Ashok Meena, IAS
Principal Secretary to Government

D.O. No. 33453 **Date:- 17.12.2020**
FIN-BUD2-CAG-0002-2020

Dear Sri Basantiaji,

Sub: Compliance to audit observation on mis-classification between capital and revenue heads of accounts during 2019-20.

This has reference to Letter No-AA-Fin-1-1-(2019-20)-231 Dt.12th October, 2020 on the above subject. Clarification is sought for on the mis-classification to the tune of Rs.5,942.66 crore of revenue expenditure under capital/ loan Major Heads in respect of 17 nos. of Grants with 26 nos. of Major Heads. The audit observations were looked into carefully, and a compliance note was sent by Finance Department vide Letter No-30942/F Dt.20.11.2020 wherein it was stated that the accounting treatment of the grants should be considered from the ownership point of view i.e Grants for Creation of Capital Assets.

2. Subsequently, the issue was discussed in the Exit Conference held on 26th November, 2020. In this regard, I would like to draw your kind attention to Rule-30 and 31 of Government Accounting Rules, 1990 regarding the criteria for determining whether expenditure should be classified under heads of Capital Section or Revenue Section of the Consolidated Fund. **Expenditure of a capital nature to be classified in the Capital Section shall broadly be defined as expenditure incurred with the object of either increasing concrete assets of a material and permanent character. Expenditure on a temporary asset or expenditure on Grants-in-aid to local bodies or institutions for the purpose of creating assets which will belong to these local bodies or institutions to be classified as Revenue Expenditure.**

3. The basic principles governing the allocation of expenditure on a Capital Scheme, between Capital and Revenue accounts is that **Capital account should bear all charges for the first construction and equipment of a project as well as charges for intermediate maintenance of the work while not yet opened for service. It would also bear charges for such further additions and improvements as may be sanctioned under rules made by competent authority.** However, revenue account shall bear all subsequent charges for maintenance and all working expenses.

4. In most of the cases pointed out by the audit, the works are executed by separate societies/ institutions. Audit has pointed out that the societies / institutions being separate legal entities, the expenditure should have been booked as grants to the entities and thus treated revenue expenditure. This is, however, in contradiction of the fact that the societies/ institutions/entities in all these cases are only implementing agencies for creation of Assets for the Government and to be owned by the Government. In case of construction of

Medical College buildings, the assets are kept in the books of Works Department though the institutions are given some operational autonomy. Similarly, in case of piped water supply projects under BASUDHA, the assets created are owned by the State Government but is handed over to GPs or other institutions to operate. Hence, the expenditure in all such cases should be booked under Capital Section in terms of Rule-30 of Government Accounting Rules, 1990 as the assets created are owned by the State Government. Besides, in certain cases, the amount has been wrongly drawn in Grant-in-Aid bills, which may be procedural lapse, but the expenditure in such cases has been incurred for Capital asset creation owned by the State Government and thus should be treated as Capital expenditure.

5. For example, in case of PMGSY work, audit has pointed out that at the time of release of fund from the State exchequer to the PMGSY society, the expenditure is booked under Capital Sector even though no asset is created at that point of time. Hence, it should be treated as revenue expenditure. It is submitted that it is only as per Government of India guidelines for the Scheme, fund is released to the society account within a specific timeline of receipt of the Central Assistance. But, ultimately the fund is utilized to create road asset which is owned by the State Government. State Government accounts are maintained on cash basis (not accrual basis). Thus, if it is treated as revenue expenditure at the time of release, there is no scope on a later date to book it as Capital expenditure when the actual asset is created. Hence, we do not agree to the audit observations for booking it as revenue expenditure.

6. I would also like to appraise the position on grants to Energy sector as a glaring example suggesting treatment of grants as capital expenditure. The focus point of Audit observation is on grants released to distinct legal entities like OPTCL. It is claimed in Audit that as the grants were utilised by these legal entities for creation of assets like power transmission and distribution infrastructure which were then accounted for in the balance sheet of the concerned entities, such grants should be accounted for as revenue expenditure as per provisions of IGAS 2. It is once again reiterated that the concerned entities in such cases are acting as implementing agencies. The assets so created out of these grants are owned by the Government and does not form part in Balance sheet of entities as an asset. It is worth mentioning that such entities are entitled to take 6% supervision charges on implementation of such infrastructure projects for the Government.

Clause 14 of IGAS 2 states that "Grants-in-aid are classified and accounted for as revenue expenditure in the Financial Statements of the grantor irrespective of its ultimate application by the grantee. This position holds true even in those cases where Grants-in-aid are utilized by the grantee for the purpose of creation of assets. Receipts of grants-in-aid are also required to be treated as revenue receipts in the Financial Statements of grantee Government."

It may kindly be appreciated that such transfers are actually not an "Aid" to such institutions nor they are in the nature of subsidy/ incentives to promote industries. Funds have been placed at their disposal for creation of Assets for the Government and as such they are not entitled to treat the stated grants as their revenue income. Fact stands that OPTCL is a 100% Government owned corporation.

In a remote imaginary situation, if at all, such assets take a part in the balance sheet of such entities, the source of funding (the grant by Government) cannot be treated as a revenue income by the entity and therefore, at best, can be treated as deferred revenue expenditure in their balance sheet (a matching liability against the asset) which can be amortised over the service life of the asset.

7. Again in the case of grant 34, Cooperation department, it has been contended in Audit that payments made to Odisha State Co-operative Marketing Federation Limited was in the nature of an interest free loan of Rs. 40 crores, This entity does not have any material sources of income independent of the State Government and hence, repayment of the interest free loan would be dependent on release of further loans/ grants from the State Government. The statement is factually wrong in so far as that the Federation have their identifiable source of income and the amount is repaid by them by 28th February each year. Therefore treatment of the same as revenue expenditure is not appropriate.

Similar being the observation of Audit in almost all cases, it is submitted that the expenditure may be treated as Capital expenditure of the Government as the assets created are owned by the State Government. We would take steps to correct the procedural lapses pointed out in the audit observations. It is therefore, requested that the audit observations in this regard may kindly be dropped and where it is not possible to drop the audit observations, views of Finance Department may be incorporated in the notes to accounts.

With warm Regards,

Yours sincerely,

Sd/-

(**Ashok Meena**)

Sri Bibhudatta Basantia, IA&AS
Principal Accountant General (A&E)
Odisha, Bhubaneswar