

Query No. 35

Subject: Accounting treatment of government grant received by an entity which was subsequently incorporated as a company under Ind AS framework.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is incorporated in India and is limited by shares. It is one of the seven (7) new Defence Public Sector Units (DPSUs) formed by converting the Ordnance Factory Board into fully government owned enterprises. The Company has been incorporated under the Companies Act 2013 on 14th August, 2021; however, its commencement of business took place on 1st October 2021 and notified by the Department of Defence Production (DDP). It comprises the following production and non-production units: Rifle Factory Ishapore, Small Arms Factory, Kanpur, Gun and Shell Factory, Cossipore, Ordnance Factory Tiruchirapalli, Ordnance Factory, Kanpur, Field Gun Factory, Kanpur, Gun Carriage Factory, Jabalpur, and Ordnance Factory Project Korwa and non- production units at Ordnance Factories Institute of Learning Ishapore. The financial statements were authorised for issue in accordance with a resolution of the Board of Directors on November 15, 2022.

2. In pursuance of the decision of the Union Cabinet on 16th June 2021, the Government of India, vide Office Memorandum dated 24th September 2021, decided to corporatise the functions of the Ordnance Factories. Accordingly, the assets and liabilities in respect of the business being carried out on account of the Government were transferred to the new DPSUs on the Net Asset Value thereof. Provisional Net Asset Value as on 31.03.2021 was Rs. 12,217 crores.

3. Indian Accounting Standard (Ind AS) 101, ‘First-time adoption of Indian Accounting Standards’ permits a first-time adopter to elect to measure an item of property, plant, and equipment at the transition to Ind AS at its fair value and use that fair value as its deemed cost at that date. This exemption can also be used for intangible assets covered by Ind AS 38 ‘Intangible Assets’.

4. The Company has, accordingly, elected to measure all items of its property, plant and equipment and intangible assets at carrying value as recognised in the previous financial statements on the date of transition to Ind AS and used those carrying values as deemed costs of property, plant, and equipment and intangible assets since there is no change in the functional currency.

5. All the fixed assets were funded by the Government through grant which is evident from the previous commercial financial statements prepared by the Principal Controller of Accounts, Kolkata, which includes manufacturing account, profit and loss account, balance sheet, significant accounting policies and notes to accounts. The formats of such commercial accounts had been approved by the Comptroller and Auditor General (C&AG) of India. The querist has separately informed that the units of the erstwhile Ordnance Factory Board (OFB) were maintaining books of account in respect of assets. The proforma accounts of ordnance factories were prepared as far as possible in conformity with the Generally Accepted Accounting Principles (GAAP) in India, as embodied in various Accounting Standards,

¹ Opinion finalised by the Committee on 9.11.2023.

Guidance Notes etc. issued by the Institute of Chartered Accountants of India (ICAI) from time to time.

As per the commercial accounts, net block of fixed assets including capital work-in-progress is exactly matching with Capital Outlay Account, which, according to the querist, means that the source of funds for fixed assets is capital grant. The querist has also separately informed that capital outlay represents the amount equivalent to the Net Block plus capital dues (including Stock Pile) and Work-in-progress in respect of capital items. Further, separate fund used to be allocated to the erstwhile OFB for procurement of capital assets under the heading “New Capital” and “Renewal & Replacement”. Asset on commissioning/ put to use was recorded in fixed asset register of units of erstwhile OFB. Assets after completion of useful life used to be disposed off following government guideline for disposal by custodian units of the erstwhile OFB. After incorporation of the Company, disposal of unusable assets are being done as per government guideline followed during the erstwhile OFB time. Erstwhile OFB was subordinate office of department of defence production Government of India. Owner, promoter and Government are same for erstwhile OFB.

6. The querist has stated that as per paragraph 26 of Ind AS 20, ‘Accounting for Government Grants and Disclosure of Government Assistance’, government grant is recognised as deferred income that is recognised as income in the statement of profit and loss on a systematic basis over the useful life of the assets for which it is received. Therefore, the accounting treatment of government grant is in accordance with Indian Accounting Standards prescribed under section 133 of the Companies Act, 2013 read with rule 3 of Companies (Indian Accounting Standards) Rules, 2015 as amended.

7. In view of above, the Company has elected to measure all its property, plant, and equipment and intangible assets at carrying value as recognised in the previous commercial financial statements on the date of transition to Ind AS and used those carrying values as deemed costs of property, plant, and equipment and intangible assets worth of Rs. 2158.24 crore.

8. As mentioned supra, all the fixed assets are sourced from government grant, the Company has recognised capital outlay as government grants equivalent to deemed cost of fixed assets and treated it as a deferred income as per paragraph 26 of Ind AS 20.

9. Following the accounting treatment mentioned above, the Company has credited Rs. 65.65 crore as income out of capital grant in the Statement of Profit and Loss of the Company for the year ended 31st March 2022 in proportion of depreciation on Property Plant and Equipment (PPE). Remaining government grant amounting to Rs. 2092.58 crore was booked as liability (Rs. 1998.74 crore as non-current and Rs. 93.84 crore as current) in the balance sheet of the Company as at 31st March 2022.

10. *Observation by C&AG*

- (i) The Company’s accounts are audited by C&AG and C&AG auditors have submitted their comments under section 143 (6) (b) of the Companies Act, 2013 on accounts of the Company.

- (ii) C&AG has commented the following:

In pursuance of the decision of the Union Cabinet on 16th June 2021, the Government of India, vide Office Memorandum dated 24th September 2021,

decided to corporatise the functions of the ordnance factories. Accordingly, the assets and liabilities in respect of the business being carried out on account of the government were transferred to the new DPSUs on the Net Asset Value thereof. The Company has, however, treated the deemed cost of fixed assets worth Rs. 2158.24 crores as government grants, out of which depreciation on Property Plant and Equipment (PPE) amounting to Rs. 65.65 crore was accounted for as income in the Statement of Profit and Loss of the Company for the year ended 31st March 2022. Remaining government grant amounting to Rs. 2092.58 crore was booked as liability (Rs. 1998.74 crore as non-current and Rs. 93.84 crore as current) in the Balance Sheet of the Company as at 31st March 2022.

- (iii) This has resulted in the overstatement of 'Other Income' as well as profit of the Company by Rs. 65.65 crore. Further, this has also resulted in the overstatement of government grant by Rs. 2092.58 crore and understatement of 'Other Equity' by Rs. 2158.24 crore.

11. *Accounting Policy and its rationale adopted by the management*

- (i) Ind AS 101 permits a first-time adopter to elect to measure an item of property, plant, and equipment at the transition to Ind AS at its fair value and use that fair value as its deemed cost at that date.
- (ii) However, as per paragraph D7AA of Appendix D, 'Exemptions from other Ind ASs', "Where there is no change in its functional currency on the date of transition to Ind ASs, a first-time adopter to Ind ASs may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition ..."
- (iii) The Company has elected to measure all its property, plant and equipment and intangible assets at carrying value as recognised in the 'Periodical Accounts of the Ordnance & Ordnance Equipment factories in Commercial format' on the date of transition to Ind AS and used those carrying values as deemed cost of property, plant and equipment and intangible assets since there is no change in the functional currency.
- (iv) As per the 'Periodical Accounts of the Ordnance & Ordnance Equipment Factories in Commercial Format' as per the previous GAAP, all the fixed assets were acquired out of capital outlay i.e., capital grant.
- (v) By following Ind AS 20, paragraph 26, government grant is recognised as deferred income that is recognised as income in the Statement of Profit and Loss on a systematic basis over the useful life of the assets for which it is received.
- (vi) Therefore, the accounting treatment of government grant is in accordance with Indian Accounting Standards prescribed under section 133 of the Companies Act, 2013 read with Rule 3 of Companies (Indian Accounting Standards) Rules, 2015 as amended.
- (vii) It may be noted that paragraph 7 of Ind AS 101 requires 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. 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.
- (viii) Hence, the accounting for government grants has been done to comply with Ind AS 101, as the non-compliance with Ind AS will be considered as non-compliance with the provisions of law, which in this case, is Companies Act 2013.

12. The querist has also separately informed the following:

The Government of India announced to convert Ordnance Factory Board (OFB), an attached office of Ministry of Defence, Department of Defence Production, into seven different wholly owned corporate entities by the Government of India, registered under the Companies Act, 2013. Accordingly, the following production and non-production units: Rifle Factory Ishapore, Small Arms Factory, Kanpur, Gun & Shell Factory, Cossipore, Ordnance Factory Tiruchirapalli, Ordnance Factory, Kanpur, Field Gun Factory, Kanpur, Gun Carriage Factory, Jabalpur, and Ordnance Factory Project Korwa and non-production units at Ordnance Factories Institute of Learning Ishapore of the erstwhile OFB (referred to as 'business') were transferred to the Company on October 1, 2021 vide an Order issued by Department of Defence Production, Ministry of Defence, Government of India.

The Company was newly formed to take over the business from the erstwhile OFB. The Company therefore did not, according to the querist, meet the definition of 'Business' at the time of re-organisation as per Ind AS 103, 'Business Combinations'. Accordingly, this transaction is not construed as a business combination under common control, rather as a business reorganisation. There is no guidance under Ind AS on accounting for business reorganisation. However, since the business has remained under common control (i.e., by the Government of India), before and after the reorganisation, the management has determined that it is appropriate to apply provisions of Appendix C to Ind AS 103 that deals with business combinations under common control, as per the policy choice provided by Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'. Accordingly, the Company has accounted for the assets and liabilities of the business transferred at their existing carrying values adjusted for the effect of harmonising the accounting policies with those followed by the Company at Rs. 2158.24 crores, by following the provisions under Appendix C to Ind AS 103.

The consideration payable has been agreed in the form of equity shares to be issued by the Company to the Government of India, based on the fair value of the net assets of the business accounted by the Company. Provisional Net Asset Value (NAV) as on 31.03.2021 was Rs. 12,217 crores. The Company has issued shares on the basis of NAV mentioned above. Thus, the NAV was considered for issue of shares to Government of India. However, the Company has accounted for the assets and liabilities of the business transferred at their existing carrying values Rs. 2158.24 crores since the business has remained under common control (i.e., by the Government of India), before and after the reorganisation by applying the provisions of Appendix C to Ind AS 103 that deals with business combinations under common control.

B. Query

13. In view of the above, the opinion is sought from the Expert Advisory Committee of the ICAI as to whether the accounting treatment of government grant is correct.

C. Points considered by the Committee

14. The Committee notes that the basic issue raised by the querist relates to the appropriateness of accounting treatment of the funds provided by the government, for acquiring items of property, plant and equipment, to various ordnance factories, which were subsequently incorporated as a 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, determination of the fair value of the assets transferred, appropriateness of the Company's

assessment as business combination as per Ind AS 103, detailed application of requirements of Ind AS 103, Ind AS 101 and application (if any) of requirements of Ind AS 8, etc. The Committee has examined the issue only from an accounting perspective and has not examined the regulatory or legal requirements and implications, including those under Income-tax Act, 1932. Further, the opinion has been expressed in the context of Indian Accounting Standards (Ind AS), notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended or revised from time to time.

15. At the outset, the Committee understands from the Facts of the Case that the Company has been formed in the financial year 2021-22 by the Government by transferring the assets of various ordnance factories under the control of Ordnance Factory Board (OFB), which itself was an arm of the Government. In lieu of such transfer of assets, the Government has been issued shares of the Company at fair value of these assets as on 31.3.21, which was Rs. 12,217 crores. These assets were earlier acquired by the ordnance factories out of the funds provided by the government. Further, the net carrying value of these assets was Rs. 2158.24 crores, at which value, these have been recognised in the financial statements of the Company by applying the option of carrying value as deemed cost, available under D7AA of Ind AS 101; and also the Company treated the corresponding value as a government grant related to assets and has accordingly recognised the same as deferred income under Ind AS 20. Now, the issue that has been raised is with regard to the appropriateness of the aforesaid treatment.

16. In the context of the issue raised, the Committee notes the following requirements of Ind AS 101:

“3 An entity’s first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind ASs, in accordance with Ind ASs notified under the Companies Act, 2013 and makes an explicit and unreserved statement in those financial statements of compliance with Ind ASs.”

“D7AA Where there is no change in its functional currency on the date of transition to Ind ASs, a first-time adopter to Ind ASs may elect to continue with the carrying value for all of its property, plant and equipment as recognised in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments in accordance with paragraph D21 and D21A, of this Ind AS. For this purpose, if the financial statements are consolidated financial statements, the previous GAAP amount of the subsidiary shall be that amount used in preparing and presenting consolidated financial statements. Where a subsidiary was not consolidated under previous GAAP, the amount required to be reported by the subsidiary as per previous GAAP in its individual financial statements shall be the previous GAAP amount. If an entity avails the option under this paragraph, no further adjustments to the deemed cost of the property, plant and equipment so determined in the opening balance sheet shall be made for transition adjustments that might arise from the application of other Ind ASs. This option can also be availed for intangible assets covered by Ind AS 38, Intangible Assets and investment property covered by Ind AS 40, *Investment Property*.”

From the above, the Committee notes that an entity’s first Ind AS financial statements are the first annual financial statements in which the entity adopts Ind ASs and therein makes an explicit and unreserved statement of compliance with Ind ASs. In the extant case, after

incorporation, the Company has presented its first financial statements wherein it has adopted Ind ASs and thus, in the view of the Committee, requirements of Ind AS 101 are applicable (The Committee presumes that an explicit and unreserved statement of compliance with Ind AS has been included in the said financial statements). The Committee further notes that paragraph D7AA of Ind AS 101 permits a first-time adopter to elect to measure all its Property, Plant, and Equipment at the date of transition to Ind AS at the carrying value under previous GAAP, after making the adjustments in accordance with paragraphs D21 and D21A provided there is no change in the functional currency of the entity. Based on the facts provided, the Company’s functional currency has not changed upon transition to Ind AS. Therefore, the Company’s election of the exemption of the previous GAAP deemed cost for all its Property, Plant, and Equipment at the date of transition to Ind AS seems appropriate.

17. In the context of the issue raised with regard to accounting treatment by the Company as government grant, the Committee notes the following requirements of Ind AS 20:

- “2 This Standard does not deal with:
 - (a) ...
 - ...
 - (c) government participation in the ownership of the entity.
 - ...”

“Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

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.”

The Committee also notes that the applicable accounting standard prior to transition to Ind AS, viz., Accounting Standard (AS) 12, ‘Accounting for Government Grants’, provides as follows:

- “2 This Standard does not deal with:
 - (i) ...
 - ...
 - (iii) government participation in the ownership of the enterprise.
 - ...”

“3.2 Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. 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 enterprise.”

The Committee notes that under both AS 12 and Ind AS 20, government grants represent 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. Paragraph 2(iii) and 2(c) of AS 12 and Ind AS 20, respectively, excludes from the scope of AS 12 and Ind AS 20, government participation in the ownership of the entity, or in other words, the transactions with the Government acting in the capacity as owner/shareholder. Thus, in the view of the Committee, if any assistance being provided to the entity is being given by the Government acting in its capacity as an owner, such assistance will not be within the scope of AS 12 and Ind AS 20.

18. The Committee notes that in the extant case, the ordnance factories or businesses were owned and controlled by the GoI through Ordnance Factory Board before the incorporation of the Company and these businesses were earlier being carried out by the erstwhile OFB on account of the Government. Further, separate funds used to be allocated to the erstwhile OFB for procurement of capital assets under the heading “New Capital”. Furthermore, the Committee notes that in the accounts prepared by the factories earlier, these were presented as ‘capital outlay’ and not as government grant, and not treated as deferred income under AS 12. This indicates that funds received from the Government for acquisition of assets were in the capacity of owner and not as government grant. Further, even after the transfer of the assets pertaining to the factories or business to the Company, the GoI retains the ownership of the Company and, in turn, controls the business. The Committee is of the view that merely the reorganisation of the business from Ordnance factories under OFB to the Company does not change the nature of funds being provided by the Government in the capacity as owners to that of a government grant on application of Ind AS 20. Therefore, the Company’s accounting treatment of funds provided by the government as a government grant under Ind AS 20 is incorrect.

19. With respect to accounting for funds provided by the Government, the Committee notes that the definition of ‘income’ as per the Conceptual Framework for Financial Reporting under Ind AS provides that “Increases in assets, or decreases in liabilities, that result in increases in equity, *other than those relating to contributions from holders of equity claims.*” (Emphasis supplied by the Committee.) Thus, increase in assets relating to contributions from owners/holders of equity claims is not income of an entity. Further, the Committee notes that Ind AS 1, ‘Presentation of Financial Statements’ states the following:

“Statement of changes in equity

Information to be presented in the statement of changes in equity

106 An entity shall present a statement of changes in equity as required by paragraph 10. The statement of changes in equity includes the following information:

...

(d) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) disclosing changes resulting from:

(i) ...

...

(iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and ...

...”

From the above, the Committee notes that changes in equity resulting from transactions with owners acting in their capacity as owners are not considered for income/expense presented in the entity's Statement of Profit and Loss. Accordingly, the Committee is of the view that in the extant case, since the transaction is in the nature of a transaction in capacity of owners of the entity, the same shall not be recognised in the Statement of Profit and Loss; rather the same should be recognised as an equity inflow under an appropriate head using an appropriate nomenclature in the balance sheet.

D. Opinion

20. As discussed in paragraphs 17 to 19 above, the accounting treatment of funds provided by the government as government grant under Ind AS 20 is incorrect.
