

Query No. 23

Subject: Accounting treatment of pre-project expenses for which fund approval is pending under Ind AS framework.¹

A. Facts of the Case

1. Union Cabinet, on 7th January 2004 decided to build and operate strategic crude oil reserves of 5 MMT capacity through a special purpose vehicle, which would be 100% owned by one of the oil public sector undertakings (PSUs). Accordingly, a company (hereinafter referred to as 'the Company') was incorporated on 16th June 2004 as a subsidiary of I Ltd.

2. Further, in line with Cabinet Committee on Economic Affairs (CCEA) meeting held on 6th January 2006, the Company was made as subsidiary of Oil Industry Development Board (OIDB) by transferring the entire shareholding held by I Ltd. to OIDB. The share transfer was completed on 9th May 2006.

3. The Company constructed strategic crude oil storages at three locations. Capital costs for construction of caverns were provided by OIDB against which the shares were allotted to OIDB.

4. All these caverns were commissioned by the year 2019 and currently are fully operational. Day-to-day expenditure for operation and maintenance are incurred by the Company out of grants/reimbursement given by the Ministry of Petroleum and Natural Gas (MoPNG)/Government of India (GoI).

5. Vide Note dated July 2021, the Cabinet has approved partial commercialisation of the Company in the following manner:

- a. Leasing/Renting of 30% of overall storage capacity to Indian or foreign companies (*Refer Note 1*),
- b. Sale/Purchase of 20% of overall storage capacity of crude oil to Indian companies (*Refer Note 2*).

Remaining 50% of overall storage capacity will remain strategic.

Note 1: *The Company has sold 30% sovereign crude oil reserves during the financial Year (F.Y.) 2021-22 to create space for leasing/renting and sale proceeds from the same have been remitted back to the Government of India (GOI).*

Note 2: *No transaction has been undertaken by the Company till date.*

6. The Company was mandated to construct additional storage at other two locations in Phase-II under public-private-partnership (PPP) mode with viability gap funding (VGF) provisions through capital grant. For study of suitability and feasibility of location under Phase II project, the Company had to incur some pre-project expenses. Initially, the Company had estimated pre-project expenses on account of environmental impact assessment, survey of offshore and onshore pipeline for single point mooring and owners' activities including national and overseas road shows etc. to Rs. 19 crore. As per direction from the MoPNG vide

¹ Opinion finalised by the Committee on 31.7.2023.

letter dated 11th December 2018, an amount of Rs. 19 crore was provided by parent organisation, OIBD (100% shareholder of the Company) during the period from March 2019 to March 2022. The funds received from the OIBD were for expenses for pre-project activity (which are revenue in nature).

7. However, during placement of order and execution of pre-project activities, the cost got escalated to around Rs. 23.20 crore against the sanctioned amount of Rs. 19 crore. Against the escalated cost of Rs. 23.20 crore, bills for a value of Rs. 21.22 crore have been received till the end of financial year 2021-22 but the disbursement could be done for only Rs. 19 crore (approx.) i.e. to the tune of fund sanction and disbursed by OIBD. Balance payment for Rs. 2.22 crore for which bills are in hand, could not be made in the absence of funds.

8. The Company requested additional funds from the controlling ministry, MoPNG. In a subsequent development, the parent company (i.e. OIBD) has provided shortfall of funds on the directions of MoPNG after the assurance given to the Comptroller and Auditor General of India (CA&G) that an opinion will be obtained from the Institute of Chartered Accountants of India (ICAI) regarding depiction of liability.

Current accounting practice by the Company

9. The Company follows the below-mentioned accounting policy with respect to shareholder grants:

“Grants received from Shareholder are recognised in profit or loss on a systematic basis over the periods in which the Company recognises as expenses the related costs for which the grants are intended to compensate”.

On the basis of same, grant received by the Company from its shareholder (i.e. OIBD) is treated as income in the Statement of Profit and Loss (income recognised on accrual basis, i.e., to the extent of expenditure incurred irrespective of actual amount of grant receipt). Correspondingly, amount of expenditure incurred out of that grant is shown as expenses in the Statement of Profit and Loss. Accounting policy with respect to revenue grant received from shareholders was followed for the sanctioned and disbursed grant of Rs. 19 crore from OIBD, however liability for the unpaid invoices in hand to the tune of Rs. 2.22 crore could not be provided in the books and financials in the absence of sanction of funds from MoPNG/GoI.

10. C&AG in their *Provisional comment No. 02 for the F.Y. 2021-22* has stated that not providing of liability in the books of account has resulted in understatement of liabilities and understatement of loss to the extent.

11. As per the Company, no accounting was done for the said transaction because of the following:

- (i) There was no certainty regarding source of funds, i.e., whether funds will be provided by Ministry through Gross Budgetary Support (GBS) or from the grant of OIBD.
- (ii) Due to uncertainty about receipt of funds and source of funds, the Company was not able to provide for liability in its books of account, as grant from shareholder (i.e. OIBD) and corresponding expenses form part of income and expense in the Statement of Profit and Loss; however grant from MoPNG does not form part of

the Statement of Profit and Loss and the expenses to the extent of grant received are to be set off in the Statement of Profit and Loss.

- (iii) Any provision of expense will result in depiction of expense in the Statement of Profit and Loss, without recognising corresponding income in the Statement of Profit and Loss due to non-receipt of grant/fund.

As the source of funds is now ascertained to the Company, necessary income and expense can now be shown by the Company in its financial statements for F.Y. 2022-23. (Emphasis supplied by the querist.)

Considering the difference of opinion about the depiction of transaction in the books of account of the Company, assurance was given by the Company to C&AG that the Company will obtain opinion from the Expert Advisory Committee of the ICAI.

B. Query

12. In view of above, the querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India with respect to transaction undertaken by the Company on the following issues:

- (i) Whether or not the Company's accounting treatment for not making provision for expenses incurred in the books of account in the absence of fund source and not providing for liability for the same in books of account was in order.
- (ii) If not, what accounting/disclosure methodology would have been adopted by the Company with respect to such transaction and/or situation?

C. Points considered by the Committee

13. The Committee notes that the basic issue raised by the querist relates to the timing of recognition of liability/provision in respect of pre-project expenses incurred in the absence of fund source or for which fund approval is pending. The Committee has, therefore, considered only this issue and has not examined any other issues that may arise from the Facts of the Case, such as, appropriateness of accounting for funds or grants received by the Company from OADB/MoPNG/GoI, accounting treatment of pre-project expenses and whether these meet the capitalisation criteria, whether the expenditure incurred meets the terms and conditions of the sanction/grant etc. The Committee notes from the annual report of the Company for the financial year 2021-22 that the Company follows Indian Accounting Standards (Ind AS) in its financial statements and has therefore examined the issue from Ind AS perspective. Further, the opinion expressed hereinafter is purely from accounting perspective and the Committee has not examined any regulatory or legal aspects including under Income-tax Act, 1961 or Rules made thereunder or legal interpretation of various orders or communications with Ministry/OADB/GoI including whether the Ministry/OADB/GoI is required to reimburse the Company for escalated cost etc.

14. At the outset, the Committee notes from the Facts of the Case that due to uncertainty about receipt of funds and source of funds, the Company has not provided for any expense or liability in its books of account in the F.Y. 2021-22 and due to subsequent development, as the source of funds is now ascertained to the Company, necessary income and expense will be shown by the Company in its financial statements for F.Y. 2022-23. In this context, the Committee notes the following requirements of Ind AS 1, 'Presentation of Financial

Statements’ and Ind AS 37, ‘Provisions, Contingent Liabilities and Contingent Assets’, notified under the Companies (Indian Accounting Standards) Rules, 2015 and the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS), issued by the ICAI:

Ind AS 1

“88 An entity shall recognise all items of income and expense in a period in profit or loss unless an Ind AS requires or permits otherwise.”

Ind AS 37

“Provisions and other liabilities

11 Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

- (a) trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and
- (b) accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.”

Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS)

“Definition of a liability

4.26 A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

4.27 For a liability to exist, three criteria must all be satisfied:

- (a) the entity has an obligation (see paragraphs 4.28–4.35);
- (b) the obligation is to transfer an economic resource (see paragraphs 4.36–4.41); and
- (c) the obligation is a present obligation that exists as a result of past events (see paragraphs 4.42–4.47).”

“4.69 Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.”

“5.4 The balance sheet and statement of profit and loss are linked because the recognition of one item (or a change in its carrying amount) requires the recognition or derecognition of one or more other items (or changes in the carrying amount of one or more other items). For example:

(a) ...

(b) the recognition of expenses occurs at the same time as:

(i) the initial recognition of a liability, or an increase in the carrying amount of a liability; or

(ii) the derecognition of an asset, or a decrease in the carrying amount of an asset.”

“5.5 The initial recognition of assets or liabilities arising from transactions or other events may result in the simultaneous recognition of both income and related expenses. For example, the sale of goods for cash results in the recognition of both income (from the recognition of one asset—the cash) and an expense (from the derecognition of another asset—the goods sold). The simultaneous recognition of income and related expenses is sometimes referred to as the matching of costs with income. Application of the concepts in the Conceptual Framework leads to such matching when it arises from the recognition of changes in assets and liabilities. However, matching of costs with income is not an objective of the Conceptual Framework. The Conceptual Framework does not allow the recognition in the balance sheet of items that do not meet the definition of an asset, a liability or equity.

Recognition criteria

5.6 Only items that meet the definition of an asset, a liability or equity are recognised in the balance sheet. Similarly, only items that meet the definition of income or expenses are recognised in the statement of profit and loss. However, not all items that meet the definition of one of those elements are recognised.”

“5.10 It is important when making decisions about recognition to consider the information that would be given if an asset or liability were not recognised. For example, *if no asset is recognised when expenditure is incurred, an expense is recognised*. Over time, recognising the expense may, in some cases, provide useful information, for example, information that enables users of financial statements to identify trends.”

(Emphasis supplied by the Committee.)

From the above, the Committee notes that as per Ind AS 1, an entity shall recognise, in a period in profit or loss (unless an Ind AS requires or permits otherwise), all items of expense, which is defined in the Conceptual Framework as decreases in assets, or *increases in liabilities*, that result in decreases in equity. The ‘Conceptual Framework for Financial

Reporting under Indian Accounting Standards (Ind AS) defines 'liability' as a present obligation of the entity to transfer an economic resource as a result of past events. Further, Ind AS 37 states that accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier and these accruals are often reported as part of trade and other payables. Thus, the Committee is of the view that irrespective of the type of liabilities, an entity should recognise the same in its financial statements when it has an obligation (legal or contractual) to pay to the other party or service provider. Further, the incurrance of liability shall give rise to an expense, which should be recognised in the Statement of Profit and Loss unless an Ind AS requires or permits otherwise.

In this context, the Committee notes that in the extant case, during placement of order and execution of pre-project activities, the cost got escalated to around Rs. 23.20 crore against the sanctioned amount of Rs. 19 crore. Against the escalated cost of 23.20 crore, bills for a value of Rs. 21.22 crore have been received till the end of financial year 2021-22 but the disbursement could be done for only Rs. 19 crore (approx.) i.e. to the tune of fund sanction and disbursed by OIDB. Balance payment for Rs. 2.22 crore for which bills are received has not been made in the absence of funds.

Thus, in the extant case, on execution of pre-project activities by the supplier of goods or services, a present obligation arises on the Company to pay cash to the supplier, which should be recognised by the Company with a corresponding expense in the Statement of Profit and Loss unless such expenditure can be capitalised as per the requirements of applicable standards, such as, Ind AS 16, 'Property, Plant and Equipment'.

Accordingly, the Committee is of the view that the Company in extant case should have recognised a liability in respect of the pre-project expenses when the pre-project activities are executed by the supplier of goods or services and as a result of which, a present obligation arises on the Company to pay cash to the supplier. Therefore, the present accounting treatment followed by the Company of not recognising the liability in respect of expenses incurred in the financial statements for the F.Y. 2021-22 is not correct.

15. The Committee is also of the view that in the extant case, since the Company did not follow the above-mentioned accounting treatment, the same (if material) should be rectified in the current reporting period, considering it as an error, as per the following requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

“Prior period errors are omissions from, and misstatements in, the entity’s financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were approved for issue; and**
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.”

- “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.”**

Further, the definition of ‘material’ as given in Ind AS 1, ‘Presentation of Financial Statements’ should also be considered which is as follows:

“Material:

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.”

D. Opinion

16. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 12 above:

- (i) The present accounting treatment followed by the Company of not recognising the liability in respect of expenses incurred (but not approved) in the financial statements for the F.Y. 2021-22 is not correct, as discussed in paragraph 14 above.
- (ii) The Company should have recognised a liability in respect of the pre-project expenses when the pre-project activities are executed by the supplier of goods or services and as a result of which, a present obligation arises on the Company to pay cash to the supplier, as discussed in paragraph 14 above. Since the Company did not follow the above-mentioned accounting treatment, the same, if material, should be rectified in the current reporting period, considering it as an error, as per the requirements of Ind AS 8, as discussed in paragraph 15 above.