Chapter 2

Automotive sector - Impact of PLI scheme on financial reporting

This article aims to:
Provide an overview of the financial reporting impacts of the PLI scheme on the companies operating in the automotive sector.

Introduction

Automotive is one of the most important sectors in India which has been under stress from quite some time.

The Production Linked Incentive (PLI) scheme, introduced by the Government of India (GoI) in March 2020, has been introduced to boost domestic manufacturing under the GoI's *'Aatmanirbhar Bharat'* initiative. The PLI scheme aims at incentivising companies on incremental sales from products manufactured in India. Incentives under the scheme may vary, depending upon underlying sector, type of products and qualifying criteria.

On 15 September 2021, the GoI approved the PLI scheme for automobile and auto component industry[1] (auto sector). The PLI scheme for the auto sector envisages to overcome the cost disabilities of the industry for manufacture of advanced automotive technology products in India. The incentive structure requires industry to make fresh investments for indigenous supply chain of advanced automotive technology products. As per the estimates of GoI, the PLI scheme for automobile and auto components industry is expected to entail fresh investments of over INR42,500 crore, an incremental production of over INR2.3 lakh crore and is likely to create additional employment opportunities of over 7.5 lakh jobs over a period of five years.

1. The scheme and the guidelines for the PLI scheme for automobile and auto component have been notified in the Gazette of India on 23 September 2021.

PLI scheme for automotive sector – An overview

Components of the scheme

The PLI scheme for auto sector is open to existing automotive companies as well as new non-automotive investor companies (who are currently not in automobile or auto component manufacturing business). The scheme has following two components:

a. **Champion OEM Incentive Scheme:** It is a 'sales value linked' scheme, applicable on battery Electric Vehicles (EVs) and hydrogen fuel cell vehicles of all segments and any other advanced automotive technology vehicle prescribed by the Ministry of Heavy Industries (MHI) depending upon technical developments. The threshold determined sales value for the first year is INR125 crore in respect of all companies.

   The incentive payable for champion OEM and new non-automotive (OEM) investor company can range from 13 per cent to 16 per cent. An additional incentive of two per cent will also be applicable to support high growth achievers.

b. **Component Champion Incentive Scheme:** It is a 'sales value linked' scheme, applicable on pre-approved advanced automotive technology components of all vehicles, Completely Knocked Down (CKD)/Semi Knocked Down (SKD) kits, vehicle aggregates of two-wheelers, three-wheelers, passenger vehicles, commercial vehicles and tractors including automobile meant for military use and any other advanced automotive technology components prescribed by MHI depending upon technical developments. The threshold determined sales value for the first year is INR25 crore in respect of all companies.

The incentive payable for component champion and new non-automotive (component) investor company ranges from 8 per cent to 11 per cent with an additional 5 per cent incentive for battery EVs and hydrogen fuel cell vehicle components.

Eligibility criteria

a. A company or its group company(ies) with existing presence in India or globally in the automotive vehicle and components manufacturing business should meet the following criteria:

Eligibility criteria	Auto OEM	Auto component
Global group[2] revenue (from automotive and/ or auto component manufacturing)	Minimum INR10,000 crore	Minimum INR500 crore
Investment	Global investment of company or its group company(ies) in fixed assets (gross block) of INR3,000 crore.	Global investment of company or its group company(ies) in fixed assets (gross block) of INR150 crore.

b. A new non-automotive investor company or its group company(ies)[3] that may want to participate in this scheme should have a global net worth of INR1,000 crore based on audited financial statements for year ending 31 March 2021 and specified committed investment in India over five year period.

In case a company fails to meet the cumulative domestic investment condition in any given year, it will not receive any incentive for that year, even if the threshold for determined sales value is achieved. However, it will still be eligible to receive the benefits under the scheme in the following years if it meets the cumulative domestic investment condition defined for that year. Further, any eligible product will be incentivised only once - component level or vehicle level.

The scheme for automobile and auto components will be implemented over of a period of five years effective from FY2022-23. FY2019-20 should be treated as the base year for calculation of eligible sales.

Other points for consideration are as follows:

- Year on year growth of minimum 10 per cent of the threshold determined sales value (as mentioned above) for the first year and thereafter for next five years, has to be achieved to claim incentives.
- New investments should be made from the same legal entity as the one applying for the incentive.
- Preference will be given to eligible company or its group company(ies) committing to front load their investment during the scheme period.
- In case the approved company meets the investment condition few years before the end of the scheme, then also it will be eligible for incentives throughout the tenure of the scheme subject to meeting other conditions of the scheme.
- Only those battery EVs will be eligible for incentives which meet the performance criteria of FAME-II scheme or as notified from time to time by MHI.

Impact on financial reporting

The PLI scheme should be evaluated as it is likely to result in financial reporting implications for companies. In the following section, we cast our lens on some of the key considerations for companies operating in automotive sector.

Increase in R&D expenditure and investment in advanced technology

As mentioned above, the PLI scheme for the auto sector has laid down greater emphasis on technologically innovative auto components. The auto sector is undergoing technological transformation and this would require huge investment in advanced technology and new programmes for product development. Accordingly, significant increase in Research and Development (R&D) expenditure is expected to be incurred by automotive companies. From accounting and financial reporting perspective, companies would need to critically assess the criteria of Ind AS 38, *Intangible Assets* for recognition of intangible assets.

2. Group company(ies) shall mean two or more enterprises which, directly or indirectly, are in a position to:
   a. Exercise 26 per cent or more of voting rights in the other enterprise or
   b. Appoint more than 50 per cent of members of Board of Directors in the other enterprise.
3. New non-automotive investor company or its group company(ies) will be defined as those who have no revenue from manufacturing of automobile or auto-components as on 31 March 2021.

Capitalisation of PPE

Grant of incentives under the PLI scheme is directly linked to production capacity/incremental turnover. Major portion of this investment is likely to be made in Property, Plant and Equipment (PPE) by automotive companies. Companies may embark on this capital expansion journey with the help of borrowed funds. Hence, in order to capitalise the borrowing cost, the standard to be critically evaluated would be Ind AS 23, *Borrowing Costs.*

It is also expected that there would be a huge technological advancement and it would require companies to appropriately assess the useful life of their PPE. Due to the technological changes and revised business strategies, companies would also need to assess the recoverable amounts and useability of assets already in books and in turn assess if there are any triggers for impairment in accordance with Ind AS 36, *Impairment of Assets.*

Government grants

Under the PLI scheme, incentives up to 18 per cent on incremental sales will be offered to automotive industry. Companies would need to critically evaluate and comply with Ind AS 20, *Accounting for Government Grants* and disclosure of government assistance including appropriate presentation of grant i.e. whether the grant needs to be presented as grant related to assets or grant related to income. Companies would need to carefully assess the terms and conditions attached to the incentive scheme and assess the same as per Ind AS 20 for accounting treatment of incentives.

Discontinued operations

As there is a considerable shift in the demand for advanced automotive technology and eco-friendly vehicles and also to cater to the requirements of the PLI scheme, companies might consider discontinuing some of their current operating segments. Accordingly, requirements of Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations* will also need to be considered, in particular the disclosures which should enable users of the financial statements to evaluate the financial effects of discontinued operations. For instance, revenue, expenses and pre-tax profit or loss of discontinued operation, related income tax expense and gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

Wage structuring/employee benefit scheme

With change in technology and future investments, it is expected that there would be a huge demand of skilled labour with knowledge of new technology. Companies would need to look for talent acquisition and also retention of talent within organisations. This would require companies to relook at their policies, wage restructuring and various employee benefit schemes under Ind AS 19, *Employee Benefits* and Ind AS 102, *Share based Payments.*

Detailed processes

Companies would also need to have robust systems and policies in place to assess the compliances with the requirements of the scheme in order to be eligible to claim the incentive. For instance, adequate systems for computation of cumulative domestic investments.

Conclusion

PLI scheme for automotive sector is expected to act as a growth enabler to make the sector cost competitive, increase market share, attract investments, promote R&D, local value addition and creating jobs. Other aspects to consider while implementing the PLI scheme would be to keep tight monitoring of working capital and efficient supply chain management. This will help companies to assess their preparedness for complying with the conditions of the scheme to avail the benefits and also need to evaluate the impact of the scheme on their financial reporting and related matters. This assessment would depend on the facts and circumstances of each case.