

## **Query No. 25**

**Subject:** *Accounting treatment of export incentives.*<sup>1</sup>

### **A. Facts of the Case**

1. A central public sector entity (CPSE) (hereinafter referred to as ‘the Company’) registered under the erstwhile Companies Act, 1956, is engaged in the business of engineering consultancy. The Company is a multidisciplinary engineering and consultancy organisation providing diversified and comprehensive array of services, such as, project management consultancy, quality assurance, pre-feasibility report (PFR) / detailed project report (DPR), design & drawing, transaction advisory etc., in all facets of transport infrastructure, i.e., railways, metros, highways, airports, ports, ropeways, urban transport and inland waterways in India and abroad. The Company is also engaged in construction of project on turnkey basis, export of rolling stock and wet leasing of locomotive to clients engaged in power/mining/metal sector. The Company has four reportable business segments, viz., consultancy, turnkey project, export of rolling stock and leasing of locomotives.

2. The Company’s export business mainly consists of sale of rolling stock and locomotives to various countries in Asia and Africa, majority being funded by line of credit. After getting the export order from clients, the Company enters into a back-to-back agreement with Indian Railway’s production units for manufacturing of rolling stock/locomotives as per drawings and specifications approved by the client. Once the rolling stock/locomotives are ready by production units, these are dispatched in compliance with the terms and conditions of respective agreement with the clients. Further, International Commercial terms (INCOTERMS), such as, free on board (FOB), cost insurance and freight (CIF), free alongside ship (FAS) etc., as stipulated in the respective agreement are followed.

3. The Company is getting incentives on export under Foreign Trade Policy (FTP) of the Government of India, Directorate General of Foreign Trade (DGFT) read with RoDTEP (Remission of Duties and Taxes on Exported Products) notified by the Ministry of Finance vide Notification No. 76/2021-Customs (N.T.) dated 23<sup>rd</sup> September 2021. (Copy of Notification of RoDTEP and Chapters 3 and 4 of Foreign Trade Policy 2015-20 have been supplied by the querist for the perusal of the Committee.) The Company is receiving following two types of export incentives:

(a) *Incentive by way of duty credit scrips under RoDTEP Scheme* (prior to 1.01.2021 known as Merchandise Exports from India Scheme (MEIS)): These duty scrips are due at the time of realisation of foreign currency against the export, though in RoDTEP scheme, prior realisation of foreign currency is not mandated and duty credit scrips are allowed against the presentation of shipping bill or bill of export but subject to realisation within the stipulated period as per Foreign Exchange Management Act (FEMA), 1999 failing which duty scrip shall be deemed to be ineligible. The value of incentive varies from 1.5% to 2.0% of FOB value depending upon the Harmonized System of Nomenclature (HSN) code under which export material is covered. Duty credit scrips can be used by the Company for payment of import duty, or it is also tradeable in the market, value of which varies from 80% to 95% of value of scrips depending upon the demand and supply of duty credit scrips in the market. This incentive is due on realisation of export proceeds and after completing administrative

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<sup>1</sup> Opinion finalised by the Committee on 13.12.2022.

formalities with the concerned department. Accordingly, income is booked on receipt of duty credit scrips based on estimated market value which varies from 80% to 95% of value of duty credit scrips.

(b) *Duty Drawback incentive*: In this scheme, the Company gets the cash incentive which varies from 1.5% to 2.0% of FOB value depending upon the HSN code under which exported material is covered. Duty drawback incentive is due at time of export of goods and the amount of eligible duty drawback is endorsed by the custom authority on the shipping bill. Accordingly, revenue on account of duty drawback as export incentive is being recognised at the time of export.

The Company is recognising both the above export incentives as 'other operating income', since export incentive is directly linked with the revenue from operations (export segment) of the Company.

4. The Company's significant accounting policy on export incentives is reproduced below:

“1.2.2.3 Export incentives

Export incentive is recognized when there is a reasonable assurance that the incentive will be received and all the attached conditions have been complied with.”

Further, the Company is treating both the above export incentives as government grant. Accordingly, following disclosure related to government grant as per Indian Accounting Standard (Ind AS) 20, 'Accounting for Government Grants and Disclosure of Government Assistance' is given:

“The Company is receiving government grant in the form of export incentive on export of Rolling stock and spare parts. There are two types of export incentive i.e. duty drawback and Merchandise Exports from India Scheme (MEIS) Scrips. The Company has recognized ₹ 21.12 crore (previous year ₹ 3.57 crore) as export incentive. The export incentive receivable at the end of the year is ₹ 10.52 crore (previous year ₹ 1.40 crore).”

5. During supplementary audit of financial statements of the Company under section 143(6) of the Companies Act, 2013, office of the Comptroller and Auditor General (C&AG) of India through Principle Director of Railway Commercial raised the following observation on significant accounting policy on export incentive and disclosure on 'Accounting for Government Grants and Disclosure of Government Assistance'. The observation is reproduced below:

“Note No.41 – Disclosures on 'Accounting for Government Grants and Disclosure of Government Assistance':

Paragraph 39 of Ind AS-20 on Accounting for Government Grants and Disclosure of Government Assistance states that the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements shall be disclosed. During audit, it was observed that neither the significant accounting policy 1.2.2.3 on Export Incentives nor did the above note disclosed the method of presentation adopted in the financial statement. Hence, the disclosure made is deficient to that extent.”

6. Management response to the above observation is also reproduced herein below:

“Relevant extract of Note No. 41 of the financial statements is reproduced below:

The Company is receiving government grant in the form of export incentive on export of Rolling stock and spare parts. There are two types of export incentive i.e. duty drawback and Merchandise Exports from India Scheme (MEIS) Scrips. ... Note no-1.2.2.3 on accounting policy of Export Incentive is reproduced below:

Export incentive is recognised when there is a reasonable assurance that the incentive will be received and all the attached conditions have been complied with.

Para 39 of Ind AS-20 on Accounting for Government Grants and Disclosure, states that the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statement shall be disclosed.

As regards to method of presentation, Para 24 and Para 29 of Ind AS -20 are relevant, which inter-alia prescribed three methods i.e. i) to be presented as revenue, ii) as reduction in expenditure and iii) grants related to fixed assets.

Since the government grant on account of export incentives recognized by the company are only revenue in nature (emphasis provided) and does not receive other grants which are to be reduced from expenditure or grants related to fixed assets, as such, company has only disclosed about revenue nature grants. However, the point raised by the Audit is noted for future compliance for necessary disclosure in Notes to Accounts / Significant Accounting policies related to other type of grants, even though the company does not deal with such type of grants.”

Since management’s view was not agreed to, management assured to review the accounting policy / disclosure in this regard in financial year (F.Y.) 2022-23.

7. The querist has stated that as can be seen that observation of government audit is in reference to paragraph 39 of Ind AS 20, which stipulates disclosure of accounting policy on government grant including method of presentation; and management’s view was that accounting policy and disclosure through notes are sufficient since the government grant on account of export incentives received by Company are only revenue in nature and does not receive other grants which are to be reduced from expenditure or grants related to fixed assets. However, in view of definition and purpose of government grant and government assistance as per Ind AS 20 and the purpose for which export incentives are provided under FTP read with RoDTEP, there seems a definite case to ascertain whether such export incentive, by whatever name called, i.e. MEIS, SEIS, Duty draw back, RoDTEP etc., is actually a government grant / assistance. In this regard, attention is invited to an earlier opinion of the Expert Advisory Committee (EAC) (Query No. 14 of Compendium of Opinions - Volume XXXIX) wherein EAC without examining the issue related to nature of grant under Ind AS 20, has opined that duty credit scrips / entitlements under Service Export from India Scheme (SEIS) may be presented as ‘other operating income’. In case export incentive is shown as ‘other operating income’, it would contravene paragraph 29 of Ind AS 20, which stipulates that grant related to income is shown as ‘other income’.

## B. Query

8. Keeping in view the above, opinion of Expert Advisory Committee is solicited as to whether incentive / duty draw back as per FTP read with RoDTEP, as briefed above falls within the definition of government grant/assistance, thereby attracting the disclosure requirements of Ind AS 20 as required in paragraph 39 including all the methods of presentation, and whether the disclosure of export incentive/government grant as other operating income is not contravening paragraph 29 Ind AS 20 which requires government grants to be shown under general heading such as 'Other Income'.

## C. Points considered by the Committee

9. The Committee notes that the basic issues raised by the querist relate to (i) whether the incentive/duty draw back benefits under FTP read with RoDTEP scheme, received by the Company (hereinafter collectively referred to as 'incentives') fall within the definition of government grant/assistance under Ind AS 20 and (ii) presentation of these incentives in its financial statements. The Committee has, therefore, considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, the classification and nature of the incentives as asset related grant or grant related to income, and other aspects of recognition, including timing of recognition of incentives, measurement, etc. The Committee has examined the issue only from an Ind AS perspective and has not examined the regulatory or legal aspects and implications including eligibility of the Company and compliance with the conditions attached, etc.

10. With regard to the issue, whether the incentives received by the Company under the schemes mentioned above could be considered as 'government grant', the Committee notes that Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', defines the term 'government grants' as follows:

***“Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.”***

Further, paragraph 9 of Ind AS 20 states that, “the manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government.”

In accordance with the above, the Committee notes that in the extant case, the benefit of incentive/ duty draw back either in the form of scrips or cash incentive is received in return for compliance with certain conditions, for example, export of goods, etc. Therefore, the benefit of incentive/ duty draw back is a government grant and should be accounted for as per the provisions of Ind AS 20.

11. The Committee further notes from the Facts of Case that the Company has classified the grant as a grant related to income under Ind AS 20. Therefore, without examining the nature and classification of government grant (since this issue has not been raised by the

querist), the Committee notes that Ind AS 20 states the following with respect to the presentation of government grant related to income:

- “29 Grants related to income are presented as part of profit or loss, either separately or under a general heading such as ‘Other income’; alternatively, they are deducted in reporting the related expense.”
- “30 Supporters of the first method claim that it is inappropriate to net income and expense items and that separation of the grant from the expense facilitates comparison with other expenses not affected by a grant. For the second method it is argued that the expenses might well not have been incurred by the entity if the grant had not been available and presentation of the expense without offsetting the grant may therefore be misleading.
- 31 Both methods are regarded as acceptable for the presentation of grants related to income. Disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.”

Further, the Committee notes that Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 (Revised January 2022 Edition), issued by the Institute of Chartered Accountants of India (ICAI) states as follows:

“**9.1.7.** Revenue from operations needs to be disclosed separately as revenue from

- (a) sale of products,
- (b) sale of services and
- (c) other operating revenues.

It is important to understand what is meant by the term “other operating revenues” and which items should be classified under this head vis-à-vis under the head “Other Income”.

**9.1.8.** The term “other operating revenue” is not defined. This would include Revenue arising from a company’s operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes “other operating revenue” or “other income” is to be decided based on the facts of each case and detailed understanding of the company’s activities.

**9.1.9.** The classification of income would also depend on the purpose for which the particular asset is acquired or held. For instance, a group engaged in manufacture and sale of industrial and consumer products also has one real estate arm. If the real estate arm is continuously engaged in leasing of real estate properties, the rent arising from leasing of real estate is likely to be “other operating revenue”. On the other hand, consider a consumer products company which owns a 10 storied building. The company currently does not need one floor for its own use and has given the same temporarily on rent. In that case, lease rent is not an “other operating revenue”; rather, it should be treated as “other income”.

**9.1.10.** To take other examples, sale of Property, Plant and Equipment is not an operating activity of a company, and hence, profit on sale of Property, Plant and Equipment should be classified as other income and not other operating revenue. On the other hand, sale of manufacturing scrap arising from operations for a manufacturing company should be treated as other operating revenue since the same arises on account of the company's main operating activity."

From the above, the Committee notes that Ind AS 20 gives an option to either reduce the grant from the related expenses or to present either separately or under a general heading such as 'Other income'. Thus, it does not specifically require or prescribe a line item in the financial statements for presentation of grants related to income.

The Committee also notes that as per the requirements of the Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013, "other operating revenue" would include revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services; and whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities.

The Committee also notes that Ind AS Schedule III sets out the minimum requirements for disclosure in the financial statements including notes and requires that line items or sub-line items can be added on the face of the financial statements when such presentation is relevant to the understanding of the company's financial position or performance. Accordingly, presentation of grant will require exercise of judgement based on the facts and circumstances of each case.

12. In this context, the Committee notes that as per RoDTEP Scheme of the Government, "the duty credit is issued-

- (a) in lieu of remission of any duty or tax or levy, chargeable on any material used in the manufacture or processing of goods or for carrying out any operation on such goods ...
- (b) against export of goods notified in...FTP..."

Further, Chapter 3 of FTP inter alia, states with regard to 'Objective' of Exports from India Schemes that "The objective of schemes ... is to provide rewards to exporters to offset infrastructural inefficiencies and associated costs."

Similarly, Chapter 4 of FTP inter alia, states with regard to 'Objective' of Duty Exemption/Remission Schemes that "Schemes under this Chapter enable duty free import of inputs for export production, including replenishment of inputs or duty remission."

From the above, the Committee is of the view that the objective of these schemes is essentially to compensate the exporter for cost of duty/taxes paid on the inputs or materials used in exported goods and to promote export, which are essentially part of the operating activities of the Company. The Committee also notes that the value of incentive of duty credit scrips and duty drawback is based on a specific percentage of FOB value depending upon the specific item being exported (HSN Code) which indicates that the incentives in the extant case are directly linked with and arise on account of the main operations of the Company. Further, since the Standard allows the deduction of the grant related to income from the associated costs, this itself shows that in some cases, grants may be considered as part of the

operating activities depending upon the nature of such costs. Therefore, considering the nature and purpose of grant in the extant case, and also considering the nature of activities of the Company, which include export business and sales of rolling stock and locomotives to various countries, the Committee is of the view that the incentives/ benefits that the Company earns, can be considered to arise from its main business operations. Therefore, based on the guidance in ICAI's Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013, the Committee is of the view that the presentation of the income from government grant in the extant case as 'other operating revenue' is not inappropriate.

13. Further, with regard to disclosures, the Committee notes that paragraph 39 of Ind AS 20 specifically requires to disclose the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements. Also, paragraph 31 of the Standard provides that disclosure of the grant may be necessary for a proper understanding of the financial statements. Disclosure of the effect of the grants on any item of income or expense which is required to be separately disclosed is usually appropriate.

Therefore, the Committee is of the view that the above disclosure requirements as per the Standard should be complied with by the Company with regard to incentives in the extant case.

**D. Opinion**

14. The benefits of incentive/ duty draw back are 'government grants' as per the provisions of Ind AS 20. As mentioned in paragraph 12 above, the presentation of the income from government grant as 'other operating revenue' in the extant case is not inappropriate. Also, as discussed in paragraph 13 above, the disclosure requirements as per Ind AS 20 should be complied with by the Company with regard to incentives in the extant case.

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