Disclosure of Feedstock Subsidy

A. Facts of the Case

1. A Company (hereinafter referred to as 'the Company') is a joint venture (JV) company of G Ltd., O Ltd., N Limited and Government of Assam, (GoA) under the administrative control of Department of Chemicals & Petrochemicals, Ministry of Chemicals & Fertilizers. As per JV agreement, G Ltd. holds 70% of the equity stake and O Ltd., N Ltd. and GoA shall hold 10% each. The Company has set up a 280 KTPA petrochemical complex at Lepetkata, district Dibrugarh, Assam and implemented the flagship project of Government of India called "Assam Gas Cracker Project (AGCP)". The Assam Gas Cracker project is outcome of famous Assam Accord signed on 15th August, 1985 between the Government of India and the leaders of the Assam Movement in New Delhi with the motive of overall socio-economic development of the region.

2. The Cabinet Committee on Economic Affairs (CCEA) at its meeting held on 24.12.2019 inter alia accorded approval of feedstock subsidy to the Company for 15 years of plant operation to maintain minimum internal rate of return (IRR) of 10% (post-tax). To bring the IRR to 10%, the Company has estimated feedstock subsidy of approximately ₹ 4,600 crore for the project for 15 years of plant operation as per the approved methodology. To work out the feedstock subsidy, the Company shall carry out a study to ascertain the IRR considering the current scenario w.r.t. polymer, naphtha and gas prices and actual capital cost without changing the fixed cost parameters (as approved by the Government). Based on the current IRR, the feedstock subsidy amount shall be worked out to ensure minimum post-tax Project IRR of 10% while maintaining the bankability of the project. In the proposed methodology, it has been ensured that feedstock subsidy is provided to the project only to compensate for change in gas, naphtha and polymer prices while keeping all other cost/parameters same as considered by the Government.

3. As per the approved methodology, claims for subsidy since commissioning till the last financial year (F.Y.), shall be submitted immediately after the approval of CCEA. The feedstock subsidy for previous years has been computed as differential of projected and actual gross margins per unit of actual production. The methodology ensures that subsidy is only a function of gas, naphtha and polymer prices and the total subsidy is limited to actual production only. The subsidy for 3 years has been worked out to be ₹ 930.49 crore. The claim was accordingly submitted to the Government on 07.01.2020.

Accounting for feedstock subsidy pertaining to previous years

4. The Company has submitted its claim of ₹ 930.49 crore for financial years 2015-16 (3 months), 2016-17 and 2017-18 and accounted for the same as an 'exceptional item' in the third quarter of the financial year. Referring to the Educational Material on Ind AS 1, issued by the erstwhile Ind AS Implementation Committee of the Institute of Chartered Accountants of India (ICAI), the Company has accounted for the feedstock subsidy for past years as an exceptional item considering the following:

   i. the accounting for past years of feed stock is a one-time incidence which will not recur in future;

   ii. it is arising from ordinary activity since the feedstock subsidy has been sanctioned based on initial commitments to the project for sustaining 10% post-tax IRR for a period of 15 years commencing from commissioning date;

   iii. it is a material amount considering that the income to be recognised for period ended up to 31.03.2019 will amount to estimated ₹ 1300 crore which is near to 50 % of revenue from overall operations in the year of accounting;

   iv. separate disclosure will be relevant to users of financial statements by enabling clear understanding of the nature of this income.

5. The presentation of the receivable amount of feedstock subsidy for the past periods as an 'Exceptional Item' is however a matter, which requires review since the term 'exceptional item' is neither defined nor used in Indian Accounting Standards (Ind ASs). The term 'Exceptional Items' to some extent has been clarified under the 'Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013', issued by the Institute of Chartered Accountants of India. While noting the absence of definition of the term 'exceptional items' in Ind ASs, paragraph 9.6 of the Guidance Note states that Ind AS 1 has reference to such items in paragraphs 85, 86, 97 and 98 of that Standard. The said paragraphs conclude that separate disclosure of an item of income/ expense is warranted considering factors including materiality and the nature and function of the items of income and expense. Further, an entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance. Similar view was also been expressed in the erstwhile Accounting Standard 5.

6. *Detailed Methodology*

To work out the feedstock subsidy, the Company shall carry out revised study to ascertain the IRR considering the current scenario w.r.t. polymer, naphtha & gas prices, actual capital cost and other costs as per approved projections. Based on the current IRR, the feedstock subsidy amount shall be worked out to ensure minimum post-tax project IRR of 10% while maintaining the bankability of the project. The detailed methodology is given below:

Part A: Methodology for determination of subsidy on yearly basis shall be as under:

I. Subsidy Amount

Subsidy amount shall be calculated on yearly basis as under:

(i) Projected yearly subsidy as per the model with Projected Gross Margin (PGM) to ensure minimum Post Tax Project IRR of 10% while maintaining Bankability of the Project.

Plus

(ii) [PGM (A) – AGM (B)] (If Positive) X Quantity (C)

A. Projected Gross Margin (PGM) per unit of polymer as per the model for the relevant year.

B. Actual Gross Margin (AGM) per unit of polymer earned during that year.

C. Quantity for determination of Subsidy:

Plant Capacity Utilisation of the relevant year as per DFR or Actual Production during the relevant year, whichever is lower.

Total Yearly Subsidy Amount = (i) + (ii)

II. Computation of Gross Margin:

Total revenue of Polymer net of discounts divided by net sales quantity of Polymer for the relevant year.

less:

Total Cost of Feed Stock (i.e. Naphtha, Natural Gas etc.) divided by net production quantity of Polymer during the period.

Part B: Procedure for claiming subsidy

- Within 1 month after the audit of accounts of financial year, the Company shall submit its claim of subsidy to the administrative Ministry, as per methodology mentioned above.
- Claim for subsidy since commissioning till the last F.Y., shall be submitted immediately after the approval of CCEA.

Submission of claims for previous years:

As per the approved methodology, claims for subsidy since commissioning till the last F.Y., has been submitted immediately after the approval of CCEA. The feedstock subsidy for previous years has been computed as differential of projected and actual gross margins per unit of actual production. The methodology ensures that subsidy is only a function of gas, naphtha and polymer prices and the total subsidy is limited to actual production only. The subsidy for 3 years has been worked out and claimed as below:

	Projections as Per RCE-II **Year ended** Projected Capacity Utilization Projected Production (MT) Projected Sale (MT)	**31-Mar-16** 80.00% 54,180 40,389	**31-Mar-17** 90.00% 2,23,493 2,23,062	**31-Mar-18** 94.00% 2,46,519 2,45,054
A	**Projected Gross Margin (PGM) Per MT (₹/MT)**	**57,667**	**61,310**	**65,056**
	Actuals as per Audited Accounts Actual Capacity Utilization Actual Production (MT) Actual Sale (MT)	5% 3,349 223	37% 99,540 87,012	78% 2,12,569 2,05,275
B	**Actual Gross Margin(AGM) Per MT (₹/MT)**	**-2,72,289**	**25,444**	**43,273**
A-B	**PGM- AGM**	**3,30,074**	**35,867**	**21,778**
(A-B) X Actual Production	Feedstock Subsidy [(PGM-AGM) X Actual Qty of Production] (₹ in Cr)	110.54	357.02	462.93
Total for 3 years (₹ in Cr)				**930.49**

B. Query

7. On the basis of above, the opinion of the Expert Advisory Committee is sought as to whether the feedstock subsidy claims for previous years (till 31.03.2019) is to be presented as an 'Exceptional Item' in the statement of profit and loss for the financial year ended 31.03.2020. Alternatively, whether the above transaction can be considered as 'Other Income' as a separate line item and recognized in the financial statements accordingly.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised by the querist relates to presentation of feedstock subsidy claims for previous years, viz., whether the same should be considered as an exceptional item and should be disclosed on the face of the statement of profit and loss under the head 'Exceptional Items' or the same should be considered as 'other income' as a separate line item in the financial statements. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, measurement and methodology for calculation of feedstock subsidy claims for previous years, accounting in relation to joint venture agreement, timing of accrual and recognition of feedstock subsidy, applicability of the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', etc. Further, the opinion has been expressed in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as 'the Rules'). At the outset, the Committee notes from the Facts of the Case that claims for subsidy since commissioning (which is apparently in financial year 2015-16) till the financial year 2017-18 have been submitted immediately to the Government on 07.01.2020 after the approval of CCEA on 24.12.2019, which amounts to ₹ 930.49 crore and the same has been accounted for as an 'exceptional item' in the third quarter of the financial year 2019-20. Further, it appears that the subsidy claim for the financial year 2018-19 is yet to be submitted and the total estimated amount of subsidy claim upto financial year 2018-19 would be ₹ 1300 crore.

9. The Committee notes that Part II of Division II of Schedule III to the Companies Act, 2013

(hereinafter referred to as the 'Ind AS Schedule III'), which prescribes the format of statement of profit and loss applicable for companies adopting Ind ASs, requires presentation of 'Exceptional Items' as a separate line item in the statement of profit and loss. Further, Note 7 of the 'General Instructions for Preparation of Statement of Profit and Loss' applicable for companies adopting Ind ASs requires that a Company should disclose by way of notes, additional information regarding aggregate expenditure and income on some items. One of the items to be disclosed in this regard is 'details of items of exceptional nature'. However, the term 'exceptional item' is not defined in 'Ind AS Schedule III'. Further, the term 'exceptional item' is neither defined nor used in Ind ASs.

10. The Committee also notes the following paragraphs of Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements', notified under the Rules:

"31 Some Ind ASs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an Ind AS if the information resulting from that disclosure is not material except when required by law. This is the case even if the Ind AS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."

"85 An entity shall present additional line items (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance."

"86 Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement of profit and loss, and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense. For example, a financial institution may amend the descriptions to provide information that is relevant to the operations of a financial institution. An entity does not offset income and expense items unless the criteria in paragraph 32 are met."

"97 When items of income or expense are material, an entity shall disclose their nature and amount separately.

98 Circumstances that would give rise to the separate disclosure of items of income and expense include:

(a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;

(b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;

(c) disposals of items of property, plant and equipment;

(d) disposals of investments;

(e) discontinued operations;

(f) litigation settlements; and

(g) other reversals of provisions."

Further, the Committee notes that the concept of 'materiality' has been discussed in paragraph 7 of Ind AS 1 as below:

"*Material Omissions* or misstatements of items are material if they could, individually or collectively, influence the economic

decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor."

11. From the above, the Committee notes that material items need to be presented as line items and/or disclosed in financial statements, which includes the notes. As per Ind AS 1, materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. Further, as per the requirements of paragraphs 85 and 86 of Ind AS 1, events and transactions which differ in frequency should be presented as additional line items/headings when such presentation is relevant to understanding of the entity's financial performance having regard to factors including materiality and the nature and function of the items of income and expense.

    The Committee also notes that paragraph 12 of Accounting Standard (AS) 5, 'Net profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', notified under the Companies (Accounting Standards) Rules, 2006 states that, "when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately".

    Therefore, the Committee is of the view that exceptional items are those items which meet the test of 'materiality' (size and nature) and the test of 'incidence'; and that all material items are not exceptional items. The Committee is further of the view that 'incidence' refers to frequency of occurrence and the meaning of the term 'material' should be construed as per paragraph 7 of Ind AS 1, as reproduced above. Thus, the Committee is of the view that for an item to be classified as an 'exceptional item', it has to be both 'material' as well as infrequent/non-recurrent in nature.

    In the above context, the Committee notes that the querist has stated in the facts of the case that the accounting for past years of feedstock is one time incidence which will not recur in future, it is arising from the ordinary activities and the same is of material amount as the income to be recognized for period ended 31.03.2019 is around 50% of the revenue from overall operations in the year of accounting.

    However, the Committee is of the view that feed stock subsidy of past years is only previous years' accumulated subsidy, which without the approval of CCEA could not be processed earlier and accounted for. Just because it is an accumulated amount pertaining to past years, it cannot be considered as having one time incidence or non-recurring. Further, considering that feedstock subsidy will be received by the Company for a period of 15 years from the date of commissioning, the Committee notes that such item will arise even after the financial year 2019-20 as well (although may be pertaining to the current reporting period only). Furthermore, the Committee is of the view that considering the nature of the industry to which the Company belongs to, although the methodology of determining feed stock subsidy in the extant case may not have been used in the past, but the granting of subsidy of this nature may not be irregular and uncommon.

    As far as the issue regarding disclosure under the head 'other income', as raised by the querist, the Committee is of the view that feedstock subsidy is of the nature of grant related to income as per the requirements of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance'. Accordingly, with regard to

presentation of such grant, the Committee notes paragraph 29 of Ind AS 20, which states as follows:

" **Presentation of grants related to income**

29 Grants related to income are presented as part of profit or loss, either separately or under a general heading such as 'Other income'; alternatively, they are deducted in reporting the related expense."

From the above, the Committee is of the view that the feedstock subsidy in the extant case may be presented as a part of the statement of profit and loss either separately or under the general head of 'other income' considering the materiality of the item. Further, with regard to whether the item is 'material' or not and accordingly whether or not it requires separate disclosure, the Committee is of the view that it is a matter of judgement. In this regard, the Committee notes from paragraph 7 of Ind AS 1, reproduced above, that an item should be considered material if it can influence the economic decisions of the users and that materiality depends on both size and/ or nature of an item. Accordingly, the Committee is of the view that the same should be decided by the Company in its own facts and circumstances considering the factors as discussed above and accordingly, if it is material, the Company should comply with the disclosure requirements of paragraph 97 of Ind AS 1.

However, since both the materiality and incidence tests are required to evaluate whether an item is exceptional or not and in this case, even though the item is material, it does not meet the test of incidence merely on the basis of being related to past years, as discussed above, the Committee is of the view that the feedstock subsidy claims of previous years cannot be classified as 'exceptional item'.

D. Opinion

12. On the basis of the above paragraphs, the Committee is of the opinion that the feedstock subsidy claims of previous years cannot be classified as 'exceptional item'. Further, considering the requirements of Ind AS 20, the feedstock subsidy in the extant case may be presented as a part of the statement of profit and loss either separately or under the general head of 'other income' considering the materiality of the item. However, whether this item is material or not and accordingly whether or not it requires separate disclosure, is a matter of judgement and the same should be decided by the Company in its own facts and circumstances, considering the factors as discussed in paragraph 11 above; and accordingly, if it is material, the Company should comply with the disclosure requirements of paragraph 97 of Ind AS 1, as discussed in paragraphs 10 and 11 above.

1.	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2.	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on May 23, 2020. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3.	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty six volumes. A CD of Compendium of Opinions containing thirty six volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4.	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5.	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.in.