

Query No. 17

Subject: *Accounting treatment of grant under AS 12.*¹

A. Facts of the Case

1. Government of India (GoI) has launched Smart City Mission in June 2015 with an objective to promote sustainable and inclusive cities that provide core infrastructure and give a decent quality of life to its citizens, a clean and sustainable environment and application of ‘Smart’ solutions.

2. The implementation of the Mission at the city level will be done by a Special Purpose Vehicle (SPV) created for the purpose. The SPV will plan, appraise, approve, release funds, implement, manage, operate, monitor and evaluate the Smart City development projects. Each smart city will have a SPV which will be headed by a full time CEO and have nominees of Central Government, State Government and Urban Local Body (ULB) on its Board. The States/ULBs shall ensure that, (a) a dedicated and substantial revenue stream is made available to the SPV so as to make it self-sustainable and could evolve its own credit worthiness for raising additional resources from the market and (b) Government contribution for Smart City is used only to create infrastructure that has public benefit outcomes. The execution of projects may be done through joint ventures, subsidiaries, public-private partnership (PPP), turnkey contracts, etc. suitably dovetailed with revenue streams.

3. The SPV Company (hereinafter referred to as ‘the Company’) is a limited company incorporated under the Companies Act, 2013 at the city-level, in which the State/Union Territory (UT) and the ULB will be the promoters having 50:50 equity share holding. The private sector or financial institutions could be considered for taking equity stake in the SPV, provided the shareholding pattern of 50:50 of the State/UT and the ULB is maintained and the State/UT and the ULB together have majority shareholding and control of the SPV.

4. The querist has stated that the funds provided by the Government of India in the Smart Cities Mission to the SPV will be in the form of tied grant and kept in a separate Grant Fund. These funds will be utilised only for the purposes for which the grants have been given and subject to the conditions laid down by the Ministry of Housing and Urban Affairs.

5. The State Government and the ULB will determine the paid-up capital requirements of the SPV commensurate with the size of the project, commercial financing required and the financing modalities. To enable the building up of the equity base of the SPV and to enable ULBs to contribute their share of the equity capital, the GoI grants will be permitted to be utilised as ULBs share of equity capital in the SPV, subject to the conditions given in Smart City Guidelines. Initially, to ensure a minimum capital base for the SPV, the paid up capital of the SPV should be such that the ULB’s share is at least equal to Rs. 100 crore with an option to increase it to the full amount of the first instalment of funds provided by the GoI (Rs. 194 crore). With a matching equity contribution by State/ULB, the initial paid-up capital of the SPV will thus be Rs. 200 crore (Rs. 100 crore of the GoI contribution and Rs. 100 crore of State/UT share). Since the initial GoI contribution is Rs. 194 crore, along with the matching contribution of the State Government, the initial paid up capital can go up to Rs. 384 crore at the option of the SPV. The paid up capital may be enhanced in the subsequent

¹ Opinion finalised by the Committee on 27.10.2021.

years as per project requirements, with the provision mentioned above ensuring that ULB is enabled to match its shareholding in the SPV with that of the State/UT.

6. The Smart City Mission will be operated as a Centrally Sponsored Scheme (CSS) and the Central Government proposes to give financial support to the Mission to the extent of Rs. 48,000 crore over five years, i.e., on an average Rs. 100 crore per city per year. An equal amount, on a matching basis, will have to be contributed by the State/ULB; therefore, nearly Rupees one lakh crore of Government/ULB funds will be available for Smart Cities' development.

7. The distribution of funds under the Scheme will be as follows:

- i. 93% project funds.
- ii. 5% Administrative and Office Expenses (A&OE) funds for the State/ULB (towards preparation of Smart City Proposals (SCPs) and for Project Management Consultants (PMCs), pilot studies connected to area-based developments and deployment and generation of smart solutions, capacity building as approved in the challenge and online services).
- iii. 2% A&OE funds for Ministry of Urban Development (MoUD) (Mission Directorate and connected activities/structures, research, pilot studies, capacity building, and concurrent evaluation).

8. K City has been successfully selected as a city to be developed as Smart City in Round-1 of Smart City Challenge. It is proposed to implement various initiatives for Area Based Development (ABD) and Pan City Solutions worth about INR 1993 crore in K City under Smart City Mission.

9. The Company is an SPV incorporated on 07.03.2016 under the Companies Act, 2013 for implementation of Smart City projects in K City. The SPV will plan, appraise, approve, release funds, implement, manage, operate, monitor and evaluate the Smart City development projects.

10. Total grant received so far from the Government of India and the State Government together is Rs. 577 (384+193) crore out of which Rs. 200 crore have been considered as authorised and paid up share capital as per the instructions of the Ministry of Urban Development and the Smart City Guidelines (A copy of guidelines applicable to the Smart City Mission as applicable for projects execution and related compliances have been supplied separately by the querist for the perusal of the Committee) issued by it. The balance amount of Rs. 367 crore shown under Grant (Capital Reserve) for projects execution and transferred to Profit and Loss Account as and when the project expenditure is incurred and balance Rs. 10 crore has been marked as Grant (Capital Reserve) for Administrative & Office Expenses (A&OE). The querist has separately informed that till August, 2021, the Company has received an amount of Rs. 488 crore from the State Government and Rs. 490 crore from the Central Government. The Company has utilised an amount of Rs. 239.14 crore from the State Government fund and an amount of Rs. 444.51 crore from the Central fund till August, 2021.

11. The Company is executing several projects in K City on the lands owned by State Municipal Corporation (ULB) like laying of roads, development of existing parks, construction of buildings etc., within the limits of ULB. The querist has further informed that

the grant can be used for core infrastructure elements in a Smart City, which include, adequate water supply, assured electricity supply, sanitation, including solid waste management, efficient urban mobility and public transport, affordable housing, especially for the poor, robust IT connectivity and digitalisation, good governance, especially e-Governance and citizen participation, sustainable environment, safety and security of citizens, particularly women, children and the elderly, and health and education. However, no agreements or MOUs are entered into with ULBs either regarding ownership rights or for any lease arrangements for the expenditure incurred/capital assets created. This project expenditure is not capitalised since the ownership of the lands is not with the Company. The expenditure incurred towards execution of the projects is debited to Profit and Loss Account. At the year-end, Grant (Capital Reserve) Account, to the extent of expenditure incurred towards execution of projects, is transferred to Profit and Loss Account as other income.

12. Similar accounting treatment is followed in respect of revenue grant and revenue expenditure, i.e., transfer from revenue grant account to Profit and Loss Account as other income to the extent of administrative expenditure incurred. The project expenditure in financial year 2019-20 exceeded the available balance in Grant (Capital Reserve) Account since it was met out of the funds accounted for as share capital of Rs. 200 crore, resulting in loss of about Rs. 145 crore in the Profit and Loss Account. This is because the share capital created cannot be transferred to the Profit and Loss Account to the extent of the project expenditure met out of it.

13. It can be observed that at the end of all projects, following this practice, the loss in the Profit and Loss Account would rise up to Rs. 200 crore (i.e. the share capital amount spent but cannot be transferred to Profit and Loss Account.)

B. Query

14. In view of the above, the querist has sought the opinion of the Expert Advisory Committee as to whether the accounting treatment followed for accounting project expenditure and the grants received is in line with Accounting Standard (AS) 12, 'Accounting for Government Grants'. In case it is felt otherwise, accounting of project expenditure and the grants received may be advised.

C. Points Considered by the Committee

15. The Committee notes that the basic issue raised in the query relates to accounting treatment for project expenditure and grants received in relation to smart city mission. The Committee has, therefore, considered only this issue and has not examined any other issue(s) that may arise from the Facts of the Case, such as, calculation of total funds received so far towards execution of projects and towards A&OE, accounting for funds received from the GoI/State Government as share capital and issue of shares against those funds, etc. Further, the opinion, expressed hereinafter is purely from accounting perspective and not from the legal perspective, such as, interpretation of Smart City Guidelines etc. The Committee notes that the issue has been raised in the context of AS 12, notified under the Companies (Accounting Standards) Rules, 2006² and accordingly, the opinion expressed hereinafter is from the perspective of the Accounting Standards, and not from the perspective of Indian

²Companies (Accounting Standards) Rules, 2021 supersedes the Companies (Accounting Standards) Rules, 2006 with effect from accounting periods commencing on or after 1.4.2021.

Accounting Standards (Ind ASs) notified under the Companies (Indian Accounting Standards) Rules, 2015.

The Committee presumes from the Facts of the Case that the State Government/GoI/ULB, while providing funds to the Company is not acting in the capacity of owner; rather acting as 'Government' as per Accounting Standard (AS) 12, 'Accounting for Government Grants'. The Committee further presumes from the Facts of the Case that the Company is not working as an agent of Government of India/State Government/ULB; rather it is working in the capacity of principal.

16. The Committee notes from the Facts of the Case that the Company is executing several projects in the City on the lands owned by the State Municipal Corporation (ULB). However, no agreements or MoUs are entered into with ULBs either regarding ownership rights or for any lease arrangements for the expenditure incurred/capital assets created. It is further stated in the Facts of the Case that the project expenditure is not capitalised since the ownership of the lands is not with the Company and the expenditure incurred towards execution of the projects is debited to Profit and Loss Account. From the above, the Committee is of the view that in the extant case, as the ownership of the land is not with the Company and there is no agreement/MoU entered into with ULBs either regarding ownership rights or for right-of-use of any asset created out of the expenditure incurred as a part of smart city development project, in the absence of anything contrary, at present, the Company neither has the power to obtain the future economic benefits out of the expenditure incurred nor can restrict the access of others to those benefits.

17. In this context, the Committee notes the definition of 'asset' and paragraph 14 from Accounting Standard (AS) 26, 'Intangible Assets' as follows:

“6.2 An asset is a resource:

- (a) controlled by an enterprise as a result of past events; and***
- (b) from which future economic benefits are expected to flow to the enterprise.”***

“14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.”

“56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. ...”

From the above, the Committee notes that an asset is a resource *controlled* by the enterprise and an enterprise *controls* an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. Accordingly, the Committee is of the view that it is only where the

asset is controlled by the Company in the manner envisaged by paragraph 14 of AS 26, the Company should recognise asset in its financial statements in respect of the expenditure incurred. The Committee is of the view that in the extant case since at present, the Company neither has the power to obtain the future economic benefits out of the expenditure incurred nor can restrict the access of others to those benefits, as discussed in paragraph 16 above, the Company does not *control* the assets created/modified under smart city development project in the manner envisaged in the above-mentioned paragraphs of AS 26. Therefore, the expenditure incurred for the smart city development should not be capitalised as an asset in the financial statements of the Company. Further, the Committee notes the following requirements of AS 5, ‘Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies’:

“5. All items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period unless an Accounting Standard requires or permits otherwise.”

From the above and considering the requirements of paragraph 56 of AS 26, as reproduced above, the Committee is of the view that the expenditure incurred by the Company for the smart city development should be recognised as an expense in the Statement of Profit and Loss of the Company.

18. With regard to the accounting for the funds received from the GoI/State Government/ULB against which shares have not been issued, the Committee notes the following requirements of Accounting Standard (AS) 12, ‘Accounting for Government Grants’:

“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.”

“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 in the extant case, part of the funds provided by the Government of India/ULB and State Government against which shares have not been issued have been granted to the Company for project execution and administrative and office expenses (A&OE) as per Smart City Guidelines. Accordingly, these are government grants under AS 12. As far as the nature of such grants, the Committee notes that these funds are being

provided by the GoI/State Government/ULB from time to time for various projects and administrative and office expenditure under the Guidelines and cannot be considered as a one-time initial support or with reference to total investment in the Company or by way of contribution towards capital outlay only. Therefore, grant in the extant case cannot be considered as grant of the nature of promoters' contribution. Further, as discussed above, no fixed asset comes into existence for the Company out of the expenditure incurred on various projects under the Guidelines and therefore, grant in the extant case cannot also be considered as grant related to specific fixed asset. Accordingly, the Committee is of the view that the grant in the extant case should be considered as grant related to revenue.

19. With regard to disclosure and presentation of the grant related to revenue, the Committee notes the following requirements of AS 12:

“9.1 Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as ‘Other Income’. Alternatively, they are deducted in reporting the related expense.”

“15. Government grants related to revenue should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. Such grants should either be shown separately under ‘other income’ or deducted in reporting the related expense.”

From the above, the Committee is of the view that the grant received from the GoI/State Government/ULB for meeting the project expenditure and A&OE should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. In this context, the Committee also wishes to point out that the grant received but unspent should be considered as unamortised deferred credit (and not as capital reserve) and should be suitably disclosed in the balance sheet with appropriate nomenclature, such as ‘deferred revenue grant’.

With regard to loss in the Statement of Profit and Loss due to project expenditure exceeding the available balance in Grant and being met out of the funds accounted for as share capital, the Committee wishes to mention that the facts and circumstances underlying such loss should be appropriately explained in the notes to accounts for a better understanding of the users of financial statements.

D. Opinion

20. On the basis of the above, the Committee is of the opinion that the expenditure incurred by the Company for the smart city development should be recognised as an expense in the Statement of Profit and Loss of the Company as discussed in paragraph 17 above and the funds received as grant for project execution and A&OE should be recognised on a systematic basis in the Profit and Loss Statement over the periods necessary to match them with the related costs which they are intended to compensate, as discussed in paragraphs 18 and 19 above.
