular item, as asserted by the management of the company. Consequently, based on the above discussion, the Committee is of the view that in the extant case, provision made by the company in respect of crossflow claim is not an exceptional item and need not be shown on the face of the statement of profit and loss; the same should however be disclosed as per the requirements of Ind AS 37. However, in case, it meets the 'materiality' and 'incidence' test, the company should disclose the same as 'exceptional item'.

D. Opinion

22. On the basis of the above paragraphs, the Committee is of the opinion that the disclosure of provision made by the company in respect of crossflow claim appears to be appropriate. However, this being material should be disclosed as per paragraphs 97 and 98 of Ind AS 1.

Query No. 32

Subject: Provision for disputed tax cases.[1]

A. Facts of the Case

1. A private limited company (hereinafter referred to as 'the company') is registered under the Companies Act, 1956. The company is engaged in the manufacturing of heavy equipments and providing services to group companies outside India.

2. The querist has stated that the financial statements of the company are prepared in accordance with Indian Accounting Standards (Ind ASs) notified vide Companies (Indian Accounting Standards) Rules, 2015 under section 133 of the Companies Act, 2013 (the Act) and other relevant provisions of the Act.

3. In line with the requirements of Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' the company has adopted the following accounting policy with respect to accounting for provisions, contingent liabilities and contingent assets specifically related to corporate income taxes:

> "Provisions are recognised when the company has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount can be made. Provisions are reviewed regularly and are adjusted where necessary to reflect the current best estimates of the obligation. When the company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset, only when such reimbursement is virtually certain.
>
> Contingent Liabilities: Contingent liabilities are disclosed when there is a possible obligation arising from past events, the existence of which will be confirmed only by the occurrence or non-occurrence of one or more

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[1] Opinion finalised by the Committee on 8.1.2019.

uncertain future events not wholly within the control of the company or a present obligation that arises from past events where it is either not probable that an outflow of resources will be required to settle, or a reliable estimate of the amount cannot be made."

4. During the course of assessment proceedings under the Income-tax Act, 1961, certain disallowances/additions are made to the taxable income as reported in the corporate income tax returns by the Assessing Officer/Transfer Pricing Officer and demands are raised. In respect of the disallowances/additions which are contested before the higher authorities ('the disputed tax positions'), the tax demands paid/adjusted, if any/as appropriate are shown as advances and included under 'Advance Income Tax' (current tax asset) in the balance sheet.

5. As per the querist, for various reasons, some positions assumed by the company at the time of finalising the financials/filing the returns are not disputed by the tax authorities (CBDT). However, subsequently, these positions may be disputed by CBDT for other corporations and won against various appellate forums, based on which the positions assumed by the company may be rendered *certain or uncertain*. In such cases, CBDT may even open closed assessments for scrutiny as long as the relevant assessment years are not time-barred for further evaluation. (Emphasis supplied by the querist.)

6. The company evaluates all open / disputed tax positions based on actual prior income tax audit history for similar matters, relevant external judicial precedents for the matters disputed and legal opinions as appropriate, to ascertain the probability and likelihood of sustaining the company's tax return filing position upon appeal. Based on such assessment, no reserve is created if a favourable outcome is *certain*. (Emphasis supplied by the querist.)

B. Query

7. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee for the above explained tax positions as to:

(a) Whether the accounting policy adopted by the company of not making tax provision in respect of disputed tax positions which have favorable judicial precedence/attorney opinion as discussed in paragraphs 5 and 6 above, is acceptable as per the generally accepted accounting practices of the Indian Accounting Standards and the prudence concept.

(b) For uncertain positions in such disputed tax cases, through the company's evaluation as discussed in paragraphs 5 and 6 above,

(i) where the company has a 'more likely than not' assessment of a favourable outcome, whether a contingent liability disclosure alone is appropriate?

(ii) where the company does not have a 'more likely than not' assessment of a favourable outcome, should the accounting treatment be creation of reserve (including reserve for interest)?

(c) When no provision/ contingent liability is recognized, should there be any disclosure to this effect in the notes to the financial statements, assuming the outcome is certain?

C. Points considered by the Committee

8. The Committee notes that the basic issue raised in the query relates to accounting for disputed tax positions, viz., the disallowances/additions which are contested by the company before the higher authorities. 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 tax positions taken by the company which have not yet been disputed by the Income-tax authorities for the tax returns filed by the company, accounting for tax demands paid/adjusted in respect of disputed tax positions, etc. Further, the Committee wishes to point out that its opinion is expressed purely from accounting perspective and not from any legal perspective. At the outset, the Committee wishes to mention that the opinion expressed hereinafter is based on the Ind ASs applicable for the financial year 2018-19. However, the Committee wishes to point out that future amendment to Ind AS 12 'Income Taxes', viz., Appendix C relating to 'Uncertainty over Income Tax Treatments' which is applicable from future date, may have a bearing on the extant issue.

9. With regard to accounting for disputed tax positions, the Committee notes that Ind AS 12 provides guidance on current tax and deferred tax, however does not provide detailed guidance on provisions relating to income tax disputes and uncertainties. In this regard, the Committee notes that Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' provides detailed guidance on provision relating to similar kind of disputes and uncertainties. Accordingly, although provisions relating to income taxes have not been addressed in Ind AS 37, the Committee has considered, hereinafter, the requirements of Ind AS 37 in the context of such provisions. The Committee further notes the following requirements of Ind AS 12, 'Income Taxes' and Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', notified under the Companies (Indian Accounting Standards) Rules, 2015:

Ind AS 12:

88 An entity discloses any tax-related contingent liabilities and contingent assets in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities. Similarly, where changes in tax rates or tax laws are enacted or announced after the reporting period, an entity discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see Ind AS 10, *Events after the Reporting Period*).

Ind AS 37:

"A *provision* is a liability of uncertain timing or amount.

A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

An *obligating event* is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

A *legal obligation* is an obligation that derives from:

(a) a contract (through its explicit or implicit terms);

(b) legislation; or

(c) other operation of law.

A c*onstructive obligation* is an obligation that derives from an entity's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A *contingent liability* is:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence

or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability."

"14 A *provision* shall be recognised when:

(a) an entity has a present obligation (legal or constructive) 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 shall be recognised.

15 In rare cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period.

16 In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

(a) where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and

(b) where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86)."

"23 For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, ie the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote (see paragraph 86)."

"27 An entity shall not recognise a contingent liability.

28 A contingent liability is disclosed, as required by paragraph 86, unless the possibility of an outflow of resources embodying economic benefits is remote."

"86 Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable:

(a) an estimate of its financial effect, measured under paragraphs 36–52;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement."

"91 Where any of the information required by paragraphs 86 and 89 is not disclosed because it is no practicable to do so, that fact shall be stated."

10. The Committee notes from the above that an element of judgement is required to determine whether the demand raised in respect of additions /disallowances in cases pending before various Income-tax authorities should be provided for in the accounts or treated as contingent liability and disclosed by way of a note to the accounts depending upon the assessment of likelihood of

the outcome of the uncertainty. It is for the management of the enterprise to decide and for the auditor to assess, considering the circumstances of each case, whether the demand raised warrants recognition of provision or disclosure of contingent liability. The Committee is of the view that while making such judgement, all the facts and circumstances of the case and all the evidences available on the reporting date, including for example, legal opinion of an expert on the possibility and extent of outcome (success or failure) of the company's cases in the court of law, experience of the company or other enterprises in similar cases, decisions of appropriate authorities, etc. should be considered. Further, the Committee is also of the view that events after the reporting period but, before the date of finalization of accounts, should also be taken into consideration. The Committee wishes to clarify that the fact that no demand has been raised by the authorities does not necessarily indicate that demand cannot be raised in future. Accordingly, on the basis of above evaluation, if it is determined that it is more likely than not that a present obligation exists at the end of the reporting period, the company should recognise a provision (if the recognition criteria are met) and where it is more likely that no present obligation exists at the end of the reporting period, the entity should disclose a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote.

11. Further, the Committee is of view that accounting for the interest liability that may arise on demands should be dealt with considering the same principles as for the original income tax liability, as discussed in paragraph 10 above.

D. Opinion

12. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 7 above:

(a) and (b) Considering the requirements of Ind AS 12 and Ind AS 37, as discussed in paragraphs 9 and 10 above, in respect of disputed tax positions where the demands have been raised in respect of additions/disallowances, an element of judgement is required to determine whether the same should be provided for in the accounts or treated as contingent liability and disclosed by way of a note to the accounts depending upon the assessment of likelihood of the outcome of the uncertainty. While making such judgement, all the facts and circumstances of the case and all the evidences available on the reporting date, including for example, legal opinion of an expert on the possibility and extent of outcome (success or failure) of the company's cases in the court of law, experience of the company or other enterprises in similar cases, decisions of appropriate authorities, etc. and events after the reporting period but, before the date of finalization of accounts should be considered. On the basis of above evaluation, if it is determined that it is more likely than not that a present obligation exists at the end of the reporting period, the company should recognise a provision (if the recognition criteria are met) and where it is more likely that no present obligation exists at the end of the reporting period, the entity should disclose a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote. Accounting for interest liability (if any) should be dealt with considering the same principles as for the original income tax liability, as discussed in paragraph 11 above.

(c) Since no provision/ contingent liability is recognised/ disclosed considering the requirements of Ind AS 37, no disclosure is required in the notes to financial statements.

PART II:
Opinions on Accounting Standards

Query No. 33

Subject: Considering Debenture Redemption Reserve (DRR) for calculation of Net Worth of a Company.[1]

A. Facts of the Case

1. A company (hereinafter referred to as the 'company') is a public limited company and shares of the company are listed on National Stock Exchange and Bombay Stock Exchange. Over the years, the company has made various provisions towards reserves and others and it includes the reserve created under the head 'Debenture Redemption Reserve' (DRR). DRR created out of profits of the company.

2. The querist has stated that ABC Ltd. has issued notice inviting tender for the construction of Hydro Mechanical Package of a Hydroelectric Project (60 MW). One of the eligibility criteria for the company towards the net worth of the company responding to the invitation reads as under:

> "The net worth shall be positive for the last three financial years which shall be calculated based on subscribed and paid up Share Capital plus Share premium plus free reserves plus Unallocated Balance/Surplus amount of profit and Loss account less (a) expenses not written off, (b) Accumulated losses in Profit and Loss account, if not reduced from reserves and surplus. The revaluation reserves, Capital reserves, and amount of intangible asset like goodwill etc. will not be taken into account while calculating Net Worth".

3. From the plain reading of the above eligibility criteria relating to Net Worth, it consists of two parts:

(a) First part states that following are to be included in net worth.
   a. Subscribed and paid up Share capital
   b. Share premium
   c. Free Reserves
   d. Unallocated Balance/Surplus amount of profit and loss account less expenses not written off and accumulated losses in the profit & loss account.

(b) Second part states that following cannot be included in net worth:
   a. Revaluation reserves,
   b. Capital reserves, and
   c. amount of intangible asset like goodwill etc.

[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

From the above mentioned criteria for computation of net worth, it can be concluded that out of various provisions made in the Balance Sheet, only the items mentioned in second part will not form part of net worth. As such, the DRR created by the Company will be part of net worth and it will not be reduced as per definition of net worth.

Further, as per the first part, free reserves will be part of the net worth and as per the discussion held with designated officials of ABC Ltd., DRR will not be part of free reserves. However, free reserve has not been defined under notice inviting tender documents.

4. For computation of net worth, the querist has made reference to definition of net worth which has been defined by various authorities. Relevant extracts of definition of net worth is given here under:

Section 2(57) of Companies Act, 2013 defines Net Worth as under:

> ""net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation"

Section 3(1)(ga) of the Sick Industrial Companies (Special Provisions) Act 1985

> "Net Worth means the sum total of the paid up capital and free reserves.
>
> Explanation – For the purposes of this clause, "free reserves" means all reserves credited out of the profits and share premium account but does not include reserves credited out of re-evaluation of assets, write back of depreciation provisions and amalgamation."

Guidance Note on "Terms Used in Financial Statements issued by the Institute of Chartered Accountants of India" defines Net Worth and Net Assets as per following definitions :

> **"11.08 Net Worth**
>
> See **Net Assets"**

> **11.01 Net Assets**
>
> The excess of the *book value of assets* (other than *fictitious assets*) of an enterprise over its *liabilities*. This is also referred to as **net worth** or **shareholders' funds.**

Further, free reserves are defined under Companies Act, 2013 as

> Section 2(43): "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:
>
> Provided that-
>
> (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
>
> (ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,
>
> shall not be treated as free reserves.

B. Query

5. In view of the said facts and the circumstances given here above, the querist has sought opinion of the Expert Advisory Committee on the following issues:

(i) In view of the definition of Free Reserves under Companies Act 2013 which is for the purpose of distribution of dividend only and definition of Free reserves given in Sick Industrial Companies (Special Provisions) Act 1985 for the purpose of Net Worth, whether DRR, created by the company, is a part of free reserve or not for the purpose of computation of net worth as per the criteria prescribed under Notice Inviting Tender.

(ii) As per the criteria prescribed under Notice Inviting Tender for working out the net worth, whether the exclusion of the reserves and other provisions be restricted to revaluation reserve, capital reserve & amount of intangible asset like goodwill etc. given in second part of definition of Net Worth given in Notice Inviting Tender, hence DRR be not deducted from Net Worth and is part of Net Worth.

C. Points considered by the Committee

6. The Committee notes from the Facts of the Case that the query is with regard to whether Debenture Redemption Reserve created out of profits of the company is a free reserve or not and also whether the same is to be considered as a part of networth as defined in invitation document. 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 treatment of Debenture Redemption Reserve, need and rationale for creation and maintenance of DRR etc. The Committee wishes to point out that the opinion expressed hereinafter is purely from the perspective of accounting principles, viz., Indian GAAP and not from legal perspective, such as, interpretation of the terms of Notice inviting tender or Companies Act, 2013 or Sick Industrial Companies (Special Provisions) Act, 1985, etc. The Committee also assumes that notice inviting tender does not mandate the application of definition under Companies Act, 2013. Further, the Committee can lay down only the accounting principles for determination of networth and not calculate the net worth as such. The Committee also wishes to point out that net worth may be defined by different authorities/regulators for different purposes and, accordingly, the term defined for one purpose may not be relevant for other purpose.

7. At the outset, the Committee considers it appropriate to note the definition of the following terms from the 'Guidance Note on Terms Used in Financial Statements', issued by the Institute of Chartered Accountants of India (ICAI):

> **"6.13 Free Reserve**
>
> A *reserve* the utilisation of which is not restricted in any manner.
>
> **11.01 Net Assets**
>
> The excess of the *book value of assets* (other than *fictitious assets*) of an enterprise over its *liabilities*. This is also referred to as **net worth** or **shareholders' funds**."
>
> "**11.08 Net Worth**
>
> See **Net Assets**"

From the above, the Committee notes that the term, Free Reserve has been defined as a reserve which can be utilised freely without any restriction. The Committee also noted the nature and purpose of the reserve outlined in its financial statements for the year ended 31st March 2017 at page 141:

"The Company has recognised Debenture Redemption Reserve [DRR] as per the provisions of the Companies Act 1956. As per the provision, the Company shall credit adequate amount to DRR from its profits every year until such debentures are redeemed. The amount credited to DRR shall not be utilised by the Company except for the redemption of debentures."

From the above the Committee noted that DRR cannot be utilised for any other purpose till such time as the Debentures are redeemed.

Accordingly, the Committee is of the view that DRR is not a free reserve.

Further the Committee notes that the term 'net worth' has been defined in terms of net assets which is excess of the book value of assets over liabilities. Thus, it does not exclude any kind of reserve. Accordingly, the Committee is of the view that purely from accounting perspective, net worth includes all reserves, whether capital or revenue. However, the Committee wishes to point out that whether a particular item (for example, DRR) is to be included or not in net worth would depend on the purpose for which such net worth is being computed, for instance, from the Companies Act, 2013 perspective, some specific reserves are excluded from the definition of net worth. Similarly, for some other specific purposes, the net worth may be defined by specifically considering the purpose for which it is to be used.

D. Opinion

8. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 5 above:

(i) From the accounting perspective Debenture Redemption Reserve (DRR) is not a Free Reserve, as discussed in paragraph 7 above.

(ii) Without examining the issue from legal perspective, such as, interpretation of the terms of Notice inviting tender or Companies Act, 2013 or Sick Industrial Companies (Special Provisions) Act, 1985, as discussed in paragraph 6 above, the Committee is of the view that purely from accounting perspective, net worth should include all reserves, as discussed in paragraph 7 above. However, the definition of Net worth given in 'Guidance Note on Terms Used in Financial Statements', issued by the Institute of Chartered Accountants of India (ICAI), differs from the definition of net worth given in notice inviting tender which intends to include only free reserves as a part of networth. Therefore, DRR not being a free reserve will not be included for the calculation of net worth.

Query No. 34

Subject: Manner of appropriation to capital reserve and presentation/disclosure thereof.[1]

A. Facts of the Case

1. A corporation is a Central Public Sector Undertaking under the Administrative Ministry of Social Justice and Empowerment and is registered under section 8 of the Companies Act, 2013. The accounts of the corporation are subject to audit by the statutory auditors appointed by the Comptroller and Auditor-General ('C&AG') of India under section 139(5) of the Companies Act, 2013 (hereinafter referred to as 'the Act'). The statutory auditors are responsible for expressing opinion on the financial statements under section 143 of the Act based on the independent audit in accordance with the standards on auditing prescribed under section 143(10) of the Act. The C&AG is required to conduct supplementary audit under section 143(6)(a) of the Act and to give its report.

2. The Corporation has embarked upon a modernisation plan which has been sanctioned by Government of India for a total approved outlay of Rs. 338.04 crore wherein the source of finance as per the Standing Finance Committee of the Administrative Ministry finalised in July 2015 was Rs. 200.00 crore from Grant-in-aid from the Ministry and the balance from internal accruals. The approval also mentions that any cost escalation and addition at the time of implementation is to be borne from out of the internal accruals.

3. During 2016-17, the management of the corporation thought it prudent to apportion a part of interest income (on corporation's contribution of Rs. 138.04 crore) to Capital Reserve and meet the escalations and its contribution from the reserve so created as a prudent business practice. Accordingly, Rs. 861.63 lakh were taken out of the interest income and credited to the Capital Reserve. (Copy of the annual report of the corporation for the financial year 2016-17 has been furnished by the querist for the perusal of the Committee).

4. The querist has drawn attention to paragraph 10.9.1 of the 'Guidance Note on Revised Schedule VI to the Companies Act, 1956[2]', (hereinafter referred to as the 'Guidance Note'), issued by the Institute of Chartered Accountants of India, which clarifies that profits may be appropriated to free reserve as deemed appropriate by the management. Further, as per paragraph 8.1.2.9 of the Guidance Note, "Appropriations to the profit for the year (including carried

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[1] Opinion finalised by the Committee on 4.4.2018 and 5.4.2018.

[2] This Guidance Note was subsequently revised as 'Guidance Note on Schedule III to the Companies Act, 2013', consequent to enactment of Companies Act, 2013.

forward balance) is to be presented under the main head “Reserve and Surplus”. Unlike the current prevailing practice, under the Revised schedule VI, the Statement of Profit and Loss will no longer reflect any appropriations, like dividends transferred to Reserves, bonus share etc.”

5. The corporation feels that the capitalisation of interest is appropriation and is covered by the above provisions of the Guidance Note and, therefore, has been shown in the main head “Reserve and Surplus” and interest income has accordingly been shown as such, which is in line with the Guidance Note.

6. The statutory auditors were of the opinion that the case does not fit in the Guidance Note and, hence, qualified the report as below:

> “During the year 2016-17 a sum of Rs. 861.63 lakh has been credited under the head “Interest Capitalized for Modernization Expenses” by debiting Interest earned account. Accordingly, Interest Income is under-stated to that extent and Capital Reserve overstated”.

7. The C&AG, while conducting supplementary audit, expressed that the qualification of the statutory auditors was not justified in view of management’s view of prudence and relevant paragraphs of the Guidance Note mentioned above. The impasse was resolved after resolving to approach the Expert Advisory Committee of the Institute of Chartered Accountants of India for its opinion. The top management is of the view that such appropriations are essential and prudent to the operations of the corporation in view of fluctuating receipt of grants for carrying out the main activity of the corporation and that amount from out of this reserve shall be used towards the internal accruals of the corporation required for the project.

B. Query

8. The querist has sought the opinion of the Expert Advisory Committee on continuance/ discontinuance of appropriation till the proposed project is completed.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to manner of appropriation to capital reserve and presentation/disclosure thereof. The Committee has, therefore, considered only this issue and has not examined any other issue that may be contained in the Facts of the Case. From the copy of annual report for the financial year 2016-17 (also referred to as ‘current year’ hereinafter) furnished by the querist, the Committee notes that since the corporation in the extant case is a non-profit making corporation, it prepares balance sheet, statement of income and expenditure and cash flow statement. This is acceptable, since, as per sub-clause *(ii)* of clause *(40)* of section 2 of the

Companies Act, 2013 (hereinafter referred to as 'the Act'), in the case of a company carrying on any activity not for profit, the financial statements include an income and expenditure account for the financial year instead of profit and loss account. Further, from the copy of annual report for the financial year 2016-17 furnished by the querist, the Committee notes that for the said year, the company has followed Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as 2006 Rules) and not Companies (Indian Accounting Standards) Rules, 2015. Hence, the Committee has not considered the requirements of the Companies (Indian Accounting Standards) Rules, 2015 while expressing its views.

10. The Committee notes from the Facts of the Case that the management of the corporation has appropriated a portion of the interest income (on corporation's contribution to the modernization plan) (hereinafter referred to as 'interest appropriation') for the current year to capital reserve to meet any cost escalation and addition at the time of implementation of the plan. The Committee notes that the format of Statement of Profit and Loss given in Division I of Schedule III to the Act does not mention any appropriation item on its face. As per Note 6 of the 'General Instructions for Preparation of Balance Sheet' given in Division I of Schedule III to the Act, Notes to Accounts should include a note on "Reserves and Surplus" which, inter alia, includes 'Capital Reserve' and 'Surplus i.e., balance in Statement of Profit and Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc'. Further, additions to, and deductions from, each of the specified heads under 'Reserves and Surplus' since last balance sheet are to be shown. Further, Note 5(iv) of the 'General Instructions for Preparation of Statement of Profit and Loss' given in Division I of Schedule III to the Act requires the following disclosure to be made in the Notes to Accounts:

"(iv) (a) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance sheet is made up.

(b) The aggregate, if material, of any amounts withdrawn from such reserves"

Further, the Committee notes the following paragraphs of the 'Guidance Note on Schedule III to the Companies Act, 2013' (hereinafter referred to as 'the Guidance Note'), issued by the Institute of Chartered Accountants of India:

"8.1.2.9. Surplus i.e. balance in Statement of Profit and Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves, etc.

Appropriations to the profit for the year (including carried forward balance) is to be presented under the main head 'Reserves and Surplus'. Under the Schedule III, the Statement of Profit and Loss will no longer reflect any appropriations, like dividends transferred to Reserves, bonus shares, etc.

...

8.1.2.10. Additions and deductions since the last Balance Sheet to be shown under each of the specified heads:

This requires the company to disclose the movement in each of the reserves and surplus since the last Balance Sheet.

…."

"10.9 The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve [Clause (a) of Note 5(iv)]

10.9.1 Disclosure is required for amounts set aside or proposed to be set aside to reserves out of the profits for the period. The said transfers can be in terms of the applicable statute under which the Financial Statements are prepared i.e., the Companies Act, 2013 or any other applicable statute e.g. Income Tax Act, 1961, or RBI Act, 1932, etc. Further, profits may also be appropriated to free reserves as deemed appropriate by the management.

10.9.2. …

10.10 The aggregate, if material, of any amounts withdrawn from such reserves [Clause (b) of Note 5 (iv):

In case the company has made any withdrawals from any reserves created in terms of Clause (a) of Note 5(iv) above, the same is to be disclosed separately.

It may be noted that such setting aside as well as withdrawal from reserves is to be disclosed under applicable Line item of Reserves and Surplus, and not under the Statement of Profit and Loss since the same is an appropriation of profits and not a charge against revenue."

The Committee further notes paragraph 5 of Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' which provides as follows:

"5. All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise."

11. From the above, the Committee notes that an item of income recognised in a period should be necessarily included in the determination of net profit or loss and that 'appropriation of income' arises only if the item of income is included in the Statement of Profit and Loss. In this regard, the Committee noted that paragraph 4 of the General Instructions For Preparation of Statement of Profit and Loss, of Division I of Schedule III to the Act requires the company to classify interest income as part of 'Other Income' in the Statement of Profit and Loss.

12. Accordingly, the Committee is of the view that as per present requirements of the Act and the 2006 Rules, interest income should be recognised and disclosed in the Statement of Profit and Loss. Further, the Committee is of the view that while amount to be appropriated may be linked to a particular item of income, the appropriation should be out of profit/surplus for the reporting period which is determined after including that particular item in the Statement of Profit and Loss. Hence, in the extant case, the correct method of appropriation is to first include the item of income in the Statement of Profit and Loss and then appropriate the required amount from the 'Reserves and Surplus' by way of a deduction from the 'Surplus' i.e., balance in the statement of income and expenditure (as per balance sheet) and as an addition to the designated reserve. The said deduction and addition should be described appropriately, for example, as 'Transfer to capital reserve' and 'Transfer from surplus in the statement of income and expenditure' respectively with disclosure of reasons for the said transfer. The reason could be, for example, to retain funds for meeting escalation in the modernisation plan expenses.

The Committee wishes to point out that the corporation, if so desires, may (but is not required to) make appropriation of a portion of surplus to capital reserve. Paragraph 10.9.1 of the Guidance Note merely states that profits may also be appropriated to free reserves as deemed appropriate by the management. It does not mention that profits cannot be appropriated to capital reserve. In fact, the title of paragraph 10.9 of the Guidance Note, which is based on the requirement of Division I of Schedule III of the Act, uses the term 'reserves'.

13. The Committee notes that in the extant case, recognition of interest income in the statement of profit and loss and the appropriation to capital reserve is not made in the manner explained in paragraph 11 and 12 above. In the extant case, interest income is debited and 'Interest Capitalized for Modernization Expenses' is credited, which is exhibited as an element of capital reserve (see the discussion that follows in paragraph 14 below). This has the effect of understating interest income in the statement of profit and loss and, consequently, surplus for the current year. However, capital reserve is *not* overstated.

14. Further, from the copy of the annual report for the year 2016-17 furnished by the querist, the Committee notes that in Note 16 on 'Other Income', net interest income (after transfer to capital reserve) is shown, with further break-up of gross interest income and a deduction towards transfer to capital reserve but described as 'Interest Capitalized for Corporation's share in Modernization Plan'. This gives an impression as if a portion of interest income is credited to some asset(s) account, which has not happened in the extant case. Credit to capital reserve cannot be described as capitalisation. The Committee is of the view that creation of capital reserve cannot be considered as capitalisation of interest *income*.

D. Opinion

15. On the basis of the above, the Committee is of the opinion that the corporation can choose to continue or discontinue the appropriation to designated reserve as per the management's decision. However, the manner of appropriation and presentation/ disclosure followed at present is not correct. The same should be as explained in paragraphs 11 to 14 above.

Query No. 35

Subject: Revenue recognition policy for Online Testing and Assessment Services (OTAS) division of the company.[1]

A. Facts of the Case

1. A company (hereinafter referred to as the 'company') is a 'Mini Ratna' public sector enterprise wholly owned under the administrative control of the Ministry of Human Resource Development (MHRD), Government of India. The company offers project management and consultancy services in the area of education and human resource development value chain addition within India and overseas.

2. The clients of the company include mostly state and central government department, public sector undertakings (PSUs) and autonomous bodies including IITs, IIMs, IIITs, Kendriya Vidyalaya and Navodaya Vidyalaya. The vision of the company is to be the most trusted project management and consultancy organization offering educational and human resource consultancy services. The company undertakes end-to-end projects on turnkey basis from concept to commissioning and ensures effective management of activities from identification

[1] Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

of objectives through continuous monitoring leading to optimal fulfilment of targets within the stipulated time frame. The verticals of the company have leveraged expertise gained over three decades, strong alliances and commitment of dedicated teams to ensure a strong national and global presence for the company. These have strengthened the company's core competency in all areas of education and human resource development. The company presently has strong verticals in the following areas:

(i) Online Testing and Assessment Services (OTAS)

Based on two decades of expertise in handling offline recruitment tests, the company switched over to offering online recruitment solutions to bring in higher transparency and efficiency. This is the biggest vertical of the company which has received overwhelming market response. The clients include central and state governments, large PSUs and autonomous bodies etc. The vertical organises online recruitment tests across multiple segments of employees covering varied sectors of the economy. Being a PSU, targeted towards meeting educational needs, the company focuses on organising online examinations for recruitment of teachers and principals as a specialised service.

(ii) Educational Infrastructure Services

Following key services are provided by the vertical covering educational infrastructure management (turnkey execution and project management consultancy) services:

- Concept Design
- Detailed Drawings
- Detailed Project Estimate with Bill of Material
- Construction Schedule /Procurement Plan
- Request for Proposal (RFP) documents
- RFP Process Management
- Project Construction Monitoring
- Incident Monitoring
- Modifications in Schedule
- Quality Assurance and Control
- Billing and Payments
- Getting Completion / Occupancy Certificates from Statutory Authorities
- Final Project Completion Report with Expense Analysis

(iii) Educational Procurement Services (Lab Equipment, Information technology (IT) products, Furniture etc.)

Leveraging three decades of experience in domestic and overseas sector, following key services are provided by the vertical as part of the procurement services focusing on maximizing TCO in educational and human resource development space:

- Educational product research
- Vendor empanelment
- Demand aggregation
- Development of sourcing strategy
- E-Tendering
- Bid analysis
- Finalisation of contract
- Order placement
- Monitoring receipt of shipment including quality check at client site
- Vendor payment management
- Monitoring Annual Maintenance Contract (AMC)/Warranty
- Monitoring client feedback.

(iv) Digital Education System

The company strongly believes that digitization will be a game changer in addressing of quality, quantity and governance needs in both school and higher education. The company accordingly focuses on all emerging areas of IT/Information and Communication Technologies (ICT) applications in the sector. Following key services are provided by the vertical as part of the digital education system:

- Wi-Fi and Network Solutions
- Enterprise Resource Planning (ERP) Implementation
- Digitisation of Records
- E-content Preparation
- Virtual Classrooms
- Smart Campuses
- Online Admission System
- Computer Labs

(v) Advisory Services

Following key services are offered by the advisory vertical in the education (school chains and higher education) and Human Resource (HR) advisory space:

- Preparation of Detailed Project Reports (DPRs) (Greenfield and Brown field)
- Organization Restructuring (sectoral /institutional)
- Improving Operational Efficiency
- Digitization Planning
- Training Designing
- Impact Assessment (ICT/other schemes)
- Designing of New Education Schemes
- Education Content Design

(vi) Overseas Education Services

Based on strong Ministry of External Affairs (MEA)/MHRD endorsement with in India, client confidence and alliances gained globally over three decades, the vertical executes sponsored and aggregated inbound overseas student admissions and faculty hiring and also effectively meets the individual needs of inbound students wanting to study in India. The vertical focuses on high potential target markets covering mostly South Asian Association for Regional Co-operation (SAARC), Middle East and African nations. The following services are specifically offered:

- Placement of overseas students in select Indian institutes (sponsored schemes as well as SFS segments)
- Placement of Indian faculty in overseas institutes
- Student/faculty exchanges
- All other project management and consulting services extended in domestic sector

(vii) TSG (Technical Support Group)

This is the company's project management and logistical support vertical (also known as Technical Support Group – TSG) to extend operational support to MHRD in implementing several mega pan-India projects. The services include:

- Logistical support to various large MHRD schemes

- Outsourcing of consultants etc.
- Event management support
- Procurement services
- Transportation support

3. The querist has further provided activity-wise details for its Online Testing & Assessment Services (OTAS) division as follows:

i) Preparation of business development letters for sending to new/old clients

- Preparation of business development letters for sending to new clients (central/state government departments, public sector undertakings, autonomous organisations and institutions of central and state Governments, etc.) detailing the modalities involved for successful conduct of computer based test / online examination.
- Fix-up the meeting with the clients for giving detailed presentation about the conduct of computer based test/examination.
- Oral or written request from the prospective client for conduct of computer based test / online examination
- Examine the requirement of client for conduct of computer based test /online examination and seek necessary details from the client for preparation of detailed proposal.
- On receipt of necessary clarification and information from client, the detailed proposal (scope of work, general approach & methodology of the company and client, scheme and syllabus, time schedule of exam, payment terms and other terms and conditions, etc.), along with cost estimate (based on the pricing policy of the company) / financial bid shall be prepared in line with the requirement of the client and submitted to the competent authority through finance department for necessary vetting and approval for submission to client.

ii) For award of project

- After submission of the proposal to the client, necessary follow-up shall be made.
- Additional clarification, if required by the client, shall be provided from time to time.
- If required by the client, negotiation meeting of the proposal wherever required, shall be arranged.

- Obtaining approval of competent authority on negotiated cost/proposal and submission to the client.
- Necessary follow-up with the client for award of project and issuance of LOA.

iii) Signing of Memorandum of understanding (MOU)/Agreement

- If required by the client, preparation of draft agreement/MOU in consultation with client.
- Vetting of agreement/MOU by legal cell and finance department of the company.
- Obtaining approval of agreement/MOU by competent authority and forwarding the same to client for approval and signing of the same.

iv) Formation of project implementation team

Issuance of office order by Head of Department (HOD), OTAS for formation of project implementation team (PIT) for smooth implementation of each project/assignment, keeping in view the pre-occupation of the existing manpower and value of the Project.

v) Release of advance by client

- Preparation and submission of performa invoice(s) to client along with RTGS details for the release of advance amount as per the terms of proposal / agreement / MOU.
- Coordination with PIT and the client for the release of advance funds for the execution of the project.
- Coordination with PIT and ensure submission of copies of proposal, award letter, agreement/MOU, etc. to finance department.

vi) Examination Related Activities

a) Pre-examination activities

- Provide the detailed advertisement to the service provider (XYZ) for design, development of software for acceptance of online applications.
- Provide the demo to the client for acceptance of prepared software; changes, if any, to get incorporated in the software.
- Hosting of software for acceptance of online applications on the specific date & time, liaison with XYZ and client(s).

- Ensure set up of help desk facility to clarify the query(ies) of prospective candidates while the online applications are being received.
- Compilation of applications data, bifurcation of data post-wise, common candidates-wise.
- Provide the application data to client.
- Co-ordination with service provider and client for conduct of computer based tests in number of centres / city(ies).
- Verification of roll numbers and capacity of centres for computer based test.
- Development of software for e-admit card in consultation with client and XYZ.
- Deputation of officials/appointment of observers in examination centres.
- Briefing meeting of the company's officials / observers.
- Uninterrupted communication with client and XYZ for smooth conduct of examination.
- Setting up of facilitation counter in city of examination to address the grievances of candidates related to e-admit cards.
- Liaison with XYZ and client for arrangements of local police personnel to handle any law and order situation in each centre of examination.

b) On the day of examination

- Set-up of control room in the company and supervision, operation and monitoring of all the examination centres. Monitoring to ensure decryption of the question papers at the specified time for each post.
- Conduct of online examination, ensuring physical security, data security, web surveillance, mobile phone jamming and bio-metric verification.

c) Post-examination activities

- Collection of raw data of examination completed from the service provider.
- Collection of content/question paper/answers from the service provider and providing link to the client for inviting objection management from the candidates.

- Re-verification of question paper & answer from the concerned subject expert after the examination and objection management, if required.
- Preparation /compilation of merit lists as per the advertisement, handing over the same to client in soft copies and hard copies (if required).
- Conduct of interviews / skill test, if required by client(s)
- Raising of invoice(s) for release of balance and final payment and receipt of funds from client. Sending of post examination material to client.
- Obtaining feedback from client.
- Filing of closure report.

4. During the financial year (F.Y.) 2015-16, the company introduced a new technology based on on-line examination product. XYZ Limited is a channel partner for the said business. Based on the experience gathered during the F.Y. 2015-16, the actual work completed for the online examination had been worked out and a detailed evaluation had been framed by the company during the year based on stage completion in accordance with Accounting Standard (AS) 9, 'Revenue Recognition' as under:

Stages	Particulars	Percentage of work completed
I	Pre-examination activity till the despatch of admit card	26%
II	Conduct of examination	71%
III	Declaration of result	3%
	Total	100%

As evident from above, there are three identifiable stages involved in the conduct of on-line examination. Based on this analysis, the company adopts revenue recognition policy for online testing and assessment vertical which is approved by its Board of Directors (BOD) also as under:

Stages	Particulars	Percentage of revenue to be recognized as per AS 9
I	Pre-examination activity till the dispatch of admit card	26%
II	Conduct of examination	71%
III	Declaration of result	3%
	Total	100%

5. Payment to XYZ Limited for conducting the examination is made in the following stages:

Stages	Particulars	Current Payment Terms with XYZ
I	Hall ticket Issuance	25%
II	Conduct of examination	50%
III	Result Publication	25%
	Total	100%

Payment terms as per agreement with one of the client of the company are as follows:

Stages	Payment Terms with Client
I	80% advance of the total project cost along with service tax at the time of award of project.
II	10% of the total project cost plus service tax after despatch of e-admit cards to the candidates.
III	Balance 10% of remaining total project cost plus service tax after conduct of examination and at the time of submission of results.

This is resulting in a gap for revenue recognition and expenditure booked as explained below:

Stages	Particulars	Current Payment Terms with XYZ	Current Revenue Policy approved by BOD	Lag
I	Hall Ticket Issuance	25%	26%	(25-26)= 1%
II	Conduct of Examination	50%	71%	(75-97)= 22%
III	Result Publication	25%	3%	(100-100)= 0%

6. The querist has stated that payment terms are fixed via agreement according to which invoices are raised upon the company by XYZ Limited and revenue is being recognized according to the approved policy of board. But the percentages fixed are not in uniformity. To match the equation between the revenue and the associated cost, provisioning of expenses is required instead of merely booking as per the differential percentages. Accordingly, in stage I, since the revenue is being recognized at 26% and payment would be done 25%, to fill the gap of 1%, provision should be made for 1% less payment. Accordingly in stage 2nd, while making payment and booking cost of 50% of the total amount payable to vendor for the project, 21% of the amount payable to vendor for the project should be provisioned as expenses with the recognized revenue of 71% of contract value. And after conclusion of final, i.e., 3rd stage, while booking balance 3% of revenue, 3% of the total amount payable to vendor for the project should be booked as project expense and provision made in earlier stages (1%+21%=22%) should be credited to Vendor Account and balance payment amounting 25% of the contract value should be released as per the terms of the agreement.

7. The querist has informed separately that the normal duration/time taken by the company for completing one cycle of online testing and assessment service (OTAS) division normally varies from 90-100 days wherein the first stage normally is receipt of purchase /work order from the client and the final stage is issue of merit list apart from receipt of payment from the client. Further, the querist has clarified that the other activities/cost involved e.g. administrative activities apart from the payment made to the channel partner are as follows:

1) **Pre-examination activities till the dispatch of admit card**: These activities by the company apart from activities performed by channel partner include inputs related to recruitment rules and advertisement to the client as per the current government guidelines and rules and provide guidance to the technical team for various parameters such as categories, experience, etc. while designing and development of the application portal. The project team along with the technical team checks all the application parameters with respect to the categories, posts etc. to ensure an error free application portal. Checks are done to ensure that the admit cards have all the parameters as per the advertisement released earlier and the scheme of the examination. The admit cards are also checked at random to ensure that there is no mismatch in roll numbers, name, photos and other parameters and these are as per the details filled by the candidates. The company provides guidance on data finalisation and advises the technical team to remove the junk and duplicate applications.

Accordingly, the major cost shall be related to channel partner only and the company's cost shall be limited to the administration cost.

2) **Conduct of examination:** It includes finalisation of the examination centres, examination days, examination shift in different cities after analysing the data and in consultation with the client. The company deputes around 15 full time manpower staff which is dedicated only for OTAS (Online testing and assessment services) division and ensures that proper question papers have been set as per the client's requirements by preparing necessary checklists. The company also hires external observers (which varies from project to project) for the conduct of examination and also almost all junior company staff visits different examination cities 02-03 days prior to examination date to check the centres as per checklist and ensure that no last-minute issues arise due to lack of any infrastructure or technology. The company opens facilitation counters manned by the company's employees at various centres to address queries that a candidate may have before the start of examination. The company's team supervises all the activities from the entry of the candidates, registration, photo, thumb impressions and during the conduct of examination at each centre to tackle any unseen issue that may come-up. Ensure encrypted delivery of question papers on the day of examination as well as check the decryption via password, either system generated or otherwise. Command centre is operated at the centralised level manned by the senior officials of the company for giving the necessary instructions and response to the queries. The records such as CCTV camera footage, biometrics and offline thumb impressions, hard-copies of online and offline attendance sheets, admit card copies with signature and photo taken on the date of examination, authorised signed and duly filled feedback forms are shared with the client. Objection management is done which takes care of any query, a candidate has regarding the question paper and answers. The objected questions are reviewed by subject matter experts and the merit list is prepared thereafter. The company's cost includes fixed manpower cost of dedicated team for OTAS division, manpower cost of senior executives and various other junior staff, hiring cost of observers, boarding and lodging cost of the company's observers and travelling cost etc. According to the querist, the same contributes around 20-25% of total cost of the project. In view of above discussion, 97% revenue has been booked up to this stage.

3) **Declaration of result:** At this stage, only nominal 3% portion is taken for the revenue booking because almost all the activities are completed in the examination phase itself.

The above discussed activities and costs by the company are significant as the overall responsibility of the entire project remains with the company. Further, the legal consequences, if any, in future shall also be on account of the company. Hence, these activities and cost are significant to complete any project under online testing and assessment service division.

B. Query

8. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India as to whether the revenue recognition policy and accounting treatment for booking of income and expense for online testing and assessment service division of the company is in accordance with applicable accounting standards and comply with the matching principle.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to accounting for costs and revenue relating to contracts of online testing and assessment service division of the company. Therefore, the Committee has considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, accounting for costs and revenue in relation to other divisions of the company, accounting for the difference between the revenue recognised at any stage and the amount receivable as per the payment terms of the contract with the client, correctness of determination of various stages of completion of contract activities for recognition of revenue and the percentage of work completed upto that stage, what items of costs can be considered as contract costs, etc. Further, since AS 9 has been referred to in the Facts of the Case, the Committee has expressed its views, hereinafter in the context of Accounting Standards, notified under the Companies (Accounting Standards) Rules, 2006 and not in the context of Indian Accounting Standards (Ind ASs).

10. With regard to the issue raised, the Committee notes the following paragraphs of Accounting Standard (AS) 9, 'Revenue Recognition', notified under the Companies (Accounting Standards) Rules, 2006:

"7.1 Revenue from service transactions is usually recognised as the service is performed, either by the proportionate completion method or by the completed service contract method.

(i) ***Proportionate completion method***—Performance consists of the execution of more than one act. Revenue is recognised proportionately by reference to the performance of each act. The revenue recognised under this method would be determined on the basis of contract value, associated costs, number of acts or other suitable basis. For practical purposes, when services are provided by an indeterminate number of acts over a specific period of time, revenue is recognised on a straight line basis over the specific period unless there is evidence that some other method better represents the pattern of performance.

(ii) ***Completed service contract method***—Performance consists of the execution of a single act. Alternatively, services are performed in more than a single act, and the services yet to be performed are so significant in relation to the transaction taken as a whole that performance cannot be deemed to have been completed until the execution of those acts. The completed service contract method is relevant to these patterns of performance and accordingly revenue is recognised when the sole or final act takes place and the service becomes chargeable."

"9.1 Recognition of revenue requires that revenue is measurable and that at the time of sale or the rendering of the service it would not be unreasonable to expect ultimate collection."

"12. In a transaction involving the rendering of services, performance should be measured either under the completed service contract method or under the proportionate completion method, whichever relates the revenue to the work accomplished. Such performance should be regarded as being achieved when no significant uncertainty exists regarding the amount of the consideration that will be derived from rendering the service."

"4.3 <u>**Proportionate completion method**</u> ***is a method of accounting which recognises revenue in the statement of profit and loss proportionately with the degree of completion of services under a contract."***

On the basis of above, the Committee notes that as per the requirements of AS 9, where the contract involves execution of more than one act, revenue should be recognised proportionately by reference to the performance of each act or degree of completion of services under the contract, which is commonly referred to as 'proportionate completion method'. The Committee notes that the service contract in the extant case involves execution of many activities for which payment is receivable from time to time and is not dependent upon the execution of final act, viz., declaration of result. Moreover, since as per the querist, almost, all the activities are completed by the examination stage itself, which is an intermediate stage and not till the last stage (viz., declaration of result), the Committee is of the view that 'completed service contract method' should not be applied in the extant case. The Committee further notes that AS 9 does not give detailed guidance on application of proportionate completion method and accordingly, although Accounting Standard (AS) 7, 'Construction Contracts' is not applicable for the contracts of online testing and assessment service in the extant case, requirements/principles provided under AS 7 with reference to percentage of completion method which is also commonly known as proportionate completion method can still be applied in the extant case. Accordingly, the Committee notes the following requirements of AS 7:

> "24. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.
>
> 25. Under the percentage of completion method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting periods in which the work is performed. Contract costs are usually recognised as an expense in the statement of profit and loss in the accounting periods in which the work to which they relate is performed. ..."

From the above, the Committee notes that under the percentage of completion method, revenue is recognised in the statement of profit and loss on the basis of stage of completion/work performed irrespective of the fact whether or not payment has been received or settled (provided other conditions of revenue recognition are also being fulfilled). Similarly, costs are also recognised in the statement of profit and loss of the period in which the work to which they relate are performed. Thus, both costs and revenue are recognised with reference to the work performed, i.e., stage of completion, which may be determined in a variety of ways, such as, surveys of work performed, completion of a physical proportion of the contract work, etc., depending on the nature of the contract and whichever method reliably measures the work performed. Payment terms with the client and that with the sub-contractor do not have any impact in determining stage of completion as it may not necessarily reflect the work performed. Thus, if the stage of completion of a contract is 26%, both costs and revenue should be recognised with reference to such stage irrespective of the payments made or becoming due to be made to the sub-contractors and amount collected or due to be collected from the clients. Accordingly, in the extant case, on reaching stage I, along with recognition of revenue of 26% corresponding to the stage of completion of the service contract, contract costs which are incurred in reaching 26% of stage of completion of the contract (which shall include the costs of activities performed by the company itself as well as by the service provider XYZ) should be recognised in the statement of profit and loss irrespective of the fact that a lesser percentage is to be paid as per the payment terms under the sub-contract. The difference as per the payment terms and the contract cost recognised will be provided/accounted for as contract payables. Similarly, for other stages of completion also, the costs and revenue should relate to the work performed/stage of completion.

11. Incidentally, the Committee wishes to mention that nature of individual contracts may vary; hence variations from contracts to contracts should also be factored into while determining the stage of completion, and revenue recognition from the contract. Thus, it is possible that even under the same vertical/division, (for example, for Online Testing and Assessment Services vertical) there are two different stages of completion and revenue recognition for two different types of contract considering the requirements of AS 7.

D. Opinion

12. On the basis of the above, the Committee is of the opinion that the revenue recognition policy and accounting treatment for booking of income and expense for online testing and assessment service division of the company should be with reference to the stage of completion of each act (depending on the nature of each contract). Payment terms with the client and that with the sub-contractor do not have any impact in determining stage of completion. Thus, if the stage of completion of a contract is 26%, both costs and revenue should be recognised with reference to such stage irrespective of the payments made or becoming due to be made to the sub-contractors and amount collected or due to be collected from the clients as discussed in paragraph 10 above. Accordingly, if the company is following the above accounting treatment, the same would be in accordance with the applicable accounting standards and comply with the matching principle.

Query No. 36

Subject: Preparation of Income and Expenditure Account or Profit and Loss Account for a section 8 company, undertaking commercial activities.[1]

A. Facts of the Case

1. A corporation is a company (Public Sector Undertaking) (hereinafter referred to as 'the company)' originally established under section 26 of the Companies Act 1913 on 31st December 1953 which after enactment of the Companies Act, 1956 became a section 25 company under the Companies Act 1956 and now after enactment of the Companies Act 2013, it is a company under section 8 of the Companies Act 2013.

2. The company operates with a mandate to promote, develop and to commercialise indigenously developed technologies from universities, National Research and Development (R&D) Institutions and individual inventors etc. The company is strengthening the technology resource base by nurturing long-term relationship with R&D Institutions as well as universities, technical organisations, industries as well as individual inventors. Also it specialises in technology transfer, Intellectual Property (IP) portfolio management and project consultancy.

3. Besides the above, the company has undertaken various promotional activities of the Government of India (GoI) by receiving grants-in-aid from the GoI since 1970. Presently, the company carried out the following promotional activities on behalf of the Government of India and received grants-in-aid from the Department of Scientific and Industrial Research (DSIR):

Scheme I: Programme for Inspiring Inventors and Innovators (PIII)

Scheme II: Programme for Development of Technologies for Commercialisation (PDTC)

The company also undertakes the following programmes as consultancy services:

- The company has been integrated with Department of Industrial Policy and Promotion (DIPP) for Start-up India Action Plan.
- Implementing IOCL start-up scheme.
- The company has been designated by DIPP as government facilitator for IP filings for start-ups under Startups Intellectual Property Protection (SIPP) Scheme.

[1] Opinion finalised by the Committee on 17.10.2018.

- Various services being offered to Incubators/Start-ups.

4. Presently the company prepares profit and loss account for its commercial activities as per Schedule III of the Companies Act 2013 and for promotional activities, yearly grants-in-aid from the Government of India relating to revenue and expenditure have been recognised in income and expenditure separately *under the Notes to Accounts* (emphasis supplied by the querist). The unspent balances of grants-in-aid are carried forward to subsequent years under the head 'Current Liabilities and Provisions' for adjustment against expenses. Excess of expenditure over the amount of grants received after adjusting income, if any, related thereto, has been carried forward to subsequent years under the head 'Loans and Advances' as amount receivable from Government of India. Presently the company also paid tax under the Income tax Act, 1961 and filed the return under section 139 thereof.

5. The querist has mentioned that section 2(40) of the Companies Act, 2013 states as follows:

> "financial statement in relation to a company, includes-
>
> (i) a balance sheet as at the end of the financial year;
>
> (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year; …"

B. Query

6. In view of the facts mentioned above, the querist has sought the opinion of the Expert Advisory Committee that being section 8 company and also doing commercial activities whether the company should prepare income and expenditure account or profit and loss account for both promotional and commercial activities and accordingly, whether grants received for promotional activities from the Government of India are required to be shown in the profit and loss account or income and expenditure account or continue to show separately in the notes to accounts.

C. Points considered by the Committee

7. The Committee notes that the basic issue raised by the querist relates to whether the company is required to prepare income and expenditure account or profit and loss account for both promotional and commercial activities and accordingly, whether grants received for promotional activities from the Government of India are required to be shown in the profit and loss account or income and expenditure account or continue to show separately in the notes to accounts. 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,

whether the company is acting as a principal or as an agent of the Government while carrying out the promotional activities, accounting for individual grants received by the company etc. Further, the Committee has examined the query only from the accounting perspective and not from legal perspective, such as, interpretation of Income-tax Act, 1961, etc.

8. The Committee notes from the Facts of the Case that the company was earlier a section 25 company under the Companies Act, 1956 and now after enactment of the Companies Act, 2013, it is a company under section 8 thereof which provides as follows:

> **"8. Formation of companies with charitable objects, etc**.—(1) Where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered under this Act as a limited company—
>
> > (a) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;
> >
> > (b) intends to apply its profits, if any, or other income in promoting its objects; and
> >
> > (c) intends to prohibit the payment of any dividend to its members,
> >
> > the Central Government may, by licence issued in such manner as may be prescribed, and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company under this section without the addition to its name of the word "Limited", or as the case may be, the words "Private Limited", and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section.
> >
> > …"

9. The Committee further notes section 2(40) of the Companies Act, 2013 which states as below:

> "(40) "financial statement" in relation to a company, includes—
>
> > (i) a balance sheet as at the end of the financial year;
> >
> > (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
> >
> > …"

From the above, the Committee notes that section 2(40) uses the expression 'carrying on any activity not for profit', which has not been specifically defined/explained in the Companies Act. The Committee is of the view that the key principle is whether the company is applying its profits to its 'not for profit' objective and does not distribute any dividends to its members. The Committee is further of the view that the expression, 'carrying on any activity not for profit' does not mean that company need not earn profits. Even a company carrying on activities not-for-profit may earn profits for its sustenance and carry on commercial activities for its intended objectives. However, the objective of the company to earn profits should not be for distribution among its members. In this regard, the Committee notes clause 113 of the Articles of Association (AoA) of the company (separately provided by the querist for the perusal of the Committee) which states as below:

> "113. No dividends in any form or shape shall be paid to members so long as the licence granted by the Government of India under Section 25 of the Act remains in force and is not rescinded or withdrawn."

From the above, the Committee is of the view that the objective of the company is not to earn profits for distribution among its members. The profits earned, if any, will be used for the furtherance of the objectives of the company.

Accordingly, in the extant case, as the company is applying its profits to its 'not for profit' objective and does not distribute any profit by way of dividends to its members, it can be construed as a company carrying on activity not for profit and, therefore, is required to prepare only the income and expenditure account (both for promotional and commercial activities) instead of profit and loss account. Incidentally, the Committee notes that AoA of the company requires preparation of both profit and loss account as well as income and expenditure account. In this context, the Committee wishes to point out that considering the views expressed above, the company should consider modification (if any), required to be made in the AoA in this regard.

10. The Committee also notes that 'General Instructions for Preparation of Statement of Profit and Loss' of Schedule III to the Companies Act, 2013 states as below:

> "1. The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of clause (40) of section 2 in like manner as they apply to a statement of profit and loss."

From the above, the Committee notes that for Schedule III purposes, income and expenditure account shall be prepared in a similar manner as the profit and loss account and the General Instructions for Preparation of Statement of Profit and

Loss also apply equally on the preparation of an income and expenditure account.

11. Therefore, the Committee is of the view that the income and expenditure account is required to be prepared in place of profit and loss account, as required under section 2(40) of the Companies Act, 2013, and not as a part of notes to accounts as being done by the company in the extant case.

12. As far as accounting (including disclosures) for the grants received for promotional activities from the Government of India is concerned, the same would depend upon the nature of grant received and the capacity in which the funds are received by the company (viz. as a principal or as an agent) and the same would require separate consideration as per the applicable accounting standards and principles on the basis of specific facts and circumstances and conditions under which such grant/amount has been sanctioned/provided to the company.

D. Opinion

13. On the basis of above, the Committee is of the opinion that the company should prepare income and expenditure account for all its activities (both promotional and commercial activities) instead of profit and loss account, as discussed in paragraphs 9 and 10 above. As far as accounting (including disclosures) for the grants received for promotional activities from the Government of India is concerned, refer paragraph 12 above.

Query No. 37

Subject: Accounting treatment of R&D expenditure as capital work-in-progress and treatment of grants-in-aid received as liability.[1]

A. Facts of the Case

1. XYZ is a society registered on 16.6.1984 under the provisions of Societies Registration Act 1860, under the administrative control of Department of Defence (R&D), Ministry of Defence (MoD). The Defence Minister and the Finance Minister are President and Vice President, respectively, of the general body and the scientific advisor to Defence Minister is the chairman of the governing body. The society has been entrusted with Research & Development (R&D) of light combat aircraft (LCA) and the Cabinet Committee for Political Affairs (CCPA) has

[1] Opinion finalised by the Committee on 17.10.2018.

approved the cost and laid down certain time frame to complete the task. It is a non-profit organisation.

2. XYZ is engaged in the design and development of light combat aircraft both for the Indian Air Force (IAF) and Indian Navy (IN). The objectives of the society are to undertake, aid, promote, guide, manage, co-ordinate and execute research in aeronautical science, design & development of various types of aircraft and rotorcraft.

3. The primary mission of the Tejas Programme is to design and develop a world class fighter aircraft for IAF and IN to replace MiG series of aircraft for IAF and sea harrier for the IN and to create a technology base within the country. As a first step, demonstration of technology through R&D has been initiated with the active participation of a public sector undertaking, ABC Ltd. (a wholly owned government company) and other work centres. XYZ is a programme management organisation for the LCA Programme and ABC Ltd. is the principal partner in the programme. Besides, there are about 100 work centers involved in the programme. It includes laboratories under the Department of Defence Research & Development (DRDO), Council of Scientific & Industrial Research (CSIR), Public Sector Undertaking (PSU), Indian Space Research Organization (ISRO), Academic Institutions and Indian Air Force (IAF).

4. The querist has stated that XYZ annually prepares receipts and payments account, income and expenditure account and balance sheet. As no trading is involved, there is no profit and loss account. No depreciation is being provided. Excess of expenditure over income (income which is of minor nature, such as, recoveries of house rent, transport charges etc.) is capitalised and transferred to balance sheet as project expenditure (under the head project management expenditure). In fact, there is no balance which is charged off in the income and expenditure account and receipts and payments accounts, unlike in the conventional profit and loss account. Financial statements are audited by the Comptroller and Auditor General of India (C&AG). The annual report together with annual accounts shall be laid on the table of Lok/Rajya Sabha in the Parliament.

5. XYZ receives grants-in-aid from the Government of India for financing the requirements of the light combat aircraft project. Grants-in-aid are shown on the liability side of the balance sheet. The society has been exempted from paying income-tax as per Rule 5C and 5D of the Income-tax Rules, 1962 with effect from 1.4.2006 as it has been approved as a 'Scientific Research Association' under clause (ii) of sub-section (1) of section 35 of Income-tax Act, 1961.

6. XYZ is the nodal funding and monitoring agency for the Tejas Programme. LCA/ Tejas Programme is a project of national importance funded by the Ministry of Defence (Department of Defence, R&D). As per Memorandum

of Understanding (MoU) with ABC Ltd., prototypes developed by ABC Ltd. are not deliverables to XYZ and are meant for flight testing. The whole development exercise including activities at ABC Ltd. is to demonstrate the technology of design and to develop a light combat aircraft.

7. As of today, the development of Tejas project is not complete. So far, the technology to design and develop LCA has been partially demonstrated. Technology demonstrators and prototype vehicles have been built and/or are under flight test. These technology demonstrators/prototypes will have to undergo mandatory flight tests leading to Initial Operational Clearance (IOC), which has been completed and eventually Final Operational Clearance (FOC) (scheduled to be completed during the year 2018), issued by the Centre for Military Airworthiness and Certification (CEMILAC). Thereafter, the LCA will be inducted by IAF.

8. Intellectual Property Rights (IPR) of design and development of LCA remains with XYZ. However, technology has been transferred to ABC Ltd. so as to enable them to manufacture and supply LCA directly to IAF. Production of LCA contract is directly signed and executed by IAF and ABC Ltd. without any involvement of XYZ, which is a design agency. On achievement of FOC, XYZ's responsibility will be limited to attend to any issues with reference to design deficiency, if any, and improvement as and when requested. Ownership of assets procured by work centre and funded by XYZ shall rest with XYZ. On completion of work packages issued by XYZ to its work centre, assets or facilities funded by XYZ for LCA programme in respect of DRDO labs and academic institutions like Indian Institute of Science, IITs will be transferred to the respective work centre. In respect of assets or facilities funded by XYZ in respect of ABC Ltd. and other CPSUs, ABC Ltd. / CPSU will have the option to take over such property at a value mutually agreed upon. In the event of ABC Ltd./CPSU not exercising this option, disposition of these assets will be decided by XYZ in consultation with ABC Ltd.

9. The querist has clarified that Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI) are not applicable to XYZ as XYZ is a non-commercial organisation. The querist has also mentioned that the Preface to the Statements of Accounting Standards, issued by the ICAI provides that the Institute will issue Accounting Standards for use in the presentation of general purpose financial statements issued to the public by commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members. Though the accounting standards are not applicable, XYZ has adopted prudent accounting policies as per the Accounting Standards wherever possible.

10. The querist has also stated that XYZ being a programme implementing agency, has accounted for the receipt of grants-in-aid which are released for the development of LCA, as capital receipt as per Accounting Standard (12) 'Accounting for Government Grants'. Also XYZ has not been charging depreciation towards assets as there is no financial provision towards depreciation/ replenishment of assets in Cabinet Committee on Security (CCS) sanctions accorded for development of LCA programme.

11. As per paragraph 7 of the Manual of Budget and Accounts of XYZ, "All preliminary expenditure on surveys and investigations of projects which have fructified is treated as capital expenditure leaving it open to the Governing Council to decide to write back this expenditure to revenue over a period of years".

12. During the course of supplementary audit of the accounts of XYZ under section 20(1) of Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 by the audit party of Comptroller and Auditor General (C&AG) of India, it was observed that:

"Audit Observation no. 1

Classification as R&D Expenditure

XYZ has capitalized its entire expenditure on the grounds that it is towards research and development. This is an incorrect treatment which is in violation of the accounting standards because of the following reasons.

No Accounting Standard allows the capitalisation of R&D expenditure. It is always treated as revenue or deferred revenue expenditure. The reason stated by XYZ for capitalising its expenditure is that, its entire expenditure is on the LCA project, for the development of the light combat aircraft. Audit finds this argument to be incorrect because LCA is not an asset for XYZ, but an asset for Indian Air Force. According to Accounting Standards (International Public Sector Accounting Standard (IPSAS) 17, International Accounting Standard (IAS) 16, and Accounting Standard (AS) 10), items of property, plant and equipment shall be recognised as assets only when:

a) It is probable that the future economic benefits or service potential associated with the item will flow to the organisation.

b) The organization has control over the assets.

c) The cost or fair value of the item can be measured reliably.

Control over assets arises when an entity can: i) use or otherwise benefit from the asset in pursuit of its objectives; and ii) exclude or otherwise regulate the access of others to that benefit. This standard applies to specialist military equipment like fighter aircraft (LCA).
LCA cannot be an asset for XYZ as future economic benefits will flow to IAF and not to XYZ. XYZ is the executing agency. It has no control over the asset, LCA. All the expenditure incurred by XYZ does not get converted to asset as some of the development activities do not fructify. For instance, the development of multi–mode radar, flight control system actuators etc. for LCA did not fructify and these items had to be imported.

Audit Observation No. 2

Treatment of Grants as Liability

According to Accounting Standard (AS) 12 and IAS 20, the grants received by an autonomous body can either be classified under liability as Shareholders' Funds (Capital Approach) or income for a given period (Income Approach).

It is appropriate to treat grants as 'Liability' in the following situations:

I. When grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in the case of such grants.

II. When they are not earned, but represent an incentive provided by government without related costs.

It is appropriate to treat grants as 'Income' in the following situations:

I. Grants are given to an organization for a specific purpose to compensate the costs incurred by the organisation for an activity undertaken on behalf of the grantor.

II. As the organization renders service in return, it earns the grants through compliance with their conditions and meeting the envisaged obligations. They should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.

XYZ has adopted the Capital Approach and treated grants-in-aid as liability. But, if the accounting standards are applied correctly, in the case of XYZ, the most appropriate method is to treat grants as Income as XYZ receives grants in return for rendering R&D services/activities in compliance with the conditions set by the Government while sanctioning the grants."

(Clarifications sought by C&AG and response given by XYZ have been separately supplied by the querist for the perusal of the Committee.)

13. The querist has also separately clarified the following:

(i) XYZ is neither an 'agent' nor 'principal' vis-à-vis Government (MoD). XYZ is a society under the Department of Defence, Research and Development Organisation, Ministry of Defence (MoD), Government of India (GoI). Initial task assigned to XYZ by the GoI was design and development of LCA with full budgetary support, to meet Air Staff Requirements (ASR) specified by IAF. Subsequently, design and development of carrier borne Naval variant of LCA was also assigned to XYZ.

(ii) Grants-in-aid are authorized by Department of Research and Development to XYZ with the condition that XYZ would utilize the funds only for LCA Programme. (Copy of the sanction letter has been supplied by the querist.) XYZ receives grants-in-aid from the GoI for development of LCA. Rules governing grants-in-aid are listed in Chapter No.9 of General Financial Rules 2017, issued by the Ministry of Finance, GoI.

(iii) LCA design and development, programme management, overall control and responsibility remain with XYZ. ABC Ltd. has been designated as principal partner of XYZ during Full Scale Engineering Development (FSED) of LCA Programme to undertake detail design, development, manufacture, flight clearance and testing of LCA Technology Demonstrators / Prototype Aircraft. IPR of LCA programme will remain with XYZ. Technologies that are developed by ABC Ltd. with funding from XYZ, will remain joint property of XYZ and ABC Ltd.

Prototypes of the LCA are manufactured and maintained by ABC Ltd. for undertaking flight tests by pilots from National Flight Test Centre. All these activities are funded by XYZ. Prototype aircrafts are owned by XYZ. These prototypes are to be returned to XYZ or its disposal would be decided by XYZ.

(iv) The querist has also clarified that the opinion in the extant case is sought from the perspective of the Accounting Standards, issued by the Institute of Chartered Accountants of India. Since, its inception, financial statements of XYZ were prepared based on cash basis of accounting as decided during 1985. Recently, C&AG has insisted that XYZ should adopt accrual basis of accounting as per Common Format of Accounts for Central Autonomous Organizations/Institutions, issued by MoF dated

23.07.2006 (copy provided by the querist for the perusal of the Committee). Hence, financial statements of 2016-17 were recast. XYZ has not yet provided depreciation on its assets and reasons for the same have been elaborated in the enclosures provided with the query.

B. Query

14. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) Treatment of capitalization of entire expenditure incurred towards design and development of LCA, funded as per Cabinet Committee on Security (CCS) sanction, as capital work-in-progress (WIP) and

(ii) Treatment of grants-in-aid received as liability considering the fact that XYZ does not have any revenue stream other than grants-in-aid, also considering the fact that XYZ does not have any share capital or initial investment or any kind of borrowings and thereby annual establishment expenditure is also passed through income and expenditure account and capitalised as capital WIP during execution of the LCA programme. On completion of the programme, both grants received (liability) and programme expenditure (capital WIP) will be set off on submission of utilisation certificate to the GoI.

C. Points considered by the Committee

15. The Committee notes that the basic issues raised by the querist relate to accounting treatment of expenditure incurred towards design and development of LCA and treatment of grant-in-aid received for LCA programme. The Committee has, therefore, considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment of LCA and other assets which are acquired or generated during LCA programme, determination of expenses directly attributable to LCA programme, appropriateness of netting off of income against expenditure, appropriateness of not providing for depreciation, appropriateness of non-preparation of profit and loss account, etc. Further, the Committee has examined the query only from accounting perspective and not from any other perspective, such as, interpretation of Income-tax Act, General Financial Rules, Common Format of Accounts for Central Autonomous Organisations/ Institutions issued by MoF, or any other Act or Guidelines applicable on societies, etc. Further, since AS 12 as issued by the Institute of Chartered Accountants of India (ICAI) has been referred to in the Facts of the Case and the querist has also separately informed that Accounting Standards as issued by ICAI are being followed by XYZ, the

Committee has expressed its views, hereinafter in the context of Accounting Standards, issued by the ICAI only.

16. At the outset, the Committee notes that XYZ in the extant case is a separate legal entity registered as society under the administrative control of Department of Defence, Ministry of Defence (Government of India) wherein various minsters of the Government are on its governing and general body. Further at various places in the Facts of the query, the society (XYZ) has been referred to as 'the programme management organisation', 'design agency', programme implementing agency', 'executing agency', etc. Accordingly, considering the governing structure of the society and the functions/activities being undertaken by XYZ in the extant case, the Committee is of the view that there is a possibility that XYZ is merely an executing/implementing agency of the MoD/GoI in relation to the LCA programme. However, the same being a matter of fact and in the absence of any clarity on this in the Facts of the Case, the Committee has, hereinafter examined both the situations, viz., XYZ acting as agent of the MoD/GoI (working on behalf of the MoD/GoI) in the context of LCA programme and XYZ acting in its independent capacity (on principal basis).

In the situation where XYZ is not acting as an agent of the MoD/GoI, i.e. it is acting on principal basis

17. With regard to accounting treatment of expenditure incurred towards design and development of LCA, the Committee notes paragraphs 6.1, 20, 41, 44 and 46 of AS 26, Intangible Assets, issued by the ICAI which state as follows:

> ***"6.1 An <u>intangible asset</u> is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes."***
>
> ***"20. An intangible asset should be recognised if, and only if:***
>
> > ***(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and***
> >
> > ***(b) the cost of the asset can be measured reliably."***
>
> ***"41. No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred."***
>
> ***"44. An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, an enterprise can demonstrate all of the following:***

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

(b) its intention to complete the intangible asset and use or sell it;

(c) its ability to use or sell the intangible asset;

(d) how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

(f) its ability to measure the expenditure attributable to the intangible asset during its development reliably."

"46. Examples of development activities are:

(a) the design, construction and testing of pre-production or pre-use prototypes and models;

(b) the design of tools, jigs, moulds and dies involving new technology;

(c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and

(d) the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services."

From the above, the Committee is of the view that the expenses incurred on research activities (or on the research phase of an internal project) should be recognized as an expense when it is incurred. However, the expenses incurred on development activities (or during development phase of an internal project) should be recognised as an intangible asset if, and only if, an enterprise can demonstrate that all the conditions mentioned in paragraph 44 of AS 26 above are fulfilled. In this regard, considering the nature of activities from the Facts of the Case and the extracts of the MoU between XYZ and ABC limited, which are broadly related to design, development, testing etc. of various systems and facilities related to LCA, the Committee is of the view that activities undertaken under LCA programme are development activities, which although will not result into any tangible (fixed) asset for XYZ, will give rise to various intangible assets to XYZ, such as, IPR, technology, etc. Further, since XYZ would be able to derive future economic benefits from such IPR, technology, etc. through their internal use, expenses incurred on such development activities should be recognized and capitalized as an intangible asset provided the conditions for recognition of intangible asset as per AS 26 are fulfilled. In this regard, another issue to be examined is whether XYZ has the ability to exercise any 'control' on the asset created out of the expenditure incurred (IPR in the extant case). In this context, the Committee notes the definition of 'asset' and paragraph 14 of Accounting Standard (AS) 26, 'Intangible Assets', issued by the ICAI as follows:

"***6.2 An asset is a resource:***

(a) controlled by an enterprise as a result of past events; and

(b) from which future economic benefits are expected to flow to the enterprise."

"14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way."

From the above, the Committee notes that asset is a resource *controlled* by the enterprise and an enterprise *controls* an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. Accordingly, the Committee is of the view that it is only where the asset is controlled by XYZ in the manner envisaged by paragraph 14 of AS 26, XYZ should recognise asset in its financial statements in respect of the expenditure incurred, else the same should be recognised as an expense.

18. Further, with regard to grant-in-aid/funds received from the Government for the LCA programme, the Committee notes paragraphs 8.1 to 8.4 of AS 12 and paragraph 33 of AS 26, issued by the ICAI, reproduced as below:

AS 12

"8.1 Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

8.2 Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to specific fixed assets are regarded as acceptable alternatives.

8.3 Under one method, the grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the grant equals the whole, or virtually the whole, of the cost of the asset, the asset is shown in the balance sheet at a nominal value.

8.4 Under the other method, grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income is suitably disclosed in the balance sheet pending its apportionment to profit and loss account. For example, in the case of a company, it is shown after 'Reserves and Surplus' but before 'Secured Loans' with a suitable description, e.g., 'Deferred government grants'."

"10.1 Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income."

AS 26

"33. In some cases, an intangible asset may be acquired free of charge, or for nominal consideration, by way of a government grant. This may occur when a government transfers or allocates to an enterprise intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. AS 12, Accounting for Government Grants, requires that government grants in the form of non-monetary assets, given at a concessional rate should be accounted for on the basis of their acquisition cost. AS 12 also requires that in case a non-monetary asset is given free of cost, it should be recorded at a nominal value. Accordingly, intangible asset acquired free of charge, or for nominal consideration, by way of government grant is recognised at a nominal value or at the acquisition cost, as appropriate; any expenditure that is directly attributable to making the asset ready for its intended use is also included in the cost of the asset."

The Committee notes from the Facts of the Case that the XYZ receives grant-in-aid/funds from the Government of India (GoI) for financing the requirements of the LCA programme/project wherein the whole exercise is to demonstrate the technology of design and to develop a light combat aircraft. Thus, the grant is provided to develop certain specified tangible and intangible assets and is not with reference to total investment in an undertaking or by way of contribution towards its total capital outlay. Accordingly, the Committee is of the view that it would not be appropriate to treat the grant-in-aid/funds as 'promoters' contribution'. The Committee further notes that both AS 26 and AS 12 are silent in respect of accounting treatment for the monetary grant received for development of intangible assets. However, AS 26 specifies accounting for government grants in the form of non-monetary intangible assets (in paragraph 33 of AS 26) which is similar to the requirements in respect of grants in the form of non-monetary fixed assets as provided under AS 12. Therefore, the Committee is of the view that an analogy can be drawn from the requirements of AS 12 to apply the same to the grant/funds received in the extant case for LCA programme which gives rise to intangible asset(s) for the XYZ. Accordingly, the grant received should be treated as deferred income which is recognised in the income and expenditure account on a systematic and rational basis over the useful life of the related asset. Alternatively, the grant should be shown as a deduction from the gross value of the asset concerned in arriving at its book value. In this regard, the Committee also incidentally notes that the 'Common Format of Accounts for Central Autonomous Organisations/Institutions' (as provided by the querist for the perusal of the Committee) also prescribe similar accounting for grants in respect of specific fixed assets (depreciable).

In the situation where XYZ is acting as an agent of the MoD/GoI

19. With regard to the grant-in-aid/funds received by XYZ in its capacity of agent of the MoD/GoI, the Committee notes that in these cases, the XYZ is merely incurring expenditure out of the grant-in-aid/funds received and is holding the assets on behalf of the Government/Government agencies/departments. Therefore, the funds received from the Government to the extent not utilised for

creation of the assets or for execution of the LCA programme represents an obligation on the part of XYZ and should be disclosed on the 'Liabilities' side in the balance sheet under a separate head, say the 'Funds received for LCA programme being executed on behalf of the Government/Government departments'. Further, since any expenditure incurred by XYZ out of the grant/funds received would also be on behalf of the MoD/GoI, as discussed above, the asset(s) generated out of the expenditure incurred would not be controlled by XYZ as envisaged by paragraph 14 of AS 26, as discussed in paragraph 17 above and, therefore, should neither be recognized as its assets nor as its expense in the financial statements. The Committee is of the view that the expenditure incurred out of the funds received from the MoD/GoI should be accumulated under a separate head and should be shown as a deduction from the 'Funds received for LCA programme' in the financial statements. Further, the details of total funds received from the Government on this account, the funds utilised and the assets/project completed until transferred and capital work in progress (CWIP) should be provided in the notes to accounts to clearly explain the transactions.

D. Opinion

20. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 14 above:

(i) If XYZ is acting as a principal:

(a) The expenditure incurred towards design and development of LCA, being expenditure on development activities should be capitalised and recognised as intangible asset(s) in the balance sheet, provided the conditions for recognition of intangible asset as per AS 26 are fulfilled, as discussed in paragraph 17 above.

(b) The grant-in-aid/funds received from the MoD/GoI for the asset(s) that will be controlled by XYZ, being grant to develop certain specified tangible and intangible assets, should be treated as deferred income which is recognised in the income and expenditure account on a systematic and rational basis over the useful life of the related asset. Alternatively, the grant should be shown as a deduction from the gross value of the asset concerned in arriving at its book value in accordance with the principles of AS 12, as discussed in paragraph 18 above.

(ii) If XYZ is acting as an agent:

(a) The expenditure incurred towards design and development of LCA should be accumulated under a separate head and should be shown as a deduction from the ‘Funds received for LCA programme’ in the financial statements, as discussed in paragraph 19 above.

(b) The funds received from the Government to the extent not utilised for creation of the assets or for execution of the project should be disclosed on the ‘Liabilities’ side in the balance sheet under a separate head, say the ‘Funds received for LCA programme being executed on behalf of the Government/Government departments’, as discussed in paragraph 19 above. Further, the details of total funds received from the Government on this account, the funds utilised and the assets/project completed until transferred and capital work in progress (CWIP) should be provided in the notes to accounts to clearly explain the transactions.

ADVISORY SERVICE RULES OF THE EXPERT ADVISORY COMMITTEE
(*Applicable w.e.f. 1st July, 2017*)

1. Queries should be stated in clear and unambiguous language. Each query should be self-contained. The querist should provide complete facts and in particular give the nature and the background of the industry or the business to which the query relates. The querist may also list the alternative solutions or viewpoints though the Committee will not be restricted by the alternatives so stated.

2. The Committee would deal with queries relating to accounting and/or auditing principles and allied matters and as a general rule, it will not answer queries which involve only legal interpretation of various enactments and matters involving professional misconduct.

3. Hypothetical cases will not be considered by the Committee. It is not necessary to reveal the identity of the client to whom the query relates.

4. Only queries received from the members of the Institute of Chartered Accountants of India will be answered by the Expert Advisory Committee. The membership number should be mentioned while sending the query.

5. The fee charged for each query is as follows:

   (i) Where the queries relate to enterprises whose equity or debt securities are **listed** on a recognised stock exchange:

      (a) enterprises having an annual turnover exceeding Rs. 500 crores based on the annual accounts of the year immediately preceding the date of sending of the query

      Rs. 200,000/- plus taxes (as applicable) per query

      (b) enterprises having an annual turnover of Rs.500 crores or less based on the annual accounts of the year immediately preceding the date of sending of the query

      Rs. 100,000/- plus taxes (as applicable) per query

   (ii) Where the queries relate to enterprises whose equity or debt securities are **not listed** on a recognised stock exchange:

(a) enterprises having an annual turnover exceeding Rs. 500 crores based on the annual accounts of the year immediately preceding the date of sending of the query

Rs. 200,000/- plus taxes (as applicable) per query

(b) enterprises having an annual turnover of Rs.500 crores or less but more than Rs. 100 crores based on the annual accounts of the year immediately preceding the date of sending of the query

Rs. 100,000/- plus taxes (as applicable) per query

(c) enterprises having an annual turnover of Rs.100 crores or less based on the annual accounts of the year immediately preceding the date of sending of the query

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The fee is payable in advance to cover the incidental expenses. Payments should be made by crossed Demand Draft or cheque payable at Delhi or New Delhi drawn in favour of the Secretary, The Institute of Chartered Accountants of India or may be made online using the link given below:

https://easypay.axisbank.co.in/easyPay/makePayment?mid=MzUxNDY%3D

6. Where a query concerns a matter which is before the Board of Discipline or the Disciplinary Committee of the Institute, it shall not be answered by the Committee. Matters before an appropriate department of the government or the Income-tax authorities may not be answered by the Committee on appropriate consideration of the facts.

7. The querist should give a declaration to the best of his knowledge in respect of the following:

   (i) whether the equity or debt securities of the enterprise to which the query relates are listed on a recognised stock exchange;

   (ii) the annual turnover of the enterprise to which the query relates, based on the annual accounts of the accounting year immediately preceding the date of sending the query;

(iii) whether the issues involved in the query are pending before the Board of Discipline or the Disciplinary Committee of the Institute, any court of law, the Income-tax authorities or any other appropriate department of the government.

8. Each query should be on a separate sheet and one copy thereof, duly signed should be sent. The Committee reserves the right to call for more copies of the query. A soft copy of the query should also be sent through E-mail at eac@icai.in

9. The Committee reserves its right to decline to answer any query on an appropriate consideration of facts. If the Committee feels that it would not be in a position to, or should not reply to a query, the amount will be refunded to the querist.

10. The right of reproduction of the query and the opinion of the Committee thereon will rest with the Committee. The Committee reserves the right to publish the query together with its opinion thereon in such form as it may deem proper. The identity of the querist and/or the client will, however, not be disclosed, as far as possible.

11. It should be understood clearly that although the Committee has been appointed by the Council, an opinion given or a view expressed by the Committee would represent nothing more than the opinion or view of the members of the Committee and not the official opinion of the Council.

12. It must be appreciated that sufficient time is necessary for the Committee to formulate its opinion.

13. The queries conforming to above Rules should be addressed to the Secretary, Expert Advisory Committee, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi-110 002.