

Query No. 2

Subject: Accounting for Bearer Plants.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’), is a Schedule ‘A’ and a Mini Ratna (Category-I) Company. It has an authorized capital of Rs. 1000 crore and a paid up capital of Rs. 490.58 crore out of which the Government of India’s share is 74.71 % and 25.29 % is held by financial institutions and others. The Company currently has a total annual installed capacity of 35.68 Lakh Metric Tonnes (LMT) (Re-assessed capacity of 32.31 LMT) and is the second largest producer of urea in the country with a share of about 16% of total urea production in the country.

2. The Company is engaged in manufacturing and marketing of neem coated urea, three strains of bio-fertilizers (solid and liquid) and other allied industrial products like ammonia, nitric acid, ammonium nitrate, sodium nitrite and sodium nitrate. Urea (Fertilizer) is a controlled product and its price is controlled by the Government under its subsidy scheme. The Maximum Retail Price (MRP) of urea is fixed by the Government and is the same for all companies. The Company is also importing and trading various agro-inputs like non-urea fertilizers, certified seeds, agrochemicals, bentonite sulphur, city compost through its existing PAN India dealer’s network under single window concept.

3. *Government Audit observation on the annual accounts for financial year (F.Y.) 2020-21*

The querist has stated that during the course of audit of annual accounts of the Company for the financial year (F.Y.) 2020-21, government auditor issued the following audit note on non-measurement and recognition of fruit orchards resulting in understatement of assets.

Audit Memo No. 5

“The Company has orchards in its complex which comprises of 1658 fruit bearing trees of different varieties of which majority is of Mango (1267 number). The orchard was last tendered in March 2018 and licensing of fruits orchard for a period of five years was sold for a sum of Rs. 26,00,000 with 20 per cent return to be deposited each year. During F.Y. 2020-21 an amount of Rs. 5,20,000 has been booked as ‘Sale of Agricultural/Horticulture Products’ under ‘Non Operating Income–others’.

Indian Accounting Standards (Ind AS) provides for recognition of biological assets. As per Ind AS, a bearer plant should be accounted for as property, plant and equipment (PPE) in accordance with Ind AS 16. However, the Company has not measured and recognised these bearer plants resulting in understatement of Assets.

Thus, disclosure in Company’s Overview and Significant Accounting Policies that financial statements comply to Indian Accounting Standards (Ind AS) and Statutory Auditors report that these are in conformity with the Ind AS is deficient to that extent.”

4. The Company submitted the following reply to the government auditor in respect of the aforesaid Audit Note:

¹ Opinion finalised by the Committee on 14.3.2022.

The Company was incorporated in the year 1974 and 2 urea projects at Panipat and Bathinda were entrusted to the Company. After reorganisation of ABC Limited (ABCL) group of companies, X unit was merged with the Company in the year 1978.

The fruit orchards at this unit were planted by ABCL prior to 1978 and the cost of the asset is not known/ascertainable.

As per paragraph 7 of Ind AS 16, the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and
- (b) *the cost of the item can be measured reliably.*

(Emphasis supplied by the querist.)

As the above trees were not planted by the Company and the cost of the same is not ascertainable; hence the same cannot be measured reliably.

It can be seen from above, that cost of fruit trees (including Mango Orchard) cannot be measured reliably, and hence, has not been capitalised as bearer plant as per Ind AS 16.

Thus, disclosure in 'Company's Overview and Significant Accounting Policies' that financial statements comply to Indian Accounting Standards (Ind AS) and statutory auditor's report that these are in conformity with the Ind AS is correct.

5. Government auditors' supplementary observation through Provisional Comment (PC) No.5 (b):

Government auditors have further pursued their observation of Audit Note after considering reply of Audit Note submitted by the Company and have issued Provisional Comment (PC) on the above issue as given below:

“Disclosure in Company Overview and Significant Accounting Policies as well as Statutory Auditors report that financial statements comply with Indian Accounting Standards (Ind AS) is deficient on account of non-measurement and recognition of 1658 fruit bearing plants. As per Ind AS 16, a bearer plant should be accounted for as property, plant and equipment (PPE) which has not been done by the Company.”

6. The Company submitted the following reply to the government auditor in respect of aforesaid PC:

The Company was incorporated in the year 1974 and 2 urea projects were entrusted to the Company. After reorganisation of ABCL group of companies, X Unit was merged with the Company in the year 1978.

The fruit orchards at this Unit were planted by ABCL prior to 1978 and the cost of the asset is not known/ascertainable.

As per paragraph 7 of Ind AS 16, the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) *the cost of the item can be measured reliably.*

(Emphasis supplied by the querist.)

Further, paragraph 6 of Indian Accounting Standard (Ind AS) 16 defines the term cost, used in this standard as under:

“Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Indian Accounting Standards, eg Ind AS 102, *Share-based Payment*.”

In view of the fact that no cost has been incurred by the Company as the above trees were not planted by the Company and the cost of the same is not ascertainable, there is no non-compliance of Ind AS 16. Hence, disclosure in ‘Company’s overview and significant accounting policies’ as well as Statutory Auditors report that the financial statements comply with Indian Accounting Standards (Ind AS) is correct.

7. During the course of discussion regarding above PC with government auditors, the observation was not pursued based on the assurance given by the Company stating that recognition of above fruit bearing plants in property, plant and equipment will be reviewed in the F.Y. 2021-22.

8. The querist has stated that the Company’s X unit has issued a sale order dated 21.04.2018 for licensing of fruit orchards for different fruit crops for a period of five years on ‘As is where is basis’ and ‘As is what is basis’ for an amount of Rs. 26.00 lakh. The scope of work inter-alia includes responsibilities for surveillance, care, maintenance, up-keeping of orchards, jungle clearance, watering, applying pesticides/fertilizers and plucking and disposal of the fruits.

9. The querist has further stated that the Company has opted to continue with the carrying value of all of its property, plant and equipment recognised as at 1st April 2015 measured as per the previous GAAP and used that carrying value as the deemed cost of the property, plant and equipment.

Details of gross value of fixed assets and turnover for F.Y. 2020-21 are given below:

Particulars	Rs. in crore	
	Company	X Unit
Revenue from Operations	11905.66	1542.55
Gross Fixed Assets	5385.07	1611.53

10. Further, with regard to acquisition of the Unit X by the Company from ABCL/Government, the querist has informed that the Government of India decided in June 1977 to reorganise ABCL and the Company and set up a ‘working group’ including representative of the Company, for working out detailed implications and ensuring smooth implementation of the reorganisation. In terms of the scheme recommended by the working group and approved by the Government, ABCL and the Company had been reorganised into five companies as mentioned below:

- (i) ABCL (residual ABCL), comprising Sindri (including Sindri Modernisation and Sindri Rationalisation), Gorakhpur, Talchar, Ramagundam, Korba and Paradeep Projects.
- (ii) R Limited comprising the existing plants of ABCL in Trombay and the proposed new Projects based on the Bombay High Gas.
- (iii) H Limited comprising Barauni, Durgapur, Haldia and Namrup Projects.
- (iv) The Company comprising X Unit (including Expansion unit), Bathinda and Panipat Projects.
- (v) F Ltd. comprising the Planning and Development Division at Sindri.

The above grouping was made after taking into account the size of the group, the technology and the feedstock of different plants, geographical locations and contiguity of marketing zones.

The President of India issued directives on 13.01.1978 to the Company under Article 127 of its Article of Association, to implement the reorganisation scheme and accordingly, with the approval of shareholders at their extraordinary general meeting held on 23rd January, 1978, the Company entered into a Tripartite Agreement on 29.03.1978 with the President of India, and ABCL, in terms of which the assets and liabilities of X and X Expansion Unit, as a going concern, were transferred to the Company on 01.04.1978, for a consideration of Rs. 68.81 crore in lieu of equity shares of equal value issued to the President of India, and a loan liability for Rs. 57.61 crore from ABCL, effective from the same date.

B. Query

11. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether the fruit bearing trees should be capitalised as property, plant and equipment (PPE) in the books of account in accordance with provisions of Ind AS 16.
- (ii) If yes, how to determine the cost and the useful life to be considered for computation of depreciation in the books of account?
- (iii) Any other advice for proper accounting of the above assets.

C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to the accounting treatment of the fruit bearing trees in the books of account of the Company. 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 treatment of sale of agricultural/horticulture produce of fruit bearing trees, accounting for acquisition of the X unit/plant by the Company, consideration of 'materiality', application of the exemptions for business combinations under Ind AS 101, 'First-time Adoption of Indian Accounting Standards', appropriateness of disclosure in Company's Overview and Significant Accounting Policies and Statutory Auditor's report etc. The Committee wishes to point out that Indian Accounting Standards referred to in the opinion are the Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended/revised from time to time.

13. At the outset, the Committee notes the following paragraphs of Ind AS 16, 'Property, Plant and Equipment':

“3 This Standard does not apply to:

...

- (b) biological assets related to agricultural activity other than bearer plants (See Ind AS 41, *Agriculture*). This Standard applies to bearer plants but it does not apply to the produce on bearer plants.”

“A bearer plant is a living plant that:

- (a) is used in the production or supply of agricultural produce;**
- (b) is expected to bear produce for more than one period; and**
- (c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.”**

“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.”**

“7 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and**
- (b) the cost of the item can be measured reliably.”**

Considering the definition of bearer plants quoted above, the Committee notes that the fruit bearing trees in the extant case are bearer plants as per the requirements of Ind AS 16, ‘Property, Plant and Equipment’ as these are living plants which produce agricultural produce (i.e., fruits) for more than one period and would not be sold as agricultural produce. Further, as per the requirements of paragraph 7 of Ind AS 16 above, since in the extant case, future economic benefits from these bearer plants in the form of agricultural produce (fruits) flow to the entity, these should be recognised as an item of Property, Plant and Equipment if their cost can be measured reliably.

14. The Committee notes from the Facts of the Case that the fruit trees were acquired by the Company as a part of acquisition of Unit X from ABCL in the year 1978. Further, although these trees met the definition of fixed asset as per the erstwhile Accounting Standard (AS) 10, ‘Fixed Assets’, there was no specific accounting guidance available in respect of bearer plants under the accounting standards framework. However, under Indian Accounting Standards framework, Ind AS 16 contains specific requirements in respect of bearer plants. Therefore, on transition to Indian Accounting Standards in the financial year 2016-17, the Company should have accounted for these bearer plants as per the requirements of Ind AS 16 and Ind AS 101, ‘First-time Adoption of Indian Accounting Standards’. In this context, the Committee notes the requirements of Ind AS 101 as follows:

- “6 An entity shall prepare and present an *opening Ind AS Balance Sheet* at the *date of transition to Ind ASs*. This is the starting point for its accounting in accordance with Ind ASs subject to the requirements of paragraphs D13AA and D22.

Accounting policies

- 7 **An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in paragraphs 13–19 and Appendices B–D.”**
- “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.
- 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.”

From the above, the Committee notes that an entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements and that those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, except as specified in Ind AS 101.

Further, as per Ind AS 101, except as specified in the Standard, an entity shall, in its opening Ind AS Balance Sheet, recognise all assets and liabilities whose recognition is required by Ind ASs; 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 apply Ind ASs in measuring all recognised assets and liabilities. Furthermore, the resulting adjustments due to change in accounting policies in opening Ind AS Balance Sheet from those that it used for the same date using previous GAAP

shall be recognised directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs.

The Committee also notes that Ind AS 101 (a) prohibits retrospective application of some specific aspects of other Ind ASs and (b) grants voluntary exemptions from some specific requirements of other Ind ASs. From this, it implies that the Standard requires retrospective application of all the other requirements of Ind ASs. In other words, the Standard requires that all assets and liabilities shall be recognised, classified and measured as per the requirements of Ind ASs retrospectively unless these are specifically covered under exemption or exception under Ind AS 101. In this regard, the Committee notes that Ind AS 101 does not contain any exemption or exception in case of bearer plants. Therefore, the Committee is of the view that the Company, on transition to Indian Accounting Standards in the F.Y. 2016-17, which is the first year of implementation of Ind ASs on transition to Ind ASs, should have followed the requirements of Ind AS 16 in respect of bearer plants to the fruit trees in the extant case retrospectively, i.e., from the date such bearer plants were acquired. The resulting adjustments due to change in accounting policies in the opening Ind AS Balance Sheet from those that it used for the same date using previous GAAP shall be recognised directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs, as per the requirements of paragraph 11 of Ind AS 101.

Further, the Committee is of the view that at the time of acquisition of Unit X, a portion of cost was incurred towards acquisition of fruits orchard/ trees. Therefore, on transition to Ind ASs, the Company should separate the value of fruits orchard/trees from the value of land or plant or any other asset(s) in which the cost of the trees is included and allocate a part of cost to the bearer plants on a reasonable basis.

In this context, the Committee notes that the Company has opted to continue with the carrying value of all of its property, plant and equipment recognised as at 1st April 2015 measured as per the previous GAAP and used that carrying value as the deemed cost of the property, plant and equipment. The Committee is of the view that as the Company has adopted the previous GAAP carrying values as deemed cost, all items of PPE including bearer plant should be carried at its previous GAAP carrying values. Further, since, in the extant case, the Company does not seem to have the component-wise historical cost, (as the trees were apparently considered as a component of land or other fixed asset(s) at the time of acquisition), it should allocate cost to the component (viz., trees) on a reasonable basis; for example, break-up of cost (if any) provided by ABCL; cost break-up by internal/external technical expert; fair values of various components on the date of transition; current replacement cost of the asset and applying the same basis on the historical cost of asset etc. Therefore, the Committee does not agree with the contention of the querist that the cost of the trees cannot be ascertained reliably in the extant case.

15. Further, with regard to depreciation, the Committee is of the view that since the Company, on transition to Indian Accounting Standards, has to follow the requirements of Ind AS 16 in respect of bearer plants to the fruit trees in the extant case retrospectively, i.e., from the date such bearer plants were acquired, as discussed above, the requirements of depreciation as per Ind AS 16 also need to be followed by the Company retrospectively. In this regard, the Committee notes the following requirements of Ind AS 16 in respect of depreciation:

“Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.”

“Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.”

“The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.”

“Useful life is:

- (a) the period over which an asset is expected to be available for use by an entity; or**
- (b) the number of production or similar units expected to be obtained from the asset by an entity.”**

“43 Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.”

“50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

51 The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*”

“Depreciation method

60 The depreciation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity.

61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.”

From the above, the Committee notes that depreciation is a systematic allocation of depreciable amount of an asset over its expected useful life. The Company should determine the useful life of the bearer plants, i.e., the period over which these are expected to be available for use by the Company or the number of agricultural produce expected to be obtained from them by the Company. With regard to the depreciation method to be used, the method shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the Company. The residual value, the useful life and the depreciation method shall be reviewed at least at each financial year-end and changes, if any, should be accounted for as per the requirements of Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’.

16. On the basis of the above discussion, the Committee is also of the view that, since on transition to Ind AS, the Company in the extant case, did not follow the above-mentioned

requirements of Ind AS 101 and Ind AS 16, the same should be rectified in the current reporting period, considering it as an accounting error, as per the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'. In this regard, the Committee notes the following paragraphs of Ind AS 8:

“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.”**

D. Opinion

17. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

- (i) Yes, the fruit bearing trees should be capitalised as bearer plant under 'Property, Plant and Equipment (PPE)' in the books of account in accordance with requirements of Ind AS 16 and Ind AS 101, as discussed in paragraphs 13 and 14 above.
- (ii) The cost and the useful life to be considered for computation of depreciation in the books of account shall be determined, as discussed in paragraphs 13 to 15

above. Further, non-recognition of fruit trees/bearer plants on transition to Ind AS is a prior period error, which should be accounted for as per the requirements of Ind AS 8, as discussed in paragraph 16 above.

(iii) Refer above.
