Accounting for payments made in respect of land pending execution of conveyance deeds and borrowing costs incurred in respect thereof

The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. The Government of India directed a State Port Trust (SPT) to construct a new Port. Accordingly, SPT acted as the executing agency and completed a Port. The Government of India provided a sum of ₹426.11 crore to SPT towards implementation of the Port. The Government of India vide their letter dated 14.02.2002 directed SPT to handover the completed Port to ABC Limited (hereinafter referred to as 'the company') which is owned by the Government of India and was incorporated with the specific purpose of corporatising the Port. Both parties acknowledge that cost of land acquired by the SPT for the Port amounting to ₹14.81 crore has not been included in the estimated cost of the project arrived at as on 22.06.2001 (which is the date on which commercial operation of the Port was achieved) on the advice of the Government of India. Both parties expressly undertook to be bound by the decision of the Government of India on the cost of the land. Accordingly, the SPT handed over all the assets (excluding land) and liabilities with respect to the Port Project to the management of the company on 22.06.2001.

2. The querist has stated that the Port has been developed / constructed on 2,083.74 acres of land acquired from 3 Government agencies as given below. The following amounts were paid to the Government agencies being the vendors of land while taking possession of the land. The kind of title that will accrue to the company against these payments was not known at the time of making these payments.

Vendors of acquired land	Extent (in acres)	Total Amount	Paid by SPT	Paid by the company
State Electricity Board (SEB), State Government	1103.98	15,20,87,099	5,20,87,099	10,00,00,000
State Industrial Development Corporation Ltd (SIDCO), a State PSU	950.00	9,56,72,600	9,56,72,600	Nil
Salt Department, Government of India	29.76	11,35,692	11,35,692	Nil
Total	2083.74	24,88,95,391	14,88,95,391	10,00,00,000

3. The above amount of ₹24.89 crore was paid by (i) SPT to the extent of ₹14.89 crore and (ii) the company to the extent of ₹10.00 crore, all during the construction period.

4. SPT used its own financial resources and constructed the Port. The entire amount spent by SPT (as the Executor of the Project) together with all the assets created except land was transferred by SPT to the company on 22.06.2001 at its actual values as per the Government directives. However, the amount of ₹14.89 crore paid by SPT towards taking possession of land for the company was retained by SPT in its books and not transferred to the books of the company as per the Government directions.

5. After nearly 6 years, viz., in the financial year 2007-08, the Government of India finally decided that the land can be owned by the company and directed the company to pay to SPT the amount of ₹14.89 crore (originally paid by SPT towards land for the port of the company) together with interest of ₹16.51 crore, all totaling to ₹31.40 crore. The breakup for interest of ₹16.51 crore is (i) interest from the date(s) of payments to 22.06.2001- ₹6.58 crore and (ii) interest from 23.06.2001 to the day of payment by the company- ₹9.93 crore.

6. The company paid the said sum of ₹31.40 crore to SPT. Since the nature of title that will accrue to the company was not known at the time of making these payments, the company retained the entire amount of ₹31.40 crore in its books as 'Advance for Land' and grouped under 'Loans and Advances' in its balance sheet as on 31.03.2008.

7. Thus, the total amount retained in 'Advance for Land' in the books of the company stands at ₹41.40 crore as on 31.03.2008, comprising (i) ₹24.89 crore of amounts paid for acquisition of land and (ii) ₹16.51 crore of interest relating to the period after taking possession of the land / commencement of commercial operations.

8. Based on the subsequent developments in this regard between the company, the Government and Government agencies involved in this issue, the company expects to get 'Orders of Alienation of Title' for the land from the respective vendors of the land in due course of time. The querist has informed that formal transfer of title for the land would be through issuance of 'Orders of Alienation of Title' by the transferor Government, when land is transferred by Government agencies to a Public Sector Undertaking.

B. Query

9. On the facts and in the circumstances of the case, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

   (i) Whether the company can capitalise the value of land at ₹24,88,95,391 in the financial year 2010-11, with a suitable disclosure in the Notes to Accounts as 'Pending receipt of formal Orders of Alienation of Title, the consideration of ₹24,88,95,391 paid for acquisition of land in earlier years is capitalised during this year'.

   (ii) Whether the company can charge the interest of ₹16.51 crore paid to SPT to its profit and loss account of the financial year 2010-11 as a separate line item with a suitable disclosure in the Notes on Accounts by stating that "Interest of ₹16.51 crore paid to SPT during the financial year 2007-08, which was kept under 'Advance for Lands' has been charged to revenue during this year as the company expects to get Orders of Alienation of Title for the land from the respective vendors of the land in due course of time. This is an extraordinary item and non-recurring in nature".

   (iii) If the answer to the above questions are negative, what is the correct treatment to be accorded in the books of account of the company for this total amount of ₹41.40 crore? What kind of disclosure would be required to be made in the Notes to Accounts of the company ?

C. Points Considered by the Committee

10. The Committee notes that the basic issue raised in the query relates to accounting treatment of payment made in respect of land of Port pending execution of conveyance deeds. The Committee, while answering the query, has considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for the assets (except land) and liabilities transferred from SPT to the company, propriety of deducting TDS from the amounts paid by the company to SPT, etc. The Committee also wishes to point out that in paragraph 1 of the Facts of the Case, the querist has stated that the amount paid by the SPT towards acquisition of land is ₹14.81 crore, whereas, at other places, the same is stated at ₹14.89 crore. Accordingly, the amount of ₹14.81 crore seems to be a typographical error.

11. As regards accounting for payments made in respect of land, the Committee notes paragraph 17(b) of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies' and paragraph 35 of the Framework for the Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India, which provides as follows:

   AS 1
   "17(b) Substance over Form
   The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form."

   Framework for the Preparation and Presentation of Financial Statements

   "35. If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, where rights and beneficial interest in an immovable property are transferred but the documentation and legal formalities are pending, the recording of acquisition/disposal (by the transferee and transferor respectively) would in substance represent the transaction entered into."

From the above, the Committee is of the view that for accounting purposes, the transactions and events should be recorded in accordance with their substance and economic reality rather than legal form. The Committee notes from the Facts of the Case that in the extant case, the company has paid consideration for purchase of land and it is not only possessing such land but also utilising the same for its commercial purposes. However, the formal transfer of such land is yet to be executed in favour of the company. The Committee is of the view that in the present case, the execution of Orders of Alienation of Title is only procedural in nature and if it does not affect the beneficial interest which are bestowed on the company, the company can account for such land in its books at the time of transfer of such beneficial interest to the company provided other conditions for recognition of asset as detailed in paragraph 12 below are fulfilled. The company, in such case, should also give suitable disclosures to convey to the users of financial statements that the execution of conveyance deeds in favour of the company is in progress.

12. The Committee further notes paragraphs 49(a), 58 and 88 of the Framework for the Preparation and Presentation of Financial Statements, issued by the Institute of Chartered Accountants of India, as below:

> "49(a) An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise."
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> "58. There is a close association between incurring expenditure and obtaining assets but the two do not necessarily coincide. Hence, when an enterprise incurs expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. …"
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> "88. An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and *the asset has a cost or value that can be measured reliably."* (Emphasis supplied by the Committee.)

The Committee notes from the Facts of the Case that until and unless the Government issued a final order that the title to the land can be obtained by the company alongwith determining the final payments that the company would make to SPT, the cost of land cannot be measured reliably. Accordingly, in accordance with paragraph 88 of the Framework, as reproduced above, the Committee is of the view that although in the extant case, the land may meet the criteria of an asset for the company, but before the financial year 2007-08 when the said order was issued by the Government of India, it cannot be recognised in the books of the company.

13. The Committee notes that as per the Government Order issued during the financial year 2007-08, the company was requested to make payment to SPT of the amount invested by it for land acquisition along with interest thereon @ SBI PLR as amended from time to time. The Committee is of the view that the payments determined on the basis of SBI PLR cannot be treated as 'borrowing costs' as neither the company has borrowed any funds from SPT on which the borrowing costs may be said to have incurred nor it is payment for any delays on the part of the company. In fact such delay has occurred on the part of the Government for reaching the final decision for transfer of land. The Committee notes that it is based on the order of the Government that assets are being transferred from one entity to another at the amounts specified in the Order. Considering the principle of 'Substance over Form', as discussed in paragraph 11 above, the Committee is of the view that in the extant case, the reference by the Government to a rate of interest is only as a reference point for determination of final sale consideration of the land and does not automatically lead to an inference that the amount so computed is of the nature of interest. In substance, the company is paying the total amount as a consideration to obtain the title to land. Accordingly, the company should recognise the total amount of ₹41.40 crore as cost of land in its books of account. The Committee is, therefore, of the view that the question of disclosure of interest paid, as an extraordinary item, does not arise.

D. Opinion

14. On the basis of the above, the Committee is of the

following opinion on the issues raised in paragraph 9 above:

(i) The company should capitalise the total amount of ₹41.40 crore paid to SPT as 'land' and not as 'Advance for land' from the date when the company possess the beneficial interest in the same and its cost can also be measured reliably as discussed in paragraphs 11 and 12 above and not in the financial year 2010-11. However, the company should give suitable disclosures to convey to the users of financial statements that the execution of conveyance deeds in favour of the company is in progress.

(ii) The Government has made reference to a rate of interest as a means to compute final sale consideration of the land. The amount so determined is in substance not "interest" in the facts and circumstances of the case as stated in paragraph 13 above. Therefore, the question of disclosure of interest paid as an extraordinary item does not arise.

(iii) Refer to (i) 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 10.10.2011. 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 twenty nine volumes. A CD of Compendium of Opinions containing twenty nine 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'.
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