

Query No. 4

Subject: Capitalisation of ATS Charges due on Intangible Asset under development (ERP).¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’), a Schedule ‘A’ and a Mini Ratna (Category-I) Company, was incorporated on 23rd August 1974. It has an authorised capital of Rs. 1000 crore and a paid up capital of Rs. 490.58 crore out of which Government of India’s share is 74.71 % and 25.29 % is held by financial institutions and others. The Company has five gas based Ammonia-Urea plants. The Company currently has a total annual installed capacity of 35.68 Lakh Metric Tonnes (LMT) (re-assessed capacity of 32.31 LMT) and is the 2nd largest producer of Urea in the country with a share of about 16% of total Urea production in the country. The Company is engaged in manufacturing and marketing of Neem Coated Urea, three strains of Bio-Fertilizers (solid and liquid) and other allied industrial products like ammonia, nitric acid, ammonium nitrate, sodium nitrite and sodium nitrate. Urea (fertilizer) is a controlled product and its price is controlled by the Government under its subsidy scheme. The MRP of Urea is fixed by the Government and is same for all companies. The Company is also importing and trading various agro-inputs like non-urea fertilizers, certified seeds, agrochemicals, bentonite sulphur, city compost through its existing PAN India dealer’s network under single window concept.

Compliance with Ind AS

2. The financial statements are prepared on accrual basis, as a going concern and comply in all material aspects, with Indian Accounting Standards (Ind ASs) notified under section 133 of the Companies Act, 2013 (the Act) [Companies (Indian Accounting Standards) Rules, 2015](as amended) and other relevant provisions of the Act. The financial statements up to year ended 31st March, 2016 were prepared in accordance with the Accounting Standards notified under Companies (Accounting Standards) Rules, 2006 (as amended) and other relevant provisions of the Act.

Background of the Present case

3. The Company, vide work order dated 30.07.2020, has awarded the contract to M/s Tech M for implementation of SAP – ERP solutions at the Company for a total value of Rs. 76.73 crore, which includes IT Infrastructure & cloud hosting, ERP License, ERP License Annual Technical Support (ATS), ERP Application Support, SDWAN Solution etc.

4. As per the agreed terms of the work order, the implementation of SAP – ERP solutions was to be completed within 12 months from the date of work order, i.e., 29.07.2021. However, due to unavoidable delays on the part of implementing agency M/s Tech M and other issues, the implementation of SAP – ERP solutions got delayed and implementation is still under process.

¹ Opinion finalised by the Committee on 8.4.2024.

Accounting Treatment by the Company

5. After start of the implementation of SAP – ERP solutions at the Company, it has incurred an amount of Rs. 30.44 crore upto 31.03.2023 and has capitalised the same including ATS Charges of Rs. 7.42 crore based on the value of work executed as per terms of contract. The year-wise break-up of cost incurred is as under:

Particulars	Rs. in crore				
	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
ERP - SAP	4.10	4.44	21.42	0.48	30.44

About ATS Charges

6. The ATS Charges comprise of following:

- a. ATS for core ERP Functions.
- b. ATS for E-Office solutions including DMS and workflow (if applicable).

Work order details relating to ATS

As per the work order dated 30.07.2020 for implementation of ERP, referring to the scope of work order with regard to ATS, the clause is as below:

ERP License Annual Technical Support (ATS) is due one year after delivery of License upto 5 years (a copy of Work Order dated 30.07.2020 has been supplied separately by the querist for the perusal of the Committee).

Further, Sr. No. 9 of payment terms of work order dated 30.07.2020 placed on M/s Tech M for implementation of ERP provides the following regarding ATS for ERP:

ATS for ERP and all other Licenses shall be paid from second year onwards (1 year after delivery of Licenses) on submission of the following documents:

- a. Proof of payment made by M/s Tech M to the OEM(s) for the respective year's ATS Charges being claimed from the Company.
- b. Submission of certificate by M/s Tech M for commencement of ATS services for respective year.
- c. Submission of preceding year's report by the OEMs containing details of support services delivered, updates, upgrades and patches installed for the ERP software solution and License (as applicable).

The querist has stated that no invoice has been raised by M/s Tech M for Annual Technical Support Services (ATS) and no payment has been made to M/s Tech M. However, based on principle of conservatism, a provision of Rs. 7.42 crore (Rs. 3.73 crore per year) is being made in the books of account and charged to capital work in progress (CWIP).

7. *Government Audit observation on the annual accounts for the financial year (F.Y.) 2022-23:*

However, during the course of audit of annual accounts of the Company for the financial year (F.Y.) 2022-23, *audit observed that the Company has to release ATS price to the tune of Rs. 7.42 crore for the un-implemented period of ERP project, which had not given any benefit to the Company. Since ATS has to be paid on yearly basis which is of recurring nature and not directly attributable cost of the development of ERP, the same should not be capitalised under the head “Intangible assets under development”. The detailed Audit Observation issued by the Govt. Audit on Capitalisation of Annual Technical Support (ATS) Charges due on Intangible Asset under development (ERP) is reproduced below:*

Audit Observation

“Ind AS 38, Intangible Assets states that “the cost of a separately acquired intangible asset comprises: (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and (b) any directly attributable cost of preparing the asset for its intended use”.

BoD approved (June 2020) the implementation of ERP in the Company and subsequently, Notification of Award (NOA) of contract and the work order for implementation of ERP solution at the Company was issued in favor of M/s Tech M on 30.07.2020. As per the terms and conditions of work order, the ERP project was to be implemented within 12 months from the date of work order i.e., 30.07.2020.

As per the schedule of rate for implementation of ERP for the Company, Annual Technical Support (ATS) price of Rs. 3.73 crore (exclusive of GST) for licenses was payable to M/s Tech M. Accordingly, the Company has created a provision of Rs. 7.42 crore for ATS for the years 2021-22 and 2022-23 and same has been shown under the head “Intangible assets under development”.

In this regard, audit observed that the Company has to release ATS price to the tune of Rs. 7.42 crore for the un-implemented period of ERP project, which had not given any benefit to the Company.

Further, ATS was to be paid during operations & maintenance phase, which was not the part of “Development/Implementation Phase”. Moreover, ATS has to be paid on yearly basis which is of recurring nature and not directly attributable cost of the development of ERP. Hence, the same should not be capitalised under the head “Intangible assets under development”.

Thus, this has resulted into understatement of ‘provision for expenses’ and overstatement of profit by Rs. 7.42 crore.

The above facts and figures may please be confirmed and remarks of the management/statutory auditor along with supporting papers may please be furnished within 2 days of receipt of this audit observation.”

Management Reply to Audit Observation: The Company submitted the following reply to the Government Audit in respect of aforesaid Audit Observation:

“Paragraph 27 of Ind AS 38 states as under:

“The cost of a separately acquired intangible asset comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
- (b) any directly attributable cost of preparing the asset for its intended use.”

Further, paragraph 30 of Ind AS 38 states as under:

“Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. ...”

Further, paragraph 8 of Ind AS 38 inter-alia states as under:

“Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.”

It is informed that for development of ERP software, ERP licenses are purchased and these licenses are used for coding, programming and testing etc. till go-live.

Annual Technical Support is in relation to the above said licenses on which ERP development, testing etc. is still continuing. Therefore, the provisional expenditure of Rs. 7.42 crore on Annual Technical Support is being capitalised as Intangible Asset (ERP).

As the ERP is still under development stage and ATS to be paid is in relation to licenses procured, which are currently being used and will continue to be used for development of ERP till milestone of Go-Live is achieved. Therefore, no benefit has arisen or generated to the Company from licenses during the period, as those are being used for development of Intangible Asset “ERP”. Accordingly, expenditure to the tune of Rs. 7.42 crore on ATS has been correctly recognised under “Intangible assets under development”.”

Government Audit Supplementary Observation through Provisional Comment (PC) No.1:

“Ind AS 38, ‘Intangible Assets’ states that “the cost of a separately acquired intangible asset comprises: (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and (b) any directly attributable cost of preparing the asset for its intended use.”

BoD approved (June 2020) the implementation of ERP in the Company and subsequently, Notification of Award (NOA) of contract and the work order for implementation of ERP solution at the Company was issued in favor of M/s Tech M on 30.07.2020. As per the terms and conditions of work order, the ERP project was to be implemented within 12 months from the date of work order i.e., 30.07.2020.

As per the schedule of rate for implementation of ERP for the Company, Annual Technical Support price of Rs. 3.73 crore (exclusive of GST) for licenses was payable

to M/s Tech M. Accordingly, the Company created a provision of Rs. 7.42 crore for ATS for the years 2021-22 and 2022-23 and same has been shown under the head “Intangible assets under development”.

The Company has to release ATS price to the tune of Rs. 7.42 crore for the unimplemented period of ERP project, which had not given any benefit to the Company. Further, ATS was to be paid during operations & maintenance phase, which was not the part of “Development/Implementation Phase”. Moreover, ATS has to be paid on yearly basis which is of recurring nature and not directly attributable cost of the development of ERP. Hence, the same should not be capitalised under the head “Intangible assets under development”.

Thus, it has resulted in understatement of ‘provision for expenses’ and overstatement of profit by Rs. 7.42 crore.”

Management Reply to Provisional Comment: The Company submitted following reply to the Govt. Audit in respect of aforesaid PC:

“Paragraph 27 of Ind AS 38 as under:

“The cost of a separately acquired intangible asset comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
- (b) any directly attributable cost of preparing the asset for its intended use.”

These licenses were procured in year 2020-21 to start development of ERP software and without these licenses, intended use of SAP i.e. coding, programming and testing etc. till go-live is not possible. As the intangible asset is still under development stage and licenses are continued to be used for intended use (yet to be achieved), therefore ATS has been correctly classified as Intangible Asset under development. To support contention of the Company, paragraph 30 of Ind AS 38 states as under:

“Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. ...”

Further, paragraph 8 of Ind AS 38 inter-alia states as under:

“Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.”

The ERP is still under development stage and ATS to be paid is in relation to licenses procured, which are currently being used and continue to be used for intended use of intangible assets. Further, with respect to recurring annual cost as mentioned in the PC, it is fundamental principle under Ind AS, whether development of tangible or intangible assets, any cost incurred till intended use is achieved, has to be capitalised till ‘intended use’ is achieved; thereafter similar cost capitalised earlier in relation to development of those assets become recurring revenue costs i.e. interest, annual charges etc.”

B. Query

8. In the above background, opinion in the subject matter is requested for the following:
- (i) Whether the capitalisation of ATS Charges due on intangible asset under development (ERP) in the books of account of the Company is in accordance with the provisions of Ind AS 38.
 - (ii) Any other advice for proper accounting of the above assets.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to accounting for ATS Charges due on intangible asset under development (ERP) in the financial statements of the Company. 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 any other expenditure incurred (viz. IT Infrastructure & cloud hosting, ERP License, ERP Application Support), appropriateness of accrual of the ATS charges in the absence of receipt of invoice from the vendor, accounting before transition to Ind ASs and accounting during transition, accounting for E-office and other licenses and ATS thereof, appropriateness of the amount capitalised so far (Rs. 76.73 crores) and its breakup, etc. The Committee has answered the issue only from accounting perspective and not from legal perspective, such as, legal interpretation of work order etc. Further, the Accounting Standards referred to in the opinion are Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time.

At the outset, the Committee wishes to mention that the Committee has not examined that whether intangible asset under development (viz., ERP system) meets the definition and recognition criteria of 'Intangible Asset' as per Ind AS 38 and the Committee has proceeded on the premise that the Company has correctly recognised the same as 'Intangible Asset under development'. Further, the Committee wishes to point out that not all costs incurred during development of an intangible asset can be capitalised. The costs or expenses during the development of an intangible asset are capitalised as per the requirements of Ind AS 38.

Further, the Committee notes that the querist has submitted that due to unavoidable delays on the part of implementing agency and other issues, the implementation of SAP – ERP solutions got delayed and implementation is still under process. The Committee wishes to mention that, if an entity incurs cost during an extended period in which there is a suspension of the ERP implementation activities necessary to prepare the asset for its intended use, the costs incurred during such a period do not qualify for capitalisation. If there are delays on account of substantial technical and administrative work necessary for getting the asset ready for its intended use, an entity may continue to capitalise costs during such a period. In the absence of anything to the contrary, the Committee has not examined whether the ATS costs after 12 months of work order even without the SAP implementation is due to suspension / no active development towards activities for SAP implementation or substantial technical / administrative activities necessary for SAP implementation. It has been assumed that the nature of the ATS charges in question is not due to suspension / no active development towards activities for SAP implementation.

10. The Committee notes the following features of ATS Charges from the work order:

“Key Information for Implementation of ERP in the Company

ERP type and ERP Name	COTS (Commercial off the Shelf) – SAP S4/HANA
Number of ERP User Licenses	1500 (Including DR Site)
...	...
Implementation Period	12 Months from date of work order
ERP License Annual Technical support (ATS)	5 Years (One year after delivery of licenses)

...

1. General Scope of Work

...

- Provide Annual Technical Support (ATS) including the implementation of latest upgrades, service packs, enhancements and patches to the offered SAP S4/HANA product and other products during the 5 years ATS period post the implementation.
- Provide support services including full-fledged help desk solution post-implementation until end of Post Implementation Support Period (2 years post Implementation).

...

1.5. Implementation of SAP S4/HANA Application:

- a) Implementation of SAP S4/HANA Application: this includes design, customization, configuration, deployment and commissioning of COTS process(s)/ sub-process(s)/ functionalities to comply with the business needs of the Company. The implementation shall be based on the approved business blueprint and design. (FRS Requirement)
- b) The SAP S4/HANA application will be based on the configuration/ customization of COTS product.
- ...
- d) Identify and Integrate with all Internal and external systems and services as per the requirement of the proposed system.

...

1.5.1 Development:

Developments shall be in the nature of enhancements to existing applications, additional applications, additional reports and form changes etc. M/s Tech M shall validate and confirm the need for any such developments that are required in order to meet the functionality of processes. ...

...

1.7.4. Post Implementation Support:

In addition to clause above, M/s Tech M is required to provide post implementation technical & functional support services which include the rectification of all the latent or identified defects, bugs and Improvements for two (2) years from the end of implementation. ... All the enhancements, patches, latest version upgrades, service packs etc. (as applicable) are to be installed within 3 months of release of a stable version in consultation with the Company. ...

...

1.7.10. Supply of Software/ Licenses:

- a) M/s Tech M shall supply all the software with adequate number of licenses, required for the proposed SAP S4/HANA system. All system software, licenses etc. have to be procured in the name of the Company.
- b) The licenses should be perpetual. The software licenses shall not be restricted based on location and the Company should have the flexibility to use the software licenses for other requirements (if required).
- c) The software provided should have the OEM support for a period of not less than 5 years from the date of implementation.
- d) Tools, software for implementation, data migration, testing etc. shall be part of the offered solution.
- e) All support services including updates, upgrades and patches for all SAP S4/HANA processes shall be provided by M/s Tech M till the end of the warranty/ ATS Period.”

“5. Licenses

M/s Tech M should provide the requisite types of licenses for selected SAP S4/HANA application, related database, middle-ware, any additional bolt-on third party tools (if proposed) and all other required tools and/or applications with sufficient number of user and product licenses. ... The supplied licenses should be valid for the latest/current version as on the date of actual procurement. The licenses should be supplied only on the basis of written confirmation from the Company.

M/s Tech M should propose all the required processes/functions from a single SAP S4/HANA suite to meet the Company requirements. In case any specific function(s) are not available in the proposed standard SAP S4/HANA suite, M/s Tech M may propose additional SAP S4/HANA product vendor processes or third party bolt-on tools. M/s Tech M will ensure that the entire solution is seamlessly integrated and users should be able to perform their business roles through a single sign-on.

...”

“8. Configuration, Customization & COTS

...

Preferably, changes should be kept as minimal as possible to the SAP S4/HANA core processes. This is important to ensure that future upgrades, enhancements and bug fixes

are not impacted. Any customization as may be necessary should be done only after confirmation from SAP S4/HANA product vendor of non-availability of standard functionality and obtaining prior written approval from the Company. Every custom development must be documented in detail and the script ownership should be passed on to the company as soon as this becomes part of production environment.

...”

“19. Payment Terms

Project Milestone	SAP S4/HANA Application License	Timelines From date of Work Order (TO)
...
a. Yearly <i>ATS</i> Payment of ERP, Licenses (1500) as per contract (Annexure-A: Sr. No. 2-a of price schedule)	100% of respective year	One year after License delivery date and subsequently for 4 years”
...		

“Payment Terms - Instructions

...

9. *ATS* for ERP and all other Licenses shall be paid from second year onwards (1 year after delivery of licenses) on submission of following documents:
 - a. Proof of payment made by M/s Tech M to the OEM(s) for the respective Year's *ATS* Charges being claimed from the Company.
 - b. Submission of certificate M/s Tech M for commencement of *ATS* services for respective Year.

...”

From the above and the facts supplied, the Committee understands that for the implementation of SAP-ERP software solution/ system in the Company, in the beginning, certain perpetual ERP licenses (SAP S4/HANA) have been procured from OEM in the name of the Company, which will be installed, customised and integrated as per the Company’s requirements and functions/operations by M/s Tech M. In respect of such licenses, yearly *ATS* (Annual Technical Support) payment after one year of license delivery date (i.e. from second year onwards) and subsequently for a period of 4 years has to be made by the Company (for 5 years in total). Further, *ATS* services include delivery of support services, implementation of latest updates, upgrades, service packs, enhancements and installation of patches for the ERP software solution and licenses. Initially, as the implementation of the ERP software was to take place within 12 months from date of work order, payment for *ATS* was to be made during 5 years post implementation of ERP. However, since the implementation could not be achieved in the specified period of 12 months, the Company understands that the payment of *ATS* is due after 12 months and therefore, has created an accrual for the same and is capitalising the same with the cost of intangible asset (ERP software) under development. Presuming that the Company’s understanding with regard to its obligation towards *ATS* after twelve months is correct, the Committee examines the issue of accounting for the same in subsequent paragraphs.

11. In context of the issue raised, the Committee notes the following requirements of Ind AS 38, 'Intangible Assets':

“21 An intangible asset shall be recognised if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and**
- (b) the cost of the asset can be measured reliably.”**

“Cost of an internally generated intangible asset

65 The cost of an internally generated intangible asset for the purpose of paragraph 24 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 21, 22 and 57. Paragraph 71 prohibits reinstatement of expenditure previously recognised as an expense.

66 The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:

- (a) costs of materials and services used or consumed in generating the intangible asset;
- (b) costs of employee benefits (as defined in Ind AS 19) arising from the generation of the intangible asset;
- (c) fees to register a legal right; and
- (d) amortisation of patents and licences that are used to generate the intangible asset.

Ind AS 23 specifies criteria for the recognition of interest as an element of the cost of an internally generated intangible asset.”

From the above, the Committee notes that the cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. It includes costs, such as, cost of material and services used or consumed and cost of employee benefits in generating the intangible asset, amortisation of patents and licenses that are used to generate the intangible asset etc. The Committee is of the view that 'directly attributable' costs are generally such costs which are necessary to generate the asset and without the incurrence of these costs, the asset cannot be created, produced or prepared to be capable of operating in the manner intended by management.

The Committee notes that in the extant case, with regard to ATS Charges, it is informed by the querist that ERP licenses were procured for development of ERP software and without these licenses, intended use of SAP-ERP software solution/ system i.e. coding, programming and testing etc. till go-live is not possible. Further, Annual Technical Support is in relation to these

licenses on which ERP development, testing, etc. is still continuing. Thus, it appears that incurring license charges including ATS Charges are necessary for development of ERP (intangible asset) in the extant case.

Further, as discussed in paragraph 10 above, it appears that in the extant case, ERP license is the base over which the SAP-ERP software solution/ system of the Company is to be developed and ATS ensures the upgradation/updation of the licenses over which ERP system will be developed. Therefore, it appears that ATS Charges are directly attributable costs necessary to create, produce, and prepare the updated/upgraded ERP software/system for it to be capable of operating in the manner intended by management. Accordingly, to the extent and till the ERP software/system is under development and ATS Charges relate to that period, the same may be capitalised to the cost of ERP software/system under development. Thus, capitalisation of ATS Charges due on intangible asset under development (ERP) in the books of account of the Company appears to be in accordance with provisions of Ind AS 38.

D. Opinion

12. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 8 above:

- (i) Capitalisation of ATS Charges due on intangible asset under development (ERP) in the books of account of the Company appears to in accordance with provisions of Ind AS 38, as discussed in paragraphs 10 and 11 above.
- (ii) In view of (i) above, this issue does not arise.
