Query No. 25

Subject:

1. Accounting for preliminary and other pre-operative expenses.

2. Accounting for grants received.

3. Preparation of profit and loss account for the period before commencement of commercial operations.[1]

A. Facts of the Case

1. A State Government vide order dated 26.12.2007 accorded sanction for implementation of the High Speed Rail Link to the International Airport. A company, A Ltd., a wholly owned Government company within the meaning of section 617 of the Companies Act, 1956, was appointed as the nodal agency of the State Government for the High Speed Rail Link (HSRL) Project and to play a similar role that it has been playing in the implementation of another International Airport.

2. The querist has stated that vide that Order, sanction was also accorded to constitute a Special Purpose Vehicle (hereinafter referred to as 'SPV Ltd.') to implement the project on Public Private Partnership – Build, Operate and Transfer (PPP-BOT) basis by inviting Expression of Interest (EoI) and Request for Proposal (RFP). A Ltd. was also authorised to engage the services of another company, B Ltd. on assignment basis as project consultants to assist SPV Ltd. in the implementation of this project.

3. By another Government order dated 16.01.2008, sanction was accorded to release an amount of Rs. 2.50 crore to A Ltd. for utilising the funds to pay for the following:

(a) Consultancy fee to study the impact of City Airport Terminal (CAT) on the traffic and to suggest engineering solutions to tackle the traffic problems.

(b) For project consultancy services to assist SPV Ltd. and also for incorporation of SPV Ltd. and documentation charges/fee for preparation of Memorandum of Association (MoA) / Articles of Association (AoA), etc. of SPV Ltd.

4. The Managing Director of A Ltd. was authorised to draw this amount and to send proposal for further release of funds after incurring 80% expenditure of the released amount for this project on various expenses, including expenses for incorporation of the company (SPV Ltd.).

[1] Opinion finalised by the Expert Advisory Committee on 26.4.2012.

5. Vide another letter dated 30.01.2008, approval was accorded for incorporation of SPV Ltd. Accordingly, A Ltd. incorporated SPV Ltd. on 31st March, 2008 with the main objective to implement High Speed Rail Link (HSRL) Project to an International Airport under PPP concept. SPV Ltd. was incorporated under the provisions of the Companies Act, 1956. Initially, 49,996 shares of SPV Ltd. were issued for cash to A Ltd. and 4 shares to nominees of the State Government from out of the funds provided by the State Government. Consequent to this, SPV Ltd. became a subsidiary of A Ltd. and thus, it also became a Government company within the meaning of section 617 of the Companies Act, 1956.

Financial Year 2008-09

6. After incorporation of SPV Ltd., the State Government by an order dated 04.03.2009, had accorded sanction to release Rs. 2.00 crore to A Ltd. for making payment to different agencies towards expenditure incurred for High Speed Rail Link Project.

7. SPV Ltd. prepared its accounts for the period from the date of incorporation to 31st March, 2009 and under 'Significant accounting policies & Notes forming part of the accounts', the following disclosures were made:

"I. SIGNIFICANT ACCOUNTING POLICIES

(a) Pre-operative/implementation (construction) period expenses:

All expenses, including general administrative expenditure incurred by the company till the completion of the project shall be capitalised under the head pre-operative/implementation (construction) period expenses. Further, decision regarding the appointment of such accumulations amongst the cost of projects undertaken by the company or otherwise to write off of such expenses, will be taken at the completion/implementation of each of such projects.

(b) Preliminary expenses:

Preliminary expenditure is being amortised in 5 equal installments and over a period of 5 years commencing from the year in which the company commences its operations; funds received and expenditure incurred (except the preliminary expenses and pre-operative expenses) were not accounted, pending a decision in the matter.

II. NOTES ON ACCOUNTS

(2) Profit and Loss Account

Since the company has not commenced its operations during the period for which accounts are made up, profit and loss account has not been prepared.

(4) During the period from the date of incorporation of the company till 31.03.2009, A Ltd. has incurred Rs. 2.21 crore, being expenditure relating to project implementation and other administrative expenses, including payment to project consultants in terms of the GO No. IDD 157 dia 2007; and A Ltd. has received Rs. 4.50 crore from the State Government for meeting the project pre-operative expenses. Pending instructions/decisions from the State Government and A Ltd. regarding the treatment of the above expenditure in the books of the company, the same has not been brought to books of the company."

8. For the first year (viz., financial year 2008-09), only balance sheet was prepared and no profit and loss account or income and expenditure account was prepared. The audited accounts were adopted at the first Annual General Meeting (AGM) held in September, 2009.

Financial Year 2009-10

9. While finalising the accounts for the second year (viz., financial year 2009-10), SPV Ltd. prepared the profit and loss account for the year and the preliminary expenses and pre-operative expenses as at the close of 31st March, 2009 were charged to the profit and loss account. During the year 2009-10, SPV Ltd. has incorporated the transactions given effect to by A Ltd.

10. During the year 2009-10, additional 49,49,996 equity shares at Rs. 10 per share were allotted to the State Government by the Board of Directors and consequently, SPV Ltd. ceased to be a subsidiary of A Ltd.

11. While preparing the accounts for the year 2009-10, SPV Ltd. has accounted for the aggregate amount of funds received and transferred/expensed by A Ltd. as its income/expense in its books and balance has been accounted as balance receivable from A Ltd. A Ltd. had received funds aggregating Rs. 4,60,00,960 (including share capital and tender fee) as per the details furnished and it had incurred an expenditure of Rs. 2,63,94,127 (including preliminary expenses, pre-operative expenses and on capital items (computers, car and furniture and fixtures) and had transferred Rs. 1,50,00,000 to SPV Ltd. in the year 2009-10. The balance Rs. 46,06,833 has been shown under claims receivable. The amount due as per A Ltd. is Rs. 41,05,873. While the expenditure debited to the project has been accounted, interest income, if any, received by A Ltd. on the funds it received from the State Government and placed in Fixed Deposits has not been brought to books in the absence of information/details. The matter has been taken up with A Ltd. to give credit to the income earned on funds received from the State Government and surplus funds deployed by it. These facts are disclosed in the notes forming part of the accounts for the year 2009-10.

12. The statutory auditors have furnished their report and there are no comments upon or supplement to the report of the auditors by the Comptroller and Auditor General of India under section 619(4) of the Companies Act, 1956.

13. SPV Ltd. is of the view that accounting for funds received and expenses incurred by A Ltd. as well as by SPV Ltd. and preparation of profit and loss account is in consonance with the Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India and Opinions issued by the Expert Advisory Committee of the ICAI.

14. The querist has stated that as per Accounting Standard (AS) 10, 'Accounting for Fixed Assets', the expenses now incurred do not fall under the nature of 'directly acquiring the assets'. These expenses are incurred mainly as facilitators to the PPP Partners to have an insight into the project. No construction/project implementation by the company itself has been envisaged. The expenditure on the project construction will be borne by the PPP Partner and SPV Ltd. is only an authority for monitoring the implementation of the project as per the Agreement. SPV Ltd. is playing the role as a Transaction Adviser. It will remain as a shell company to oversee the implementation, operation and maintenance of the project during the concession period and will take over the project immediately after completion of the concession period or earlier in case of termination of the conession as per the conditions of the concession agreement. Further, as per the querist, during the concession period, the concessionaire will own the assets and once the concession period is over, SPV Ltd. will have ownership rights of the project assets.

15. The querist has further stated that the following issues were also kept in view while finalising the accounts for the year 2009-10:

Under the Companies Act, 1956:

Section 210(1) requires that: "At every annual general meeting of a company held in pursuance of section 166, the Board of directors of the company shall lay before the company –

(a) a balance sheet as at the end of the period specified in sub-section (3); and
(b) a profit and loss account for that period."

Section 210(3) states: "The profit and loss account shall relate – (a) in the case of the first annual general meeting of the company, to the period beginning with the incorporation of the company and ending with a day which shall not precede the day of the meeting by more than nine months..."

Department of Company Affairs (DCA) (Now known as Ministry of Corporate Affairs) Circular (Letter No.2/17/64-PR, dated 29.1.1964) while clarifying section 210 states: "The intention underlying this section is that every company should render to its shareholders an account of its expenditure and income even though they may have been incurred or received during the period of construction. It is no doubt true that a company

does not really commence its business operations till the period of construction is over. There will of course be no objection if such account is called “Development Account”, “Expenditure During Construction Account” or by any other suitable name so long as these accounts give details of the revenue expenditure and income during the period covered, in the manner required by Part II of Schedule VI to the Act. Sub-section (3) of Section 210 makes it quite clear that it is mandatory for every company to prepare a “Profit and Loss Account” from the date of its incorporation."

Schedule VI, Part II, inter alia, states, "The profit and loss account shall be so made out as clearly to disclose the result of the working of the company during the period covered by the account". According to the querist, it cannot be regarded that only commencement of commercial operations reflects the 'result of the working' of the company rather other activities, like, construction or winding up activities also denote the working of the company. Hence, the company prepared a profit and loss account from the second year (viz., financial year 2009-10).

Companies (Accounting Standards) Rules 2006 (hereinafter referred to as the ‘Rules’):

AS 10 is the applicable standard for capitalisation of fixed assets and Accounting Standard (AS) 26, ‘Intangible Assets’ is the applicable standard for capitalisation of intangible assets. The Guidance Note on Treatment of Expenditure during Construction Period has been withdrawn by the ICAI. In view of withdrawal of the Guidance Note by the ICAI, now, there is no concept of accumulating all the expenditure incurred into one account and then charging it off to revenue once the commercial operations are commenced.

As per paragraph 9.2 of AS 10, notified under the ‘Rules’, administration and other general overhead expenses are usually excluded from the cost of fixed assets because they do not relate to a specific fixed asset. Hence, as per the querist, all the general expenses cannot be capitalised and should be charged off to the profit and loss account, which implies that the profit and loss account has to be prepared. Further, as per paragraph 9 of AS 10, the expenditure does not fall under the components of costs. Since there is no concept of pre-operative expenses and the expenditure does not fall under the definition of fixed asset as per paragraph 6 of AS 10, the accounting done by SPV Ltd. is in compliance with the Accounting Standards framed by the ICAI.

16. Further, according to the querist, the funds received by A Ltd. (Rs. 4.50 crore) from Government are not in the nature of capital grants or for construction of project or for acquiring capital assets. To meet the expenses, the State Government had provided funds and according to the querist, as per Accounting Standard (AS) 12 ‘Accounting for Government Grants’, the funds received may have to be set off against the expenditure. A Ltd. had transferred Rs. 1.50 crore in the financial year 2009-10 to SPV Ltd. from out of the funds it had received from the State

Government and by bringing the transactions into books of account in the year 2009-10, SPV Ltd. is of the view that it has complied with AS 12 also.

17. *SPV Ltd. has requested A Ltd. to pass on the interest income it would have received on the surplus funds out of the funds received from the State Government to the company* (emphasis supplied by the querist).

18. SPV Ltd. is of the view that A Ltd. was an authorised agency/promoter for having SPV Ltd. incorporated and taking initial steps for initiation of process of consultancy contracts, etc. Accordingly, the funds were received by it from the State Government in fiduciary capacity and the income earned on the surplus funds deployed should be passed on to SPV Ltd. since as per the normally accepted conventions, the promoter/agent is bound to account for income. A Ltd. has also debited salaries and allowances of its officers and other expenses to SPV Ltd.

19. A Ltd. is of the view that the funds received by it from the State Government need not be accounted for in the books of account of SPV Ltd. and the expenditure should have been shown as pre-operative expenses since operations have not commenced and the funds received by SPV Ltd. (Rs. 1.50 crore) should not have been accounted as income. SPV Ltd. has accounted for funds received by A Ltd., interest income earned by SPV Ltd. and expenditure incurred by A Ltd. as well as by SPV Ltd. in the profit and loss account after taking into consideration the following:

(a) The State Government has provided funds for meeting the expenses by A Ltd. and Rs. 4.50 crore has been given, which represents reimbursement of expenses and no amount needs to be carried forward. The total funds received by A Ltd., expenses incurred by it and funds transferred have been considered and the net amount receivable has been shown under claims receivable. In the first year accounts, only a note was given for not accounting the expenditure.

(b) The nomenclature "Expense – A Ltd." has been given to identify the expenses incurred by A Ltd. during pre-incorporation period.

(c) The expenses are not in the nature of pre-operation expenses and the State Government has provided budgetary support of Rs. 4.50 crore. The project is implemented on Public Private Partnership (PPP) – Design, Build, Finance, Operation and Transfer (DBFOT) mode. The concession period is for 30 years. The expenses will also be reimbursed by the State Government. SPV Ltd. is only a SPV for the implementation of the project under PPP – DBFOT mode. The concession period may also be extended beyond 30 years. SPV Ltd. will not be owning assets till the completion of the concession period. After the project construction, the project will be operated by the concessionaire till the completion of the concession period including extensions, if any.

(d) The expenses mainly represent the expenses which are not only incurred by A Ltd. for SPV Ltd. but also the expenses incurred by SPV Ltd. The expenses are in the nature of consultancy fee, salaries and wages, travel expenses, rent for the office premises, etc. and are mainly incurred to provide information to the concessionaire. The expenditure cannot be carried forward, since the State Government has provided funds to meet these expenses and these expenses have to be set off against these funds. Further, as per AS 26, the expenses do not constitute intangible assets as these are not held for use in the production or supply of goods or services or for rental or for administrative purposes. Accordingly, as per the querist, such expenses do not meet recognition criteria of intangible assets as per paragraphs 19 to 54 of AS 26.

(e) The expenses incurred by A Ltd. and funds received by it as a promoter from the State Government have been rightly accounted for in the profit and loss account under 'expenses' and 'income' separately. Consequent to withdrawal of Guidance Note on Treatment of Expenditure during Construction Period and since there will be no intangible asset to be created by SPV Ltd., the expenses incurred will not be in the nature of pre-operative expenses which could be capitalised in view of the above facts.

20. The company has disclosed the following in the accounting policies and notes on accounts for the year 2009-10:

"(9) Other Accounting Policies

Since the company has been established for implementing various projects under PPP Model, other accounting policies will be declared as and when reportable transactions occur.

II. NOTES ON ACCOUNTS

(4) The State Government by an Order dated 26.12.2007 had accorded sanction for implementation of the High Speed Rail Link to the State International Airport and A Ltd. was appointed as the nodal agency and the State Government by an Order dated 16.01.2008 had accorded sanction to release an amount of Rs. 2.50 crore to A Ltd. for utilising the funds to pay for various expenses, including expenses for incorporation of the company. State Government by an Order dated 30.01.2008 accorded approval for incorporation of the company. The company was incorporated under the provisions of the Companies Act, 1956 on 31st March, 2008. After the incorporation of the company, the State Government by Order dated 04.03.2009 had accorded sanction to release Rs. 2.00 crore to A Ltd. for making payment to different agencies towards expenditure incurred for High Speed Rail Link Project. In the accounts for the period from the date of incorporation of the company to 31st March, 2009, funds received and expenditure

incurred (except the preliminary expenses and pre-operative expenses) were not accounted, pending a decision in the matter. During the year 2009-10, the company has incorporated the transactions given effect to by A Ltd.

(5) A Ltd. had received aggregate funds to the tune of Rs. 4,60,00,960 (including share capital and tender fee) as per the details furnished and it had incurred an expenditure of Rs. 2,63,94,127 (including preliminary expenses, pre-operative expenses on capital items) and had transferred Rs. 1,50,00,000 to SPV Ltd. in the year 2009-10. The balance Rs. 46,06,833 has been shown under claims receivable. The amount due as per A Ltd. is Rs. 41,05,873. While the expenditure debited to the HSRL project has been accounted, interest income, if any, received by A Ltd. has not been furnished and the same has not been accounted. The matter has been taken up with A Ltd. to give credit to the income earned on funds received from the State Government and surplus funds deployed by it.

(6) Consequent to allotment of 49,49,996 equity shares at Rs. 10 per share to the State Government by the Board of Directors during the year, SPV Ltd. ceased to be a subsidiary of A Ltd.

(10) During the year, Rs. 4,84,120 being the preliminary expenses have been fully written off since in the opinion of SPV Ltd., this is not recoverable and in the nature of impairment of assets. Similarly, Rs. 17,155 representing pre-operative expenses has been written off, since SPV Ltd. is a SPV for implementation of the HSRL project on PPP model and is not recoverable or allocable to the project. To this extent, there is a change in accounting policy and the loss to the extent of Rs. 5,01,275 is overstated."

21. Some directors of SPV Ltd. are of the view that preparation of profit and loss account for the year 2009-10 and accounting for funds received by A Ltd. for the project for meeting the expenses under income and also accounting for expenses by A Ltd. under various heads (shown separately) as the project has not been implemented may not be in accordance with Accounting Standards and the expenses should have been carried forward as was accounted in the financial year 2008-09 under the head of account 'pre-operative expenses pending capitalisation' and the accounting policies of the first year should be continued to be followed. The funds received by A Ltd. from the Government for meeting the expenses should not have been accounted under 'income' but should have been shown under 'Reserves and Surplus'.

B. Query

22. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee as to whether the accounting by SPV Ltd. for expenses/funds which was received by A Ltd. as promoter of SPV Ltd. by preparing profit and loss account for the current year is in compliance with the requirements of the Companies Act, 1956 and Accounting Standards issued by ICAI. If not, what is the appropriate accounting treatment?

C. Points Considered by the Committee

23. The Committee notes that the query relates to accounting treatment of preliminary and other pre-operative expenses and receipt of funds from the State Government to implement the High Speed Rail Link Project. The Committee, while answering the query, has considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, statutory implications of non-preparation of profit and loss account for the year 2008-09 and other requirements relating to holding of AGM, etc. in accordance with the Companies Act, 1956, treatment of income earned from surplus funds with A Ltd., accounting for shares issued to the State Government or A Ltd., accounting for funds received or expenses incurred by A Ltd. in the books of A Ltd., determination of amount of claims receivable from A Ltd., etc. The Committee further notes from the Facts of the Case that the querist has stated that during the concession period, the concessionaire will own the assets. The Committee is of the view that such ownership rights generally do not exist with the concessionaire in DBFOT type of concession agreements. Since the existence or non-existence of such ownership right with the concessionaire does not affect the opinion of the Committee, the Committee has not examined this issue. The Committee also notes that the query primarily relates to accounting for preliminary and other pre-operative expenses of SPV Ltd. and it is not related to expenses of the HSRL project. Therefore, the Committee has also not examined accounting for project related expenses. Further, the opinion expressed hereinafter is purely from the accounting point of view and not from legal point of view.

24. The Committee notes from the Facts of the Case that A Ltd. was appointed by the State Government as a nodal agency. Accordingly, it is presumed that all the expenses were incurred and funds were received from the State Government by A Ltd. on behalf of the company. The Committee further notes paragraph 56 of AS 26, notified under the Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as 'the Rules'), which is reproduced below:

> "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. For example, expenditure on research is always recognised as an expense when it is incurred (see paragraph 41). Examples of other expenditure that is recognised as an expense when it is incurred include:
>
> (a) expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;
(c) expenditure on advertising and promotional activities; and
(d) expenditure on relocating or re-organising part or all of an enterprise."

The Committee notes from the above that the start-up costs referred in AS 26 relate to costs of starting up an activity that includes incorporation expenses incurred in bringing an enterprise into existence as a separate legal entity. The Standard lays down a general rule that expenses of such nature should be expensed as no intangible asset or other asset is acquired or created that can be recognised, unless such expenditure is required to be capitalised as a part of the cost of a fixed asset as per AS 10. The Committee is of the view that the preliminary expenses incurred by A Ltd. towards incorporation of SPV Ltd. which were later given effect to by SPV Ltd. in the books of the account for the financial year 2009-10 are of the nature of 'start-up costs', which are incurred for the purposes of bringing an entity into its legal existence. AS 26 specifically provides that in these cases, such expenses are to be expensed as and when incurred as no intangible asset or other asset is acquired or created. The Committee is of the view that expenses incurred on formation of an entity cannot be said to be attributable to bringing an asset/project into existence and, therefore, cannot also be included as part of cost of fixed assets. Accordingly, these expenses should be expensed off in the profit and loss account in the year in which these are incurred and should not be carried forward to be amortised over a period.

25. As regards accounting for other pre-operative expenses, the Committee notes paragraph 9.2 of AS 10, notified under the Rules, which is reproduced below:

> "9.2 Administration and other general overhead expenses are usually excluded from the cost of fixed assets because they do not relate to a specific fixed asset. However, in some circumstances, such expenses as are specifically attributable to construction of a project or to the acquisition of a fixed asset or bringing it to its working condition, may be included as part of the cost of the construction project or as a part of the cost of the fixed asset."

The Committee notes from the Facts of the Case that other pre-operative expenses in the extant case appear to be basically administrative and general expenses which were incurred towards project consultancy and for facilitating the PPP Partners. The Committee is of the view that such pre-operative expenses which have been primarily incurred towards project consultancy or facilitating PPP partners and which can not be identified to construction/acquisition of any specific fixed asset should be charged off to the profit and loss account as and when incurred as enunciated in paragraph 9.2 of AS 10 read with paragraph 56 of AS 26. However, if such expenses are specifically attributable to the acquisition of a fixed asset for SPV Ltd. or bringing it to its working condition (refer paragraph 11 above), these may be capitalised as fixed asset of SPV Ltd.

26. The Committee notes from the Facts of the Case that SPV Ltd. has received funds from the Government to implement the project which are specifically stated by the querist not to be of capital in nature. In the context of funds received, the Committee notes the following paragraphs of Accounting Standard (AS) 12, 'Accounting for Government Grants', notified under the Rules:

> ***"3.2 <u>Government grants</u> are assistance by government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the enterprise."***
>
> "5.1 Two broad approaches may be followed for the accounting treatment of government grants: the 'capital approach', under which a grant is treated as part of shareholders' funds, and the 'income approach', under which a grant is taken to income over one or more periods."
>
> "5.4 It is generally considered appropriate that accounting for government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants."
>
> "9.1 Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense."
>
> ***"15. Government grants related to revenue should be recognised on a systematic basis in the profit and loss statement over the periods necessary to match them with the related costs which they are intended to compensate. Such grants should either be shown separately under 'other income' or deducted in reporting the related expense.***
>
> ***16. Government grants of the nature of promoters' contribution should be credited to capital reserve and treated as a part of shareholders' funds."***

From the above, the Committee is of the view that the funds received from the Government meet the definition of 'government grants' as per the provisions of AS 12 and should be recognised accordingly. The Committee further notes from the Facts of the Case that the funds have been received from the State Government for the purposes of meeting consultancy expenses and for assisting SPV in the discharge of its activities; towards share capital; and also towards incorporation of the company and other expenses for bringing SPV Ltd. into its legal existence. Accordingly, the Committee is of the view that the funds received are both in the nature of grants related to revenue and of the nature of promoters' contribution. Hence, the Committee is of the view that to the extent the funds have been received for meeting the envisaged obligations of SPV Ltd., these should be taken to income to match against the expenses incurred for the period.

The grants received can either be shown as a credit in the profit and loss account or can be deducted in reporting the related expense in accordance with the requirements of AS 12. Further, to the extent, the funds have been provided in the nature of 'promoters' contribution', these should be taken to capital reserve as per the requirements of AS 12. However, the amount (cash/bank) received from the Government against which shares are being issued to the Government should be recognised as share capital rather than grant of the nature of promoter's contribution.

27. As regards preparation of profit and loss account before commencement of commercial operations, the Committee notes that as per the requirements of section 210 of the Companies Act, 1956, a profit and loss account has to be prepared for each annual general meeting from the date of incorporation of SPV Ltd. Further, Circular No. 2/17/64-PR dated 29th January, 1964, issued by the Department of Company Affairs (Now known as Ministry of Corporate Affairs), as reproduced by the querist in paragraph 15 above reiterates to provide that it is mandatory for every company to prepare a profit and loss account from the date of its incorporation. Further, as discussed above, the preliminary expenses and other expenses incurred are to be expensed in the year of their incurrence as per the requirements of AS 26/AS 10. Similarly, the grants which are earned by SPV Ltd. during the period should be recognised as per the requirements of AS 12. Accordingly, the Committee is of the view that the profit and loss account should be prepared by SPV Ltd. from the date of its incorporation even before the commercial commencement of the project.

The Committee further notes that in the extant case, while preparing the accounts for the year 2009-10, SPV Ltd. has accounted for the balance receivable from A Ltd. by simply adopting the aggregate amount of funds received and expensed by A Ltd. till that date without considering the periods when they were earned or expensed for by SPV Ltd. Accordingly, the Committee is of view that since in the extant case, the preliminary expenditure on incorporation of the company, other pre-operative expenditure and funds received from the Government have been treated incorrectly by SPV Ltd., the same should be rectified in the current year as a 'prior period item' in accordance with the requirements of Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', notified under the 'Rules'. The Committee notes that paragraph 15 of AS 5 requires that "***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***".

D. Opinion

28. On the basis of the above, the Committee is of the opinion on the issues raised in paragraph 22 above that the accounting by SPV Ltd. for expenses/funds received by A Ltd. as promoter of SPV Ltd. by simply adopting the aggregate amount of funds received and expensed by A Ltd. till that date without considering the periods when they were earned or expensed for by SPV Ltd. while preparing the profit and loss account of the financial year 2009-10 is not correct and is not in compliance with the requirements of AS 10, AS 26 and AS 12, as discussed in

above paragraphs. The expenses / funds received should be accounted for in the profit and loss account of SPV Ltd. of the respective years in which these are incurred/earned, as discussed in paragraphs 24 to 27 above.