

Query No. 33

Subject: *Accounting treatment of expenditure towards Special Development Plan (SDP) by the Company, under Ind AS framework.¹*

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is a wholly owned undertaking of the Government of Karnataka (GoK), incorporated under the Companies Act, 2013 on 20th October, 2016 in the state of Karnataka as a Special Purpose Vehicle to cater to the drinking water and irrigation needs of drought prone areas of various districts of the Karnataka. The Government has transferred the following projects to the Company which cover the above districts for expeditious implementation:

1. U B Project
2. Y Integrated Drinking Water Project
3. K Tank Filling Project
4. V Sagar Project
5. G Project

2. Besides, in keeping with the demands of certain districts which have been facing persistent drought situation owing to poor rainfall and depletion of groundwater without any permanent source of irrigation, the Government has constituted an expert committee to study alternative sources of water availability from different sources to provide permanent irrigation facilities to these districts. Any such project recommended by this committee if approved and entrusted by the Government, the Company will take action for its implementation.

3. The Company functions as a corporate entity through financial assistance by way of budgetary support from the Government of Karnataka; besides, it will also borrow the funds from financial institutions based on government guarantee to execute its projects.

4. Shareholding pattern of the Company is as follows:

Sl.	Name of the Shareholder	No. of Shares	Equity Share Capital as on 31.03.2024	% of Holding
1	Government of Karnataka	21,48,89,631 (Face value of Rs.1,000/- each)	2,14,88,96,31,000	100%

5. *Objectives of the Company include:*

Providing irrigation facilities to drought areas of Karnataka such as:

- i. To take up and implement the projects proposed based on the study report to be submitted by the Expert Committee for formulation of permanent irrigation facilities to certain districts and has transferred the Y Integrated drinking water project and the U B Irrigation Project and allied projects from K Nigam Limited and also other projects that

¹ Opinion finalised by the Committee on 30.12.2024.

the State Government may entrust from time to time for catering to the water needs of the drought prone areas of various districts of Karnataka.

- ii. To plan, investigate, estimate, build, operate, and maintain all kinds of infrastructures like Dams, Reservoirs, Barrages, Weirs, Canals, Lift Irrigation Schemes, Solar Irrigation Systems, Pipelines, Road Works, etc. required for the Project for supply of water for irrigation, drinking, power generation and other purposes including the works of Command Area Development Authority (CADA).
- iii. To promote, adopt modern irrigation systems / methods like sprinkler, drip, solar water pumps and any other methods or systems for effective utilisation of water and build, construct, operate, maintain irrigation project entrusted by the State Government including providing rehabilitation of people and places affected by the building of water utilisation projects and promote suitable scheme for afforestation and control flood by adopting suitable ways, means and standards and also providing navigation, leisure / recreation activities, fisheries, etc., in the rivers / water bodies.
- iv. The Government has also entrusted the work of providing irrigation and other facilities to backward classes of the society through Special Component Plan (SCP) and Tribal Sub Plan (TSP) and other Government schemes (National Bank for Agriculture and Rural Development (NABARD) and Special Development Plan (SDP).

6. *Financial transactions of the Company:*

The Company executes and fulfills the objectives out of budgetary support from the Government of Karnataka. Apart from the main objectives, the Company executes Special Component Plan (SCP) & Tribal Sub Plan (TSP) works and Special Development Plan (SDP) works through specific budgetary allocations.

The Company avails loans from banks and financial institutions to execute the works and repays the loans from budgetary support from the Government of Karnataka.

The Company capitalises the project as and when it is completed and depreciates accordingly. The commercial operations are yet to be commenced for two major projects viz., Y Integrated Drinking Water Project and U B Irrigation Project. Further, the revenue generated from the two completed projects, viz., V and G Reservoir Projects is very meager, which does not cover its operation and maintenance.

7. *Accounting treatment of the transactions:*

The Company is following Indian Accounting Standards (Ind AS) for preparation of its financial statements.

A. Receipt of Grants from the Government of Karnataka:

Sl.	Grants Head	Nature	Purpose
1.	Capital Grants - Received as Advance against equity	To execute the main projects.	To execute the core objectives of the Company and the assets owned by the Company.

2.	Capital Grants - Received as Advance against equity	To acquire land	To acquire the land to execute the core objectives and the assets owned by the Company.
3.	Capital Grants - Received as Advance against equity	SCP Grants	To execute the Special Component Plan and the assets are not owned by the Company.
4.	Capital Grants - Received as Advance against equity	TSP Grants	To execute the Tribal Sub Plan and the assets are not owned by the Company.
5.	Capital Grants - Received as Advance against equity	SDP Grants	To execute the Special Development Plan head works and the assets are not owned by the Company.
6.	Maintenance/ Revenue Grants	Maintenance Grants	To maintain the completed projects.
7.	Revenue Grants	Payment of Interest on Loans	Towards payment of interest on loan borrowed to execute the core objectives.
8.	Capital Grants - Received as Advance against equity	Repayment of Principal of Loan	Towards repayment of principal portion of loans.
9.	Revenue Grants	Payment of Guarantee Commission (GC)	Towards payment of GC to Government of Karnataka.

B. Accounting treatment of Grants:

Sl.	Nature of Grants	Debit	Credit
1.	Capital Grants to execute the main projects.	Expenditure is treated as Capital Work-in-progress under Property, plant and equipment.	Grant Receipt is treated as advance against equity and consequently treated as share capital on allotment.
2.	Capital Grants to acquire the land for main projects.	Expenditure is treated as Land under Property, plant and equipment.	Grant Receipt is treated as advance against equity and consequently treated as share capital on allotment.
3.	Capital Grants to execute the Special Component Plan.	Expenditure is offset against the grant's receipts grouped under liabilities.	Grant Receipt is in the nature of advance against equity and consequently converted as specific grants and offset against SCP CWIP.
4.	Capital Grants to execute the Tribal Sub Plan.	Expenditure is offset against the grant's receipts grouped under liabilities.	Grant Receipt is in the nature of advance against equity and consequently converted as specific grants and offset against TSP CWIP.
5.	Capital Grants to execute the Special Development Plan.	Expenditure is treated as revenue and debited to the Statement of Profit and Loss.	Grant Receipt is treated as advance against equity and consequently treated as share capital on allotment.
6.	Revenue Grants for maintenance of the completed projects.	Expenditure is treated as revenue and debited to the Statement of Profit and Loss.	Grant receipt is treated as income under the Statement of Profit and Loss.

7.	Revenue Grants for payment of interest.	Interest payment is treated as per Ind AS 23, 'Borrowing Costs'.	Grant receipt is treated in accordance with interest payment.
8.	Capital Grants for repayment of loan.	Utilised for Repayment of Loans by debiting loan liabilities.	Grant receipt is treated as advance against equity and consequently treated as share capital on allotment.
9.	Revenue Grants for payment of Guarantee Commission.	Treated as borrowing costs as per Ind AS 23, 'Borrowing Costs' net of grants received towards guarantee commission.	Grant receipt is initially treated as liability and fully set off against the guarantee commission paid.

The querist has stated that it may be observed from the above that the above accounting treatments are consistent with conservative accounting principles and Indian Accounting Standards.

In respect of SDP grants, refer to point no. 5 of the table.

8. The Company receives certain amount of equity funds under the mandate that it has to build infrastructure to make good the identified sector backlog in backward taluks. The expenditure on Special Development Plan (Dr. Nanjundappa Package) works are identified and executed in the back-ward regions of the State coming under the purview of the Company's projects approved by the Planning Department, GoK.

9. The works under this plan head majorly comprise construction of barrages, check dams, roads and bridges, community halls etc., These works are generally capital in nature and some works like improvement to roads, repairs of existing barrages etc., are revenue in nature.

10. During the financial year (F.Y.) 2022-23, the Company has incurred an expenditure of Rs. 7977.93 lakhs towards construction of barrages under SDP. Since the Company does not exercise control over the assets created under SDP and hands over the same to the Government, the Company is charging such expenditure to the Statement of Profit and Loss since F.Y. 2017-18 as there is no future economic benefit from such assets to the Company.

Statutory Auditors' view:

11. The statutory auditors of the Company have been qualifying the treatment of expenditure on SDP works as follows:

“Expenditure incurred on construction of barrages under Special Development Plan in specified areas are capital in nature. Treating capital expenditures into revenue expenditure deviates the principles of fundamental accounting assumptions. Consequently, the Loss is overstated.”

The statutory auditors' view is that:

- (i) Grants received from Government is under the head of capital services and the treatment of such capital expenditure into revenue expenses deviates the concept of revenue and capital items.

- (ii) Further, corresponding grants received to execute the SDP are treated as advance against equity and consequently treated as share capital which is in deviation of matching principles in the Statement of Profit and Loss.

Comptroller and Auditor General of India (C&AG) View:

12. The Comptroller and Auditor General of India (C&AG) has observed that “As the Company was not creating its own asset using these funds and was acting only as an executing agency for the Government, the expenditure incurred was not capital in nature. Hence, the accounting treatment for booking the expenditure through profit and loss account was appropriate”.

B. Query

13. In view of the divergent opinions between statutory auditor and the C&AG, the Company is seeking an opinion from the Expert Advisory Committee (EAC) on expenditure incurred on Special Development Plan on the following issues:

- (i) Whether the accounting treatment followed by the Company of treating the expenditure on construction of barrages, other civil infrastructures, not owned by the Company as revenue expenditure by debit to Statement of Profit and Loss is appropriate and complies with the generally accepted accounting principles.
- (ii) If the accounting treatment followed by the Company is not in order, what is the correct accounting treatment that needs to be followed by the Company?

It is to be noted that the funds received from the Government of Karnataka towards SDP are in the form of ‘Advances against Equity’ and subsequently, shares are allotted towards the same.

C. Points considered by the Committee

14. The Committee notes that the basic issue raised by the querist relates to accounting treatment of expenditure towards Special Development Plan (SDP) by the Company. The Committee has therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as accounting treatment of various projects transferred by the government to the Company and works/expenditure undertaken by the Company other than SDP works (such as, SCP and TSP plans, etc.), accounting treatment of various funds borrowed from banks and financial institutions based on government guarantee for execution of projects including repayment thereof, accounting for funds or grants received from the government towards various projects/programmes including SDP, accounting for advance against equity and issuance of shares of the Company, timing of capitalisation of these projects (if any), accounting for payment of GC, appropriateness of reporting or expression of opinion by the auditors, etc. Further, the Accounting Standards referred hereinafter are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended/revised from time to time.

At the outset, the Committee notes from the facts provided and various government orders shared by the querist that the funds released to the Company towards SDP shall be considered as equity. Further, as per the submissions of the querist, the shares shall be issued for these

advances against equity. Therefore, in the extant case, the Committee understands that there is no principal and agent relationship between the Company and the Government of Karnataka with regard to the funds provided for SDP and expenditure incurred out of these funds. Further, the Committee also wishes to point out that ‘matching of costs with income’ principle and source of funds do not constitute the criteria for treatment of expenditures to be met from using those funds; rather accounting for expenditure depends upon whether or not the expenditure meets the definitions and recognition criteria of ‘asset’ or ‘expense’ as per the relevant accounting framework.

15. With regard to the issue raised, the Committee notes that the work covered under SDP Project majorly comprises construction of barrages, check dams, roads and bridges, community halls, improvement to roads, repairs of existing barrages etc. In this regard, the Committee examines, whether such expenditure leads to creation or recognition of an ‘asset’ (tangible or intangible) for the Company. Accordingly, the Committee notes the definition of ‘asset’ and other requirements from the ‘Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)’, issued by the Institute of Chartered Accountants of India, as follows:

“4.3 An asset is a present economic resource controlled by the entity as a result of past events.

4.4 An economic resource is a right that has the potential to produce economic benefits.

4.5 This section discusses three aspects of those definitions:

- (a) right (see paragraphs 4.6–4.13);
- (b) potential to produce economic benefits (see paragraphs 4.14–4.18); and
- (c) control (see paragraphs 4.19–4.25).

Right

4.6 Rights that have the potential to produce economic benefits take many forms, including:

- (a) rights that correspond to an obligation of another party (see paragraph 4.39), for example:
 - (i) rights to receive cash.
 - (ii) rights to receive goods or services.
 - (iii) rights to exchange economic resources with another party on favourable terms. Such rights include, for example, a forward contract to buy an economic resource on terms that are currently favourable or an option to buy an economic resource.
 - (iv) rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs (see paragraph 4.37).
- (b) rights that do not correspond to an obligation of another party, for example:

- (i) rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are a right to use a physical object or a right to benefit from the residual value of a leased object.
- (ii) rights to use intellectual property.”

“Potential to produce economic benefits

4.14 An economic resource is a right that has the potential to produce economic benefits. For that potential to exist, it does not need to be certain, or even likely, that the right will produce economic benefits. It is only necessary that the right already exists and that, in at least one circumstance, it would produce for the entity economic benefits beyond those available to all other parties.”

“Control

4.19 Control links an economic resource to an entity. Assessing whether control exists helps to identify the economic resource for which the entity accounts. For example, an entity may control a proportionate share in a property without controlling the rights arising from ownership of the entire property. In such cases, the entity’s asset is the share in the property, which it controls, not the rights arising from ownership of the entire property, which it does not control.

4.20 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.”

“4.69 Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.”

“5.5 The initial recognition of assets or liabilities arising from transactions or other events may result in the simultaneous recognition of both income and related expenses. For example, the sale of goods for cash results in the recognition of both income (from the recognition of one asset—the cash) and an expense (from the derecognition of another asset—the goods sold). The simultaneous recognition of income and related expenses is sometimes referred to as the matching of costs with income. Application of the concepts in the *Conceptual Framework* leads to such matching when it arises from the recognition of changes in assets and liabilities. However, matching of costs with income is not an objective of the *Conceptual Framework*. The *Conceptual Framework* does not allow the recognition in the balance sheet of items that do not meet the definition of an asset, a liability or equity.

Recognition criteria

5.6 Only items that meet the definition of an asset, a liability or equity are recognised in the balance sheet. Similarly, only items that meet the definition of income or expenses are recognised in the statement of profit and loss. However, not all items that meet the definition of one of those elements are recognised.”

“5.10 It is important when making decisions about recognition to consider the information that would be given if an asset or liability were not recognised. For example, if no asset is recognised when expenditure is incurred, an expense is recognised. Over time, recognising the expense may, in some cases, provide useful information, for example, information that enables users of financial statements to identify trends.”

The Committee notes from the above that an asset can be recognised only when there is: (a) a right; (b) potential to produce economic benefits by using that right; and (c) control over the right as a resource. In the extant case, as per the facts submitted by the querist, the Company does not own or exercise control over the assets created under SDP. Further, the Company hands over the assets created to the Government after execution of works. Therefore, it can be said that the Company does not have the ability to direct the use of the assets created or to prevent other parties from directing their use or obtaining benefits from them. Furthermore, it is also specifically stated that there is no future economic benefit from such assets to the Company. Thus, the Company neither has any right or control over the resources created nor there is any potential of future economic benefits from the expenditure incurred or the resources created in the extant case. Accordingly, the expenditure incurred towards SDP does not result into creation of any asset for the Company. Moreover, the facts submitted by the querist also do not suggest that expenditure incurred under SDP is attributable to the construction or development of another asset that may be recognised by the Company in its financial statements as per the requirements of relevant Ind AS, such as, Ind AS 16, Ind AS 38, etc. Therefore, considering the above-reproduced requirements of the Conceptual Framework, the Committee is of the view that the expenditure incurred towards SDP should be recognised as an expense in the Statement of Profit and Loss.

D. Opinion

16. On the basis of the above, the Committee is of the following opinion on the issue raised in paragraph 13 above that:

- (i) The accounting treatment followed by the Company of treating the expenditure on construction of barrages, other civil infrastructures, not owned by the Company as revenue expenditure by debit to Statement of Profit and Loss is appropriate, as discussed in paragraph 15 above.
- (ii) In view of (i) above, answer to this question does not arise.
