

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
- (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.

¹ Opinion finalised by the Committee on 8.1.2019.

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 that 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.