

Query No. 40

Subject: Accounting treatment of certain expenditure incurred for the project under AS framework.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is registered under section 8 of the Companies Act, 2013 as ‘Not-for-Profit’ organisation, wholly owned by the State Government with an authorised share capital of Rs. 5,00,000/- on 02-02-2017. The Company is a Special Purpose Vehicle formed for development of infrastructure at Tumakuru. The equity share capital of the Company consists of Rs. 5,00,000/- (50,000 shares of Rs. 10/- each). The shares of the Company are not listed in the stock exchanges. The Company is a government company formed in association with the Ministry of Heavy Industries, Government of India (GoI) and Department of Commerce & Industries/ State Industrial Areas Development Board (SIADB), State Government.

2. The major sources of income of the Company is grant (non-recurring/non-refundable/capital grant) of Rs. 125 crore from the Government of India and Rs. 125 crore from the State Government for development of infrastructure works (roads, electricity works, Sewage Treatment Plant (STP), Solid Waste Management (SWM), etc.).

3. From the financial year (F.Y.) 2017-18 to 2020-21, the Company capitalised the infrastructure works to Capital Work in Progress (CWIP). The Company accounted for the administration and establishment expenses pertaining/attributable to the project (salary, office rent, advertisement etc.) in the Income and Expenditure Account. There is no revenue generated by the Company since the project is formed for development of infrastructure in the Company’s layout. The only income in Income and Expenditure Account till these years is interest on TDS on deposits received from Income-tax Department.

4. During the financial year 2021-22, the statutory auditor who has been appointed by the Comptroller and Auditor General of India (C&AG) stated that the administration and establishment expenses were directly attributable to the project cost. Since, the grant received from the Government of India and State Government are capital in nature, the administration and establishment expenses have to be capitalised and shown in ‘Capital Work in Progress’. The auditor also told to reclassify the administration and establishment expenses since inception (i.e., F.Y. 2017-18) amounting to Rs. 5.98 crore to capital work in progress. The Company also reclassified the administration and establishment expenses of Rs. 5.98 crore to capital work in progress and prepared the financial statements for the F.Y. 2021-22. The Income and Expenditure Account showed other income of Rs. 4 lakh and depreciation of Rs. 1.36 lakh resulting in excess of income to expenditure to the extent of Rs. 2.64 lakh.

5. The C&AG made the following observation at the time of audit and reply issued by the Company and the statutory auditor to the C&AG are as below:

C&AG Observation	Reply issued by the Company	Reply Issued by the statutory auditors
Note No. 03: Reserves & Surplus: Rs. 24,89,547 thousands.	1. The Grant in Aid received by the Company	With regard to the Audit Enquiry No. 5,

¹ Opinion finalised by the Committee on 6.12.2023.

<p>Note 13: Other Income Rs. 400 thousands</p> <p>Note No. 15: Other Expenses: Rs. 0 thousands.</p> <p>Government of India implemented the Integrated Industrial Infrastructure Facilities (IIFC) Scheme for Enhancement of Competitiveness in the Indian Capital Goods vide Notification dated 05th November 2014. Integrated Industrial Infrastructure Facilities for machine tool industry was one of the scheme where 80 percent of the project cost including plant and machinery, human resources and computers etc., but not vehicles, laptops/tablets video camera, roads, street lights & greenery, land and building) subject to maximum of Rs. 125 crore was given by GoI and balance 20 % was to be invested by the Special Purpose Vehicle. No Government assistance was given for land and building. Matching Rs. 125 crore was provided by SIADB along with 530 acres of land in V village in T District. Apex Committee of Department of Heavy Industry, GoI gave in-principle approval on 28.01.2016 for project cost of Rs. 421 crore including land value of Rs. 191.68 crore and infrastructure cost of Rs. 229.32 crore and additional funds, if any, required to meet time and cost overruns will be paid by SIADB representing Special Purpose Vehicle (SPV).</p> <p>As per Scheme Gazette Notification, paragraph 11, in case of Administrative Expenses, Guidelines of Government GOs/General Financial Rules (GFR) should be followed and as per paragraph 12, General Conditions as per GO/GFR/Scheme Specific, should be followed. As per paragraph 12.4, the financial assistance provided under this scheme would be of non-recurring and capital nature. Funds</p>	<p>from GoI / State Government are <i>Non-recurring Grant or Capital Grant or Corpus</i> in nature. The same is verified by the Grant sanction letter/s.</p> <p>The presentation of Government Grants which are in the nature of Non-recurring / Capital is given in <i>paragraph 10.1</i> of Accounting Standard 12 '<i>Accounting for Government Grants</i>'. The same is reproduced below for your reference: -</p> <p><i>“10. Presentation of Grants of the nature of Promoters’ contribution</i></p> <p>10.1 Where the government grants are of the nature of promoters’ contribution, i.e., they are given with reference to the total investment in an undertaking <i>or by way of contribution towards its total capital outlay</i> (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.”</p> <p>In view of the above, the Government Grants received by the Company in the nature of non-recurring shall be treated as '<i>Capital Reserve</i>' only. Considering the 5% of the total grant received as</p>	<p>we understand that Grant in Aid received by the Company from GoI / State Government are Non-recurring Grant or Capital Grant or Corpus in nature.</p> <p>The presentation of Government Grants which are in the nature of Non-recurring / Capital are required to be in accordance Accounting Standard 12 '<i>Accounting for Government Grants</i>'.</p> <p>As regards to the Company’s shifting of employee expense and other administration expenses from 2017-18 to 2021-22 to capital work in progress and accounting for 5% Consultancy, PMC/Supervision, as mentioned earlier, the Company is carrying out only one project which is considered as a 'single project' or 'the project as whole', all costs incurred till the project is completed will be the cost directly attributable to the project of the Company and the said reclassification is done during the year 2021-22 and we</p>
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<p>may not be used directly to pay salaries and allowances etc., for the institute's faculty, staff or administrators. However, services may be charged to the Centers.</p> <p>As per GoI GFR 2005, Rule 79 relating to Capital or Revenue Expenditure, significant expenditure incurred with the object of acquiring tangible assets of a permanent nature or enhancing the utility of existing assets shall broadly be defined as capital expenditure. Subsequent charges on maintenance, repair, up-keep and working expenses, which are required to maintain the assets in a running order as also all other expenses incurred for the day-to-day running of the organisation, including establishment and administrative expenses shall be classified as revenue expenditure.</p> <p>The State Government accorded administrative approval on 01.09.2016 for formation of Special Purpose Vehicle, a not for profit organization called the Company and the same came into existence on 02.02.2017. Memorandum of Understanding (MoU) was signed between SIADB representing SPV (the Company), Department of Commerce and Industry representing the State Government and Department of Heavy Industry representing GoI on 06.11.2016.</p> <p>As per MoU tentative cost of activities eligible for grant from GoI was Rs. 159.25 crore and 80% of this cost being Rs. 127.40 crore and Grant from GoI was limited to Rs. 125 crore with matching grant from SIADB totalling to Rs. 250 crore. As per Annexure III of the MoU, Rs. 12.5 crore being 5% was consultancy, Project Management Consultants (PMC) /Supervision charges (5%) was receivable from GoI and SIADB for total grant of Rs. 250 crore.</p>	<p>revenue grant will lead to non-compliance of Accounting Standard 12 and accounting policy of the Company.</p> <p>2. The paragraph 9 of Accounting Standard 10 'Property, Plant and Equipment' (PPE) states that the unit of measurement for recognition of PPE requires the <i>judgement</i> to <i>specific circumstances</i> of an enterprise (In case of the Company, 'single project' or 'the Project as a whole'):</p> <p>"9. This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to specific circumstances of an enterprise. An example of a 'unit of measure' can be a 'project' of construction of a manufacturing plant rather than individual assets comprising the project in appropriate cases for the purpose of capitalisation of expenditure incurred during construction period. Similarly, it may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value. An enterprise may decide to expense an item which could otherwise</p>	<p>find that that the reclassification to Capital work in progress (CWIP) is done to reflect appropriate accounting of financial accounts of the Company.</p> <p>In our view, each and every amount incurred including calling for tenders is only for developing the project which is of capital in nature and not for any revenue purposes and no way distorts the true and fair picture of the financial statements.</p>
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<p>The Company was a special purpose vehicle and there was no revenue to pay towards salary and allowance and employee benefits to the employees and other administration expenses. The matter of meeting the expenses of SPV towards salary and administration expenses was not discussed with either GoI or State Government or SIADB. Instead the Company upto 2020-21, debited the expenses to Statement of Income and Expenditure, and accounted a loss of Rs. 162.52 lakhs for the year 2020-21. However, during 2021-22, the Company changed the method of accounting for these expenses and debited the same to Capital work in progress stating all these expenses are directly attributable to Project.</p> <p>As per Accounting Standard 10, 'Property, Plant and Equipment' (PPE) paragraph 17, 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 is to be included in the cost of an item of PPE. The examples given for directly attributable costs are costs of employee benefits (as defined in AS 15, Employee benefits), professional fees etc., In paragraph 20, examples of costs that are not costs of an item of PPE are given, which included costs of introducing a new product or service (including costs of advertising and promotional activities), administration and other general overhead costs.</p> <p>Further in paragraph 88, it is stated that where an entity has in past recognized an expenditure in the statement of profit and loss which is eligible to be included as a part of the cost of a project for construction of PPE, it may do so retrospectively for such a project. The effect of such</p>	<p>have been included as property, plant and equipment, because the amount of the expenditure is not material.”</p> <p>The Management of the Company, based on specific circumstances and nature of activities involved, considered the development of industrial infrastructure activities at T District, as a ‘single project’ or ‘the project as whole’.</p> <p>The accounting policy of the Company towards Fixed Assets / PPE which also includes Capital work in progress (CWIP), states that:</p> <p><i>“Fixed assets are stated at cost less accumulated depreciation. All direct costs related to acquisition of fixed assets are capitalized until the assets are brought to its installation and working condition and are ready to use.”</i></p> <p>As per paragraph 17 of Accounting Standard 10, 'Property, Plant and Equipment', the cost of a fixed asset should consist of 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.</p> <p>Also, paragraph 18 of</p>	
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<p>retrospective application of this requirement, should be recognised net-of-tax in revenue reserves.</p> <p>As per AS 12, Accounting for Government Grants' and as per the significant accounting policy of the SPV, grant received from GoI and SIADB is treated as capital grant of the nature of promoter's contribution and treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.</p> <p>With this background, the Company's shifting of employee expense and other administration expenses from 2017-18 to 2021-22 to capital work in progress and accounting for 5% Consultancy, PMC/supervision charges was reviewed and commented as below:</p> <ol style="list-style-type: none"> 1. Either GoI or State Government or SIADB are not providing any revenue grant or financial assistance to meet the employee and administration cost separately to SPV. Hence 5% Consultancy, PMC/Supervision charges mentioned in MoU should have been recognised as income in Statement of Income and Expenditure in proportion to the stage of completion in previous/current year and accounted as other income. Instead full amount is accounted as capital reserve. Non-accounting of consultancy, PMC/ supervision charges has resulted in understatement of other income amounting to Rs. 12.45 crore (prior period) (5% of grant received till date amounting to Rs. 249 crore) and overstatement of Capital Reserve to that extent. 2. As, as per AS 10, costs of introducing a new product or service (including costs of advertising and promotional activities), administration and 	<p>Accounting Standard 10 provides <i>examples</i> of directly attributable costs which includes costs of employee benefits, professional fees, site preparation charges, delivery and handling costs, installation, and assembly costs.</p> <p>Further the Company has not incurred any advertising or promotional activity cost to introduce a new product or service. The cost incurred as advertisement are towards calling of tenders for carrying out the work/s at T District, which is directly attributable cost of the Company's Project.</p> <p>Since the Company is carrying out only one project which is considered as a '<i>single project</i>' or '<i>the project as whole</i>', all costs incurred till the project is completed <i>will be the cost directly attributable to the project</i> of the Company and eligible to be treated as Capital work in progress (CWIP).</p> <p>Therefore, there is no overstatement of CWIP or understatement of other expenses.</p> <p>In view of the above facts, the audit observation may kindly be dropped.</p>	
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<p>other general overhead costs are not 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, other expenses amounting to Rs. 249.40 lakhs incurred upto 2020-21 and Rs. 195.56 lakhs incurred during the year 2021-22 should have been debited to Statement of Income and Expenditure instead of debiting it to Capital Work in Progress resulting in overstatement of CWIP by Rs. 444.96 lakhs and understatement of other expenses Rs. 195.56 lakhs (current year) and prior period expenses by Rs. 249.40 lakhs and loss to that extent.</p> <p>Facts and figures may be confirmed and remarks if any may be offered.</p>		
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6. The C&AG on receipt of the reply by the Company, issued preliminary comments for the above query. The preliminary comments by C&AG and reply by the Company and statutory auditor are as below:

C&AG Observation	Reply issued by the Company	Reply Issued by the statutory auditors
<p>Statement of Income and Expenditure</p> <p>Note 13: Other Income: Rs. 4 lakh</p> <p>The above does not include employee benefit expenses Rs. 5.98 crore accounted during 2017-18 to 2020-21 and which was withdrawn by the Company during the year and transferred to</p>	<p>The Company, has the accounting policy towards Fixed Assets / PPE which also includes capital work in progress (CWIP); the same has been disclosed in point number (c) of Note number 1 – Significant accounting policies. The above said accounting policy is reproduced herewith for your reference: -</p> <p><i>“C – Fixed Assets</i></p> <p><i>Fixed assets are stated at cost less accumulated depreciation. All direct costs related to acquisition of fixed assets are capitalized</i></p>	<ol style="list-style-type: none"> 1. As per paragraph 17 of Accounting Standard 10 ‘Property, Plant and Equipment’, the cost of a fixed asset should consist of 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. 2. Also, paragraph 18 of Accounting Standard 10 provides examples of directly attributable costs which includes cost of employee benefits, professional fees, site preparation charges, delivery and handling cost, installation, and assembly costs. 3. We are of the view that the Company has considered the

<p>Capital Work in Progress due to change in an accounting policy by the management.</p> <p>The Company hitherto was expensing all the administrative expenses and other expenses to the Income and Expenditure Account during the period 2017-18 to 2020-21. During 2021-22, the Company changed its accounting treatment by accounting all the administrative and other expenses under Capital Work in Progress during 2021-22 considering the development of industrial infrastructure as a single project. However this change was carried out retrospectively from 2017-18 due to which all expenses booked during the period 2017-18 to 2020-21 hitherto accounted as expenditure in the Statement of Income and Expenditure were transferred to Capital Work in</p>	<p><i>until the assets are brought to its installation and working condition and are ready to use.”</i></p> <p>The Management of the Company, based on <i>specific circumstances</i> and nature of activities involved, considered the development of industrial infrastructure activities at T District, as a <i>‘single project’ or ‘the project as whole’</i>. Hence, all costs incurred till the project is completed will be the cost directly attributable to the project of the Company and eligible to be treated as capital work in progress (CWIP).</p> <p>The amount of Rs. 5.98 crore related to administration and establishment is a <i>Capital Expenditure</i> to the Company. Classification of the same as Capital Expenditure is raised in previous audit enquiry and reply from the Company is accepted by your office.</p> <p>The Company has reclassified during the year Rs. 5.98 crore from Reserves and Surplus (Liabilities) to Capital work in progress (Asset). This treatment for the year 2021-2022 is correct. This cannot be reclassified to Statement of Income and Expenditure as noted in preliminary comments 2, as the expenditure of <i>Rs. 5.98 crore is a Capital Expenditure</i>. Reversing the Capital Expenditure from Reserves and Surplus to Statement of Income and</p>	<p>development of industrial infrastructure activities at T District, as a ‘single project’ or ‘the project as whole’. Hence, all costs incurred till the project is completed will be the cost directly attributable to the project of the Company and eligible to be treated as capital work in progress (CWIP).</p> <p>4. As per the above said accounting policy, the Company has transferred all the costs directly attributable to the project to CWIP which is in line with the accounting policy of the Company.</p> <p>5. The following paragraph 9 of Accounting Standard 10 ‘Property, Plant and Equipment’ (PPE) states that the unit of measurement for recognition of PPE requires the judgement to specific circumstances of an enterprise (In case of the Company ‘single project’ or ‘the Project as a whole’:</p> <p>“9. This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to specific circumstances of an enterprise. An example of a ‘unit of measure’ can be a ‘project’ of construction of a manufacturing plant rather than individual assets comprising the project in appropriate cases for the purpose of capitalisation of expenditure incurred during construction period. Similarly, it may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies and to apply the criteria to the aggregate value. An enterprise may decide to expense an item which could otherwise have been</p>
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<p>Progress. Adjustment of these expenses retrospectively is not in order as the same should have been routed through the Income and Expenditure Account as these transactions were already expensed in the previous years and consequently the comparative figures of the earlier years in the Income and Expenditure Account are vitiated.</p> <p>This resulted in understatement of Other Income and consequent overstatement of excess of income over expenditure for the year to the extent of Rs. 5.94 crore.</p>	<p>Expenditure will result in <i>error in accounting principles</i> i.e. Capital Expenditure treated as Revenue Expenditure or reversals of the same during 2021-2022.</p> <p>Further, the Company has made the additional disclosures in financial statements for the year 2021-2022 towards reclassification of items with quantification of amounts at the end of each note, wherever applicable (refer Note 3 & Note 6), to have a better disclosure and understanding of financial statements for the users. The Company's intention is appropriate presentation of the financial statements for the benefit of readers of the financial statements.</p> <p>It is to be noted that, even though the disclosure recommended in preliminary comment 2 is followed, there will not be any change in the amounts disclosed in Reserves and Surplus and capital work in progress.</p> <p>Hence, the preliminary comments may please be dropped.</p>	<p>included as property, plant and equipment, because the amount of the expenditure is not material.”</p> <p>6. Therefore, the consideration of the development of industrial infrastructure at T District as a 'single project' or 'the project as a whole' is in line with Accounting Standard 10.</p> <p>In our view, the Company's treatment of all costs as directly attributable to the project and treating the same as capital work in progress till the project is completed is appropriate and no way distorts the true and fair picture of the financial statements.</p> <p>It should be noted that expenses related to the development of the project were taken as revenue expenses and booked in the Profit and Loss (P&L) Account of the Company during previous years. If reversals of such capital expenses are reflected in P&L Account, it would amount to taking revenue in the nature of the capital item in the P&L Account which is not at all appropriate in our respectful submission. In any case, there wouldn't be any change in the Reserves and Surplus on account of this. Just because capital expenses were taken in P&L Account in earlier years does not justify reversing such capital expenses through P&L Account for the year 2021-22.</p>
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(Emphasis supplied by the querist.)

7. The C&AG has requested the Company to obtain the opinion from the Expert Advisory Committee of the ICAI on the above two queries.

B. Query

8. In view of the above, the querist has sought the opinion of the Expert Advisory Committee (EAC) as to whether the C&AG's following observation and suggestion to accounting treatment is right or the treatment given by the Company is right:

“The administration and establishment expenses were accounted in the Income and Expenditure account from 2017-18 to 2020-21 and the surplus/deficit was adjusted with the Reserves and surplus in the Balance Sheet. In the year 2021-22, the Company has changed the accounting policy considering the development of industrial infrastructure as a single project wherein the administration and establishment expenses from 2017-18 to 2021-22 were charged to Capital Work In progress. However, this change was carried out retrospectively from 2017-18 due to which all expenses booked during the period 2017-18 to 2020-21 hitherto accounted as expenditure in the Statement of Income and Expenditure were transferred to Capital Work in Progress. Adjustment of these expenses retrospectively is not in order as the same should have been routed through the Income and Expenditure Account as these transactions were already expensed in the previous years and consequently the comparative figures of the earlier years in the Income and Expenditure Account are vitiated.

This resulted in understatement of Other Income and consequent overstatement of excess of income over expenditure for the year to the extent of Rs. 5.94 crore.”

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to accounting treatment for certain administrative and establishment expenditure (including employee benefit expenses) incurred for the project that were expensed in the Statement of Income and Expenditure from 2017-18 to 2020-21 and subsequently, in the F.Y. 2021-22, the Company, considering the development of industrial infrastructure project as a single project, treated the said expenditure incurred as cost directly attributable to the project and capitalised the entire expenditure incurred as capital work in progress by credit to reserves and surplus. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for grant (if any) received for the project, accounting for land and building provided by SIADB, accounting for any other expenditure incurred by the Company in relation to the project, timing of recognition of expenditure, accounting for consultancy and PMC/supervision charges being received by the Company, recognition of income (if any) by the Company, appropriateness of selection of the unit of measure for the purpose of capitalisation of expenditure, whether the Company is acting as an agent on behalf of the Government, whether the funds provided by the Government were of the nature of grant and whether these funds were utilised for the purposes for which they were given to the Company, etc. The Committee notes from the annual report of the Company for the financial year 2020-21 that the Company follows Accounting Standards (AS) in its financial statements and has, therefore, examined the issue considering the requirements of Accounting Standards, notified under the Companies (Accounting Standards) Rules, 2021. Further, the Opinion hereinafter is purely from accounting perspective and not from legal perspective, such as, legal interpretation of Memorandum of Association (MoA), Articles of Association (AoA), Memorandum of Understanding (MoU) etc. Furthermore, since the Company is capitalising the expenditure incurred on the project as its capital work in progress, the Committee presumes that the assets arising out of such project are owned and controlled by the Company for these to be considered as property, plant and equipment for the Company, as per the requirements of AS 10.

10. At the outset, the Committee wishes to mention that accounting treatment of an item of expenditure depends upon the nature of such an item and not upon the nature of funds/grant provided for such expenditure and the timing of incurrence thereof. Further, the fact that the

Company is carrying out a single project or is engaged in construction activity or an expense is incurred during the period of construction, does not in itself, make that expenditure eligible for capitalisation; rather it depends on the nature of such expenditure in the light of the specific accounting principles/requirements for such an expenditure. Thus, merely on the basis that there is a single project which is considered as unit of measurement, does not imply that every expenditure can be capitalised.

11. With regard to the accounting for administrative and establishment expenditure incurred for the project, the Committee notes the following paragraphs of AS 10, 'Property, Plant and Equipment':

“17. 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, removing the item and restoring the site on which it is located, referred to as 'decommissioning, restoration and similar liabilities', the obligation for which an enterprise 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.

18. Examples of directly attributable costs are:

- (a) costs of employee benefits (as defined in AS 15, *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment;
- (b) costs of site preparation;
- (c) initial delivery and handling costs;
- (d) installation and assembly costs;
- (e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
- (f) professional fees.”

“20. Examples of costs that are not costs of an item of property, plant and equipment are:

- (a) costs of opening a new facility or business, such as, inauguration costs;

- (b) costs of introducing a new product or service (including costs of advertising and promotional activities);
- (c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- (d) administration and other general overhead costs.”

From the above, the Committee notes that the basic principle to be applied while capitalising an item of cost as a part of an item of 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 carrying on of 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.

The Committee further notes that paragraph 20 of AS 10, as reproduced above, states that administration and other general overhead costs are examples of the costs that are not costs of an item of property, plant and equipment (PPE). Therefore, administrative expenses cannot be considered as ‘directly attributable cost’ of construction of the project and cannot be capitalised as cost of an item of property, plant and equipment/project. Similarly, establishment expenses of the nature of costs of introducing a new product or service (including costs of advertising and promotional activities) or the costs of conducting business in a new location or with a new class of customer (including costs of staff training) cannot also be considered as ‘directly attributable cost’ of construction of the project/PPE.

With regard to employee benefit expenses, the Committee notes that paragraph 18 of AS 10 gives examples of directly attributable costs and they include costs of employee benefits (as defined in AS 15, 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 project/PPE, such as, employee benefit costs of workers, labourers, engineers, architects, etc. engaged in construction activity should only be capitalised and rest should be charged to the Statement of Income and Expenditure as and when incurred.

12. Further, the Committee notes from the Facts of the Case that in respect of the retrospective capitalisation of administrative and establishment expenditure incurred on the project to capital work in progress, reference has been made to the requirements of paragraph 88 of AS 10, which provides as follows:

“Transitional Provisions²

88. Where an entity has in past recognized an expenditure in the statement of profit and loss which is eligible to be included as a part of the cost of a project for construction of property, plant and equipment in accordance with the requirements of paragraph 9, it may do so retrospectively for such a project. The effect of such

² Ministry of Corporate Affairs, Government of India, inserted the following footnote in Companies (Accounting Standards) Rules, 2021, which is relevant for companies: “Transitional Provisions given in Paragraphs 88-91 are relevant only for standards notified under Companies (Accounting Standards) Rules, 2006, as amended from time to time”.

retrospective application of this requirement, should be recognised net-of-tax in revenue reserves.”

The Committee is of the view that transitional provisions are provided with a view to facilitate a smooth switch-over to a new method of accounting enunciated in a new accounting standard. In case of AS 10, the Standard was revised and titled as ‘Property, Plant and Equipment’ by the Ministry of Corporate Affairs, Government of India, vide Notification dated 30th March, 2016, which was to be applicable for accounting periods commencing on or after the date of Notification. However, in this context, the Committee notes that the Company was formed in February 2017 when the revised AS 10 was already in effect and therefore, the transitional provisions are not applicable in the extant case.

13. The Committee is of the view that in the extant case, if the Company did not follow the above-mentioned requirements of AS 10, the same should be considered as an error of prior periods with an adjustment to Statement of Income and Expenditure, as per the following requirements of AS 5, ‘Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies’:

“4.3 Prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods.”

“Prior Period Items

15. The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived.

16. The term ‘prior period items’, as defined in this Standard, refers only to income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The term does not include other adjustments necessitated by circumstances, which though related to prior periods, are determined in the current period, e.g., arrears payable to workers as a result of revision of wages with retrospective effect during the current period.

17. Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, or oversight.”

D. Opinion

14. On the basis of the above, the Committee is of the opinion that the accounting treatment of administrative and establishment expenditure (including employee benefit expenses) incurred for the project should be as per the requirements of AS 10, as discussed in paragraph 11 above. In the extant case, if the Company did not follow the above-mentioned requirements of AS 10, the same should be considered as an error of prior periods with an adjustment to Statement of Income and Expenditure, as per the requirements of AS 5, as discussed in paragraph 13 above.