Accounting Treatment of Liability for Unbilled Work-in-Progress in the Books of Executing Agency

The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A government company (hereinafter referred to as 'the company') was set up as a special purpose vehicle for executing the infrastructure development and related projects in a state with quality and speed. The projects are identified by the Government and these projects are entrusted for execution to the company.

2. For executing the projects, the company engages the services of various contractors who are required to use their own men, materials and machines and the company does not supply any of these. The querist has also clarified that the company has not received the projects from the Government in the capacity of a contractor, rather to the Government has entrusted the work in the capacity of executing agency through Memorandum of Understanding (M o U) (copy of which has been supplied by the querist for the perusal of the Committee). Hence, the projects have not been sub-contracted by the company. Further, as per the querist, the ownership interest relating to contract assets and liabilities vest with the Government. The company is not raising any bill for the work executed by it.

3. The financing for the projects undertaken and executed is through budgetary allocation in the state budget and through borrowings from banks and financial institutions against state government guarantee.

4. The company is charging development fees at certain pre-fixed percentage of the development expenditure incurred, to the Government towards the services rendered.

5. As per agreed terms of contract, the contractor raises running account (R.A.) bills on the company for the work done by him and final bill is raised after completion of the project. The billing period generally falls into two or more financial years, i.e., the bill covers part period of current financial year and part period of following or earlier financial year(s).

6. The querist has stated that the company is providing for the liability towards work executed upto the financial year-end based on bills received till finalisation of accounts. However, on the basis of advice from the Comptroller and Auditor General of India (CAG), the company started providing for work executed till financial year-end towards the works for which bills have not been received on the basis of estimated value worked out by the engineering department of the company. Many times, this resulted in excess booking of work-in-progress and liability and excess deduction and payment of tax at source.

7. This matter was deliberated in a meeting of Audit Committee of the company. The Audit Committee is of the opinion that there is no need to provide for any liability towards unbilled work-in-progress on estimated value basis on the following grounds:

   (i) As the materials and labour belong to the contractor, the company has no right title, interest or ownership in the said unbilled work-in-progress.

   (ii) In case of destruction of such work-in-progress, the contractor will claim the compensation towards unbilled portion and the company will claim towards billed and booked portion of work. Insurance company will settle claim proportionately.

(iii) Under the provisions of the Indian Contract Act, 1872, Transfer of Property Act, 1882 and Sale of Goods Act, 1930, ownership of the unbilled work-in-progress does not get transferred to the company. Only upon its billing, the ownership will get transferred to the company and till that time, the ownership is that of the contactor and not of the company.

(iv) Since materials belong to the contractor and the company is not raising any sales bills, matching principle has no application and consequently, question of showing the unbilled work-in-progress under 'Current Assets' and liability towards the contractors under 'Current Liabilities' as well as showing corresponding figures in the profit and loss account does not arise.

(v) Contractor will show the unbilled work-in-progress in his balance sheet as his current asset and if the company also provides for the same on estimate basis as its assets, it will amount to showing the same asset twice under two ownerships.

B. Query

8. Based on the above facts, the querist has sought the opinion of the Expert Advisory Committee as to whether or not the company should recognise liability in respect of unbilled work-in-progress.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist is related to accounting for liability in respect of unbilled portion of work-in-progress in the books of the company with respect to a project which has been entrusted to it in the capacity of executing agency. Therefore, the Committee has examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, propriety of using estimated value worked out by the engineering department of the company for recognising work-in-progress, accounting for arrangement between the company and the Government including treatment of development fees received by the company, accounting treatment in the books of Government, etc. At the outset, the Committee notes that in paragraph 2 above, it has been stated by the querist that the ownership interest relating to the contract assets and liabilities vest with the Government. However, in paragraph 7 (iii), it has been mentioned that the ownership of the unbilled work-in-progress of the contract will get transferred to the company. Thus, there is a contradiction in the Facts of the Case. However, on a perusal of the MoU between the company and the Government and other facts of the query, it appears to the Committee that the ownership interest relating to contract assets and liabilities vest with the Government. Further, the Committee wishes to point out that its opinion is expressed purely from the accounting point of view.

10. The Committee notes from the Facts of the Case that the company in the extant case is acting merely as an execution agency of the Government, for which it is getting a development fee for rendering its services. The Committee further notes that the terms 'Asset' and 'Liability' are defined in paragraphs 49(a) and 49(b) respectively of the 'Framework for the Preparation and Presentation of Financial Statements', issued by the Institute of Chartered Accountants of India, as follows:

"(a) An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise."

"(b) A *liability* is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits."

The Committee notes that in the extant case, the future economic benefits from the project assets are not expected to flow to the company. On completion of the project, the assets would be taken over by the Government. Further, the Committee notes from the M o U between the company and the Government that the project assets are not funded by the company. In substance, they are funded by the Government. Accordingly, the liabilities which arise during the transactions are those of the Government and not that of the company. Thus, all the significant risks and rewards relating to the ownership of project assets and liabilities vest with the Government. Insofar as the company is

concerned, the Committee is of the view that the project assets and project liabilities do not meet the definitions of 'Asset' and 'Liability' respectively and as such, the project assets and liabilities of the said business should also not be recorded in the books of account of the company.

11. On the basis of the above, the Committee is of the view that the liability for work-in-progress and the corresponding asset, viz., the work-in-progress (billed or un-billed) in respect of the project, if any, would also not be recognised in the books of account of the company.

D. Opinion

12. On the basis of the above, the Committee is of the opinion that the company should not recognise liability in respect of unbilled work in-progress under construction contract as the company is merely an executing agency of the Government and all the project assets and liabilities are of the Government and not of the company, as discussed in paragraphs 10 and 11 above.

1	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on 04.04.2012. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty nine volumes. A CD of Compendium of Opinions containing twenty nine volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.org.

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