Query No. 2

Subject: Accounting treatment of cost of land acquired and cost incurred on construction of staff quarters of polytechnic college under Ind AS framework.[1]

A. Facts of the Case

1. A Company (hereinafter referred to as 'the Company') was formed in the year 2013 with 50:50 equity participation of the Government of India and the State Government, to execute Mass Rapid Transit System (MRTS) in L city by providing Metro Rail. L Metro Project is in operation from 8th March 2019 and construction activities of K and A Metro Rail Projects are under progress. Priority corridor of K Metro Project is also operational from 28.12.2021. During the construction of depot building of K Metro Project, land of depot building having an area of 16.2 hectare was received free of cost, on the order of the State Government. In the State Government Order, there was a condition that the Company will construct the staff quarter building of polytechnic college out of their own funds (a copy of the Government Order has been separately provided by the querist for perusal of the Committee). There was a building which was constructed and operated upon by polytechnic college on the said land. After the acquisition of said land, the Company dismantled the building and constructed the metro depot and staff quarters for polytechnic college. The estimated cost to be incurred on the staff quarter is Rs. 83.95 crore and the same is under construction.

2. *Accounting treatment adopted by the Company*

The Company recognised the cost of land ₹ 526.50 crore at the circle rate (₹ 32500/ Sq. Mtr) issued by the Government by debiting 'Land Barter' and crediting 'Cost against Barter land' with the estimated cost of construction of staff quarters of polytechnic college (₹ 83.95 crore) and 'Non-monetary Government Grant' with the balancing figure of ₹ 442.55 crore. Journal entry passed is mentioned below:

S.No.	Particulars	Nature of Account	Debit (₹ in Crore)	Credit (₹ in Crore)
1	Land Barter	Assets	526.50	
	Cost against barter land	Liability		83.95
	Non- Monetary Government Grant	Liability		442.55 (Balancing Figure)
	(Being land acquired from Polytechnic College against construction of staff quarters for staff of polytechnic college. Value of land ₹ 526.50 crore and cost of construction of staff quarters ₹ 83.95 crore)			

The 'Non-monetary Government Grant' so credited will be amortised and credited in the Profit and Loss in the ratio of depreciation of depot building over the life of assets (Refer Journal entry No.2 below). The 'Cost against barter land' will be debited and settled against

[1] Opinion finalised by the Committee on 8.4.2024.

the actual cost of construction of staff quarters, as and when incurred (Refer the Journal entries No. 3 and 4 below):

S.No.	Particulars	Nature of Account	Debit (₹ in Crore)	Credit (₹ in Crore)
2	Government Grant	Liability	XX	
	Profit and Loss Account	Income		XX
	(Being Grant amortised in P&L in the ratio of depreciation of assets)			
3	Capital work-in-progress (CWIP) polytechnic staff quarter	CWIP	XXX	
	Bank	Assets		XXX
	(Being cost incurred for construction of staff quarters of polytechnic college)			
4	Cost against barter land	Liability	XXX	
	CWIP polytechnic staff quarter	CWIP		XXX
	(Being cost incurred for the construction of staff quarters of polytechnic college adjusted against the cost provided for Land Barter)			

3. *Draft Comment issued by the Comptroller and Auditor General of India (C&AG)*

The querist has stated that during the supplementary audit of financial statements for financial year (F.Y.) 2022-23, the C&AG was of the view that cost of construction of staff quarters for polytechnic college should be treated as expenses and not to be adjusted against the cost of land. Draft comment raised by C&AG is mentioned below:

> Expenses:
>
> Other Expenses: ₹ 752.81 lakh
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> The above head does not include a sum of ₹ 83.95 crore to be incurred on account of construction of staff quarter of Polytechnic college against Land received for K metro project. As per the applicable Government order, this expenditure was to be incurred by the Company from its own resources.
>
> It was noticed that the Company has adjusted the above amount of ₹ 83.95 crore against the capital grant of ₹ 526.50 crore for the fair value of land received free of cost from the State Government, which was not in order.
>
> Thus, Non-current Liabilities (Other Non-current liabilities) and Expenses (Other expenses) are understated by ₹ 83.95 crore. Consequently, loss is also understated to that extent.

4. *Reply of the Company against draft comments raised by C&AG*

As per Indian Accounting Standard (Ind AS) 16, ‘Property, Plant and Equipment’, in case of exchange of assets, value of assets to be recognised is the fair value of the assets given or acquired. In this particular case, the Company has booked the cost of land acquired in the exchange of construction of staff quarter of Polytechnic College at fair value of land acquired i.e. ₹ 52650.00 lakh. In this regard, the Company has provided below-mentioned explanations:

(i) As per dual entry system of the accounting, against the above value of land i.e. ₹ 52650.00 lakh, cost of construction to be incurred i.e. ₹ 8394.75 lakh has been booked as liability (credit) and the balance amount of ₹ 44255.25 lakh recognised as grant being the difference of the fair value of the assets recognised and cost to be incurred.

(ii) Cost of construction i.e. ₹ 8394.75 lakh as mentioned above is shown under the head Note 23 'Other Current Liabilities' and will get adjusted against the actual cost of construction as and when it is incurred.

(iii) Above expenditure is not in 'Revenue' nature, so the contention of audit to include the same in other expenses is not justifiable and the same is recognised as assets under the Note No. 1 'Property, Plant and Equipment'.

(iv) The Company was to construct and hand over the residential building to Polytechnic College in exchange of land. It is to be noted that these staff quarters were to be used by the employees of polytechnic college and not by the Company's staff.

(v) Further, the ownership of assets related to staff quarter will be with the polytechnic college and the Company has got the land against the construction of the staff quarter, so the Company has recognised the value of land based on fair value.

So, based on above facts it is clear that neither the liabilities nor the expenses are understated and transaction has been properly recognised as per accounting principle laid down in the relevant Ind AS. In light of the above, audit is requested to review the comment and drop the same.

5. *Final Comment raised by C&AG:*

Expenses:

Other Expenses: ₹ 752.81 lakh

The above head does not include a sum of ₹ 83.95 crore to be incurred on account of construction of staff quarter of polytechnic college against land received for K metro project. As per the applicable Government order, this expenditure was to be incurred by the Company from its own resources.

It was noticed that the Company has adjusted the above amount of ₹ 83.95 crore against the Capital grant of ₹ 526.50 crore for the fair value of land received free of cost from the State Government, which was not in order.

Thus, Non-current Liabilities (Other Non-current liabilities) and Expenses (Other expenses) are understated by ₹ 83.95 crore. Consequently, loss is also understated to that extent.

6. *Reply of the Company against final comments raised by C&AG:*

The Company has recognised the land received free of cost from the Government at fair value (DM's rate) at ₹ 526.50 crore as grant (non-cash). Cost of construction of staff quarters of polytechnic college has been booked as ₹ 83.95 crore, and since the staff quarters of polytechnic college are not owned by the Company and the transaction is like barter transaction, the same has been booked/ adjusted against the above-mentioned ₹ 526.50 crore grant (non-cash). Hence, the balance amount of ₹ 442.55 crore recognised as net grant (non-cash) and accordingly effected in books of account. Further, the cost of construction of staff quarters is not of revenue in nature, so advice of audit to include the same in 'Other Expense' forming part of Profit and Loss Account seems not justifiable. However, to finally have correct accounting treatment under Ind AS, the above matter is being referred to the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) for its opinion.

7. *Matter of Dispute:*

As per C&AG, expenses incurred for construction of staff quarters of polytechnic college should be expensed off and non-monetary grant should be booked with ₹ 526.50 crore instead of ₹ 442.55 crore (i.e. after adjustment of cost of construction of staff quarters).

As per the Company, expenses incurred on the construction of staff quarter is not of 'revenue' nature, so the booking of expenditure against the same is not justified. Further, the ownership of the staff quarters will be with the polytechnic college, so assets cannot be recognised in the books of the Company.

The construction of staff quarters was one of condition for acquisition of land, so the land is recognised at fair value, i.e., circle rate and estimated cost of construction is not booked separately and adjusted against the non-monetary grant so booked.

B. Query

8. In the view of the above, the opinion of the EAC is sought regarding the accounting treatment of cost of land so acquired and cost of construction incurred on construction of staff quarters of polytechnic college. Also, it is requested to clarify that the treatment adopted by the Company is correct or not.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to accounting treatment of land acquired and cost incurred on construction of staff quarters of polytechnic college by the Company. The Committee has, therefore, considered only this issue, and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for construction cost of depot building or metro project, determination of fair value of land including appropriateness of determination of fair value based on circle rates of land, allocation to the periods over which the grant is to be recognised, presentation of grant, application (if any) of the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', applicability of Appendix D, 'Service Concession Arrangements' to Ind AS 115 'Revenue from Contracts with Customers', etc. Further, the Committee has examined the query only from accounting perspective and not from any other

perspective, such as, legal interpretation of various legal enactments and orders, for example, order of State Government, etc. The Committee wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended or revised from time to time.

At the outset, the Committee presumes from the Facts of the Case that the land provided at less than fair value is not in the form of government participation in the ownership of the entity.

10. With regard to accounting for the land received from the Government, the Committee notes the definition of 'government grant' as per Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance' 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**. ..."

In the extant case, the State Government's land has been transferred to the Company without any obligation to pay direct monetary consideration for the same. However, in lieu of the land received, the Company has to fulfil certain conditions (such as, construction of the staff quarter building of polytechnic college out of its own funds, construction of depot building for running the metro rail project, etc.). The Committee notes from the facts submitted that the value of the land received by the Company far exceeds the estimated cost of the construction of the staff quarter building of polytechnic college. The net underlying benefit that the Company has got by way of receipt of land meets the definition of government grant and therefore, the requirements of Ind AS 20 are applicable in the extant case.

11. With regard to accounting for land received as grant, the Committee notes the following requirements of Ind AS 20:

> "16 It is fundamental to the income approach that government grants should 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 grant is intended to compensate. Recognition of government grants in profit or loss on a receipts basis is not in accordance with the accrual accounting assumption (see Ind AS 1, *Presentation of Financial Statements*) and would be acceptable only if no basis existed for allocating a grant to periods other than the one in which it was received.
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> 17 In most cases the periods over which an entity recognises the costs or expenses related to a government grant are readily ascertainable. Thus grants in recognition of specific expenses are recognised in profit or loss in the same period as the relevant expenses. Similarly, grants related to depreciable assets are usually recognised in profit or loss over the periods and in the proportions in which depreciation expense on those assets is recognised.
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> 18 Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may

be appropriate to recognise the grant in profit or loss over the life of the building.

19 Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached. In such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another."

"23 A Government grant may take the form of a transfer of a non-monetary asset, such as land or other resources, for the use of the entity. In these circumstances, it is usual to assess the fair value of the non-monetary asset and to account for both grant and asset at that fair value. An alternative course that is sometimes followed is to record both asset and grant at a nominal amount."

From the above, the Committee notes that when a non-monetary asset is received as grant, the asset and the grant are usually recognised at the fair value of the asset or alternatively, in some cases, both asset and grant are recognised at a nominal amount. Therefore, land in the extant case, to the extent 'control' has been transferred to the Company, should be considered as a non-monetary grant. Further, since in the extant case, the Company has recognised land at fair value, grant should also be recognised at the same amount.

The Committee further notes from the order of the State Government issued for transfer of land (dated 27th December, 2016) that as a condition to get free land, the Company is required to incur various expenditures including construction of the staff quarter building of polytechnic college out of its own funds. Thus, apparently, it is a binding obligation of the Company and a necessary condition to obtain the grant (land). Further, the land has been provided by the State Government for the only purpose of construction of depot building. Thus, it appears that there are two conditions to the non-monetary grant (viz., land) in the extant case.

Further, the Committee notes that as per paragraph 18 of Ind AS 20, grants related to non-depreciable assets should be recognised in profit or loss over the periods that bear the cost of meeting the obligations under the grant, for example, if grant of land is conditional on erection of building, it may be appropriate to recognise grant over the life of building. Also, as per paragraph 19 of Ind AS 20, sometimes grants received have a number of conditions attached and, in such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. Therefore, it may be appropriate to allocate part of a grant on one basis and part on another. Accordingly, the Committee is of the view that the grant in the extant case should be allocated and recognised in the Statement of Profit and Loss over the periods in which the Company recognises the cost of meeting the conditions under the terms of the grant, viz., a part of the grant over the period, the Company incurs the expenditure on construction of staff quarter building of polytechnic college (which seems to be not owned and controlled by the Company, as discussed later in paragraph 12 below) and part of the grant over the life of the depot building of K Metro Project which has to be constructed on the land acquired out of this grant. Thus, on transfer of land, the Company should recognise the land at fair value with a corresponding deferred income (liability); and allocate and recognise the grant in the Statement of Profit and Loss over the periods that bear the cost of meeting obligations or conditions attached, as per the requirements of Ind AS 20, as discussed above.

12. The Committee further notes from the order of the State Government that as a condition to get land, the Company is required to incur various expenditures out of its own funds including construction of the staff quarter building owned by the polytechnic college on the balance land owned by the Polytechnic College (which is not transferred to the Company). Thus, apparently, the Company cannot exercise any 'control' over such buildings in terms of right to sell or lease and power to restrict the access of others, etc. and also, no future economic benefits out of such building will flow to the Company. Therefore, no asset, viz., resource controlled by the entity, comes into existence for the Company. Further, since these expenditures are incurred by the Company as a condition to receiving non-monetary grant (land), the same shall be recognised as part of the liability (viz., deferred income) on transfer of land to the Company, as discussed above and not as a separate liability, as being done by the Company. Furthermore, the cost of construction of staff quarters of polytechnic college should be expensed in the Statement of Profit and Loss.

D. Opinion

13. On the basis of the above, the Committee is of the opinion that accounting treatment adopted by the Company is not correct. In the extant case, on transfer of land, the Company should recognise the land at fair value with a corresponding deferred income (liability); and allocate and recognise the grant in the Statement of Profit and Loss over the periods that bear the cost of meeting obligations or conditions attached, as per the requirements of Ind AS 20, as discussed in paragraphs 11 and 12 above. Further, the cost of construction of staff quarters of polytechnic college should be expensed in the Statement of Profit and Loss.

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