Treatment of expenditure with regard to purchase of small items of plant and equipment

The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A Government of India undertaking, registered under the Companies Act, 1956, is engaged in activities similar to those carried on by the Indian Railways. It follows the accounting policy to charge to revenue all items of small plant and equipment valuing less than Rs. 1 lakh. The same policy is being followed by the Indian Railways.

2. The querist has mentioned that the statutory auditors of the company have stated that the said policy is in contravention of Accounting Standard (AS) 6, 'Depreciation Accounting' and Accounting Standard (AS) 10, 'Accounting for Fixed Assets', issued by the Institute of Chartered Accountants of India. The company has not agreed with the views of the statutory auditors on the ground that the company is basically performing the same business activities as the Indian Railways. It is a working railway and train operations are interlinked with Indian Railways in terms of train running, apportionment, hiring of rolling stock and fare structuring. The company is also a member of IRCA.

3. As per the querist, in the accounting standards issued by the Institute, the criteria for determining an item as a fixed asset or otherwise needs to be judicially considered and depends on the nature of the enterprise. It has also been mentioned that an enterprise may decide to expense an item which could otherwise have been included as a fixed asset, because the amount of expenditure is not material. Further, AS 10, which deals with accounting for fixed assets, lays down the criteria for recognition of fixed assets. One such criteria is that of 'materiality' for recognising an item as a fixed asset.

4. The querist has informed that considering the nature of railway operations and maintenance and the number of components and items required for maintenance of track, rolling stock, signalling and telecom, electrical and IT equipment, Ministry of Railways, taking all aspects of working and the materiality factor into account, decided that plant and equipment below Rs.1 lakh is to be charged to revenue. The plant and equipment purchased will, however, be entered in the Deadstock/Tools and Plant Register and verified by the verifier on a periodical basis. The querist has also argued, that since the company is engaged in the same business as the Indian Railways, the criteria adopted by the latter for determining an item as a fixed asset would also be applicable to the company and this decision is within the powers of its management.

5. The querist has expressed his view that AS 10 has not been violated as brought out by the statutory auditors. Consequently, AS 6 is also not violated.

B. Query

6. The opinion of the Expert Advisory Committee has been sought by the querist as to whether the company's accounting policy of charging small value items is in conformity with AS 6 and AS 10.

C. Points considered by the Committee

7. The Committee notes that paragraph 4.3 of the Preface to the Statements of Accounting Standards, issued by the Institute of Chartered Accountants of India, states, inter alia, that, "The accounting standards are intended to apply only to items which are material."

8. The Committee notes that paragraph 17(c) of

1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.

2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 21 volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.

Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', explains 'materiality' as below:

> *"c. Materiality*
>
> Financial statements should disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements."

9. The Committee also notes that paragraph 3 of the Statement of Standard Auditing Practices (SAP) 13 [now known as 'Auditing and Assurance Standard (AAS) 13'], 'Audit Materiality', issued by the Institute of Chartered Accountants of India, explains, inter alia, that, "Materiality depends on the size and nature of the item, judged in the particular circumstances of its misstatement." It further states in paragraph 5 that, "The concept of materiality recognises that some matters, either individually or in the aggregate, are relatively important for true and fair presentation of financial information in conformity with recognised accounting policies and practices".

10. On the basis of the above, the Committee is of the view that it is not necessary that what is material for Indian Railways is also material for the company in question. Accordingly, materiality has to be determined keeping in view the circumstances prevailing within the company which may be different from those prevailing in the Indian Railways.

11. The Committee further notes the definition of the term 'fixed asset', given in paragraph 6.1 of AS 10, as below:

> "6.1 *Fixed asset* is an asset held with the intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business."

12. The Committee also notes paragraph 8.1 of AS 10, which is as reproduced below:

> "8.1 The definition in paragraph 6.1 gives criteria for determining whether items are to be classified as fixed assets. Judgement is required in applying the criteria to specific circumstances or specific types of enterprises. It may be appropriate to aggregate individually insignificant items, and to apply the criteria to the aggregate value. An enterprise may decide to expense an item which could otherwise have been included as fixed asset, because the amount of the expenditure is not material."

13. On the basis of the above, the company may expense an item of plant and equipment on the consideration of materiality as per paragraph 10 above. In such a case, it would be considered that AS 10 has not been violated. Further, where an item of plant and equipment has been expensed on the consideration of materiality, the question of charging depreciation thereon does not arise. Accordingly, in such a case, AS 6 is also not considered to be violated.

D. *Opinion*

14. On the basis of the above, the Committee is of the opinion that the accounting policy followed by the company to charge off small value items of plant and equipment costing less than Rs. 1 lakh to revenue would be in conformity with AS 6 and AS 10, provided the aforesaid amount is not considered material on the basis of the considerations stated in paragraph 10 above.

FOR THE ATTENTION OF THE MEMBERS

Limited Revision of Statement on Qualifications in Auditor's Report

The Council of the Institute at its 235th Meeting held in July 2003 approved the recommendation of the Auditing and Assurance Standards Board to Modify paragraph 3.22 of the Statement on Qualifications in the Auditor's Report. The existing paragraph 3.22 of the Statement on Qualifications in the Auditor's Report is replaced by the following paragraph:

> "3.22 When the auditors have qualified their report and a similar note to the accounts is given by the directors also, the Board of Directors is required to comply with the relevant provisions of the Companies Act, 1956."

The revised paragraph shall come into effect from 1st January 2004.