

Query No. 26

Subject: Revenue recognition in case of an implementing agency of the State Government.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is wholly owned by the State Government. The Company was incorporated in the year 2009 under the erstwhile Companies Act, 1956. The main objective of the Company is to execute and accelerate urban infrastructure projects in the State.

2. The State Government, Urban Development and Housing Department incorporated the Company to develop infrastructure facilities (such as, storm water drainage, sewerage and sewage water treatment through Sewerage Treatment Plant (STP), water supply distribution system, construction of bus terminals, developments of roads, drainage project, construction of parks etc.) in the urban areas of the State. For schemes executed by the Company, 100% grant is provided by the State Government for state funded schemes and Central Government and State Government provide grant in pre-specified ratio for central sponsored schemes.

3. By Sankalp No. 917 dated 17.12.2009, agency charge (called centage) and consultancy fee were allowed to the Company for the work executed at the following rates:

- Scheme/Work costing up to Rs. 250 crores : 8+1% of the work done.
- Scheme/Work costing above Rs. 250 crores : 7+1% of the work done.

Further, agency charges were revised by Order No. 653 dated 25.01.2016 as follows:

S No.	Cost of work	Rate of Centage
1	Project cost up to 10 Crores	7%
2	Project Cost more than 10 Crores and up to 100 Crores	Up to Rs. 10 Crore 7% + Per Crore 5% on Project Amount above Rs. 10 Crore and up to Rs. 100 Crore
3	Project Cost more than Rs. 100 Crores	Up to Rs. 10 Crore 7% + Per Crore 5% on Project Amount above Rs. 10 Crore and up to Rs. 100 Crore + 1% per Crore on project amount above Rs. 100 Crore

4. The Company was incorporated with the objective to boost the infrastructure facilities in the urban areas of the State. The Company has been nominated as an executing agency of the Urban Development and Housing Department. For State-funded projects, the Company gets funds (including centage) from the State Government through the concerned Urban Local Bodies to which projects relate. For central sponsored projects, the Company gets funds (including centage) through the State Government.

5. The querist has stated that after getting the project sanctioned from the appropriate authority (State or Central), the Company invites tender, executes agreement for work contract, executes the projects and is responsible for defect liability period or Operations and Maintenance (O&M) period. The project period (including O&M) varies from 5 years to 15 years as per agreement. After the defect liability period or O&M period, project is transferred

¹ Opinion finalised by the Committee on 13.12.2022.

to the concerned Urban Local Bodies. All payments to the contractors are being made by the Company; liquidated damages, statutory deduction of taxes and duties at source are being deducted by the Company; and payment of statutory liabilities are being made by the Company. Road permits, E-Way bill and invoice are in the name of the Company and Tax Deducted at Source (TDS) certificates are being issued by using the Company's Permanent Account Number (PAN)/ Tax Deduction and Collection Account Number (TAN).

6. *Accounting policy of the Company:*

In the accounting policy of the Company, it has decided to show the expenditure and income in the Profit and Loss and centage will be recovered on the total expenditure (Work in Progress (WIP)) made during the year.

In compliance of above accounting policy and Accounting Standard (AS) 7, 'Construction Contracts', issued by the Institute of Chartered Accountants of India (ICAI), the Company shows all expenditure related to projects executed during the year as total expenditure (such as, payment to contractor, consultant, vehicle payment and other expenditure directly attributed to the project). At the same time, the Company recognises as income, centage plus all expenditure related to projects executed during the year.

7. The querist has informed that the turnover of the Company in the financial year (F.Y.) 2017-18 is as follows:

Profit and Loss Account (abstract)			
Particulars	Amount (in Cr.)	Particulars	Amount (in Cr.)
Total Expenditure towards Project	196.04	Total Income against Project Expenditure*	208.82
Gross Profit	13.13	Other Income	0.35
Total	209.17	Total	209.17

* it includes centage earned during the year amounting Rs. 12.78 cr.

8. The Comptroller and Auditor General (CAG) auditor in its supplementary audit report for the F.Y. 2017-18 has raised an audit para in reference to an earlier opinion given by the Expert Advisory Committee (published as Query No. 19 of Volume 31 of the 'Compendium of Opinions') that the Company should consider only centage as part of its income and should not consider current year Capital Work-in-Progress (CWIP) as its income/ expenditure. Auditor query is as below:

Audit Para "Revenue from Operations Rs. 209.17 crore"

The above includes a sum of Rs. 196.04 crore being the amount of project expenditure incurred during the year. The Company works as an implementing agency of State Government for different projects and for which the Company receives "Agency Charge (centage)" at a fixed percentage/slab rate. As per the provisions contained in AS 7 and further, opinion of the Expert Advisory Committee of the ICAI in a case clarified that since the consideration being received by the Company out of its contract for rendering of services is a fixed percentage of the project cost, the same should be considered as contract revenue of the Company. However, instead of showing "Agency Charge (centage)" as revenue from operations, the Company includes the whole amount of expenditure incurred on the projects during the year as "revenue from operations" which is incorrect. Therefore, the Company's accounting policy

approved in 14th Board of Directors (BOD) meeting is in contravention to the accounting procedure/concept formulated by the ICAI. Hence, wrong depiction of project expenditure under the head “Revenue from Operations” resulted in overstatement of income as well as expenditure for the year to the tune of Rs. 196.04 crore each.

9. The Company’s reply for the above audit para is as follows:

The facts of the above case and the Company’s accounting system are not similar. In the given case of above referred Query:

- (i) Executing agency was working as an agent of the Government,
- (ii) All invoices were raised in the name of concerned Government,
- (iii) Statutory deduction of taxes and duties at source were done by executing agency on behalf of the Government and TDS Certificate was being issued on behalf of the Government by utilising Government’s PAN/TAN/ Taxpayer Identification Number (TIN),
- (iv) The way bills/road permits are also being issued by the Government,
- (v) Ownership and risk were vested with the Government, not with the executive agency.

But in the case of the Company:

- (i) The Company is not an agent of the Government,
- (ii) All invoices are in the Company’s name,
- (iii) Statutory deduction of taxes and duties at source are being done by the Company in the name of the Company and TDS Certificate is being issued by utilising the Company’s PAN/TAN/TIN,
- (iv) The way bills/road permits are also being issued by the Company,
- (v) Ownership and risk till defect liability period (DLP) & O&M period lie with the Company.

So in the light of above, it is not the proper instance to refer the opinion in the case of the Company.

But auditor does not agree with above reply and reported in his Supplementary Report that turnover of the Company is overstated by Rs. 196.04 crores.

10. The querist has separately informed the following:

- (i) With regard to who bears the additional cost (if any), viz., the Company or State Programme Management Group (SPMG)/ULB/the State Government or any other agency or department of the Government, the querist has informed that:
 - As per Specific Condition No. V of Administrative Approval & Expenditure Sanction (AA&ES) issued by Central Government, any cost overrun over and above the liability of Central Government shall be borne by State Government.

- Similarly, as per General and Technical Condition No. V of Administrative Approval & Expenditure Sanction (AA&ES), the estimated cost for the project is supported with 15 years' Operation & Maintenance (O&M) of the Project in DBOT mode. The O&M beyond the 15 years will be responsibility of the State Government/ Urban Local Body.
- As per General and Technical Condition No. XXV of AA&ES, in case the final/negotiated quote of a contract exceeds the estimated cost, the additional cost is to be borne by the State Government.

Hence, any cost over and above the liability of Central Government has to be borne by State Government.

In case, there is any default on the part of the Company due to violation of any statutory/contractual/other requirements/compliances, which may result in additional/escalated cost/payment in the form of interest charges, penalty, liquidated damages, etc., in such case, the Company will have to bear such additional cost.

- (ii) With regard to who (the Company or SPMG/ULB) is primarily responsible to the Central/State Government for timely and qualitative completion of project as per the required standards etc., the querist has informed that the Company is primarily responsible to the Central/State Government for timely and qualitative completion of project as per the required standards etc.
- (iii) With regard to any revenue streams that are identified in future, whether the Company will have any participation in determination of such revenue (price for services rendered) or any tariff/rates to be charged from the consumers, the querist has mentioned that at present, there is no such Policy issued regarding determination of such revenue by the State Government. In future, as per Government Policy, such responsibility may be given to the Company.
- (iv) With regard to whether during the contract period including defect liability period, the Company will have any future economic benefits that may arise from the asset/infrastructure development under the project and can restrict others from accessing such economic benefits, the querist has stated that currently, Government has no such Policy to take economic benefits from these projects. In the absence of any Government Policy in this regard, the Company can restrict others from accessing such economic benefits.
- (v) With regard to whether the Company has any authority or discretion while carrying out activities related to the project, viz., for selection of contractor who will undertake the project or suppliers, deciding terms of contract, extension of time for completion of project, etc., the querist has informed that:
 - **For the State Government projects**, the Company has authority or discretion while carrying out activities related to the project, viz., for selection of contractor who will undertake the project or suppliers, deciding terms of contract, extension of time for completion of project etc.

- **For Projects related to NMCG/SPMG**, the Company after taking decision regarding above mentioned activities, such as, selection of contractors, deciding terms of contract, extension of time for completion for completion of project, etc. takes No Objection Certificate (NOC) from SPMG/World bank in this regard.
- (vi) With regard to the level of authority of the Company in the given arrangement, the querist has informed the following:
- The Company is a 100% Government Company in which 100% share has been held by the State Government.
 - As per Sankalp No. 428 dated 17.02.2009 issued by the State Government, to provide civic amenities to the citizens of the urban area, the Company has been established to determine the works in the prescribed manner as mentioned in the Memorandum of Association approved by the State Government.
 - As per Gyapank No. 5552 dated 17.11.2008, the Company has been established for following objectives:
 - (a) To handle the work of a nodal agency at the state level for infrastructure construction and development in urban areas.
 - (b) Receiving funds from various sources related to urban development and housing, including State Planning, Finance Commission, Jawaharlal Urban Renewal Mission (JNNURM) external agencies etc. and to do assigned construction works.
 - (c) Implementation of other infrastructure works assigned by the Government.
 - (d) Plan and its implementation for construction/reconstruction and development of urban development and housing related works, such as, water supply, underground sewerage, storm water drainage, paths and bridges, solid waste management and street lighting, buildings etc.
 - (e) Preparation of Probability Report (PFR), Detailed Project Report (DPR) and Detailed Engineering Design.
 - (f) To assist the municipal bodies to acquire proficiency in project development and prepare financially and technically viable projects.
 - (g) To enhance the technical, financial and management capacity of the municipal bodies to enable them to utilise the funds and deliver efficient services.
- Similarly, for the project related to NMCG/SPMG, all terms and conditions are incorporated in AA&ES.
- (vii) No accounting has been done in the books of SPMG/NMCG/ULB related to infrastructure created by the Company.

- (viii) With regard to support in respect of the querist's contention that ownership and risk till defect liability period (DLP) & O&M period lie with the Company, the querist has mentioned that the Company is a 100% Government Company in which 100% share has been held by the State Government. State related Projects have been executed on the basis of Sankalp No. 428 dated 17.02.2009 issued by the State Government and NMCG/SPMG related projects have been executed on the basis of AA&ES. Apart from Sankalp and AA&ES, no other agreement has been entered between the Company and NMCG/SPMG/State Government.

B. Query

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

- (i) In light of existing Income-tax TDS provisions, Goods and Services Tax (GST) provisions and compliance thereon, whether the case illustrated in the earlier Opinion of EAC is same as that of the Company.
- (ii) Whether the Company can show total expenditure incurred against project plus centage thereon as total turnover or only centage earned during the financial year will be the turnover of the Company.

C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to recognition of revenue of the Company as the expenditure incurred against project plus centage thereon or only centage earned during the year. 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, accounting for costs incurred on the projects, accounting for DBOT projects, timing of recognition of revenue, accounting treatment of other income being earned by the Company, presentation of the facilities being operated and maintained by the Company etc. Further, the opinion is expressed purely from accounting perspective and not from tax (income tax or GST) or legal perspective including compliances thereof. Also, since the considerations for determination of tax may be different from accounting considerations, the treatment thereunder may not be relevant for accounting purposes. The Committee wishes to point out that since the query pertains to financial year 2017-18 in respect of which Accounting Standard (AS) 7, 'Construction Contracts' has been applied by the Company, the opinion has been expressed considering the requirements of Accounting Standards notified under the Companies (Accounting Standards) Rules, 2021 and not the requirements of Indian Accounting Standards (Ind ASs), notified under the Companies (Indian Accounting Standards) Rules, 2015.

The Committee also wishes to point out that a reference to an earlier opinion issued on similar subject has been made in the query; however, since the Committee's opinions are based on the specific facts provided to it and may not necessarily apply in scenarios/situations with different facts, the Committee has independently examined the issues referred by the querist in facts and circumstances given and the extent to which the earlier opinions are applicable or are relevant has not been examined by the Committee.

At the outset, it may be pointed out that the opinion expressed hereinafter is in respect of a specific Central sponsored project, in respect of which relevant documents have been shared

by the Company and not in respect of other projects, wherein the Company may be acting in a different capacity. Furthermore, the Committee wishes to mention that although at various places, the terms, 'grant' and 'grantee' have been used, it is understood from the facts/details submitted by the querist that these are used in the context of funds being transferred from the Government for the specified projects and have no connection with the grant in the context of AS 12, 'Accounting for Government Grants'.

13. The Committee notes that the first and foremost issue to be examined in the extant case is the relationship between the Company and the Central/State Governments acting through its various departments. In this regard, the Committee notes that as per paragraph 17(b), 'Substance over Form' of Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', "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". In the context of revenue recognition, the principle of 'Substance over Form' is recognised by paragraph 4.1 of AS 9, 'Revenue Recognition', which, inter alia, states that ***"In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other consideration"***. Thus, the Committee is of the view that in the extant case, the revenue to be recognised would depend upon the assessment as to whether the Company provides the contracted goods or services in the capacity of a principal or acting as an agent. This analysis, in the view of the Committee, would require evaluation of whether the Company bears significant risks and rewards of ownership of and control over the related goods and services (though only temporarily) before these are transferred to the customer (viz., the Government or government bodies in the extant case). The said evaluation of risks and rewards and control in determination of relationship between the parties involve significant judgement based on the specific facts and circumstances of the Company, which should be made by the Company itself. Therefore, the Opinion of the Committee given hereafter is based on the overall assessment of the facts and circumstances made available to the Committee as detailed below. Thus, while some of the clauses of the sanction as reproduced below may individually appear to be protective in nature, the relationship between the parties has been assessed considering these clauses along with the substantive clauses and other facts and circumstances. The Committee also wishes to add that the Opinion may undergo a change in case different facts and circumstances emerge.

14. In this context, the Committee notes the following clauses from 'Revised Administrative Approval and Expenditure Sanction (AA&ES) for the Project on Sewerage and Sewerage Treatment' which contains terms and conditions for sanction of the Project at a sharing ratio of 70:30 between the Central Government and the State Government:

- “5 The grantee institution i.e. “State Ganga River Conservation Programme Management Society (State GCMS)” i.e. the State Programme Management Group (SPMG), is a registered society of the State Government constituted with the objective of serving as the dedicated institution for effective implementation of the Namami Gange Programme activities at the state level ...
6. ...The NMCG/Government of India reserves the right to withdraw the sanction at any stage, if it is convinced that the fund has not been properly utilized or appropriate progress is not being made.
7. In case of violation of any of the conditions of the grant or in case of closure or dissolution of the grantee organization, the Government shall take possession of all the assets of the organization acquired out of the Government grants and

use them in any manner deemed appropriate or to recover from the organization the value of such assets at its discretion.”

Annexure II ‘Conditions on Administrative Approval and Expenditure Sanction for the project’:

“1. Specific Conditions:

...

- v. Any cost overrun over and above the liability of the central government shall be borne by state government.”

“2. General & Technical Conditions:

- i. ...State GCMS, the State Programme Management Group... shall be responsible for overall planning, management and effective implementation of the project at state level.

- ii. “M Municipal Corporation” shall be the Urban Local body (ULB) responsible for ensuring commitment to ownership, commitment to reforms for sustainable O&M, and community involvement.

- iii. The Company shall be the Executing Agency (EA) of the project to be implemented under the guidance of the SPMG, in coordination and consultation with the ULB and overall monitoring of the National Mission for Clean Ganga (NMCG) as per provisions laid down in the NGRBA programme framework.

...

- v. The estimated cost for the project is supported with 15 years Operation and Maintenance (O&M) of the project in DBOT mode. The O&M beyond the 15 years will be the responsibility of the State Government /Urban Local Body. The O&M shall include basic cleaning, service management for the proposed project area. Sustainable revenue generation from beneficiaries shall be encouraged.

...

- vii. The bid document on DBOT basis should be prepared for the entire project and 15 years O&M period.

...

- ix. SPMG need to take steps to prepare bid documents in line with the standard bid documents (SBDs) and in consultation with World Bank & NMCG.

- x. The compliance of observations of the NMCG, World Bank and TPA would be ensured by SPMG at the time of finalisation of Bid Document. ...

...

- xviii. Progress of implementation of the project shall be closely monitored by the State Government/SPMG, so as to ensure that the project is completed within the stipulated period of time. In addition the progress ...needs to be reported to NMCG on regular basis...

- xix. Any cost escalation or time overrun shall be borne by the state government.

...

- xxv. The actual project cost shall be the awarded cost. In case the final/negotiated quote of a contract exceeds the estimated cost the additional cost is to be borne by the state government. NMCG's share will be limited only to the estimated cost as given in the AA&ES. On the other hand if the awarded/negotiated cost is lower than the estimated cost given in the AA&ES then NMCG's share shall be limited to only 70% of the awarded cost.
- ...
- xxvii. O&M cost estimations have been made in the project but projections for revenue generation have not been detailed in the DPR. Fund release for O&M may be made after taking the same into account.
- ...
- xxix. The State is advised to consider charging people on a monthly basis for the sewerage system to recover at-least O&M cost as the charges per household would be quite low. Suitable sewage cess/ tariff/ tax and sewer connection fee may be imposed on the beneficiaries to recover the O&M at the least to start with. However the full project cost recovery at the earliest should be aimed at.
- ...
- xlv. All the specific conditions and generic conditions mentioned in the AA&ES are to be complied by the SPMG through their Executing Agency.

2.2 Financial Aspects:

- ...
- iii. The funds released for the project shall be held in an interest earning NGRB project bank account of the SPMG...
- iv. The SPMG/EA are not permitted to seek or utilize funds for the same purpose from any other organization...without prior approval of the competent authority
- ...
- vi. It is the responsibility of the SPMG/EA/ULB to ensure that the assets are exclusively used for the purpose for which grant is sanctioned and to maintain the assets...

2.4 Flow of Funds

The fund releases by the NMCG shall be remitted by Electronic transfer to the SPMG account. The fund shall flow from the SPMG account to a separate sub-project specific zero balance bank account (the 'child account') of the EA in the same bank of SPMG. The following details may be kept updated from time to time to enable electronic remittance:

- ...
- iv. The NMCG bank will transfer funds from the NMCG'S account to the SPMG account on submission of Interim Un-Audited Financial Report (IUFR) and other document information as prescribed in the Financial Management Manual (FMM)' of the NGRBA programme framework.
- v. The SPMG Bank will transfer funds from the SPMG'S account (mother account) to the child account of EA as soon as payment instruction is issued by the EA to its banker for transfer of funds to contractors/

suppliers/service providers account on the same date through ‘Real Time Gross Settlement (RTGS)’, and thus at the end of any given day, the EA child account will always have a zero balance.”

15. The Committee notes from the above that:

- The funds have been provided by the Central Government to the State Programme Management Group (SPMG), which is a registered society of the State Government and has been specifically constituted for effective implementation of the Project at the State level. The Company has been appointed as an executing agency of the project, which is to be implemented under the guidance of SPMG. Thus, it appears that the overall primary responsibility of the project lies with the SPMG. (Refer clause 5 of AA&ES and clauses 2(i) and (iii) of Annexure II to AA&ES)
- Although bids for project execution, which is a comprehensive bid for the entire project (including construction, operation and management) are to be invited by the Company, responsibility to prepare the bid documents in accordance with the specified standards (set by Central Government, World Bank, etc.) vest with the SPMG. This indicates that the terms and conditions for the execution of the project by the third party contractor are decided by the SPMG (or the State or Central Government, in case SPMG is also acting as an agency of the Government) and the Company does not have much discretion or authority in terms of taking decisions (including pricing, decision regarding selection of contractor who will undertake the project or suppliers, etc.). (Refer clauses 2(vii), (ix) and (x) of Annexure II to AA&ES)
- For any change in the terms of the Agreement (such as, extension of time for completion of project etc.), the Company has to take NOC from the higher authorities, which indicates that the Company is only getting the project executed on behalf of others.
- Any cost overrun shall be borne by the State Government, which indicates that significant risk in terms of any cost escalation does not vest with the Company.
- The facts indicate that the Company is exposed to defect liability during the 15 years tenure of the Project, however, such liability appears to be more protective in nature stipulated to ensure protection of the interests of the owners and to avoid violation of any statutes. Further, the Company may be liable to pay liquidated damages, penalty, etc., however, the same are being recovered from the contractor (as per its contract with the contractor). In light of above, it appears that the Company does not bear the significant risks normally associated with the ownership or in-substance ownership of the asset.
- No invoices are raised by the Company on SPMG or ULB or Government; funds for execution of the project are received as per the terms and conditions of the AA&ES. (Refer clauses 2.2 and 2.4 of Annexure II to AA&ES)
- The funds released by the Government till these are paid to the contractor are held in the bank account of SPMG and any reward in terms of interest on such funds at any point of time does not arise to the Company. (Refer clause 2.4 of Annexure II to AA&ES)
- Project is closely monitored and supervised by the Central and State Government or on their behalf through various financial and non-financial regular reporting, inspection and monitoring mechanisms. Thus, the Central and State Government appear to exercise control over the project execution through these mechanisms. (Refer clauses 2(xviii) and 2.4(iv) of Annexure II to AA&ES)

- Any future economic benefit by charging to the public in future, shall be adjusted towards recovery of O&M cost and project cost being borne by the Government, which indicates that no future economic benefits or rewards are expected to the Company even during the O&M period on account of the project or various project assets. (Refer clause 2(xxix) of Annexure II to AA&ES)

16. On the basis of above, the Committee is of the view, based on the consideration of the judgment of relationship between the parties as discussed in paragraph 13 above, that the Company seems to have entered into a service contract for rendering the services as project manager in relation to the project with the SPMG/ Government for which the Company is receiving fixed service charges (centage). Therefore, the Company should recognise only the service charges received, i.e. centage in consideration of its services as its revenue.

D. Opinion

17. On the basis of the above, the Committee is of the following view on the issues raised in paragraph 11 above:

- (i) Since the Committee's opinions are based on the specific facts provided to it and may not necessarily apply in scenarios/situations with different facts, the Committee has independently examined the issues referred by the querist in facts and circumstances given and the extent to which the earlier opinions are applicable or are relevant has not been examined by the Committee. Further, the opinion is expressed purely from accounting perspective and not from tax (income tax or GST) or legal perspective including compliances thereof, as mentioned in paragraph 12 above.
- (ii) While determination of nature of relationship between the parties, i.e., whether the Company is acting in the capacity of a principal or an agent is a matter of judgment as discussed in paragraphs 13 and 16 above, in the facts and circumstances mentioned above, it appears that the overall control and ownership of the project as well as significant risks and rewards related to the ownership of Project do not vest with the Company. The Company seems to have entered into a service contract for rendering the services as project manager in relation to the project with the SPMG/ Government for which the Company is receiving fixed service charges (centage), as discussed in paragraph 16 above. Therefore, the Company should recognise only the service charges received, i.e. centage in consideration of its services as its revenue.
