

Query No. 19

Subject: *Accounting treatment of sale of fertilizers and related subsidy under Ind AS framework.*¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a listed entity operating under two segments viz., (i) Chemical and (ii) Fertilizers. The Company prepares its financial statements as per Indian Accounting Standards as notified under section 133 of the Companies Act, 2013. Under the fertilizers segment, the Company sells fertilizers to dealers/retailers/cooperatives (‘the dealers’). The market rate of fertilizers is advised by the Government of India (‘the government’). Notably, the Department of Fertilizers under the Ministry of Chemical and Fertilizers has implemented Direct Benefit Transfer (DBT) mechanism for fertilizer subsidy disbursement from September, 2017 in phased manner.

2. Under the DBT Mechanism, subsidy for fertilizers is released directly to the fertilizer companies only based on actual sales made by the dealers to the beneficiaries (‘the farmers’). The querist has emphasised that the right to claim subsidy is on sale to the farmers and not to the dealers. Sale of all subsidised fertilizers to farmers/buyers is made through Point of Sale (PoS) devices installed at each dealer shop and the beneficiaries are identified through Aadhaar Card, Kisan Credit Card (KCC), Voter Identity Card, etc.

3. The Government issues notifications specifying subsidy rates applicable for a designated period, as outlined in the notification. These subsidy rates may be subject to changes during the period. Typically, the Government notifies subsidy rate for each agricultural season i.e., Kharif (April to September) and Rabi (October to March). However, in the recent past, the Government has also revised subsidies more frequently, even on a quarterly basis. These revisions can happen prospectively or retrospectively.

4. The Company sells fertilizers to the dealers and then depending upon the type of license of the dealer, fertilizers are further sold by them to retailers and, ultimately, to the farmers. In accordance with the DBT scheme, the Government system allows the Company to raise subsidy claim on the Government only when the fertilizers are sold to the farmers and then payments are made to Company. There is always some time lag between the sales to the dealers by the Company and the ultimate sale to the farmers ranging from 15 days to several months.

5. After the sale to the dealers, it is possible that the Government increases/decreases the subsidy rate which effectively changes the entitlement of subsidy on stock lying with dealers and not sold to farmers (‘the channel stock’). Hence, as per the querist, post revenue recognition, the Company is required to correct/revise its revenue concerning the channel stock as on the date of revision of subsidy rate assuming that expected billing to Government will be done at new rate. These changes often happen after a period of closure/reporting.

6. The Company recognises revenue from the sale of fertilizers as per Indian Accounting Standard (Ind AS) 115, ‘Revenue from Contracts with Customers’. As per the querist, there are two components of transaction price in the case of the Company- one is fixed amount which is the price fixed in contract with dealer and the second is variable consideration i.e., subsidy

¹ Opinion finalised by the Committee on 28.8.2024.

revenue receivable from Government. The querist has reproduced the following paragraph from Ind AS 115:

“31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.”

The Company satisfies the performance obligation when the control is transferred to the customer, typically dealer in the case of Company and, accordingly, revenue is recognised at that time.

7. The querist has reproduced the following paragraphs from Ind AS 115:

“47 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.”

“50 If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.”

As per the querist, the fertilizer subsidy is a benefit extended to the farmers and not to the Company, as the fertilizer’s rate is reduced which is then compensated through subsidy. In essence, the Company receives a partial payment for fertilizer sales from the Government on behalf of the customer and this amount varies based on official notifications. Therefore, the Company treats subsidy income in a similar line as variable consideration in accordance with Ind AS 115 and, accordingly, recognises subsidy revenue at the time of sales only as per the notified rate. Accordingly, the Company recognises the whole revenue (price fixed in contract with dealer plus subsidy income) at a point in time when the control is transferred to the customer.

8. The querist has reproduced the following paragraphs from Ind AS 115:

“87 After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which an entity expects to be entitled in exchange for the promised goods or services.

88 An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Consequently, an entity shall not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception. Amounts allocated to a satisfied performance obligation shall be recognised as revenue, or as a reduction of revenue, in the period in which the transaction price changes.”

As per the querist, when notified rate changes, variable consideration is changed to the extent of the stock of fertilizers lying with dealers as channel stock and not sold to farmers. The impact of such changes in variable consideration is reflected in the Company's revenue recognition.

9. As per the querist, under the Company's current accounting practice, there exists significant volatility in margins for each reporting period. Additionally, the matching principle is not consistently met, as the entire cost of manufacture of fertilizers is booked in one period, while a specific portion of the revenue (resulting from changes in subsidy rates on channel stock) is recognised in another period. The Government, which was earlier notifying subsidy rate twice in a year for each season, is now changing rates more frequently and sometimes retrospectively leading to significant changes in revenue recognition and margin volatility on a quarter-to-quarter basis. In this regard, the querist has given the following illustration:

The Company sold 100 units of fertilizers to a dealer in both reporting periods, i.e., reporting period 1 and reporting period 2. Of the quantity sold, 20 units remain with the dealer as channel stock at the end of reporting period 1. These 20 units were subsequently sold by the dealer to a farmer in reporting period 2, and there is no channel stock remaining in reporting period 2. Additionally, the selling price has increased to the extent of the reduction in subsidy in reporting period 2, while the manufacturing cost remains the same in both reporting periods. Assuming that the subsidy rates have changed from the beginning of reporting 2, the financial impact and presentation would be as follows:

[Amounts in Rupees (except for E and F below)]

S. N.	Particulars	Reporting period 1	Reporting period 2
A	Selling price of fertilizer	70	80
B	Subsidy rate	30	20
C	Manufacturing cost	80	80
D	Margin per unit	20	20
E	Quantity sold to dealer	100	100
F	Quantity of channel stock out of above	20	0
G	Margin on sales to dealer	2,000	2,000
H	Impact on margin of channel stock due to change in subsidy rate	0	(200)
I	Total Margin (G+H)	2,000	1,800
J	Revenue from operations	10,000	9,800

As per the above illustration, the impact of the change in subsidy income on channel stock amounting to Rs. 200 is related to reporting period 1 but would be posted in reporting period 2. This impact is significant when compared to the gross margin on sales made in reporting period 2.

10. The querist has stated that considering the volatility in margins and matching principle not met as explained in paragraph 9 above, the management has re-evaluated the accounting treatment of subsidies and determined that recognising subsidy revenue under Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance', may be more appropriate than under Ind AS 115. As per paragraph 3 of Ind AS 20, **"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”. In the case of the Company, the subsidy received on sale of fertilizers qualifies as a transfer of resources to an entity. According to the querist, the purpose of fertilizer subsidy is to ensure availability of fertilizer at an affordable rate to farmers. Under DBT regime, the Government decides subsidy rate for each season depending on trending of few products like DAP, Urea, MOP and Sulphur which are not having any direct link with cost of production of companies. However, the Government assumes that if above mentioned products are imported today and sold at certain prices, then, the Companies require the difference as subsidy to sustain operations. Paragraph 4 of Ind AS 20 reads as, “Government assistance takes many forms varying both in the nature of the assistance given and in the conditions which are usually attached to it. The purpose of the assistance may be to encourage an entity to embark on a course of action which it would not normally have taken if the assistance was not provided.”

11. As per the querist, DBT regime requires accounting practice which is more aligned to subsidy entitlement under DBT unlike the earlier scheme where the condition to receive the subsidy was tied to the Company selling the goods, rather than when the goods were ultimately purchased by the farmer. Under DBT regime, subsidy entitlement is final when material is sold to farmer. The querist has reproduced the following paragraphs from Ind AS 20:

“7 Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

(a) the entity will comply with the conditions attaching to them; and

(b) the grants will be received.”

“12 Government grants shall 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 grants are intended to compensate.”

12. Based on the above, the Company wants to:

(a) Recognise revenue from sale of fertilizer to the dealers as per contract at the time when control is transferred in accordance with Ind AS 115 and account for only the proportionate cost of manufacture of fertilizers, and

(b) Recognise subsidy revenue and proportionate cost thereof when goods are sold by the dealers to the farmers, adhering to Ind AS 20.

To comply with Ind AS 20 and matching principle, pro-rata cost linked to subsidy revenue will be booked along with subsidy revenue. Since subsidy revenue may be recognised after primary revenue, the cost element tied to subsidy revenue will be temporarily kept in inventory and expensed when subsidy income is booked. By following the aforesaid accounting treatment, the volatility on margins would be minimised and matching principle would also be met.

B. Query

13. The querist has sought the opinion of the Expert Advisory Committee as to whether the proposed accounting treatment as suggested in paragraph above is appropriate and in compliance with Ind AS 115 and Ind AS 20.

C. Points considered by the Committee

14. The Committee notes that the basic issues raised by the querist relate to the recognition of revenue from sale of fertilizers, recognition of fertilizer subsidy and related costs in profit or loss. The Committee has, therefore, considered only these issues and has not examined any other issue that may be contained in the Facts of the Case, such as, presentation of subsidy income in profit or loss, presentation as per Schedule III to the Companies Act, 2013, etc. Further, the opinion hereinafter has been expressed in the context of Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time.

15. The Committee first addresses the issue of recognition of revenue from the sale of fertilizers to the dealers and treatment of related cost of manufacture. The Committee notes paragraphs 31 and 32 of Indian Accounting Standard (Ind AS) 115, 'Revenue from Contracts with Customers', reproduced below:

“31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

32 For each performance obligation identified in accordance with paragraphs 22–30, an entity shall determine at contract inception whether it satisfies the performance obligation over time (in accordance with paragraphs 35–37) or satisfies the performance obligation at a point in time (in accordance with paragraph 38). If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.”

As per the Facts of the Case, the Company recognises revenue from sale of fertilizers to dealers at the time it transfers control of the same to the dealers. Hence, the Company satisfies the performance obligation at a point in time. Presuming that the Company properly assesses the timing of transfer of control in accordance with Ind AS 115, the Committee is of the view that recognition of revenue at the time of transfer of control of the goods i.e., fertilizers, to the dealers is correct.

16. The Committee further notes that paragraph 95 of Ind AS 115 deals with accounting treatment of costs incurred in fulfilling a contract with a customer not within the scope of another Standard, such as, Ind AS 2, 'Inventories', Ind AS 16, 'Property, Plant and Equipment' and Ind AS 38, 'Intangible Assets'. This is also reinforced by paragraph 8 of Ind AS 2, which, *inter alia*, states that costs incurred to fulfil a contract with a customer that do not give rise to inventories (or assets within the scope of another Standard) are accounted for in accordance

with Ind AS 115. Further, the Committee notes paragraph 96 of Ind AS 115, as reproduced below:

“96 For costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.”

From the above, the Committee notes that costs of producing inventories of fertilizers are costs incurred in fulfilling the contract with the customers i.e., dealers, which should be accounted for in accordance with Ind AS 2 and not in accordance with Ind AS 115. In this regard, the Committee notes the following paragraphs of Ind AS 2:

“9 Inventories shall be measured at the lower of cost and net realisable value.

Cost of Inventories

10 The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.”

“34 When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.”

From the above, the Committee is of the view that the manufacturing cost of the fertilizer inventories should be determined in accordance with the requirements of Ind AS 2 and such inventories should be measured at the lower of cost and net realisable value. Further, when such inventories are sold to the dealers, the carrying amount of the same should be expensed in the period in which the related revenue is recognised. The issue whether *any portion* of the manufacturing cost of inventories can be treated as a separate asset is examined in paragraph 22 below.

17. With regard to accounting treatment of fertilizer subsidy, the Committee notes the following definitions from ‘Appendix A-Defined terms’ to Ind AS 115.

- “contract An agreement between two or more parties that creates enforceable rights and obligations.”
- “customer A party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.”
- “transaction price (for a contract with a customer) The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or

services to a **customer**, excluding amounts collected on behalf of third parties.”

- “50 If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.”

In the extant case, there is contract between the Company and the dealer, who is the customer. The ultimate customer is the farmer, who is the customer of the dealer. Apparently, neither the contract between the Company and the dealer nor the contract between the dealer and the farmer specifies that any portion of the consideration is payable to the Company by the Government on behalf of the farmer. Consequently, the Committee is of the view that the fertilizer subsidy does not form part of the variable consideration element of the transaction price dealt with in paragraph 50 of Ind AS 115 and is outside the scope of Ind AS 115.

18. The Committee now examines whether the fertilizer subsidy is within the scope of Ind AS 20, ‘Accounting for Government Grants and Disclosure of Government Assistance’. The Committee notes the following paragraphs of Ind AS 20:

“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.”

“Grants related to income are government grants other than those related to assets.”

- “6 Government grants are sometimes called by other names such as subsidies, subventions, or premiums.”

From the above, the Committee is of the view that the fertilizer subsidy in the extant case is of the nature of government grant related to income. This is because there is transfer of resource (i.e., money) from the government to the Company in return for past compliance with a condition i.e., sale of fertilizers to the ultimate customer (viz., farmer) at the rate advised by the government and the grant is not related to any asset. Since the subsidy meets the definition of government grant as per Ind AS 20, it should necessarily be accounted for in accordance with that Standard.

19. The Committee further notes the following paragraphs of Ind AS 20:

“7 Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

- (a) the entity will comply with the conditions attaching to them; and**
- (b) the grants will be received.”**

“12 Government grants shall 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 grants are intended to compensate.”

From the above, the Committee is of the view that the fertilizer subsidy receivable should be recognised by the Company in the balance sheet as an asset when the reasonable assurance condition prescribed in paragraph 7 of Ind AS 20 is met. The Company should assess, in its own circumstances, the point of time at which the reasonable assurance condition is met, having regard to factors such as, quantity of non-moving channel stock, if any, past experience in receipt of subsidy etc.

20. The Committee notes that in the extant case, the subsidy is intended to either reimburse to the Company a portion of cost of production of goods sold or to compensate the Company for loss of revenue arising on account of sales to the dealers at rates not commensurate with the cost of production. In both the situations, the periods in which the subsidy income should be recognised in profit or loss on a systematic basis will be the periods of sale to the dealers, provided the reasonable assurance condition prescribed in paragraph 7 of Ind AS 20 is met. This is because as already explained in paragraph 16 above, in accordance with paragraph 34 of Ind AS 2, the manufacturing cost will be expensed in the period in which the fertilizers are sold to the dealers. However, if the reasonable assurance condition prescribed in paragraph 7 of Ind AS 20 is not met during the periods of sale to the dealers, then, the subsidy income should be recognised in profit or loss for the period in which the said condition is met.

21. The Committee also notes from the Facts of the Case that there are frequent changes in the subsidy rates notified by the government which may be effective either prospectively or retrospectively. The Committee is of the view that the effect of such changes should be treated as change in an accounting estimate and should be accounted for in accordance with paragraphs 36 and 37 of Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’.

22. Now, the Committee examines whether the subsidy can be recognised by the Company in profit or loss only at the time of sale of fertilizers to the ultimate customers i.e., farmers by the dealers and whether proportionate cost thereof can be treated as inventory temporarily and expensed only at that time as suggested by the querist in paragraph 12 above.

For the reasons given in paragraphs 19 and 20 above, the Committee is of the view that recognition of subsidy receivable with concurrent recognition of the subsidy income in profit or loss *at the time of sale to farmers* by the dealers would be appropriate, only if the reasonable assurance condition prescribed in paragraph 7 of Ind AS 20 is not met before that time *and* it is only at the time of sale to the farmers there is reasonable assurance that the grant will be received by the Company.

The Committee is further of the view that even if the Company assesses, in its own facts and circumstances, that only at the time of sale to the farmer by the dealer, there is reasonable assurance that the grant will be received, proportionate cost related to the subsidy cannot be separately treated as an asset. The querist’s proposed treatment suggests that manufacturing cost of inventories sold to dealers should be bifurcated into cost attributable to transaction price and cost attributable to subsidy (hereinafter referred to as ‘cost of entitlement to the subsidy’); the former is expensed when inventories are sold to the dealers while the latter is expensed when the fertilizers are sold by the dealers to the farmers. The latter is also temporarily proposed to be treated as inventories. The Committee is of the view that such a treatment is neither

permitted nor required by Ind AS 2 as well as Ind AS 20. The Committee notes that treatment suggested by the querist involves an assumption that the cost of entitlement to the subsidy will be recovered because fertilizers will ultimately be sold to the farmers and the subsidy will be received. This means that as per the querist, the reasonable assurance condition prescribed in paragraph 7 of Ind AS 20 is met at the time of sale to the dealers warranting recognition of the subsidy receivable in the balance sheet at that time itself. In this regard, the Committee notes that paragraph 7 of Ind AS 20 requires recognition of the grant as a 'receivable' (asset) in the balance sheet and *not* the incurred cost of entitlement to the grant.

Accordingly, the Committee is of the view that attributing proportionate cost to the subsidy receivable and treating it as an asset is not appropriate. Hence, the question of treating the same as inventory does not arise at all. Consequently, attributing proportionate cost to the transaction price and expensing only that portion at the time of sale to the dealers is also not appropriate.

D. Opinion

23. On the basis of the above, the Committee is of the opinion that the proposed accounting treatment as suggested by the querist in paragraph 12 above is not completely appropriate and in compliance with applicable Standards. Recognition of revenue from sale of fertilizers to dealers at the time of transfer of control in accordance with Ind AS 115 is appropriate, subject to the presumption stated in paragraph 15 above. Further, recognition of subsidy receivable in the balance sheet with concurrent recognition of subsidy income in profit or loss at the time of sale of fertilizers to farmers by the dealers would be appropriate, only if the reasonable assurance condition prescribed in paragraph 7 of Ind AS 20 is not met before that time *and* it is only at the time of sale to the farmers there is reasonable assurance that the grant will be received by the Company. Otherwise, it is inappropriate and not in compliance with Ind AS 20. Bifurcation of cost of manufacture into cost attributable to transaction price and cost attributable to subsidy (cost of entitlement to subsidy), recognition of the former as expense on sale of fertilizers to the dealers and recognition of the latter as expense on sale to ultimate customer i.e., the farmer by the dealers and temporarily treating the latter as inventories are inappropriate and not in compliance with Ind AS 2 and Ind AS 20, as discussed in paragraph 22 above.
