

Query No. 4

Subject: Classification of 'stock of track' as inventory or property, plant and equipment.¹

A. Facts of the Case

1. A Corporation (hereinafter referred to as 'the Corporation' or 'the Company') is a non-listed company incorporated in India with 50:50 equity participation of the Government of India (GOI) and the State Government. The Company was formed as a special purpose vehicle (SPV) on 25th November 2013 to execute Mass Rapid Transit System (MRTS) in city 'L'. The Company has successfully implemented Phase 1A –North South Corridor of the city 'L' Metro Project and commenced commercial operations on 8th March 2019. The Government further mandated it to implement the upcoming projects in other cities of the State. Henceforth, the constitution and name of the company was changed to ABC Metro Rail Corporation Limited on 23rd October 2019. Presently, the Company, apart from running metro rail services in the city 'L', has commenced construction activity of metro projects in city 'K' and city 'A'.

2. The querist has stated that city 'L' Metro Project is in operation from 8th March 2019 and construction activities of city 'K' and city 'A' metro rail projects are under progress. During the construction of city 'L' Metro Project, the Company had entered into various contracts for procurement of tracks having contracts (LKT 01,02,03 and 04) value of INR 131.69 crore and a contract (LKT-05) with M/s XYZ for laying of tracks having contract value of INR 121.82 crore. The materials procured include sleepers, rails, clamps etc. Out of the total stock of these materials, material having total value of INR 12.83 crore was lying in city 'L' metro project and shown under the 'Capital Work in Progress - Track Work' in Note No. 2 of the balance sheet for the financial year (F.Y.) 2020-21, which is to be used in city 'K' and city 'A' metro rail projects, since track work of city 'L' was fully completed and there was no requirement of these materials for any future use at city 'L'.

3. *Accounting treatment adopted by the Company:*

The querist has further stated that the Company has procured the material and parked the expenditure incurred under the head 'Capital Work in Progress'. After the start of operation of the city 'L' metro on 08th March 2019, the Company has capitalised the expenditure incurred on laying down the track under the head Property, Plant and Equipment- Track work (Note No. 1 of the Balance sheet for the F.Y. 2020-21). Out of the total stock, stock having total value of INR 12.83 crore was lying in city 'L' metro project and shown under the 'Capital Work in Progress- Track Work' in Note No. 2 of the balance sheet for F.Y. 2020-21 with the intent to use track materials including rails in other metro project at city 'K' which was scheduled to be made operational in the month-end of December 2021. It may be pertinent to mention that the track is a 'fixed asset' item but capitalised on the commercial commencement of corridor.

Therefore, as a prudent practice, the track rails materials valuing INR 12.53 crore was shown under 'Capital Work in Progress' and since city 'K' Metro is going to start from the month-end of December 2021, the same will be capitalised under the head 'Track Work' in Property, Plant and Equipment (PPE).

¹ Opinion finalised by the Committee on 11.4.2022.

Comment issued by C&AG:

4. During the supplementary audit of financial statements for the F.Y. 2020-21, Comptroller and Auditor General of India (C&AG) was of the view that surplus material lying under the head capital work in progress is to be treated as inventory within the ambit of Indian Accounting Standard (Ind AS) 2, 'Inventories'. Comment raised by the C&AG is reproduced below:

“Capital Work in Progress, city L (Note-2)

Track Work (P-Way) INR 12.83 Crore

The above represents surplus store (Sleepers, Rails, clamps etc.) at city 'L' Metro Project. These items are left over items used for laying of new rail tracks and are not required at city 'L' Project as the project is already completed and commissioned.

This resulted into overstatement of 'Capital Work in Progress (city 'L')' and understatement of 'Inventory' by Rs. 12.83 crore each.”

5. *Reply of the Company given to C&AG:*

The Company was formed as a special purpose vehicle (SPV) on 25th November 2013 to execute Mass Rapid Transit System (MRTS) in city 'L' by providing metro rail. The Corporation successfully implemented Phase 1A –North South Corridor (23 Km) within strict timelines and commenced commercial operations on 8th March 2019. The Government further mandated it to implement the upcoming projects in other cities of the State. Presently, the Company, apart from running metro rail services in the city 'L', has commenced construction activity in city 'K' (32.385 Kms) and city 'A' (30.45 Kms).

As per Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment', **“Property, plant and equipment are tangible items that:**

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and**
- (b) are expected to be used during more than one period.”**

Moreover, as per the definition of 'inventories' as given under Ind AS 2, 'Inventories';

“Inventories are assets:

- (a) held for sale in the ordinary course of business;**
- (b) in the process of production for such sale; or**
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.”**

From the above, it can be noted that the classification of an asset as a 'property, plant and equipment' or 'inventories' depends on its intended primary use for an entity. If an asset is essentially held for using it for the purpose of producing or providing goods or services rather than for sale in the normal course of business, it is classified as 'property, plant and equipment'.

Auditors should appreciate the fact that tracks held by the Company are clearly falling under the definition of 'Property, Plant and Equipment' as stated above and not under the definition of 'Inventories' as per Ind AS 2. As a measure to reduce cost of city 'K' and city 'A' metro projects, management has taken conscious decision to use these materials during the construction of city 'K' and city 'A' metro projects. A part of said materials has already been transferred to the city 'K' metro project and the same will be capitalised as assets once the tracks will be put to use for city 'K' metro Project.

Based on the above facts, it is clear that the above material does not fall in the ambit of inventories as defined in Ind AS 2 and the same is correctly classified by the Company under 'Work in Progress'; hence no corrective action is envisaged on this matter.

6. *Matter of Dispute:*

As per C&AG, stock of track related items should be classified as inventory. As per the Company, this stock does not fall under the definition of inventories as per Ind AS 2 and the same is held for laying tracks which will form part of PPE only. The Company has already transferred some portion of this material to city 'K' metro rail projects for laying rail track which will be capitalised under the head 'Property, Plant and Equipment' as per Ind AS 16 after commencement of city 'K' metro rail project.

B. Query

7. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee (EAC) regarding the accounting treatment of stock of track work in view of C&AG observation. Also, whether the treatment adopted by the Company is correct or not.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised in the query relates to accounting treatment of stock of tracks held by the Company, which is surplus material for one of the metro projects but is being held for consumption in other projects. 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 for any other item, viz., sleepers, rails clamps, etc., depreciation of stock of tracks and various such other items, items of property, plant and equipments, metro projects etc., presentation of inter-unit transfers, 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.

9. In order to determine the classification of the asset (stock of track), the Committee notes the definition of the term 'inventories' as given in Indian Accounting Standard (Ind AS) 2, 'Inventories':

"Inventories are assets:

- (a) held for sale in the ordinary course of business;**
- (b) in the process of production for such sale; or**
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services."**

From the above, the Committee notes that classification of an item as ‘inventory’ depends on its intended primary use for an entity. In the extant case, the ‘stock of track’ is neither held for sale in the ordinary course of business; nor it is in the process of production for such sale; nor in the form of materials or supplies to be consumed in the production process or in the rendering of services. Therefore, the same does not meet the definition of ‘inventories’.

10. The Committee now examines the following requirements of Ind AS 16, ‘Property, Plant and Equipment’:

“Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.”

“7 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

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

(b) the cost of the item can be measured reliably.”

From the above, the Committee notes that in the extant case, stock of tracks are tangible items, which upon laying/installation as metro tracks will be used for providing services and will be used during more than one period. Therefore, tracks once laid/installed will meet the definition of property, plant and equipment (PPE).

The Committee further notes that the ‘Glossary of Terms used in Financial Statements’, issued by the Research Committee of the Institute of Chartered Accountants of India defines the term, ‘capital work in progress’ as follows:

“31. Capital Work-in-progress

Expenditure on capital assets which are in the process of construction or completion.”

The Committee notes from the Facts of the Case that the stock of tracks is surplus for the time being at the site of one project and is awaiting its use in other project. However, this does not change its basic nature of the materials acquired for construction/creation of an item of property, plant and equipment and therefore, is an expenditure on capital assets which are in the process of construction or completion. Accordingly, the same should be classified under ‘capital work in progress’. The Committee is further of the view that since metro project of city ‘L’ is fully completed and has commenced commercial operations, the stock of tracks should not be termed as capital work in progress (CWIP) of metro project of city ‘L’; rather these should be classified under CWIP of metro projects of city ‘K’ and city ‘A’ to the extent these will be used for these metro projects.

D. Opinion

11. On the basis of the above, the Committee is of the opinion that the ‘stock of track’ should not be termed as capital work in progress (CWIP) of metro project of city ‘L’; rather should be classified under capital work in progress of metro projects of city ‘K’ and city ‘A’ to the extent these will be used for these metro projects.