Query No. 3

Subject: Accounting treatment of revenue on conversion of leasehold land to freehold land under Ind AS framework.[1]

A. Facts of the Case

1. A Company (hereinafter referred to as 'the Company') is a central public sector undertaking under the administrative control of Department of Fertilizers, Government of India. The Company is engaged in manufacture and marketing of fertilizers, petrochemicals, engineering design & consultancy services and fabrication & erection of equipments.

2. The querist has stated that during the financial year (F.Y.) 2019-20, the Company had sold 481.79 acres of land at A place, to K Corporation, Government of Kerala as follows:

(i) 331.79 acres of land at the rate of Rs. 2.4758 crore per acre; and

(ii) 150 acres of land at the rate of Re. 1 crore per acre (in lieu of freehold right over 143.22 acres of land situated in E Village presently held by the Company as leasehold land).

Thus, the total monetary consideration as per the agreement is Rs. 971.44 crore and non-monetary consideration of freehold right over 143.22 acres of land situated in E Village presently held by the Company as leasehold land.

3. The Company received the consideration amounting to Rs. 971.44 crore from the transaction during the financial year 2019-20. Further, the Industries Department, Government of Kerala, had issued order dated 13/11/2019, regarding granting freehold right over 143.22 acres of land in E Village. However, the order issued by the Industries Department was not sufficient enough for materialising the transfer of the property into freehold, since the Revenue Department is the ultimate Competent Authority for land related matters.

4. Accordingly, the Company recognised the revenue from the transaction as income in the financial year 2019-20, only to the extent of Rs. 971.44 crore, being the monetary compensation. The value of the 143.22 acres of land proposed to be converted as freehold was neither recognised as income nor asset, since a valid order from Revenue Department was not received nor the title deed was transferred to the Company. The value of the said land in the books of account as on 31.03.2022 is nil.

5. The status quo was maintained during the financial year 2020-21 and financial year 2021-22 also, since there was no development in this regard and no further orders were received from the Government of Kerala. The Company was in continuous follow up with the Government for transfer of the title.

6. According to the querist, the Company was not having marketable title over the said 143.22 acres of land as on 31.03.2020/ 31.03.2021/31.03.2022. The title of the land was still lying with the Government of Kerala as per the revenue records. Effectively, the control of the asset was not transferred to the Company, even though the possession of the land was already with the Company as a lessee.

[1] Opinion finalised by the Committee on 11.4.2023.

7. Even though the procedures for granting freehold title over the land was initiated in the year 2019-20, the final order to the effect of transfer of title is issued by the Competent Authority only during the current financial year 2022-23. As the Company did not have control over the land during the previous financial years as detailed above, the accounting for the non-monetary revenue portion was deferred by the Company.

8. During the current financial year 2022-23, the Company has received the order from the Revenue Department of the Government of Kerala, dated 17.05.2022, ratifying the order of the Industries Department and conveying Government sanction for unconditional assignment of 143.22 acres of land to the Company. According to the querist, the order clearly states that the order of the Industries Department, GO (Ms) No. 99/2019/ID dated 13/11/2019 needs proper amendment and due ratification by the Revenue Department. This obviously indicates that the Industries Department's order was not sufficient for transfer of the title. Accordingly, management decided to recognise the value of 143.22 acres of land in the books of account and the corresponding revenue.

9. The querist has further stated that paragraph 24 of Ind AS 16, 'Property, Plant and Equipment' states that:

> "One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. ..."

10. In the present case, 143.22 acres of land is proposed to be accounted for at its fair value, as the exchange transaction does not lack commercial substance and fair value of asset sold and the land for which title deed will be received can be measured reliably using the valuation report of an expert valuer.

11. Accordingly, the Company has obtained a valuation report of the said 143.22 acres of land, in order to assess the fair value of the land. The fair value of the land as on the date of order of the Revenue Department is approximately Rs. 480 crore.

12. Further, as per the querist, as the Company has received valid and enforceable order from the Revenue Department only during the F.Y. 2022-23, management proposes to recognise the revenue amounting to Rs. 480 crore (approx.) on the date of Revenue Department order, during the financial year 2022-23. The equivalent value is proposed to be recognised as Land (Property, Plant & Equipment). The relevant extracts of the Ind AS which were referred to in this regard are detailed as below:

i. Paragraph 72 of Ind AS 16, 'Property, Plant and Equipment' deals with calculation of consideration on disposal of an item of property, plant and equipment. The amount of consideration to be included in the gain or loss arising from the derecognition of an item of property, plant and equipment is determined in accordance with the requirements for determining the transaction price in paragraphs 47–72 of Ind AS 115 'Revenue from Contracts with Customers'. Subsequent changes to the estimated amount of the consideration included in the gain or loss shall be accounted for in accordance with the requirements for changes in the transaction price in Ind AS 115.

ii. As per paragraph 47 of Ind AS 115, 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.

iii. As per paragraph 48 of Ind AS 115, the nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of any variable consideration and any non-cash consideration.

iv. As per paragraph 50 of Ind AS 115, 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.

v. As per paragraph 51 of Ind AS 115, the promised consideration can also vary if an *entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event.* (Emphasis supplied by the querist.)

In the current scenario, the sale of land to K Corporation involved 2 forms of variable consideration:

A) Non-monetary consideration - freehold rights over 143.22 acres of land which was being held by the Company as leasehold land on the date of sale deed.

B) Contingent consideration - Even though the sale deed mentioned non-monetary consideration as per Point A to be received by the Company, freehold rights of the said land would only be transferred to the Company on issuance of order by the Revenue Department for assignment of land to the Company.

vi. As per paragraph 53 of Ind AS 115, an entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

(a) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

(b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

vii. As per paragraph 56 of Ind AS 115, an entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

viii. As per paragraph 57 of Ind AS 115, in assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include the scenario where the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.

ix. As per paragraph 59 of Ind AS 115, at the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period. The entity shall account for changes in the transaction price in accordance with paragraphs 87–90.

x. As per paragraph 87 of Ind AS 115, 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.

xi. As per paragraph 88 of Ind AS 115, 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.

13. The querist has stated that transfer of non-monetary consideration in the contract was contingent to the issuance of the order of the Revenue Department sanctioning assignment of the 143.22 acres of land in favour of the Company. Even though the sale deed was executed in F.Y. 2019-20, the issuance of the said order was outside the Company's influence. The Company made regular submissions to the various authorities including the Revenue Department for the assignment, but it was not highly probable that the order will be issued by the Revenue Department in F.Y. 2019-20. At the end of every reporting period, similar assessment was made by the management of the Company, and it was not highly probable that the order will be issued by the Revenue Department.

14. However, while referring to paragraph 68 of the Ind AS 16, the gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised. The asset sold being 481.79 acres of land was derecognised in the Company's books of account during the year 2019-20. Hence, this expert opinion is sought to clarify on the year of recognition of the revenue and asset.

B. Query

15. The Expert Advisory Committee of the Institute of Chartered Accountants of India is requested to give its opinion as to:

(i) Whether the management’s proposal to recognise the fair value of the land on the date of order of the Revenue Department and equivalent amount as property, plant and equipment (PPE), is in order considering the relevant Indian Accounting Standards.

(ii) Whether the management’s proposal to recognise the revenue and PPE during the current Financial Year 2022-23, being the year in which the Company has received valid order from the Government of Kerala, is in order considering the relevant Indian Accounting Standards.

C. Points considered by the Committee

16. The Committee notes that the basic issue raised by the querist relates to accounting treatment of the exchange transaction, as mentioned above. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for leasehold or Right of Use (RoU) land and its associated lease liability till the same is exchanged in the financial statements of the Company as per the requirements of Ind AS 116 and transition to Ind AS 116, accounting for sale of 331.79 acres of land which was purely sold for monetary consideration, fair valuation of land, application of the requirements of Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’, etc. Further, the Committee has not examined as to whether the exchange transaction in the extant case lacks commercial substance or whether the fair value of asset(s) sold or given up and the freehold land acquired in the exchange transaction can be measured reliably or not as per the requirements of Ind AS 16 and has presumed that the contentions of the querist in this regard are appropriate. The Committee wishes to point out that the Indian Accounting Standards referred to in the Opinion are the Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time. The Opinion hereinafter is purely from accounting perspective and not from legal perspective, such as, legal interpretation of the order issued by the Industries Department, sale deed, Memorandum of Understanding (MoU) and the Order of Revenue Department in F.Y. 2022-23, whether order of Industries Department needs ratification by the Revenue Department and which is the competent authority for transfer or assignment of freehold rights etc.

17. At the outset, the Committee wishes to point out that in the extant case, although the Company has sold two pieces of land as a part of the single MoU/agreement, the exchange transaction has taken place only in respect of 150 acres of land which is sold at the monetary consideration of Re. 1 crore per acre in addition to non-monetary consideration of acquiring freehold right over 143.22 acres of land situated in E Village, which was presently held by the Company as leasehold land. Thus, the other piece of land of 331.79 acres for which monetary consideration is received should be accounted for separately from the exchange transaction in respect of 150 acres of land as per the requirements of Ind AS 16.

18. With regard to accounting for exchange transaction, the Committee notes the following requirements of Ind AS 16, ‘Property, Plant and Equipment’:

> “24 One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges

described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired item is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

25 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

(a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post -tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

26 The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident."

In the extant case, since the exchange transaction does not lack commercial substance (as stated by the querist and presumed by the Committee) and the fair values of both the asset received and the assets given up are reliably measurable, the Committee is of the view that fair value of the assets given up, viz., the piece of 150 acres of land and leasehold or Right of Use (RoU) of 143.22 acres of land (adjusted by the monetary consideration received) should form the basis of measurement of the freehold land acquired in the extant case unless the fair value of freehold land is more clearly evident. Further, it should be noted that the fair value under Ind AS 16 has been defined by reference to Ind AS 113, 'Fair Value Measurement'.

19. As far as the timing of recognition of this freehold land is concerned, the Committee notes the following requirements of Ind AS 16:

"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.”

From the above, the Committee notes that the freehold land in the extant case can be recognised only when the recognition criteria as per paragraph 7 of Ind AS 16 are met.
As per the recognition criteria, it should be probable that future economic benefits associated with the asset will flow to the entity, which requires assessment of the degree of certainty attached to the flow of future economic benefits at the time of initial recognition.

In this regard, the Committee notes from the various communication/Orders with/of the Industries/Revenue Department that there was never any disagreement or dispute with regard to the Company’s entitlement to such rights, rather only compliance of legal formalities/procedures for transfer or assignment of rights to the Company. Therefore, the Committee is of the view that order from Revenue Department, Transfer Deed for title, etc. cannot be considered as substantive so as to give rise to any uncertainty with regard to transfer of control of the asset or flow of future economic benefits therefrom to the Company and are only procedural in nature in the specific facts and circumstances of the Company. Accordingly, the Committee is of the view that in the extant case, the Company should recognise the freehold land acquired in the exchange transaction at the inception itself when the exchange transaction took place in the financial year 2019-20. However, appropriate disclosures with regard to legal title of the land should be given in the financial statements.

20. With regard to the transaction of exchange, the Committee further notes that one of the assets given up in the exchange transaction is a tangible property (land) to which the requirements of Ind AS 16 shall be applicable. Thus, such asset given up on exchange shall be derecognised as per the derecognition principles of Ind AS 16, as reproduced below:

“Derecognition

67 The carrying amount of an item of property, plant and equipment shall be derecognised:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

68 The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless Ind AS 116, *Lea*ses, requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.”

“71 The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

72 The amount of consideration to be included in the gain or loss arising from the derecognition of an item of property, plant and equipment is determined in accordance with the requirements for determining the transaction price in paragraphs 47-72 of Ind AS 115. Subsequent changes to the estimated amount of the consideration included in the gain or loss shall be accounted for in

accordance with the requirements for changes in the transaction price in Ind AS 115."

From the above, the Committee notes that the amount of consideration to be included in the gain or loss arising from the derecognition of an item of property, plant and equipment is determined in accordance with the requirements for determining the transaction price in paragraphs 47-72 of Ind AS 115, 'Revenue from Contracts with Customers'. Thus, on derecognition as per the requirements of Ind AS 16, for determining gain or loss, the consideration, monetary and non-monetary, is to be arrived at as per the requirements of Ind AS 115. In this regard, the Committee notes the following requirements of Ind AS 115:

"**Determining the transaction price**

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.

48 The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

(a) variable consideration (see paragraphs 50–55 and 59);

(b) constraining estimates of variable consideration (see paragraphs 56–58);

(c) the existence of a significant financing component in the contract (see paragraphs 60–65);

(d) non-cash consideration (see paragraphs 66–69); and

(e) consideration payable to a customer (see paragraphs 70–72)."

"Non-cash consideration

66 To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

67 If an entity cannot reasonably estimate the fair value of the non-cash consideration, the entity shall measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration."

21. From the above, the Committee notes that the transaction price is the amount of consideration (including non-cash 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. The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. While determining the transaction price or the consideration for contracts in which a customer promises consideration in a form

other than cash, an entity shall measure the non-cash consideration (or promise of non-cash consideration) at fair value.

In this context, as discussed earlier in paragraph 19 above, the Committee notes that at the time of entering into exchange transaction or thereafter, there was no uncertainty with regard to the Company's entitlement to the consideration in the form of freehold rights or future economic benefits arising therefrom as the same has been promised by the Industries Department of the State Government unconditionally and therefore, in financial year 2019-20, on derecognition of land given up, the Company should recognise the non-cash consideration (or promise of non-cash consideration) at fair value. Further, as per the requirements of Ind AS 16, any gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised, however, the gains shall not be classified as 'revenue'.

With regard to the above requirements of Ind AS 115, the Committee wishes to mention that the promised non-monetary consideration in the exchange transaction in terms of freehold land cannot be considered as variable consideration as per Ind AS 115, as being contended by the querist as it was neither a variable amount that was promised as consideration nor the Company's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event.

With regard to derecognition, the Committee also wishes to mention that on acquisition of the freehold land in the extant case, another asset that will be derecognised is the RoU or leasehold land. The Committee is of the view that the carrying amount of RoU asset and its associated lease liabilities should also be derecognised as per the requirements of paragraphs 39 and 40 of Ind AS 116.

D. Opinion

22. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 15 above:

(i) and (ii) In the extant case, as discussed in paragraph 19 above, the Company should recognise the freehold land acquired in the exchange transaction at the inception itself when the exchange transaction took place in the financial year 2019-20. However, appropriate disclosures with regard to legal title of the land should be given in the financial statements. Further, as discussed in paragraph 18 above, fair value of the assets given up, viz., the piece of 150 acres of land and leasehold or Right of Use (RoU) of 143.22 acres of land (adjusted by the monetary consideration received) should form the basis of measurement of the freehold land acquired in the extant case unless the fair value of freehold land is more clearly evident. Furthermore, the derecognition requirements of Ind AS 16 and Ind AS 116, as discussed above should be followed by the Company. Therefore, the proposed accounting treatment by the management in the extant case is not appropriate.

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