

Query No. 20

Subject: *Accounting treatment to recognise interest earned on advance fee as its income is correct as per the provisions of Ind AS 18.¹*

A. Facts of the Case

1. A company (hereinafter referred to as the ‘company’) has undertaken various metro projects for other States also on cost plus basis named as “External Projects”. As per contract agreement signed for these projects, the company is entitled to fixed percentage of fees on cost plus basis. In terms of contract agreement, two types of advances are received by the Company:

- (i) *Advance against project cost (Advance I):* As per contractual provisions interest earned on this advance is payable to the concerned State agency.

Accounting Treatment: The advance received from the concerned agency is kept in separate bank account and shown as advance from client. Simultaneously, interest earned on this account, if any, is also shown as payable to the concerned agency in line with the provisions of contract agreement.

- (ii) *Advance received against fee for execution of Projects (Advance II):* As per terms and conditions of Contract Agreement, fee is also received in advance. The fee is primarily meant for discharging liabilities related to project set up expenses and to meet day-to-day overhead & establishment expenses. The invoice for fees is raised on quarterly basis as given in the contract. This fee money which is received in advance is also kept in a separate bank account.

Accounting treatment: The amount received on account of fees received in advance is also shown as advance from the client. At the year end, the invoice is raised for total expenditure incurred during the year plus fee amount at fixed percentage as defined in the contract agreement. On the basis of invoices which are raised for the work done the turnover is booked and advance from client both on account of project fund and fee is reduced to that extent. Remaining amount of advance fee continues to be shown under the head of account ‘Advance Received from Client’. However, interest earned during the year on fee received in advance booked as income of the company as there is no obligation on the company, to refund of interest income earned on it.

2. *Observation raised by Resident Audit Party of C&AG:* On the above accounting treatment during the year 2016-17, Resident Audit Party of C&AG has issued Half Margin which is reproduced below:

“The accounting policy no. 10.8.1 relating to Revenue from External Projects, interalia stipulates that in cost plus contracts, revenue is recognized by including eligible contractual items of expenditure plus proportionate margin as per contract.

¹ Opinion finalised by the Committee on 4.4.2018 & 5.4.2018.

During 2016-17, significant fees was primarily received from four projects viz, Greater Noida, Kochi, Vijayawada and Mumbai. The fees is received quarterly in advance and a portion out of the same is recognized as revenue on the basis of accounting policy. The balance fee along with project fund received in advance is booked in Advance Customers (External) Projects and consultancy, which is shown as a current liability. However bank interest received on the above account relating to fees is treated as interest income. Recognition of income on amount which has been shown as a liability is not correct as income cannot arise from a liability.

Accounting of bank interest in above manner has resulted in overstatement of income from bank interest and understatement of current liability to that extent”.

3. *Management Reply as stated by the querist:*

“The company has undertaken various external projects including construction of Metro projects of Noida-Greater Noida, Kochi, Vijayawada, and Mumbai on cost plus basis as external project works. As per agreement signed with these agencies the company is entitled to charge fixed percentage of fee on the cost.

Further, the agreement clearly states that these agencies shall pay 5% mobilization fee in advance and balance fee will be released on quarterly basis to meet out project set up expenses and day to day overhead and establishment expenses. Accordingly, DMRC raised quarterly invoices from these agencies for claiming project fee. At the year end the bill is raised as per accounting policy No. 10.8.1 and the due fees is booked to revenue.

Since, there is no clause in the agreement regarding refund of interest on project fee received in advance, hence, interest income on advance fee is also recognized as income as per terms and conditions of the contract agreement.

Further, the accounting for interest earned on project fee has been made as per provisions of Ind AS 18, Revenue. The relevant paragraphs of Ind AS 18 in relation to booking of interest revenue are reproduced below:

“29.Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases given below:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.

34. Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity.....”

From the above it is clear that, interest revenue shall be recognized only when it is probable that the economic benefit of the transaction will flow to the entity. As there is neither any clause in the agreement which requires refund of interest earned on advance fee nor claimed

from the company, hence, it is probable that the economic benefit of this interest income will flow to the company only. This practice is consistently followed by the company in previous years also.

Further, accounting of interest on advance fee is also in line with the opinion given by ICAI in respect of accounting treatment of interest on deposits made out of equity share capital and interest free subordinated debt funded by Government. As per the opinion, accounting treatment of interest earned on these surplus fund is treated as interest income in the statement of profit and loss (Query No. 44, Volume No. 34).”

4. The querist has submitted following points for consideration of the Expert Advisory Committee:

- (i) Advance fee is provided by external project agencies for the purpose of providing liquidity to meet out project set up expenses and day to day overhead and establishment expense. However, the fee is recognized as per accounting policy of the company and remaining fund is recognized as liability in books of accounts.
- (ii) There is no specific clause in agreements which require refund of interest earned on advance fee.
- (iii) As per Audit, income cannot arise on liability. However, as per Expert Opinion given by the Institute of Chartered Accountants of India (ICAI) vide query no. 44, Volume no 34 interest earned on deposits made out of equity share capital and interest free subordinate debt funded by Government is to be recognized as income in the Statement of Profit & Loss.

B. Query

5. In view of the facts explained above opinion of the Expert Advisory Committee is required on the following queries:

- (i) Whether the company’s accounting treatment to recognize interest earned on advance fee as its income is correct as per the provisions of Ind AS 18.
- (ii) If not, what is the correct accounting treatment?

C. Points considered by the Committee

6. The Committee notes that the basic issue raised in the query relates to accounting treatment of interest income earned on advance fee received for execution of project (Advance II). 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 advance received, accounting treatment of interest earned on advance received against project cost (Advance I) etc. Further, the opinion expressed, hereinafter, is purely from accounting perspective and not from any legal perspective or interpretation of terms of contracts agreement.

7. The Committee notes from the facts of the case that the advance received against fee for execution of project is kept in a separate bank account and thus interest income is generated on the same. Therefore, the Committee considers paragraph 29 of Ind AS 18, Revenue which states as follows:

“29 Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases given below:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.”

The Committee notes from above that revenue arising from use by others of entity’s assets yielding interest shall be recognized when it is probable that the economic benefits associated with the transaction will flow to the entity and the amount of revenue can be measured reliably. In the extant case, it is probable that the interest income will flow to the entity and the same can be measured reliably. Therefore, the same should be recognized as revenue of the entity.

8. The Committee further notes the contention as made in the query that recognition of income on amount which has been shown as liability is not correct. In this regard, the Committee noted that the interest is earned on the amount held with bank (out of the advance received) and therefore, the same is income for the company.

D. Opinion

9. On the basis of the above, the Committee is of the view that the accounting treatment to recognise interest earned on advance fee as its income is proper.