Query No. 7

Subject: Accounting for the share of expenditure incurred by the company on development of power sub-station and for obtaining power connection.[1]

A. Facts of the Case

1. A company is engaged in the manufacture of automobile parts for supplying the same to various automobile manufacturers. An industrial plot for establishing its new unit was acquired by the company in an industrial estate, which was developed by M/s A Ltd. (hereinafter referred to as 'Developer'). Since the unit is a manufacturing unit, it requires power to carry out its production and other operations. A State Power Corporation Limited (hereinafter referred to as 'SPCL') is the nodal agency to provide power connection to consumers. When the unit approached them for power connection, it was informed that it will take about 3 years to provide the power connection as they are not having any sub-station in the area. The unit has been in production since March, 2010 and all the power requirements are being met through in-house DG set. Presently, all the units in the industrial estate are operating through their self-operated DG sets. The cost of operating through DG sets is very high as compared to cost of power supplied by SPCL.

2. The Developer of the industrial estate then sought the approval of SPCL for developing the said power sub-station with its own expenditure. SPCL approved the same with the condition that the said power sub-station will be handed over by the developer to SPCL without any payment. The Developer, with mutual consent of all units, has decided that the said power sub-station will be developed by the Developer on behalf of all units and will be handed over to SPCL in industrial estate without any payment so that all the units in industrial estate may get power supply. This power sub-station will be operated and maintained by SPCL and it will also have the right to provide power connections to new units. The Developer estimated the cost of developing the sub-station and allocated the proportionate cost among all units in the industrial estate on the basis of load requirements by the respective units. The share of the company comes to Rs. 62.70 lakh. Thus, the Developer is working as a *nodal* agency between various units and SPCL (emphasis supplied by the querist).

3. Besides the above, the company will have to pay to SPCL for other expenses, like connection charges, line charges, pole and cable charges. The querist has also provided certain additional points for the consideration of the Committee:

(i) The company will not have any kind of ownership/ proportionate ownership in the said power sub-station as it will be transferred by the Developer to SPCL without any payment on behalf of all units.

(ii) It has been mentioned in the land allotment letter that the respective unit will have to bear the cost of obtaining power connection from SPCL.

---

[1] Opinion finalised by the Expert Advisory Committee on 03.06.2011.

(iii) The benefits derived from above expenditure of Rs. 62.70 lakh will last for more than one accounting period.

(iv) There will be cost saving in operating through electricity instead of DG Sets.

B. Query

4. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) Whether the expenditure of Rs. 62.70 lakh to be paid to Developer and subsequent payments to SPCL for getting the power connection is capital or revenue in nature. If it is classified as capital expenditure, then the class of asset in which the expenditure should be booked may be clarified.

(ii) Whether such expenditure creates an intangible asset as defined and governed by Accounting Standard (AS) 26, 'Intangible Assets'.

C. Points considered by the Committee

5. The Committee notes that the basic issues raised in the query relate to accounting for the two types of expenditure incurred by the company, viz., (i) proportionate share of expenditure amounting to Rs. 62.70 lakh borne by the company for development of power sub-station and (ii) other expenditure incurred for obtaining power connection, like connection charges, line charges, pole and cable charges. The Committee has, therefore, considered only these issues and has not touched upon any other issue that may arise from the Facts of the Case.

6. As regards the first type of expenditure incurred by the company towards development of power sub-station, the Committee notes that paragraphs 49 and 88 of the 'Framework for the Preparation and Presentation of Financial Statements', issued by the Institute of Chartered Accountants of India, give respectively, the following definition of and recognition criteria for, an asset:

> "An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise."

> "88. An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably."

From the above, the Committee notes that an expenditure incurred by an enterprise can be recognised as an asset only if it is a 'resource *controlled* by the enterprise'. Thus, it is the *control* over the resource that is important for recognising an expenditure as an asset. The Committee is of the view that an entity that controls a resource can generally deal with it as it pleases. For example, the entity having control of a resource can exchange it for other assets, employ it to

produce goods or services, charge a price from others to use it, use it to settle liabilities, or distribute it to owners. Further, the Committee is of the view that an indicator of control would be that the entity can restrict the access of others to the benefits derived from that resource. This view is also supported by the principles enunciated in paragraph 14 of AS 26, as reproduced below:

> "14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. …"

The Committee notes from the Facts of the Case that by incurrence of such expenditure, a power sub-station has been developed, which will be owned, operated and maintained by the SPCL and it shall have the right to provide power connection to new units. In other words, the company does not possess either the ownership or the control on the power sub-station. Accordingly, the Committee is of the view that this expenditure cannot be recognised as an asset (tangible or intangible). The Committee is further of the view that in the absence of such 'control', the expenditure incurred on development of sub-station should be expensed and charged to the profit and loss account of the period in which it is incurred, even though the economic benefits are expected to flow to the enterprise from such expenditure. In this regard, the Committee notes paragraph 56 of AS 26 which provides as follows:

> "56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. …"

7. As regards the accounting for other types of expenditure incurred by the company relating to connection charges, line charges and cable charges for obtaining the power connection, the Committee is of the view that it is necessary to determine the nature of such charges as to whether such charges create any asset which are being controlled by the company, as discussed in paragraph 6 above or these charges are paid to SPCL for using the assets of SPCL (viz., pole, cable). The Committee is of the view that the expression 'charges', in relation to power connection may be taken to mean the charges being paid for using the asset of SPCL and not that such charges would give rise to any asset (tangible or intangible) which would be controlled by the company. Accordingly, the Committee is of the view that subsequent payments to SPCL for getting the power connection is revenue expenditure in nature, unless it results in creation of an asset.

D. Opinion

8. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 4 above:

   (i) The expenditure of Rs. 62.70 lakh paid to the Developer and subsequent payments to SPCL for getting the power connection are revenue in nature. Refer to paragraphs 6 and 7 above.

(ii) In view of (i) above, answer to this question does not arise.