

## Query No.19

**Subject:** *Recognition of Duty Credit Entitlement Certificates issued under the ‘Served from India Scheme’.*<sup>1</sup>

### A. Facts of the Case

1. A private limited company (hereinafter referred to as ‘the company’) domiciled in India was incorporated on March 1, 2006 under the provisions of the Companies Act, 1956, for managing the operations and modernisation of the Indira Gandhi International Airport (‘Delhi Airport’). A Limited, along with its subsidiaries, holds majority shareholding in the company. The company had entered into Operation, Management and Development Agreement (‘OMDA’) with Airports Authority of India (‘AAI’), which gives the company an exclusive right to operate, maintain, develop, modernise and manage the Delhi Airport on a revenue sharing model for an initial term of 30 years, which can be extended by another 30 years on satisfaction of certain terms and conditions pursuant to the provisions of OMDA.

2. The querist has stated that the Director General of Foreign Trade (DGFT), Government of India, has announced a ‘Served From India Scheme’. Under the Scheme, all service providers (other than hotels and restaurants) shall be entitled to duty credit equivalent to 10% of the foreign exchange earned by them in the preceding financial year. During the financial years 2006-07 to 2011-12, the enterprise obtained duty credit entitlements certificate from the DGFT under ‘Served From India Scheme’.

The salient features of the ‘duty credit certificates’ are as under:

- (a) These certificates are valid for 2 years from the date of issue.
- (b) Duty credit entitlements may be used for import of any *capital goods including spares, office equipment and professional equipment, office furniture and consumables; that are otherwise freely importable under ITC (HS) classification of export and import items, provided it is part of the main line of business.*
- (c) The entitlements and the goods imported *shall be non-transferable (except within group company and managed hotels) and be subject to actual user condition.*  
(Emphasis supplied by the querist.)

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<sup>1</sup> Opinion finalised by the Committee on 3.9.2013.

3. The company has utilised duty credit certificates *only for the purpose of import of capital goods and has neither used for purpose of import of consumables nor transferred to any other group company*. As the company had used the SFIS scrips for purpose of import of capital goods and not paid any customs duty in cash for capital items imported during the years 2006 to 2012 for its operations, therefore, the company is of the view that value of the scrips utilised for the purpose of imports should be adjusted against cost of assets imported and accordingly, *only the cost paid by the company i.e., without customs duty was capitalised in the books of account*. (Emphasis supplied by the querist.)

4. The querist has further stated that the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) vide its earlier opinion (published as Query No. 32 of Volume XXVI of the Compendium of Opinions) has opined that “even though the entitlements received under *SFIS Scheme does not strictly fall within the definition of term revenue, as defined under Accounting Standard (AS) 9, ‘Revenue Recognition’*, such duty credit entitlements is of the nature of revenue and accordingly, it should be recognised in the books of accounts” (emphasis supplied by the querist). However, the company is of the view that since out of three options available under SFIS Scheme as mentioned above, the company has utilised the scrips only for the purpose of import of capital goods, it is appropriate to capitalise the net cost of fixed asset imported in the books (without import duty). The company is of the view that SFIS scrips utilised by the company for the import of capital goods should be treated as ‘capital grant’ under Accounting Standard (AS) 12, ‘Accounting for Government Grants’ instead of ‘revenue’ under AS 9. The company differs from the earlier opinion given by the EAC of the ICAI vide Query No. 32 of Volume XXVI of the Compendium of Opinions and is of the view that the issuance of scrip issued under Served From India Scheme (SFIS) should be treated as government grant under AS 12 as the same is of the nature of assistance given by the Government in respect of import of capital goods after compliance of certain conditions.

5. The issues that have been raised by the querist are as follows:

(A) The question that is to be considered is to examine as to which of the Accounting Standards, notified under the Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as the ‘Rules’), i.e., whether AS 9 or AS 12 would be most appropriate for application and relevant, given the situation described above for accounting for the benefit derived by the company by the use of ‘duty credit entitlement certificates’.

(B) If it is held that AS 12 is more appropriate, which of the methods mentioned in paragraph 14 of the said Accounting Standard is to be followed for

accounting for the purchase of ‘capital assets’ or ‘inventory’ or ‘consumables’ utilising the government grant.

6. The views held by the company in respect of the above issues raised are as under:

(A) In support of its view to consider SFIS scrips as capital grant when the same has been utilised *only for the purpose of import of capital goods*, the company has submitted as under:

- (i) The Accounting Standards that may be considered for application in the above situation are:
  - (a) AS 9 pertaining to revenue recognition.
  - (b) AS 12 pertaining to government grant.

As per AS 9, the definition of ‘revenue’ is as follows:

***“4.1 Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.”***

The same has also been reiterated in the Guidance Note on Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India. Moreover, AS 9 which deals with revenue recognition, in paragraph 2, specially states that “This Standard *does not deal with* the following aspects of revenue recognition to which special considerations apply:

- (i) Revenue arising from construction contracts;
- (ii) Revenue arising from hire-purchase, lease agreements;
- (iii) *Revenue arising from government grants and other similar subsidies;*
- (iv) Revenue of insurance companies arising from insurance contracts.

Accounting Standards are authoritative pronouncements of the ICAI and hence, the definition of the term 'revenue' as per AS 9 is valid for all purposes. The duty credit entitlement arising under SFIS does not fall under the definition of 'revenue' as revenue is the gross inflow of consideration *from customers or clients*. The duty credit entitlement arising under SFIS cannot be said to be flowing from customers or clients and is thus not in the nature of revenue as per the definition of this term in AS 9 and Guidance Note on Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India.

(Emphasis supplied by the querist.)

- (ii) AS 12 provides as follows:

***“3.1 Government refers to government, government agencies and similar bodies whether local, national or international.***

***3.2 Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. 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 enterprise.”***

*Thus, the thrust of 'government grant' is that it is an assistance in one form or the other and not necessarily in the form of cash. It could be seen from the above definition that any form of assistance from the Government whether in cash or in kind given either for the past or future compliance with certain conditions would constitute a government grant.*  
(Emphasis supplied by the querist.)

- (iii) An examination of the features of duty credit entitlement certificate reveals that it is in *the form of assistance given by the Government*. The relevant extracts of the policy for justification of the same are as follows:

*Both the title for paragraph 3.1 of Chapter 3 of the Foreign Trade Policy is 'Promotional Measures' and the contents of paragraph states "Assistance to States for Infrastructure Development of Exports and goes on to state that the Scheme for Assistance to States... is formulated to encourage... into promoting exports."*

*Thus, it is clear that the purpose of the policy is to assist service sector industries to earn foreign exchange. Thus, the assistance given by the Government under the Scheme would amount to government grant since the definition states any assistance whether in cash or in kind would be regarded as grant.*

The salient features of the assistance are:

- (a) Paragraph 3.6.4.1 which deals with the objective of the Scheme states that *"objective is to accelerate growth in export of service etc."*
- (b) Paragraph 3.6.4.2 states that all service providers of *services listed in Appendix-10 of Handbook of Procedures (Vol. 1) who have a total foreign exchange earnings ... shall be eligible to qualify for a duty credit scrip.*
- (c) Paragraph 3.6.4.5 states that the duty credit scrip may be used for import of any *capital goods* (i.e. of fixed assets nature) including..." and should relate to *any service sector business* of the applicant.
- (d) Paragraph 3.6.4.6 *imposes a ban on transferability (except within group companies) of either duty credit scrips or the goods imported / procured by using the duty credit scrip.* Thus, it is clear that the amount denoted by the duty credit scrip is *meant to be used for acquiring capital goods and is not meant to be used for meeting any expenses or for distribution as dividend.*

(Emphasis supplied by the querist.)

- (iv) There are certain past and future compliances with certain conditions, which have to be complied with to avail the benefit under the aforesaid scheme.

*Past Compliance:*

All service providers (other than hotels and restaurants) listed in Appendix 10 of Handbook of Procedures (Vol.I) shall be be entitled to duty credit equivalent to 10% of the foreign exchange earned by them in the preceding financial year. *Foreign exchange earning is a precondition to availing benefits under the Scheme.* During financial years 2006-07 to 2011-12, the enterprise obtained duty credit entitlement certificates from the DGFT under 'Served From India Scheme' on compliance of above condition.

*Future compliances:*

- (a) These certificates are valid for 2 years from the date of issue.
- (b) *Duty credit entitlement may be used for import of any capital goods including spares, office equipment and professional equipment, office furniture and consumables, provided it is part of the main line of business.*
- (c) The entitlement and the goods imported shall be non-transferable (except with in group company and managed hotels) and be subject to actual user condition.

Since the benefit flowing from the scheme falls squarely under the scope of 'government grant' as it is in the form of assistance given by the Government and the company has complied with the past and future compliances with certain conditions attached to it as contemplated in AS 12, the applicability of AS 9 on revenue recognition *is ruled out* as that Standard excludes 'government grant' from its purview.

(Emphasis supplied by the querist).

- (B) (i) As regards the method of accounting to be followed in accounting for government grant, as per the querist, two broad approaches may be followed for the accounting treatment of government grants - the 'capital approach' under which a grant is treated

as part of shareholders' funds, and the 'income approach', under which a grant is taken to income over one or more periods.

As the company has used the scrips for the payment of custom duty on purchase of capital assets only, the querist has provided the following accounting treatment in accordance with paragraph 14 of AS 12:

- (a) Government grants related to specific fixed assets should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge.
  - (b) Where the grant related to a specific fixed asset equals the whole, or virtually the whole, the cost of the asset, the asset should be shown in the balance sheet at a nominal value.
  - (c) Alternatively, government grants related to depreciable fixed assets may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged.
  - (d) Grants related to non-depreciable assets should be credited to capital reserve under this method. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income. The deferred income balance should be separately disclosed in the financial statements.
- (ii) The duty credit entitlement certificates (i.e., duty credit scrips) can be utilised according to the scheme towards purchase of :
- a. Capital assets including
  - b. Inventory

c. Consumables

- (iii) In the case of the company, these have been used to purchase *capital assets only*. The value involved in the duty credit scrips has been utilised only for the payment of customs duty payable on such imports and not to meet the *entire cost*. Therefore, it is to be examined as to which of the methods (whether (a) or (b) or (c) or (d), as mentioned above is to be adopted. In the opinion of the company, the accounting treatment as given under (a) of paragraph 14 of AS 12 would be the only appropriate method.

(Emphasis supplied by the querist.)

7. In view of above, it is reiterated that the company is of the view that since out of three options available under SFIS as mentioned above, company has utilised the scrip only for the purpose of import of capital goods, it is appropriate to capitalise the net cost of fixed asset imported in the books (without import duty). The company is of the view that SFIS scrips utilised by it for the import of capital goods should be treated as capital grant under AS 12 instead of revenue under AS 9.

**B. Query**

8. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (a) Whether the company is correct in contending that duty credit entitlement under SFIS does not fall strictly under 'revenue' within the definition of this term as per AS 9.
- (b) Whether the company is correct in contending that duty credit entitlement under SFIS is a government grant/subsidy/assistance.
- (c) Whether the company is correct in showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value as per paragraph 14 of AS 12.

### C. Points considered by the Committee

9. The Committee notes that the basic issues raised in the query relate to recognition of duty credit entitlement certificates issued under the 'Served from India Scheme', whether the duty credit entitlement under the Scheme strictly falls within the definition of the term 'revenue', as defined under Accounting Standard (AS) 9, 'Revenue Recognition' or it should be treated as government grant/subsidy/assistance. Therefore, the Committee has considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, applicability of SFIS to the company and its entitlements to import capital goods against it, presentation and disclosure of duty credit entitlement under SFIS in the financial statements, measurement and accounting for utilisation of duty credit entitlement against imported capital goods, timing of recognition of the duty credit entitlement under SFIS, accounting for transfer of the duty credit entitlement to the group companies or managed hotels, etc.

10. With regard to the issue raised by the querist as to whether duty credit entitlement under SFIS fall under the definition of the term, 'government grants', the Committee notes paragraph 3.2 of AS 12, notified under the 'Rules', which defines government grants as follows:

***“3.2 Government grants are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. 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 enterprise.”***

From the Facts of the Case, the Committee notes that duty credit entitlement under SFIS is an assistance in kind by the Government as the company receives duty credit entitlement under SFIS that may be either adjusted against import of capital goods or their spare parts/consumables. Further, it is awarded on the basis of pre-specified percentage of exports made by the company and accordingly, the value placed upon them is reasonably determinable. Therefore, it is of the nature of government grant.

11. With regard to nature of grant obtained, the Committee notes paragraphs 8.1 and 10.1 of AS 12, notified under the 'Rules', which provide as below:

***“8.1 Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.”***

“10.1 Where the government grants are of the nature of promoters’ contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.”

The Committee notes that as per the Foreign Trade Policy, the duty credit entitlement under SFIS is granted to exporters with the objective to accelerate growth in export of services. Thus, the grant is awarded with reference to exports made by the company and not with reference to total investment in an undertaking or by way of contribution towards its capital outlay. Accordingly, the Committee is of the view that it would not be appropriate to treat the duty credit entitlement under SFIS as ‘promoters’ contribution’. Further, the Committee is of the view that the duty credit entitlement under SFIS cannot be considered as a grant related to a specific fixed asset as at the time of awarding such duty credit entitlement under SFIS, no specific asset has been identified for its utilisation. The Committee notes that such duty credit entitlement under SFIS can be utilised not only for payment of duty on import of capital goods but also for their spare parts or consumables which can be revenue in nature. Moreover, it is not necessary under the Scheme that its recipient should utilise the scrips for importing goods only. The recipient may transfer them to another company within the same group or managed hotels as per the conditions of the Scheme resulting into an income for it. Thus, the award of duty credit entitlement under SFIS should be considered to be generating income to the company. Accordingly, the Committee is of the view that as per the principles of AS 12, the duty credit entitlement under SFIS should be treated as a grant related to revenue. Therefore, adjustment against the gross value of the assets concerned does not arise.

12. With regard to applicability of AS 9, the Committee notes paragraphs 2 and 4.1 of AS 9, notified under the ‘Rules’, which state as below:

“2. This Standard does not deal with the following aspects of revenue recognition to which special considerations apply:

...

(iii) Revenue arising from government grants and other similar subsidies;

...”

***“4.1 Revenue is the gross inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise from the sale of goods, from the rendering of services, and from the use by others of enterprise resources yielding interest, royalties and dividends. Revenue is measured by the charges made to customers or clients for goods supplied and services rendered to them and by the charges and rewards arising from the use of resources by them. In an agency***

*relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration.”*

From the above, the Committee is of the view that as per the principles enunciated above, revenue is a consideration that arises from the ordinary activities of the enterprise, viz., from the sale of goods or rendering of service. The Committee notes from the Facts of the Case that duty credit entitlement under SFIS is granted to the exporters by the Government of India on the basis of foreign exchange earned by them. The Committee is of the view that the Government of India, in the extant case, is not a party to whom services have been rendered by the company, hence, duty credit entitlement cannot be construed to be a consideration received from sale of goods or rendering of services and accordingly, AS 9 is not strictly applicable for recognition of duty credit entitlement under SFIS. Thus, the principles of AS 12 are applicable in the extant case.

13. As regards earlier opinion of EAC as referred by the querist, the Committee is of the view that the earlier query was asked from the point of view of timing of recognition of duty credit entitlement under SFIS and as the principles of the timing of recognition are clearly stated in AS 9, the principles of AS 9 were applied for answering the opinion. However, the Opinion also clearly stated that the duty credit entitlement under SFIS does not strictly fall within the definition of the term ‘revenue’.

#### **D. Opinion**

14. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 8 above:

- (a) Yes, the company is correct in contending that duty credit entitlement under SFIS does not fall under ‘revenue’, as defined in AS 9, as discussed in paragraph 12 above.
- (b) Yes, the company is correct in contending that duty credit entitlement under SFIS is a government grant/subsidy/assistance as discussed in paragraphs 10 to 12 above.

- (c) No, the company is not correct in showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value rather the duty credit entitlement under SFIS should be treated as a grant related to revenue as discussed in paragraphs 10 to 12 above.