

Query No. 6

Subject: Disclosure of Government Grants.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the company’) is engaged in the business of manufacturing high-end stainless steel castings and high precision metal components for its customers across the globe. The company was founded in 1963 as a private limited company.

2. The company had received two grants from the Government of India:

Grant I - In the financial year (F.Y.) 2011-12, the company entered into an agreement with National Research Development Corporation (NRDC) on behalf of Department of Scientific & Industrial Research (DSIR) for development and commercialisation of rapid cast technology for manufacturing stainless steel castings of weight 5,000 kgs single piece for which the company has received grant from DSIR.

Grant II – In the F.Y. 2017-18, the company entered into an agreement with the Global Innovation and Technology Alliance (GITA) on behalf of Department of Heavy Industry (DHI) for development and commercialisation of titanium casting with ceramic shelling technology under Technology Acquisition Fund Programme (TAFP) for which the company has received grant from GITA of INR 10 crores.

3. *Grant I*: The total cost of the project mentioned above was Rs. 18 crores out of which Rs. 13 crores would be spent by the company and balance of Rs. 5 crores would be granted by DSIR. The total expenditure of Rs. 18 crores comprises of building prototypes, purchase of raw materials, mechanical tools, machineries etc.

The duration of the agreement was 12 years and the grant need not be repaid. Further, the company may need only to pay royalty @ 26% of the amount disbursed by DSIR for a period of 5 years on successful sale of products manufactured using this technology.

DSIR has the right to terminate the agreement if it is satisfied that the money released has not been properly utilised or the project is not being carried out as per the terms and conditions of the agreement. Further, DSIR has the right to recover from the company at any time, the money disbursed along with 12% simple interest only if the company abandons the project on its own without the approval of DSIR.

4. *Grant II*: The total cost of the project mentioned above was Rs. 51 crores out of which Rs. 41 crores would be spent by the company and balance Rs. 10 crores would be granted by DHI. The total expenditure of Rs. 18 crores comprises of purchase of technology, machineries etc. The duration of the agreement is 18 months and the grant need not be repaid even if the project is not successful or the company is not able to successfully commercialise the technology.

¹ Opinion finalised by the Committee on 23.7.2018.

DHI has the right to terminate the agreement only if the company is unable to fulfil the terms and obligations mentioned in the agreement or if the company becomes insolvent. No repayment of the amount given by DHI is stipulated under any circumstances and the only obligation on the company is in respect of the rights to the technology developed which shall be shared between the company and DHI. In this regard, the querist has separately submitted grant sanction letter and the Memorandum of Understanding (MoU) between Global Innovation Technology Alliance (GITA) and the company for the perusal of the Committee.

5. *Technical Guidance*

As per the querist, the technical guidance is based on the disclosure and presentation of the grants received from the government under Accounting Standards (IGAAP) for Grant I which was received from DISR in the F.Y. 2012-13 and with the advent of the Indian Accounting Standards (Ind ASs), the presentation and disclosure of the grants (both Grant I and Grant II) under Ind ASs.

(i) *Definition of liability*

As per the Guidance Note on Terms Used in Financial Statements, issued by the Institute of Chartered Accountants of India (ICAI), a liability is defined as the financial obligation of an enterprise other than owners' funds.

(ii) *Presentation and Disclosure under IGAAP - Disclosure and presentation of Government grants of the nature of promoter's contribution under Accounting Standard 12 issued by the Institute of Chartered Accountants of India (the 'ICAI')*

As per paragraph 10 of Accounting Standard (AS) 12, Accounting for Government Grants issued by the ICAI:

“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.”

Under IGAAP, the company treated the grant received in the nature of promoters contribution and disclosed it under 'reserves and surplus'. (Emphasis supplied by the querist.)

With the advent of the Indian Accounting Standards, the company, being a phase II company, had to prepare its financial statements in accordance with Indian Accounting Standards with a transition date of 1st April 2017 and with comparative figures as at 1st April 2016.

(iii) *Presentation and Disclosure requirements under Indian Accounting Standard (Ind AS) 20, Accounting for Government Grants and Disclosure of Government Assistance:*

“Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-

term assets. Subsidiary 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.

***Grants related to income* are government grants other than those related to assets.”**

“24. Government grants related to assets, including non-monetary grants at fair value, shall be presented in the balance sheet by setting up the grant as deferred income.”

“26 The grant set up as deferred income is recognised in profit or loss on a systematic basis over the useful life of the asset.”

“28 The purchase of assets and the receipt of related grants can cause major movements in the cash flow of an entity. For this reason and in order to show the gross investment in assets, such movements are disclosed *as separate items* in the statement of cash flows.” (Emphasis supplied by the querist.)

6. The querist has also explained some of the clauses of Memorandum of Understanding (MoU) between Global Innovation Technology Alliance (GITA) and the company as follows:

(i) Clause 14.4 of the MoU states that “a two year lock in period will be allowed from the date of approval of completion of the Project(s) by the Apex Committee before opening up the Intellectual Property Rights”. In this regard, the querist has explained that the rationale behind the lock in period is that the company is making a huge amount of investment in developing a technology/project and therefore, it has exclusive right to use the technology for initial period (like any other IP rights), which in the extant case is defined for 2 years as per the MoU. The company has exclusive right on the technology for the period, whereas in case the company wishes to transfer the technology to any other party, during this lock in period, then only it needs prior consent of DHI (clause 14.2). For its own usage, there is no restriction on the company, as IPR will be held by the company (clause 14.1). The company will consult with DHI and GITA for appropriate dissemination of technology and other benefits only, after initial lock in period of 2 years.

(ii) Clause 14.3 of the MoU states that “once the IP comes to public domain after the initial lock-in period, the issue of licensing and royalty will be finalized jointly by the DHI & GITA and the company”. In this regard, the querist has clarified that since IPR will be with the company, there is no sharing of license fee or royalty with DHI/GITA. DHI and GITA will jointly finalise the licensing fee or royalty; and this is more from the perspective of right pricing of license fee or royalty, and nothing else.

(iii) Clause 8.4 of the MoU states that “DHI would be free to use the IPR (after two years)/ equipments/; softwares procured/ developed for any scientist work or technology Development, Acquisition & Customization/ demonstration purpose on their own or can request the company for use of this infrastructure by any other organization/agency or manufacturer for scientific technology Development, Acquisition & Customization/ demonstration/ public purpose subject to IPR lock in period.” In this regard the querist has confirmed that DHI/GITA cannot use or request usage of any of resources for initial lock in period of 2 years but it is also reiterated

that the use or request for use of resources by DHI/GITA are intended for any ancillary purpose of development, scientific purposes or demonstration only and not for commercial purposes; and also that the title and possession of all such developments or resources shall remain with the company only.

(iv) Clause 7.17 of the MoU states that “In the event of any liquidation or bankruptcy proceedings or any threatened distress action against the company or any of its assets, plants, machineries, fixtures and equipment procured for the purpose of the Project out of or with support of Grant in aid shall be outside such proceedings and the GoI may assume the control and management of the company in respect of the concerned project(s) and appoint any of its officer or authorized representative to run the Project(s).” In this regard, the querist has clarified that although for all practical purposes, the company does not see possibility of any such event, referred in clause 7.17, as the company has made huge investments and is in sound financial health; even then for theoretical purposes, the company has confirmed that there is no identification of specific assets which are acquired from the Government grant. Neither it has been a requirement as per MOU nor an intention. Government grant is 25% of the project, not exceeding Rs. 10 crores, and the grant is provided with progressive development of project and amount spent by the company. There are no identified assets to which the grant is allocated.

7. With regard to classification and presentation of the government grant II, the management believes that the grant received is not in the nature of financial obligation as no repayment is expected in case of such grants by the Government body. It is the intention of the Government to participate in these projects to develop technologies which are of ‘national importance’ and hence, the classification of such grants as ‘liabilities’ shall not be a fair representation of the intention behind the disbursement of such grants. Further under Ind AS, the classification and presentation of the grants received in the nature of promoters contribution has not been dealt with; therefore, the company intends to disclose the same as a mezzanine, different line item, between ‘equity’ and ‘other non-current liabilities’.

B. Query

8. In view of the above facts and the circumstances, the querist has sought the opinion of the Expert Advisory Committee on the classification and presentation of the government grant (Grant II) received under Indian Accounting Standards (Ind ASs) for which no repayment obligation has been imposed by the concerned Government body.

C. Points considered by the Committee

9. The Committee notes that the issue raised by the querist relates to classification and presentation of government grant (Grant II) under Indian Accounting Standards (Ind AS) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as ‘the Rules’) for which, as per querist, there is no repayment obligation. The Committee has, therefore, considered only this issue and has not examined any other issue that may be contained in the Facts of the Case, such as, recognition and measurement of government grant (grant II) and accounting treatment of other government grants (Grant I) received by the company.

10. With regard to the accounting for grant of funds by the DHI/GITA, the Committee notes the following clauses from the Memorandum of Understanding (MoU) between Global Innovation Technology Alliance (GITA) and the company:

“3. OUTPUT: Techno-Economic-Social benefits and Technical Milestones

In case of Scheme components Technology Acquisition Fund Programme, acquisition of technologies are the output. The Project titled as **“Development & Commercialization of Titanium Casting with Ceramic Shelling Technology”** has a clear set of large Socio-economic objective from National prospective.

...”

“5.1 This Project is partly funded by DHI under the CG scheme through Grant in aid. The total approved financial outlay of the project as per approved proposal is INR. **51,01,87,260/- (Fifty One Crores One Lakh Eighty Seven Thousand Two Hundred and Sixty Only)** out of which GoI grant is limited to 25% of the total project cost i.e. INR. **10,00,00,000/- (Ten Crores Only)**. The ratio of GoI’s grant in aid to industry contribution will be 25:75 for the project wherein GoI grant is limited to Rs. 10 crore.

...”

“6.9 The company will ensure that assets will not be disposed-off / sold / transferred / leased / rented / transferred without prior written approval of GITA & DHI.”

“6.14 ... In case of loss or damage of such plant, machinery, fixtures and equipment, etc. the insurance monies will be payable to the Government of India.”

“7.1 It is obligatory on the part of the company to ensure free access to AC-CG members, PMRC Members / GITA officials / DHI officials / its representatives to all facilities/assets and records relating to the project located at their works.

7.2 All research publications based on this Project shall be made jointly in the names of the scientists/investigators/GITA/innovators of DHI and the company members making scientific contributions to research project. Copy of technical papers published has to be forwarded to GITA and DHI along with Quarterly Progress Report.”

“7.4 The company shall not transfer IPR/technology/process know-how or information on technology to any third party before completion of the Project without the written consent of GITA & DHI. Technology includes Technology or facility developed, expertise, knowhow etc.”

7.5 The company shall hold in trust on behalf of DHI all deliverables of the project such as full documentation pertaining to Development, Acquisition & Customization, design, detailed specification of all components and material manufacturing process, sourcing of material, test results etc. to GITA & DHI.

7.6 The company shall furnish all details of documents/test reports etc. as required for registration of patent. The Intellectual Property (IP) Generated from the projects shall be managed in compliance with paragraph 14 below.”

“7.8 The asset acquired/created wholly or substantially by the company out of Government grants except those declared as obsolete and unserviceable or condemned in accordance with the procedure laid down in the G.F.R. shall not be disposed-off encumbered or utilized for the another purpose/project, without obtaining the prior approval of GITA & DHI. In case of winding up or dissolution of the organization all the assets acquired to that effect out of the grants-in-aid by the Ministry should be returned forthwith to the Government of India.”

“7.12 No expenditure over and above the sanctioned grant shall be incurred by the company without obtaining the prior approval of GITA & DHI. Further in no case the expenditure on any scheme should exceed the approved cost of the respective scheme and quarterly targets of expenditure.”

“7.17 In the event of any liquidation or bankruptcy proceedings or any threatened distress action against the company or any of its assets, plants, machineries, fixtures and equipment procured for the purpose of the Project out of or with support of Grant in aid shall be outside such proceedings and the GoI may assume the control and management of the company in respect of the concerned project(s) and appoint any of its officer or authorized representative to run the Project(s).”

“8.4 DHI would be free to use the IPR (after two years)/ equipments/; softwares procured/ developed for any scientist work or technology Development, Acquisition & Customization/ demonstration purpose on their own or can request the company for use of this infrastructure by any other organization/agency or manufacturer for scientific technology Development, Acquisition & Customization/ demonstration/ public purpose subject to IPR lock in period.”

“14. PATENT AND TECHNOLOGY TRANSFER MECHANISM

14.1 In general, IPR will be held by the company.

14.2 IP/IPR with ownership of the company will not be transferred to any other party for a period of two years from the date of completion without the consent of Department of Heavy Industry.

14.3 Once the IP comes to public domain after the initial lock-in period, the issue of licensing and royalty will be finalized *jointly* by the DHI & GITA and the company.

14.4 A two year lock in period will be allowed from the date of approval of completion of the Project(s) by the Apex Committee before opening up the Intellectual Property Rights. After the initial lock in period, the company will take initiative for dissemination of technology and other benefits accrued from the project(s). The company will consult with GITA & DHI for dissemination of the technology at the earliest after the lock in period. Declaration for the same have been enclosed as Annexure-III.”

“16.2 Since the project is sanctioned to the company it shall not be transferred to any other **Organization**. Transfer of project money within the **Organization** or with other Institutions under the same Management is not permitted under any circumstances.”

“18 VALIDITY OF MoU

This MoU will be in force from the date of signing this MoU and is valid for a period of 4 (Four) years (First two (2) years completion of project and subsequent two (2) years for IPR) from the date of approval of by competent authority or till expiry of the lock in period in respect of IPR after completion of the project, whichever is later.”

11. The Committee notes from the Memorandum of Understanding (MoU) between the Global Innovation Technology Alliance (GITA) and the company that the basic objective of the Government behind providing funds is the development and commercialisation of ‘Titanium Casting with Ceramic Shelling Technology’ (hereinafter referred to as ‘the project’) through acquisition and customisation of technology by the company under the TAFP. Further, as per the MoU, the deliverables of the project are to be held by the company in trust on behalf of DHI and that in general, IPR will be held by the company. The MoU further states that the company shall not transfer IPR/technology/process know-how or information on technology to any third party before completing the project without the written consent of GITA & DHI. After completion of the project, IP/IPR will not be transferred to any other party for a period of two years from the date of completion without the consent of DHI. Further, after the initial lock-in-period of two years and once the IP comes to public domain, the issue of licensing and royalty will be finalised jointly by the DHI & GITA and company. Also, it is stated in the MoU that DHI would be free to use the IPR (after two years) / equipments/ software procured/ developed etc. on their own or can request the company for use of this infrastructure by any other organization/agency or manufacturer for scientific technology Development, Acquisition & Customization/ demonstration/ public purpose subject to IPR lock in period.

From the above terms, it appears that since the technology/IPR can be transferred by the company either with the consent of DHI/GITA or jointly by all the parties, there is a joint arrangement between the company and DHI/GITA, wherein both the parties are mutual beneficiaries. However, the Committee also notes that the company in the extant case has exclusive right to use the technology for initial lock in period of 2 years as per the MoU. Further, the querist has specifically stated that there is no sharing of license fee or royalty with DHI/GITA and the clause stating that DHI and GITA will jointly finalise the licensing fee or royalty is mainly from the perspective of determining the appropriate pricing for license fee or royalty. Also, the use or request for use of assets/resources developed/procured under the project by DHI/GITA is intended only for any ancillary purpose of development, scientific purposes or demonstration and not for commercial purposes. Thus, on an overall reading of the clauses of MoU and the explanations provided by the querist with regard to these clauses, as mentioned above, the Committee is of the view that intention of the parties is that the rights of DHI/GITA in the extant case are more of the nature of protective rights for appropriate dissemination and right pricing of the technology and other benefits developed under the project rather than participating rights for commercial purposes. Accordingly, the Committee is of the view that the grant of funds by the DHI/GITA in the extant case can be considered as a government grant (as per Ind AS 20) with certain conditions attached to it.

12. With regard to the classification and presentation of government grant in the extant case, without examining its nature as that related to assets or related to income under Ind AS 20, the Committee notes the following paragraphs of Indian Accounting Standard (Ind AS) 20, 'Accounting for Government Grants and Disclosure of Government Assistance':

“14 Those in support of the capital approach argue as follows:

- (a) government grants are a financing device and should be dealt with as such in the balance sheet rather than be recognised in profit or loss to offset the items of expense that they finance. Because no repayment is expected, such grants should be recognised outside profit or loss.
- (b) it is inappropriate to recognise government grants in profit or loss, because they are not earned but represent an incentive provided by government without related costs.

15 Arguments in support of the income approach are as follows:

- (a) *because government grants are receipts from a source other than shareholders, they should not be recognised directly in equity* but should be recognised in profit or loss in appropriate periods.
- (b) government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate.
- (c) because income and other taxes are expenses, it is logical to deal also with government grants, which are an extension of fiscal policies, in profit or loss.”

(Emphasis supplied by the Committee.)

The Committee further notes that Ind AS 20, while requiring to recognise all government grants in the statement of profit and 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, does not recognise 'Capital Approach' and is based on 'Income Approach'. Accordingly, as per paragraph 15(a) of Ind AS 20, reproduced above, since the government grants *are receipts from a source other than shareholders, they should not be recognised directly in equity* but should be recognised in profit or loss in appropriate periods.

13. Further, the Committee notes the definition of 'liability' as per the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards as follows:

- “49 (b) A *liability* is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.”

The Committee further notes that under Ind AS 20, government grants are 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 grants are intended to compensate. Thus, the grant is recognised over the periods that bear the cost of meeting the obligations for which grant is provided. In other words, grant is deferred/amortised over the period of fulfilment of obligations related to the grant, for example, incurrance of expenses. Accordingly, the unamortised portion of the grant represents unfulfilled obligation, the settlement of which is expected to result in outflow of resources in future (even though the same may not be refundable in future as in the extant case) and therefore, in the view of the Committee, it meets the definition of liability. Further, the Committee notes from the Facts of the Case that the grant in the extant case has been given with reference to development and commercialisation of a particular technology and the same is a long-term project (as it takes around two years as stated in the MoU) and all the liabilities in the form of fulfilment of obligations are not expected to be settled within next twelve months. Therefore, the Committee is of the view that the government grant in the extant case should be classified and presented under the head ‘Non-current Liabilities’ and ‘Current Liabilities’ in the balance sheet considering the requirements of Schedule III to the Companies Act, 2013 and Ind AS 1, ‘Presentation of Financial Statements’ and not as a separate line item between ‘equity’ and ‘other non-current liabilities’.

D. Opinion

14. On the basis of the above, the Committee is of the opinion that the government grant (grant II) in the extant case should be classified and presented under the head ‘Non-current Liabilities’ and ‘Current Liabilities’ in the balance sheet considering the requirements of Schedule III to the Companies Act, 2013 and Ind AS 1, ‘Presentation of Financial Statements’ and not as a separate line item between ‘equity’ and ‘other non-current liabilities’ as discussed in paragraph 13 above till the same is recognised in the statement of profit and loss on a systematic basis over the periods in which the company will recognise as expenses the related costs for which the grant is intended to compensate.