

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 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."

¹ Opinion finalised by the Committee on 23.7.2018.

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.
