

Query No. 8

Subject: *Accounting treatment of Government Grants.*¹

A. Facts of the Case

1. A Company (hereinafter referred to as 'the Company') is a wholly owned undertaking of Government of Gujarat, domiciled and incorporated in India. The Company is a Power Sector company. The Company including its subsidiaries are involved in generation, transmission and distribution of power in the State of Gujarat. The Company along with its group companies came into operation w.e.f. 1st April, 2005 after restructuring of State Electricity Board under the provisions of Gujarat Electricity Industry (Reorganisation and Regulation) Act, 2003 and Electricity Act, 2003. The following restructured corporate entities came into operation w.e.f. 1st April, 2005:

- (a) State Electricity Corporation Ltd., the Generation Company
- (b) State Energy Transmission Corporation Ltd., the Transmission Company
- (c) Dakshin State Vij Company Ltd., the Distribution Company
- (d) Madhya State Vij Company Ltd., the Distribution Company
- (e) Paschim State Vij Company Ltd., the Distribution Company and
- (f) Uttar State Vij Company Ltd., the Distribution Company
- (g) The Company, the residual entity and the holding company of above-mentioned 6 companies

Entities listed at (c), (d), (e) and (f) are collectively referred as Distribution Companies (DISCOMs).

2. The querist has stated that as per the Roadmap and the Notification dated 16th February 2015, issued by the Ministry of Corporate Affairs, the Company and its group companies adopted and prepared their financial statements as per Indian Accounting Standards (Ind ASs) notified under section 133 of the Companies Act, 2013 read with Companies (Indian Accounting Standards) Rules, 2015 (Rules) in the phase 1 of the transition from Accounting Standards (referred to by the querist as 'Indian GAAP' (IGAAP)) to Ind ASs. These being the group's first financial statements prepared and presented under Ind ASs, as per Rules, Ind ASs are to be applied retrospectively. Hence, even the comparative period for the first Ind AS financial reporting period, i.e., Financial Year (F.Y.) 2015-16 is required to be transitioned to Ind AS. The transition date in case of the Company and group companies, therefore, was 1st April 2015.

¹ Opinion finalised by the Committee on 31.5.2021.

3. According to the querist, the above referred retrospective application of Ind AS is subject to certain mandatory exemptions and voluntary exceptions as specified in the Rules; one of the relevant rule for the extant case, is that accounting estimates cannot be based on hind sight, i.e., an entity's estimates in accordance with Ind AS at the date of transition and for the comparative period to the first Ind AS financial statements shall be consistent with estimates made till the same date in accordance with IGAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were 'in error'. Paragraphs 14-17 of Ind AS 101, 'First-time Adoption of Indian Accounting Standards', are reproduced below for reference:

“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.

16 An entity may need to make estimates in accordance with Ind ASs at the date of transition to Ind ASs that were not required at that date under previous GAAP. To achieve consistency with Ind AS 10, those estimates in accordance with Ind ASs shall reflect conditions that existed at the date of transition to Ind ASs. In particular, estimates at the date of transition to Ind ASs of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.

17 Paragraphs 14–16 apply to the opening Ind AS Balance Sheet. They also apply to a comparative period presented in an entity's first Ind AS financial statements, in which case the references to the date of transition to Ind ASs are replaced by references to the end of that comparative period.”

4. The querist has informed that the Company and its subsidiaries being government entities, are subject to Comptroller and Auditor General (C&AG) audit including appointment

of the independent auditors under the Companies Act for all the entities involved. C&AG conducts a supplementary audit over and above the audit as required under the Companies Act, 2013 (earlier Companies Act, 1956) and issues a supplementary audit report/note on the financial statements prior to its issuance to the shareholders, i.e., the Government of Gujarat in this case.

5. The querist has stated that the Company gets grants from the Government of Gujarat for various purposes including against acquisition/creation/construction of depreciable assets, subsidies for power supply to various category of consumers, etc. The grants received against depreciable assets are usually for a part of the cost of the asset, other sources of funding the cost through an appropriate debt: equity proportion. The Company has followed deferred grant approach for grants related to depreciable assets as its accounting policy in compliance with Accounting Standard (AS) 12, 'Accounting for Government Grants' under IGAAP framework and later under Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance' under the Ind AS framework.

6. All depreciable assets (including against which grants are received) are depreciated as per the relevant Electricity Supply Act requirements which provide for depreciation of assets on Straight Line Method (SLM) at a fixed percentage for the first 12 years and thereafter the remaining depreciable value to be depreciated over the remaining useful life of the assets as specified by the Electricity Supply Rules.

7. Government grants against depreciable assets which are deferred, are recognised as per Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance', i.e., are recognised on deferred basis and are recognised in the Statement of Profit and Loss on a systematic basis over the useful life of assets. The accounting principles specify 'systematic basis' as against an arbitrary/ad-hoc basis of recognising such grants in the Statement of Profit and Loss. This requirement is the same under both Ind AS and IGAAP.

8. The Company and the group companies had assessed that Reducing Balance Method (RBM) or Written Down Value (WDV) to be an appropriate systematic basis to recognise government grants in the Statement of Profit and Loss based on relevant considerations in case of the Company and the group companies. One of the important considerations for selection of RBM / WDV method was the mismatch/difference in the timing when the asset is created/acquired and the recognition of grants on compliance of the conditions to recognise grant. Usually, the asset would be created/acquired first before becoming reasonably assured of complying with the conditions for receipt of grant and hence the grant recognition to the Statement of Profit and Loss would be in a period different from when the depreciation is charged to the Statement of Profit and Loss. The selection and application of RBM would lead to a sort of catch-up adjustment over the period of the assets. Hence, RBM was selected in the given backdrop and applied from F.Y. 2004-05 i.e., from the year when the State Electricity Board (SEB) was unbundled into the Company and group companies. This method was consistently applied till F.Y. 2015-16.

9. It may be further pointed out that IGAAP did not have a general concept of catch-up adjustment as is the case under Ind AS in the relevant years nor does it have a catch-up adjustment even now. Hence, in order to address the matter of timing mismatch and its consequential effect on the Statement of Profit and Loss where the cumulative depreciation as against the cumulative government grants recognised in the Statement of Profit and Loss would have been significantly different, RBM was selected so as to ensure that higher grant recognition in the initial years would lead to sort of a catch up adjustment as against the accumulated depreciation of the assets against which the grants have been received. This was assessed and understood to be an acceptable systematic basis as required under AS 12, given the facts as obtained at the time and the subsequent period when this was applied.

10. Selection of RBM was also noted as complying with the Accounting Standards by the independent auditors of all the concerned entities. The selection of RBM was reviewed by the independent auditors not only initially in F.Y. 2004-05 but also the continued selection of RBM during the years from F.Y. 2004-05 till F.Y. 2015-16 was also reviewed by not less than 15 independent auditors in light of the facts and circumstances as obtained for such selection. All the independent auditors noted the selection to be in compliance with the extant Accounting Standards.

11. The supplementary audits of C&AG right from the initial year of selection of RBM, i.e., F.Y. 2004-05 and during the continued period of selection of RBM i.e., from F.Y. 2004-05 till F.Y. 2015-16, did not note such selection and application either to be an error nor as a non-compliance with the extant Accounting Standards.

12. The Company and group companies revisited, reviewed, assessed, analysed and evaluated all accounting policies/methods/estimates in addition to presentation and disclosure requirements in F.Y. 2016-17 in the light of applicable Ind AS transition and implementation. The Company and group companies noted the facts and circumstances as obtained in F.Y. 2016-17 during Ind AS implementation and noted that Straight Line Method (SLM) was a more appropriate basis of recognising government grants in the Statement of Profit and Loss given the facts currently obtained, primarily as the mismatch or the timing difference as discussed in paragraph above has reduced. Hence, the Company and group companies selected and applied SLM from F.Y. 2016-17. It may be pointed out that recognition of grants in the Statement of Profit and Loss every year on SLM basis would reduce the variation with the depreciation charged to the Statement of Profit and Loss but not eliminate the variation. The change was made after assessing the present status and the expected future timing of asset creation/acquisition and recognition of grant against the assets.

13. The Company and group companies noted that the timing mismatch in the earlier years has reduced significantly over the period, though not completely eliminated. The Company also noted that the need for the consequential catch-up adjustment required due to such mismatch has also reduced. Hence, the method was changed due to change in the

circumstances. This change is in compliance with the relevant accounting standards i.e., it is allowed to be made as well as how such change should be accounted.

14. The Company's group assessed that the change in the method is determined to be a change in accounting estimate and not a change in accounting policy. The group's assessment was reviewed, assessed and evaluated by the independent auditors of all the concerned group companies and they also concluded the change to be change in accounting estimate arising on account of changed circumstances and more experience.

It may be further pointed out that the C&AG office also concludes that the change in the method is a change in accounting estimate.

15. The Company and group companies had clearly disclosed facts of the case and the group's assessment of the change being the change in accounting estimate and effected the accounts accordingly, in the year of change i.e., F.Y. 2016-17. Further, the Company and group companies also disclosed in F.Y. 2018-19, the possible impact if the change were to be made retrospectively (as per C&AG view), with a clear indication that this is for disclosure purpose only and has no impact on the financials.

16. C&AG office, though accepting that the change is a change in accounting estimate, believes it to be a correction of prior period error and hence any correction of prior period error should be applied retrospectively. C&AG's contention is that the RBM selected and applied earlier from F.Y. 2004-05, though noted and found to be in compliance with the accounting standards by all the auditors of the individual companies over the years as well as by C&AG, is to be considered as an error which is being corrected now by applying SLM. As may be noted from the C&AG office comments reproduced verbatim in paragraph 18 below, the C&AG office has noted that any change to reduce mismatch to be acceptable, but such change would mean that the earlier method was an error.

The issue for consideration is whether the selection and application of the RBM be considered as a prior period error which is being corrected now.

17. The company had also obtained an independent opinion relating to this matter on the urging of C&AG in the year 2020. The independent opinion obtained also supports the company's position, opining that it is not an error and such changes are to be considered as change in estimates and to be applied prospectively and opinion was also submitted to C&AG and has been appropriately disclosed in the notes to the financial statements for the financial year ended 31st March 2020. However, C&AG has insisted for Expert Advisory Committee opinion on the matter and hence, the Company seeks opinion of the Committee on the matter.

18. The querist has given extracts from Observations of the C&AG as follows:

“With effect from 01 April 2016, the group companies have changed the method of computing the grants/consumer contribution received against depreciable assets to be recognized in Statement of Profit and Loss from reducing balance method to the straight-line method and consequently the rates at which grant is recognized in the Statement of Profit and Loss. The Company has determined that the change to recognize grants in proportion of the depreciation expenses is a change in accounting estimates and is to be applied prospectively.

As per Accounting Standard 12, grants related to depreciable assets are treated as deferred income which is recognised in the Statement of Profit and Loss on a systematic and rational basis over the useful life of the asset. Indian Accounting Standard 20 also states that, grants related to depreciable assets are usually recognised in the Statement of Profit or Loss over the periods and in the proportions in which depreciation expense on those assets is recognised.

The above change in method was made by the group companies as there was a mismatch of the grants recognized in the Statement of Profit and Loss versus the related depreciation expense. Thus, the company has changed the method of recognition of deferred income in order to align the recognition of deferred income with the related depreciation expense. As the provisions for treatment of deferred income to be recognised in the Statement of Profit and Loss on a systematic and rational basis over the useful life of the asset are same in AS 12 and Ind AS 20, the change was not mandated by Ind AS 20. *Hence, the company changed the method in order to correct an error.*

Since the depreciable assets related to which grants/ consumer contribution received have been capitalized in the books of account, the effect of such change should have been worked out retrospectively and accounted for in the opening balance of Deferred Government Grants, Subsidies and Consumer contribution.”

19. The querist has also given the summary of the Company’s Management Response as follows:

- (i) The Company has been following RBM or WDV method from its inception in F.Y. 2004-05 and continued it till F.Y. 2015-16; and kept on recognising income from year to year out of its government grant, accumulated in deferred income on that basis.
- (ii) Useful lives of fixed asset as also expected pattern of consumption of future economic benefits embodied in such assets are estimates; (paragraph 32 of Ind AS 8); use of such estimates, made reasonably being an essential part of preparation of the financial statements, does not undermine the reliability of such financial statements. The differentiation of accounting policy vis-a-vis accounting estimate is dealt with in paragraph 35 of the said Standard.

- (iii) Being an estimate, circumstances or new information or more experience may necessitate suitable revision therein in forthcoming year(s), as clearly recognised by paragraph 34 of Ind AS 8, which also states that revision of estimate does not relate to prior period and is not the correction of error.
- (iv) As per paragraph 48 of Ind AS 8, the accounting estimates by their very nature are approximations that may need revision as additional information becomes known or when better presentation of financial statements warrant; such revisions when made, are clearly distinct from errors and these require rectifications. Thus, all the revisions of accounting estimates are not necessarily rectifications of an error of prior years. *Errors are meant to be act of omissions, oversight or lapses (including the effects of mathematical mistakes, mistakes in applying accounting policies, misinterpretations of facts, and fraud) in recognition and measurement principles of the reported items of financial statements.* (Emphasis supplied by the querist.)
- (v) As informed, in all the years, all the independent auditors of the concerned group companies noted the selection and the application of RBM to be in compliance with the extant Accounting Standards. It may be further emphasised that the selection of a method whether it be for depreciation or deferred grants in the current instance is a part of the significant accounting principles/practices which were consciously selected based on detailed deliberations after careful assessment of the facts and circumstances in light of the acceptable accounting principles and practices. This selection was assessed and evaluated by the independent auditors and found to be in compliance with the extant Accounting Standards.
- (vi) Further, the C&AG supplementary audit neither had any comments on the independent auditors' opinion on compliance of accounting standards in all the years nor did the supplementary audit raised any questions or observations about the said treatment.
- (vii) The above position reflects that the Company and group companies' assessment and consequential selection of RBM was found to be compliant with the extant accounting standards in light of the facts and circumstances obtained on initial selection and the continued selection over the years.
- (viii) The contention of CAG's observations implies that, had the Company continued its method and consequently continued recognising grant based on RBM, it would have been considered compliant with the accounting framework; but a change in the said methodology would deem to be a correction of error of earlier years. In the view of the querist, this appears to be a contradiction.
- (ix) Hence, in the view of the querist, the revision of an estimate, based on availability of some new information/development or for the reason of better presentation of

financial statements, is far from being an error of earlier years; change in estimate has to be applied prospectively and not retrospectively.

- (x) In the financial year 2016-17, the Company changed its method of recognising government grants from RBM to SLM for better presentation of the carrying value of the assets. Consequently, the Company recognised the government grant related to the concerned assets in proportion of its depreciation charge, which is also a systematic basis of recognising such deferred income as per the principle of Ind AS 20. In the year of such change, the Company is observed to have duly disclosed the fact and quantified effect of such change, as required by the applicable Standard.
- (xi) It is reiterated that the selection of method or its change is based on the facts and circumstances as obtained. The Company's group noted that there is a change in the facts and circumstances as relating to reduction in the timing difference between asset acquisition/creation and government grant recognition over the period occasioning reconsideration of the method to be selected.

20. In addition to the Company's management detailed replies to C&AG, the auditors of certain group companies had replied to C&AG with the specific considerations of relevant Ind AS as basis in which the auditors concluded the change of method to be change in accounting estimate.

B Query

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

- (i) Is the selection and application of RBM (or WDV) for recognising government grants in the previous years i.e., from F.Y. 2004-05 to F.Y. 2015-16 an error?
- (ii) If the above, is in affirmative, then what are the implications on the audit opinions including supplementary audit on the compliance of accounting standards in the earlier years as well as on the truthfulness and fairness of the financial statements?
- (iii) If conclusion to question 1 is that it is not an error, can the selection and application of SLM from F.Y. 2016-17 be considered as a correction of prior period error?

C. Points considered by the Committee

22. The Committee notes that the basic issue raised in the query relates to the method of recognition of government grants followed by the Company in the previous years i.e., from F.Y. 2004-05 to F.Y. 2015-16 and change in such method of amortisation from WDV to SLM from F.Y. 2016-17. The Committee has, therefore, considered only this issue and has not

examined any other issue(s) that may arise from the Facts of the Case, such as, appropriateness of the accounting/adjustments arising due to transition to Ind AS, nature of grant under Ind AS 20, accounting for grants received in the form of subsidies for power supply to various category of consumers, timing of recognition of grant and the appropriateness of the reason for the mismatch as stated by the querist due to difference in the timing when the asset is created/acquired and the recognition of grants on compliance of the conditions to recognise grant, accounting for the catch-up adjustment required due to the afore-mentioned timing difference, amount of grant to be recognised, accounting in the books of group companies, etc. Further, the opinion, expressed hereinafter is purely from accounting perspective and not from the perspective of interpretation of any Act/Rules such as Electricity Supply Act/Rules etc. The Committee wishes to point out that the Indian Accounting Standards referred to in the opinion are the Standards notified by the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time.

23. The Committee notes from the Facts of the Case that the Company had been following the Reducing Balance Method (RBM) or Written Down Value (WDV) to recognise deferred income in respect of government grants related to assets in the Statement of Profit and Loss from F.Y. 2004-05 till F.Y. 2015-16. Thereafter, in the F.Y. 2016-17, which was the first year of implementation of Indian Accounting Standards as per the requirements of the Companies Act, 2013, the Company changed the method of such recognition of deferred income from RBM/WDV to straight line method.

Further, the Committee notes that one of the considerations for selection of RBM/WDV method was the mismatch/difference in the timing when the asset is created/acquired and the recognition of grants on compliance of the conditions to recognise grant. Usually, the asset would be created/acquired first before becoming reasonably assured of complying with the conditions for receipt of grant and hence the grant recognition to the Statement of Profit and Loss would be in a period different from when the depreciation is charged to the Statement of Profit and Loss. The selection and application of RBM would lead to a sort of catch-up adjustment over the period of the assets. Hence, RBM was selected in the given backdrop. From these facts, it appears that the above change in method was made by the Company as there was a mismatch of the grants recognised in the Statement of Profit and Loss versus the related depreciation expense. Thus, the Company has changed the method of recognition of deferred income in order to align the recognition of deferred income with the related depreciation expense. The Committee also notes that the Company noted the facts and circumstances as obtained in F.Y. 2016-17 during Ind AS implementation and noted that Straight Line Method ('SLM') was a more appropriate basis of recognising government grants in the Statement of Profit and Loss, primarily as the mismatch or the timing difference as discussed above has reduced and the SLM basis would reduce the variation with the depreciation charged to the Statement of Profit and Loss. Thus, for better presentation of the carrying value of the assets, the Company changed its method of recognising government grants from RBM to SLM and recognised the government grant related to the concerned assets in proportion of its depreciation charge.

24. With regard to the depreciation charge, the Committee notes that the Schedule II to the Companies Act, 2013 and Ind AS 16, allow both the methods of depreciation, viz., straight line and WDV. However, Part B to schedule II, states that “The useful life or residual value of any specific asset, as notified for accounting purposes by a Regulatory Authority constituted under an Act of Parliament or by the Central Government shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of this Schedule.” Thus, where a Regulatory Authority prescribes useful life, rate of depreciation or residual value for any specific asset for accounting purposes, the company should use that useful life, rate of depreciation or residual value even though it is different from that as estimated by the management.

The Committee further notes that the querist has stated that the relevant Electricity Supply Act requirements provide for depreciation of assets on Straight Line Method (SLM) at a fixed percentage for the first 12 years and thereafter the remaining depreciable value is to be depreciated over the remaining useful life of the assets as specified by the Electricity Supply Rules. Further, the querist has stated that as per the above requirements, all depreciable assets (including against which grants are received) are depreciated at SLM. Thus, considering the regulatory requirements, the Company has been following straight line method consistently and there has been no change in the method of depreciation. The Committee notes that method of depreciation represents the pattern of consumption of economic benefits embodied in the asset and is considered as an accounting estimate. However, since there has been no change in the method of depreciation, it cannot be considered that there has been a change in the estimate due to change in the pattern of consumption of economic benefits.

25. Further, with regard to method of recognising deferred income to the Statement of Profit and Loss in respect of grants related to depreciable assets in previous years till financial year 2015-16 and thereafter, the Committee notes the following paragraphs of Accounting Standard (AS) 12, ‘Accounting for Government Grants’, which was applicable for accounting years 2004-05 till 2015-16 and Ind AS 20, ‘Accounting for Government Grants and Disclosure of Government Assistance’, which was applicable thereafter:

AS 12

“5.5 It is fundamental to the ‘income approach’ that government grants be recognised in the profit and loss statement on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption (see Accounting Standard (AS) 1, Disclosure of Accounting Policies).

5.6 In most cases, the periods over which an enterprise recognises the costs or expenses related to a government grant are readily ascertainable and thus grants in recognition of specific expenses are taken to income in the same period as the relevant expenses.”

“8. *Presentation of Grants Related to Specific Fixed Assets*

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...”

“14. *Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value. Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged. ...*”

Ind AS 20

“16 It is fundamental to the income approach that government grants should 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 grant is intended to compensate. ...

17 In most cases the periods over which an entity recognises the costs or expenses related to a government grant are readily ascertainable. Thus grants in

recognition of specific expenses are recognised in profit or loss in the same period as the relevant expenses. Similarly, grants related to depreciable assets are usually recognised in profit or loss over the periods and in the proportions in which depreciation expense on those assets is recognised.”

“24 ²Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

25 ²Two methods of presentation in financial statements of grants or the appropriate portions of grants related to assets are regarded as acceptable alternatives.

26 ²One method recognises the grant as deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.

27 ²The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation expense.”

From the above, the Committee notes that AS 12 and Ind AS 20 contain similar requirements in respect of recognition of deferred income in relation to grants related to depreciable asset and therefore, there is no change in the accounting requirements that required a change in the method of allocation of deferred income over the useful life of the asset to which the grant pertains.

The Committee notes that paragraph 14 of AS 12 specifically provides that, government grants related to depreciable fixed assets may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, *i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged*. Thus, as per the requirements of AS 12, till financial year 2015-16, for grants received in respect of depreciable assets, the Company should have allocated the deferred income to the Statement of Profit and Loss, in the proportion in which depreciation was charged over the useful life of the asset. Since straight line method of depreciation has been followed by the Company for the asset to which the grant relates, the grant should have also been recognised in proportion, depreciation was charged over the useful life, *i.e., on a straight line basis*. Similarly, Ind AS 20 (paragraph 17) also requires to amortise deferred income on a systematic basis over the useful life of the asset and in the proportions in which depreciation expense on those assets is recognised. However, since the same has not been followed while recognising the grant in the earlier years till

² Substituted vide Notification No. G.S.R. 903(E) dated 20th September, 2018.

financial year 2015-16 (when AS 12 was applicable to the Company), it results into an error in the recognition of grant.

Further, the Committee notes from the above that both the standards prescribe two methods for *presentation of grants* related to depreciable assets. Under one method, the grant is deducted from the gross value of the asset concerned in arriving at its book value/carrying amount. 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 and in proportion, the depreciation is charged. Thus, under both the methods of presentation, the grant is recognised in the profit and loss statement over the useful life of a depreciable asset; under one method, by way of a reduced depreciation charge and as per the other method, as income in proportion to depreciation over the useful life of a depreciable asset, resulting into similar impact in the Statement of Profit and Loss. The Committee notes that if for recognising the depreciation, one method, say straight line is followed while for amortising deferred income, another method, say WDV is followed, the result/impact under both the methods will not be the same, as discussed above and therefore, the Standard does not prescribe to follow different methods to be followed for charging depreciation and for amortising deferred income.

The Committee also notes from the above-reproduced requirements of AS 12 and Ind AS 20 that grants should be recognised in the income statement on a systematic basis that matches with the related costs that they are intended to compensate. Further, depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Thus, in a way, depreciation represents the allocation of cost of depreciable asset over its useful life. Therefore, in case of grants related to depreciable assets, the grant should be recognised in the income statement on a systematic basis that matches with the depreciation charged which represents the related costs of the depreciable asset. Accordingly, the Committee is of the view that as per the requirements of AS 12 as well as Ind AS 20, both the grant as well as depreciation should be charged in the same proportion over the useful life of the depreciable asset.

26. On the basis of the above discussion, the Committee is of the view that, since the Company in the extant case, did not follow the above-mentioned requirements of AS 12 till financial year 2015-16, the same should have been rectified and the method of amortisation or recognition of deferred income should have been changed to the SLM (as the method of depreciation followed for the asset to which the grant relates is the SLM), considering it as an accounting error, as per the requirements of the then applicable AS 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies (till F.Y. 2015-16) and Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'(from F.Y. 2016-17). Accordingly, the Committee is of the view that in the financial year 2016-17, the change in the method of recognising deferred income/grant should be considered as prior period item and not a change in an accounting estimate. In this regard, the Committee notes the following paragraphs of AS 5 and Ind AS 8:

AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

“4.3. Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.”

“Prior Period Items

15. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

16. The term ‘prior period items’, as defined in this Standard , refers only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period, e.g., arrears payable to workers as a result of revision of wages with retrospective effect during the current period.

17. Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight.”

Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’

“Prior period errors are omissions from, and misstatements in, the entity’s financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were approved for issue; and**
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.”

“41 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the

comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

- 42 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:**
- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or**
 - (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”**

Further, the Committee is of the view that since the method of recognition of recognising deferred income from straight line to WDV was changed in F.Y. 2016-17, which is the first year of implementation of Ind ASs on transition to Ind ASs, the Company should also follow the requirements of Ind AS 101, ‘First-time Adoption of Indian Accounting Standards’. In this regard, the Committee notes the following requirements of Ind AS 101:

- “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.”
- “24 To comply with paragraph 23, an entity’s first Ind AS financial statements shall include:
- (a) reconciliations of its equity reported in accordance with previous GAAP to its equity in accordance with Ind ASs for both of the following dates:
 - (i) the date of transition to Ind ASs; and

- (ii) the end of the latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP.
 - (b) a reconciliation to its total comprehensive income in accordance with Ind ASs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP.
 - (c) if the entity recognised or reversed any impairment losses for the first time in preparing its opening Ind AS Balance Sheet, the disclosures that Ind AS 36, *Impairment of Assets*, would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to Ind ASs.
- 25 The reconciliations required by paragraph 24(a) and (b) shall give sufficient detail to enable users to understand the material adjustments to the Balance Sheet and Statement of profit and loss. If an entity presented a Statement of cash flows under its previous GAAP, it shall also explain the material adjustments to the Statement of cash flows.
- 26 If an entity becomes aware of errors made under previous GAAP, the reconciliations required by paragraph 24(a) and (b) shall distinguish the correction of those errors from changes in accounting policies.”

The Committee notes from the above that adjustments arising from events and transactions before the date of transition to Ind ASs should be recognised directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs. Further, in accordance with paragraph 26 of Ind AS 101, if an entity becomes aware of errors under the previous GAAP, the reconciliations and disclosures required by paragraph 24(a) and (b) should distinguish the correction of those errors from changes in accounting policies.

D. Opinion

27. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 21 above:
- (i) Yes, the selection and application of RBM (or WDV) for recognising government grants in the previous years, i.e., from F.Y. 2004-05 to F.Y. 2015-16 is an error, as discussed in paragraphs 25 and 26 above.
 - (ii) The audit opinions including supplementary audit are the opinions/views of the respective auditors and therefore, the Committee does not wish to express its opinion on the same.
 - (iii) In view of (i) above, answer to this question does not arise.
