

Query No. 2

Subject: *Allocation of manpower cost during project implementation phase.*¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’), engaged in City Gas Distribution (CGD), is promoted by two Public Sector Unit (PSU) majors in the petroleum sector, namely A Ltd. and B Ltd. As per authorisation granted by Petroleum and Natural Gas Regulatory Board (PNGRB), the Company has the following Minimum Work Program (MWP) to be completed in the geographical areas (GA) of Ambala-Kurukshetra, Haryana and Kolhapur, Maharashtra within a 5-year period commencing from the respective authorisation dates.

Geographical Area (GA)	Date of PNGRB authorization	Minimum Work Program (MWP)	Date of completion of MWP
Ambala-Kurukshetra	22.02.2018	Laying of 1142 Inch – Km of pipeline #Infrastructure for 20624 Nos. of domestic PNG connections	21.02.2023*
Kolhapur	06.03.2018	Laying of 1800 Inch – Km of pipeline #Infrastructure for 38760 Nos. of domestic PNG connections	05.03.2023*

* PNGRB vide PNGRB/Monitoring/1/CGD-COVID-19/2020/Vol-II (P-1804) letter dated 24th November 2020 gave an extension on MWP target timeline by 129 days for Ambala – Kurukshetra GA and 251 days for Kolhapur. Accordingly target completion date is 07-Aug-2023 for Ambala GA and 7-Dec-2023 for Kolhapur.

Infrastructure includes City Gas Station (CGS), Mother Station (MS), facilities within domestic households for PNG connections apart from pipelines.

2. *Appointment of auditors and conduct of the audit:*

The appointment of auditors is done by the Comptroller and Auditor General of India as per powers conferred by section 139 of the Companies Act, 2013. The Comptroller and Auditor General of India reserves the power to conduct supplementary/test audit under sections 143(6) and (7) of the Companies Act, 2013.

Status of Implementation of MWP:

The table below shows implementation:

¹ Opinion finalised by the Committee on 3.4.2021.

Geographical Area (GA)	Date of PNGRB authorization	Minimum Work Program (MWP)	Status of MWP completion till 30.09.2020
Ambala-Kurukshetra	22.02.2018	Laying of 1142 Inch – Km of pipeline Infrastructure for 20624 Nos. of domestic PNG connections	547.60 Inch-Kms 1981 connections
Kolhapur	06.03.2018	Laying of 1800 Inch – Km of pipeline Infrastructure for 38760 Nos. of domestic PNG connections	255.61 Inch-Kms 218 Connections

3. The Company has three offices, which include head office (HO), Mumbai and two project Offices at each of GAs mentioned above. A Ltd. and B Ltd., by virtue of being the promoters, have entered into a Joint Venture Agreement under which officers on the payroll of the two companies have been posted on deputation in the Company. Each GA has three officers on deputation comprising the Head-GA, Head-Engineering and Head-Marketing. HO, Mumbai has three more officers on deputation comprising the CEO, CFO and Accounts Officer. The GA offices are primarily focused on implementation of the work program. For this purpose, all technical, financial, commercial and administrative support and guidance are provided by HO to ensure smooth and timely completion of the work programme. As per agreement, the promoters raise debit notes on the Company in respect of manpower cost of their officers posted on deputation in the Company.

4. The querist has informed that the current practice being followed is as follows:

The Company prepares financial statements in accordance with the Indian Accounting Standards (Ind ASs), notified under section 133 of the Companies Act, 2013.

Depending on the nature of the job profile of each of the officers on deputation, the Company follows the following practice of booking the deputation cost of manpower:

- (i) All costs in relation to the GA based officers are charged directly to Capital Work-in-Progress (CWIP) as the Company is currently engaged in the creation of facilities/infrastructure as per MWP.
- (ii) As far as officers posted in HO are concerned, the Company, based on assessment/ evaluation of their job profile, charges 15% of the manpower cost to revenue and the balance 85% to CWIP.

5. *Observations of the Comptroller and Auditor General of India (CAG):*

The CAG while conducting the audit for financial year (F.Y.) 2019-20 has observed as below in their provisional comments:

Statement of Profit and Loss

Expenses:

Manpower Deputation Expenses: ₹ 23.58 lakhs

This does not include an amount of ₹116.07 lakhs (entire deputation expenses for Accounts Officer (AO) and 85 percent of deputation expenses in respect of Chief Financial Officer (CFO) situated in headquarters of the Company) which have been charged in Capital Work in Progress as on 31 March 2020. Similarly, an amount of ₹19.13 lakhs was also charged to CWIP during 2018-19.

In this regard, attention is invited to para 16 (b) of Ind AS 16, 'Property, Plant and Equipment', as per which 'any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management' can only be considered as cost of the asset for capitalisation. As such, charging in the CWIP -as cost of asset - the manpower deputation expenses pertaining to Marketing heads of two geographical areas and AO & CFO situated in headquarters of the Company not being directly attributable cost of the asset- is thus not correct.

Charging the CFO and Accounts Officer related manpower costs in CWIP has resulted in overstatement of CWIP by ₹116.07 lakhs and understatement of Other Equity by ₹116.07 lakhs and Loss for the period by ₹ 96.93 lakhs.

The relevant paragraph of Ind AS 16, 'Property Plant and Equipment' referred to by the C&AG in their provisional comments is reproduced as under:

“Elements of Cost

The cost of an item of property, plant and equipment comprises:

...

- (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

...”

6. The querist has informed that the Company's management's stand on the matter is as follows:

The Company is currently in project implementation phase which involves creation of various facilities in the two GAs, viz., Ambala-Kurukshetra and Kolhapur. As per PNGRB authorisation, all facilities must be created within a 5-year period commencing from the date of authorisation. The primary responsibility of implementing the work programme planned for the GAs lies with the manpower deployed on deputation basis by the promotor companies. Based on an assessment of the contribution made by different personnel on deputation, it was found that except for CEO and CFO, all others are fully involved in project implementation.

The top management, comprising the CEO and CFO, is responsible for accomplishment of the Company's objectives. Listed below are some of the broad activities of the CEO and CFO during the project implementation phase:

- Review and finalisation of consolidated GA budgets including that of the HO.
- Review of actual physical progress vis-a-vis approved budget.

- Direct interaction with different government agencies, viz., municipal authorities, forest, land revenue department etc. in connection with project work.
- Review meeting with suppliers/contractors including PMC consultant to ensure compliance with the stipulated timeline.
- Tendering bid evaluation and awarding of contracts for the GAs.
- Review of DOP & Procurement rules to meet the emerging requirement of GAs as well as HO.
- Meetings with suppliers/service providers of GAs /HO.
- Processing of all payments pertaining to the GAs/HO.
- Project financing and banking activity.
- Quarterly and annual audit.
- Responding to the queries of board, promoters and other outside agencies.
- Review and monitoring of human resource (HR) and administration policy and ensuring compliance.
- Holding of Board meetings, annual general meeting (AGM), finalisation of agenda, minutes etc.

7. With the project implementation phase continuing till 2023 and considering the involvement of CFO in all project activities, as discussed above, 85% of the manpower cost attributable to him has been capitalised and balance 15% has been charged to revenue. Since the CEO and CFO are equally responsible for all functional matters, the Company in its assessment treated them alike in 2019-20 and considered capitalisation of manpower expenses in the same proportion. None of the key business decisions can be taken by either of them alone. Hence, it is reasonable that manpower cost attributable to both should be treated similarly.

8. Accounts officer posted on deputation at HO handles all project related financial activities pertaining to both the geographical areas. The roles and responsibilities of the AO are evaluation of tenders floated for laying pipelines, procurement of various capital equipment, arranging for permission for laying pipelines, participating in price negotiation with bidders, helping in arranging debt financing, maintaining fixed assets/insurance and stores account of the project for the project apart from making vendor payments against all project activities. As AO's functions are largely related to project implementation, manpower cost attributable to him is being capitalised to the extent of 85% and balance 15% is debited to revenue.

9. The Company will be able to supply domestic gas to the households only after all facilities and infrastructure required for the said purpose are created. This implies that the Company's revenue from Piped Natural Gas (PNG) sales will accrue after the requisite facilities are put to use.

10. Based on a careful analysis of the job profile of the afore mentioned officers, the Company concluded that 15% of the manpower cost of CFO and AO in terms of both time spent and nature of job may not be directly attributable to asset/facility creation. Accordingly, the Company decided for charging 85% of the cost to CWIP and balance 15% to revenue.

11. The querist has mentioned that the reasons for the Committee to address this issue is that a significant portion of manpower cost is capitalised every year and there is no clear guidance on the treatment as per Ind AS 16, 'Property Plant and Equipment' on this matter.

The published literature of some of the large accounting firms also does not highlight the exact treatment of the cost and the ratio of allocation.

B. Query

12. In view of above, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) has been sought as to : (i) whether manpower cost of CFO and AO can be capitalised and if so, in what ratio; or whether the cost should be expensed off. (ii) The basis of changes (if required) to the current treatment and whether it can be done retrospectively or prospectively.

C. Points considered by the Committee

13. The Committee notes that the basic issue raised in the query relates to accounting treatment of manpower cost of CFO and AO during the project implementation phase. The Committee has, therefore, considered only this issue and has not examined any other issue(s) that may arise from the Facts of the Case, such as, analysis of status of implementation of MWP or accounting for any other expense incurred by the company in relation to the project, accounting for manpower cost in relation to other employees including other officers posted on deputation, such as, CEO, Head GA, Head Engineering, Head Marketing etc. Further, the Committee has not examined as to whether the costs incurred in relation to arrangement of borrowings (funds) for the Project in the extant case can be considered as ‘borrowing costs’ as per the requirements of Ind AS 23, ‘Borrowing Costs’.

14. At the outset, the Committee notes that the querist has stated that 85% of manpower cost of Accounts Officer and CFO, deputed to the HO of the Company, has been capitalised to the capital work in progress by the Company. Further, although the query has been raised in respect of Accounts Officer and CFO on deputation, the specific details of the activities performed by the CFO have not been provided; rather the details of combined activities of CEO and CFO have been provided. In the absence of the separate details for the CFO, it is presumed that CFO performs all those activities, as provided by the querist in the Facts of the Case (paragraph 6 above).

15. The Committee notes the following paragraphs of Ind AS 16, ‘Property, Plant and Equipment’, notified under the Companies (Indian Accounting Standards) Rules, 2015:

“16 The cost of an item of property, plant and equipment comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

- 17 Examples of directly attributable costs are:
- (a) costs of employee benefits (as defined in Ind AS 19, *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment;
...”
- “19 Examples of costs that are not costs of an item of property, plant and equipment are:
...
(d) administration and other general overhead costs.”

16. From the above, the Committee notes that the basic principle to be applied while capitalising an item of cost to a property, plant and equipment (PPE) is that it is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The Committee is of the view that ‘directly attributable’ costs are generally such costs which are necessary to enable the construction activity, i.e. these costs are directly related to the construction activity and without the incurrance of which the asset cannot be brought to the location and condition necessary for it to be capable of operating in the manner intended by management. Further, the Committee notes that paragraph 17 of Ind AS 16 gives examples of directly attributable costs and it includes costs of employee benefits (as defined in Ind AS 19, *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment. Therefore, the Committee is of the view that the employee benefit expenses arising directly from the construction or acquisition of the PPE/project, such as employee costs of an entity’s own employees, workers, labourers, engineers, architects etc. engaged in construction activity should only be capitalised and the rest should be charged to the Statement of Profit and Loss.

17. As far as capitalisation of the manpower cost of Accounts Officer and CFO is concerned, the Committee notes that normally Accounts Officer is engaged in overall book keeping and accounting related activities and CFO of an organisation is generally involved in overall finance related activities of the Company as a whole.

The Committee is of the view that normally these activities cannot be considered to be arising directly from the construction or acquisition of the PPE/project and the costs thereof cannot be considered to be a directly attributable cost for the Project/PPE. The Committee is of the view that manpower cost of Accounts Officer and Chief Financial Officer are normally of the nature of administration and general overheads and should, ordinarily, not be capitalised with the item of PPE. However in certain exceptional cases where it can be clearly demonstrated that these are directly attributable cost for bringing the Project/PPE to the location and condition necessary for it to be capable of operating in the manner intended by management, these can be capitalised.

As far as the ratio/proportion in which such expenses may be capitalised, the Committee is of the view that it needs to be determined by the Company itself considering the nature of expenses/activities and the extent to which these are directly attributable as per the requirements of Ind AS 16 in its specific facts and circumstances and using proper rationale.

18. In this context, the Committee notes that the roles and responsibilities of the AO in the extant case have been stated to be evaluation of tenders floated for laying pipelines, procurement of various capital equipment, arranging for permission for laying pipelines, participating in price negotiation with bidders, helping in arranging debt financing, maintaining fixed assets/insurance and stores account of the project for the project apart from making vendor payments against all project activities. The Committee is of the view that although some of these activities are undertaken in connection with the construction or acquisition of PPE/project, the costs incurred thereon cannot be completely considered to be arising directly from the construction or acquisition of the PPE/Project. The Committee is of the view that the extent to which these costs are directly attributable to PPE/Project is a matter of judgement in the specific facts and circumstances, which should be exercised and demonstrated by the management of the Company. Accordingly, to the extent, such costs are directly attributable to bringing the PPE/Project to the location and condition necessary for it to be capable of operating in the manner intended by management, should be capitalised to the PPE/Project by the Company and the rest should be charged to the Statement of Profit and Loss.

The Committee further notes the activities mentioned by the querist as the activities of the CFO in paragraph 6 above. The Committee is of the view that the activities, such as, review and finalisation of consolidated GA budgets including that of the HO, review of actual physical progress vis-a-vis approved budget, interaction with government agencies, meeting with suppliers, tendering bid evaluation and awarding contracts, project finance and banking activities, review of DOP & Procurement rules to meet the emerging requirement of GAs as well as HO, quarterly & annual audit, responding to the queries of board, promoters and other outside agencies, review & monitoring of HR and Admin Policy and ensuring compliance, holding of Board meetings, AGM, finalisation of agenda, minutes etc. are overall policy making and control and supervision related activities; and are in the nature of administrative and general overheads, which as per paragraph 19 (d) of Ind AS 16, are not costs of an item of property, plant and equipment. However, if in certain exceptional circumstances, where the management can clearly justify and demonstrate that some of the activities performed by the CFO are directly attributable to bringing the PPE/Project to the location and condition necessary for it to be capable of operating in the manner intended by management, to that extent, the manpower costs incurred by the Company in relation to CFO should be capitalised to the PPE/Project and the rest should be charged to the Statement of Profit and Loss.

19. With regard to the issue raised by the querist as to whether changes required to the current treatment are to be done retrospectively or prospectively, the Committee notes that Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' states as follows:

“41 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

42 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or**
- (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”**

The Committee notes from the above that as per Ind AS 8, material prior period errors are corrected retrospectively by restating the comparative amounts for prior period(s) presented in which the error occurred. If the error occurred before the earliest period presented, the opening balance of assets, liabilities and equity for the earliest period presented are adjusted. Therefore, any changes in the accounting treatment required in the extant case due to above-mentioned discussion, should be considered and corrected by the Company as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error.

D. Opinion

20. On the basis of the above, the Committee is of the opinion on the issues raised in paragraph 12 above that although some of the activities of Accounts Officer are undertaken in connection with the construction or acquisition of PPE/project, the costs incurred thereon cannot be completely considered to be arising directly from the construction or acquisition of the PPE/Project. The extent to which these costs are directly attributable to PPE/Project is a matter of judgement in the specific facts and circumstances, which should be exercised and demonstrated by the management of the Company. Accordingly, to the extent, such costs are directly attributable to bringing the PPE/Project to the location and condition necessary for it to be capable of operating in the manner intended by management, should be capitalised to the PPE/Project by the Company and the rest should be charged to the Statement of Profit and Loss. Similarly, the activities undertaken by the CFO in the extant case are overall policy making and control and supervision related activities; and are in the nature of administrative and general overheads, which as per paragraph 19 (d) of Ind AS 16, are not costs of an item of property, plant and equipment. However, if in certain exceptional circumstances, where the management can clearly justify and demonstrate that some of the activities performed by the CFO are directly attributable to bringing the PPE/Project to the location and condition necessary for it to be capable of operating in the manner intended by management, to that extent, the manpower costs incurred by the company in relation to CFO should be capitalised to the PPE/Project and the rest should be charged to the Statement of Profit and Loss, as discussed in paragraph 18 above. Further, any changes, required in accounting treatment in the extant case due to above-mentioned discussion should be considered and corrected by the Company as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error, as discussed in paragraph 19 above.
