

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). 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:

¹ Opinion finalised by the Committee on 23.7.2018.

“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 crore².

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 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 lakh³.”

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

² 693 sqmtr=7459 sq ft. Rate per sqt feet taken as Rs 15000. 7459*15000=Rs 111885000/-

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/-.

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.

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's 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.