

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	- <u>Rs. 1417.67 crore</u>
	<u>Rs. 9965.00 crore</u>

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.

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.”

¹ Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

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) 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.*

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, incurrance 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.
