

Query No. 9

Subject: Accounting for interest income earned on fixed deposits (FD) made out of Qualified Institutional Placement (QIP) funds and QIP issue expenses, under Ind AS framework.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is a public sector undertaking, incorporated on 9th November 1967 and is under the administrative control of the Ministry of Mines, Government of India. It has the distinction of being the nation’s only vertically integrated copper producing company as it has facilities to manufacture copper right from the stage of mining to beneficiation, smelting, refining and casting of refined copper metal into downstream saleable products. Hence, the Company has the facilities for production and marketing of copper concentrate, copper cathodes, continuous cast copper rod and by-products, such as anode slime (containing gold, silver, etc.), copper sulphate and sulphuric acid. Presently, the Company is focusing on mining and beneficiation operation and is primarily selling the product copper concentrate as the main product.

2. As per the approval of the Cabinet Committee on Economic Affairs (CCEA) at its meeting held on 1.8.2018, the Company had mobilised Rs. 500 crore (including premium) equivalent to 4.52 % of the existing share capital of the Company through Qualified Institutional Placement (QIP) in April 2021 for funding the ongoing first phase of mine expansion plan. After deducting the issue expenses including fees and commission of approximately Rs. 4.46 crore (net of GST), the net proceeds of the issue was approximately Rs. 495.54 crore. The Company intends to use the net proceeds of the QIP Issue towards partial funding of the first phase of proposed capital expenditure (capex)/ expansion of the Company from 3.97 metric tonnes per annum (MTPA) to 12.2 MTPA involving number of projects in expansion plan as given under the Chapter ‘Use of Proceeds’ in QIP Document.

3. According to the querist, in terms of the approval dated August 1, 2018 from the Cabinet Committee on Economic Affairs, the Company’s management is having significant flexibility in applying the net proceeds of this issue towards any or all of the projects related to capex/ expansion from 3.97 MTPA to 12.2 MTPA in the manner it deems fit. In the QIP Placement Document, it was mentioned that pending utilisation for the purposes, the Company intended to temporarily invest net proceeds in creditworthy instruments, including money market, debt mutual funds, and deposits with banks and inter corporate loans. However, QIP Placement Document does not specifically mention about the accounting treatment of interest income from investments of unutilised QIP proceeds.

4. As on 31.03.2022, the Company has utilised Rs. 133.50 crore towards capex/ expansion of the Company in line with the QIP Placement Document and the balance QIP fund of Rs. 366.50 crore is lying in Fixed Deposits (FDs) in the bank accounts of the Company. The Company is earning interest on fixed deposits (QIP proceeds) and accounting for the same as ‘other income’ in the Statement of Profit and Loss. During the financial year (F.Y.) 2021-22, the Company has earned Rs. 12.86 crore towards interest from fixed deposits and the same was considered as ‘other income’.

¹ Opinion finalised by the Committee on 19.4.2023 and 20.4.2023.

5. The Comptroller and Auditor General (C&AG) of India, while conducting supplementary audit for the financial year 2021-22, had issued the following audit query:

“Audit Query on Consolidated Statement of Profit and Loss for the year ended on 31.03.2022

Other income	Rs. 5,024.32 lakh
Capital work in progress	Rs. 68,273.65 lakh
Other equity	Rs. 1,42,774.14 lakh

The other income includes the interest of Rs. 12.86 crore received from the investment of Qualified Institutional Placement (QIP) fund in the Bank Fixed Deposit (FD).

The fund was raised on 13.04.2021 with the objective to utilise the fund for capex and expansion of Malanjkhand Underground Mine, reopening and expansion of Kendadih and Khetri mines etc. Total fund received after deducting total issue expenses of Rs. 5.17 crore was Rs. 494.83 crore. The surplus fund of Rs. 359.48 crore was invested in interest bearing instrument by the Company. Out of the issue expenses of Rs. 5.71 crore, Rs. 4.21 crore was capitalised (CWIP) in the books of account.

In this connection, audit observed that expenses incurred in connection with QIP process were treated as capital expenditure while the revenue earned was treated as other income; this mismatch was violating the basic principle of matching concept. In this connection, it is worth mentioning that the Expert Advisory Committee (EAC) of the Institute of Chartered Accountant of India (ICAI) opined in an earlier opinion published as Query No. 38 of the Compendium of Opinions, Volume XXXIV that the Company should transfer interest to a specific reserve fund with necessary disclosure in financial statements.

Therefore, in view of the above, the expenditure incurred in connection with issue of QIP is required to be adjusted with the interest income and balance amount should be transferred to specific reserve. Hence, inclusion of the interest in the other income has resulted in overstatement of income by Rs. 12.86 crore and overstatement of Capital Work-in-Progress by Rs. 4.21 crore and understatement of specific reserve by Rs. 8.65 crore under the head ‘other equity’.”

6. In reply to the Audit Query, the management of the Company has submitted the reply duly confirmed by the Independent Auditor, which is as below:

“The Company has made investments (Fixed Deposits) of surplus equity funds in the Banks raised through Qualified Institutional Placement (QIP) as per Investment Policy of the Company, approved by the Board of Directors. The interest earned on said investments is credited to the Statement of Profit and Loss as income of the Company. Moreover, there is no specific reference in the Ind AS regarding accounting for interest income from Fixed Deposits out of temporary surplus QIP fund.

The Expert Advisory Committee (EAC) of ICAI in Query No. 38 of Volume XXXIV quoted by C&AG audit regarding accounting treatment of interest earned on surplus equity funds stated that investment made out of the surplus equity fund should be credited to the Statement of Profit and Loss as an income of the Company. However, in

the said case, in view of the specific requirement as per the condition of sanction of equity contribution, there is a restriction on utilisation of interest income. Accordingly, the EAC was of the view that the said interest income after routing through the Statement of Profit and Loss may be transferred to specific reserves as appropriation of profits with necessary disclosure in financial statements.

However, in case of the Company, there are no restrictions imposed in QIP Placement Document for utilisation of interest income as additional surplus for the new equity shareholders. As such, there is no requirement to transfer the interest income earned out of surplus equity fund to specific reserve account.

Similar opinion was also given on 01.09.2021 by Expert Advisory Committee (EAC) of ICAI for accounting of interest income out of surplus equity fund under other income (published as Query No. 14 of the Compendium of Opinions, Volume XLI). Further, it may be pertinent to state that the Company has proposed dividend @ Rs. 1.16 per share for the financial year 2021-22 to be distributed to the new equity shareholders including other shareholders out of fund generated from operations of the Company including interest income. Thus, interest income generated out of surplus QIP funds accounted for as revenue is more relevant as a matching concept.

In QIP Placement Offer document of the Company, there was a clause specifically written that the preliminary issue expenses relating to QIP are to be capitalised and there was no such other clause for adjustment of preliminary issue expenses of Rs. 4.21 crore relating to QIP against any interest income generated out of surplus funds. Accordingly, the Company has accounted for the interest income of Rs. 12.86 crore from investment of surplus QIP fund as a revenue income.”

B. Query

7. In view of above, the querist has sought the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on the following issues:

- (i) whether the Company is correct in accounting for interest earned on the FDs made out of unutilised QIP funds, as interest income of the Company by crediting it to the Statement of Profit and Loss of the Company, as there is no specific reference in Ind AS and no specific instruction in QIP Placement Document for accounting of interest income.
- (ii) whether the Company has to create the Specific Reserve as pointed out by the C&AG Audit in respect of the interest earned on the balance amount of QIP fund. In case, EAC opines to create Specific Reserve in line with the observations of C&AG Audit in respect of the interest earned on the balance amount of QIP fund, the accounting treatment of the same may be advised.
- (iii) whether the issue (QIP) expenses are adjustable from the interest income as commented by C&AG despite matter being clearly stated in QIP document under Chapter ‘Use of Proceeds’ that there are no restrictions for utilisation of interest income.
- (iv) whether the interest income earned on fixed deposit from the QIP proceeds shall be taken to ‘other income’ or it will be adjusted against CWIP of the above project.

- (v) What accounting entry should the Company adopt for the interest income earned on fixed deposit from the unutilised QIP proceeds?

C. Points considered by the Committee

8. The Committee notes that the basic issues raised by the querist relate to the accounting for interest income earned on fixed deposits made out of unutilised QIP (Qualified Institutional Placement) funds and whether the issue (QIP) expenses are adjustable from such interest income. The Committee has, therefore, examined only these issues and has not examined any other issue that may arise from the Facts of the Case, such as measurement of interest income and issue expenses, accounting for proceeds of the QIP issue (including premium), accounting for capital expenditure or expenditure incurred on expansion, accounting for investments made in FD, accounting for proposed dividend etc. Further, the opinion expressed hereinafter is purely from accounting perspective and not from the legal perspective, such as, legal interpretation of QIP placement document, etc. Furthermore, the Committee wishes to point out that the Indian Accounting Standards referred to in the opinion are the Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time.

At the outset, the Committee wishes to point out that earlier EAC opinions issued on similar subjects have been referred to by the querist in the Facts of the Case. In this regard, it may be mentioned that the Committee's opinions are based on the specific facts provided to it and may not necessarily apply in scenarios/situations with different facts. Therefore, the Committee has independently examined the issues referred by the querist in the facts and circumstances of the extant case and the extent to which the earlier opinions are applicable or are relevant has not been examined by the Committee. The Committee also wishes to point out that the accounting for an item of income or expense depends on its nature in the context of relevant accounting requirements as contained in the applicable Accounting Standards.

9. The Committee notes from the Facts of the Case that the Company has mobilised Rs. 500 crore (including premium) equivalent to 4.52 % of the existing share capital of the Company through Qualified Institutional Proceeds (QIP) for funding the ongoing first phase of mine expansion plan. As per the querist, the Company has significant flexibility in applying the net proceeds of this issue towards any or all of the projects as stated in QIP Placement document and there is no specific clause in the QIP placement document with regard to the use of interest income from unutilised QIP proceeds. The Committee also notes the following clause from the QIP placement offer document relating to interim use of net proceeds:

“Interim Use of Net Proceeds

Pending utilisation for the purposes described above, we intend to temporarily invest Net Proceeds in creditworthy instruments, including money market, debt mutual funds, deposits with banks and inter corporate loans. Such investments would be in accordance with the investment policies as approved by the Board from time to time and all applicable laws and regulations.”

10. With regard to accounting for interest income earned on fixed deposits made out of unutilised QIP funds, the Committee notes the following requirements of Ind AS 16, ‘Property, Plant and Equipment’:

“21 Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.”

In this context, the Committee notes that in the extant case, pending utilisation of the QIP funds (which were raised for funding the capital expenditure or expansion plan), the same were invested in fixed deposits, which is considered as an incidental activity in connection with the execution of the project, giving rise to income in the form of ‘interest’, but cannot be considered as an activity necessary to bring the project/asset to the location and condition necessary for it to be capable of operating in the manner intended by management as contemplated in the above paragraph of Ind AS 16. Accordingly, the Committee is of the view that interest income earned on fixed deposits from surplus funds in the extant case should not be capitalised/included in the cost of the asset/project and therefore, should be recognised in the Statement of Profit and Loss. Further, since, as per the querist, there is no restriction on utilisation of interest income, no specific reserve through appropriation of profits needs to be created.

11. With regard to the accounting for QIP issue expenses which as per the facts are preliminary expenses and includes fees and commission, the Committee notes the following requirements of Ind AS 32, ‘Financial Instruments: Presentation’:

“Interest, dividends, losses and gains (see also paragraph AG37)

35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be recognised by the entity directly in equity. Transaction costs of an equity transaction shall be accounted for as a deduction from equity.”

“37 An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.”

“39 The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately in accordance with Ind AS 1.”

The Committee also notes that with respect to transaction costs, Ind AS 32 states that the said term is defined in Appendix A of Ind AS 109, 'Financial Instruments' and is used in this Standard with the meaning specified therein. The Committee further notes that the term 'transaction costs' has been defined under Ind AS 109 as, "Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see paragraph B5.4.8). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument."

Accordingly, the Committee is of the view that since the QIP issue expenses in the extant case appear to be the transaction costs pertaining to issuance of equity instruments of the Company, these should be accounted for as a deduction from equity and should be disclosed separately in accordance with Ind AS 1, 'Presentation of Financial Statements'. Therefore, the question of adjustment of the same against the project cost in the extant case does not arise.

12. With regard to presentation of interest income, the Committee notes that since the Company is not a Non-Banking Financial Institution, requirements of Division II – Ind AS Schedule III to the Companies Act, 2013 are applicable to the Company. The Committee further notes that as per Note 5 of General Instructions for the Preparation of Statement of Profit and Loss in Division II – Ind AS Schedule III, 'Other Income' shall be classified as:

- (a) Interest Income;
- (b) Dividend Income;
- (c) Other non-operating income (net of expenses directly attributable to such income).

Further, the Committee notes the following paragraphs from the Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 (Revised January, 2022 Edition), issued by the ICAI (hereinafter referred to as 'Guidance Note'):

"9.2 Other income

The aggregate of 'Other income' is to be disclosed on face of the Statement of Profit and Loss. As per Note 5 of General Instructions for the Preparation of Statement of Profit and Loss 'Other Income' shall be classified as:

- (a) Interest Income;
- (b) Dividend Income;
- (c) Other non-operating income (net of expenses directly attributable to such income).

..."

From the above, the Committee is of the view that interest income in the extant case should be presented as 'other income' in the Statement of Profit and Loss.

D. Opinion

13. On the basis of the above, the Committee is of the following view on the issues raised in paragraph 7 above:

- (i)&(v) The Company is correct in accounting for interest earned on the FDs made out of unutilised QIP funds, as interest income in Statement of Profit and Loss of the Company, as discussed in paragraph 10 above.
- (ii) Since, in the extant case, there is no restriction on utilisation of interest income, no specific reserve through appropriation of profits needs to be created, as discussed in paragraph 10 above.
- (iii) Issues expenses should be accounted for as deduction from equity and should not be adjusted against the project cost, as discussed in paragraph 11 above.
- (iv) The interest income earned on fixed deposit from the QIP proceeds should be presented as 'other income' in the Statement of Profit and Loss, as discussed in paragraph 12 above.
