(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

GUIDANCE NOTES UNDER REVISION

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

Guidance Note on Treatment of Expenditure During Construction Period

Foreword to the Fifth Edition

This edition of the Guidance Note on Treatment of Expenditure During Construction Period contains modifications in respect of treatment of income earned during construction period and some others pertaining to preparation of profit and loss account by a company during construction period.

I am sure this edition of the publication will continue to be immensely useful to our members in the discharge of their professional duties and to others interested in the subject.

New Delhi
March 17, 1993

N.P. SARDA
President

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Foreword to the First Edition

I am very happy to write this Foreword to the "Study on Expenditure During Construction Period" prepared by the Research Committee of Council of the Institute.

This subject has always been of great importance and it has assumed even greater importance in recent times because of rapid industrialisation involving the setting up of huge and complicated plants, often with foreign collaboration. Though guidance was available to some extent, in the Statement on Auditing Practices, published in 1964 and revised in 1968, for the treatment of the expenditure involved, there was need for a detailed examination of the subject. This study is the result of such an examination.

I am particularly grateful to Shri P.M. Narielvala, F.C.A., who has made this thorough and painstaking study of the subject.

New Delhi
December 31,1970 .

M.C. BHANDARI
President

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Guidance Note on Treatment of Expenditure During Construction Period

1. Introduction and General Nature of the Problem

1.1 A recent feature of the developing economy in India is the emergence of large capital projects which involve heavy capital investment. A characteristic of such projects is that they usually involve a fairly prolonged period of construction and, owing to the incidence of heavy initial costs and charges in respect of depreciation and other similar matters, the project involves a gestation period of several years before it is able to recoup its initial losses and initial depreciation charges and is able to earn profits commensurate with the investment in the project.

1.2 During the prolonged period of construction, the project has necessarily to incur various expenses which prima facie, are of a revenue nature. During the construction period, the project also incurs various expenses of the nature of preliminary expenses, as well as expenses which are associated with the corporate form assumed by the project, such as expenses in connection with the issue of shares and debentures, and expenses in connection with maintaining the secretarial department and the share transfer department. These expenses are in addition to the preliminary project expenditure which would be incurred at a very early stage in the existence of the project and sometimes even before the project has been incorporated in the form of a company.

1.3 Since large capital projects are rarely financed out of shareholder's funds alone, it is usual to find that they incur financial expenses in the way of interest charges and commitment fees during the period of construction, in respect of funds borrowed for the purpose of construction.

1.4 At the same time, the project may also earn some interest and other income during its construction phase from the temporary investment of surplus funds or from other sources.

1.5 An accounting problem is posed by the various matters referred to above. The problem is not merely one of accounting for the income and expenditure which may arise during the construction period. There is also the problem involved in regard to the tax treatment of such income and

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expenditure during this period and in regard to the method of disclosing such income and expenditure in the financial statements of a company, prepared in accordance with the provisions of the Companies Act. Since there is a certain amount of confused thinking in regard to these matters, it is felt that members would appreciate some advice from the Council and it is possible that the issuance of a recommendation by the Council on this matter will help to achieve a certain degree of uniformity of accounting treatment. It is also hoped that the Government of India and authorities responsible for the administration of the Companies Act and the Income-tax Act will be influenced by the Council's pronouncement in regard to the correct accounting treatment of income and expenditure during the period of construction.

1.6 Although large capital projects may assume any particular form of organisation, other than the corporate form, it is considered that, in large majority of cases, such projects would be formed as companies under the Companies Act. Consequently, this Note has been framed with special reference to the problems of large capital projects which are organised in the corporate form.

1.7 The expenditure — other than direct capital expenditure — which may be incurred by a new project during its construction or pre-production period, may be classified under the following different heads, each of which will be considered in later paragraphs of this Note.

(a) Preliminary expenses, formation expenses, expenses in connection with the issue of shares and debentures, expenses in connection with public documents such as the prospectus, etc.

(b) Preliminary project expenditure incurred in connection with the work of preparing the project report, conducting feasibility studies, preliminary financial studies, land surveys, location studies, etc., handling preliminary negotiations with foreign collaborators and with the Government for the purpose of arranging for industrial licences, etc.

(c) Financial expenses such as interest charges and commitment fees on loans, as well as expenditure incurred for preparing and issuing loan agreements and other documents including

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debentures, trust deeds in favour of lenders, mortgage and hypothecation deeds, etc.

(d) Indirect expenditure relating to the construction of the project comprising items of expenditure which would normally be regarded as of revenue nature, if incurred after the project commences commercial production.

(e) Other items of expenditure which would also normally be regarded as revenue expenditure if incurred after the project has commenced commercial production which are incurred during the construction stage, although they do not relate either directly or indirectly to the construction work itself.

(f) Corporate expenses, that is, expenses incurred by a company owing to its corporate status.

1.8 Two other problems are also considered in this Note. The first problem relates to the determination of the point of time at which a new project can be said to have concluded the construction stage of its activities and entered into the production stage. Usually, all expenses up to this point of time are capitalised whereas all expenses thereafter are treated as revenue expenses, unless they are directly of a capital nature. Consequently, the exact determination of this point of time is very important both from an accounting point of view as well as from a tax point of view. Another problem which is connected with this arises in a case where there is delay in the start-up or commissioning of the plant for active production after its construction has been physically completed. Such delay may occur due to several reasons many of which are usually beyond the control of the management. For example, electric or water supply may not be ready or there may be delay in the receipt of the first consignment of the raw materials required for the plant. Quite often, such a period of delay may extend to several weeks or even several months. During this period, various indirect expenses continue to be incurred since it would not be practical to discharge employees who have already been engaged, nor it would be possible to reduce the various fixed overhead expenses. The accounting and tax treatment of the expenses incurred during this period, is therefore, also a matter for serious consideration.

1.9 The other problem which is considered in this Note is the one which relates directly to the accounting treatment of indirect expenses

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incurred by an existing project during the period when it is engaged in a programme of substantial capital expansion. It is considered appropriate to deal with this problem in this Note because it is analogous, in many respects, to the problem relating to the indirect expenditure incurred by a new project during its construction period.

2. Preliminary Expenses

These expenses would include formation expenses, expenses in connection with issue of shares and debentures, expenses in connection with public documents such as the prospectus, etc. The present practice is that such expenses are carried forward on the balance sheet and shown under the general group heading of "Miscellaneous Expenditure" except to the extent that they are written off to profit and loss account. There is no legal requirement to write-off these expenses to profit and loss account within any specified period of time nor is there any rigid accounting convention in regard to this matter. However, good corporate practice recognises the need to write-off these expenses to profit and loss account within a period of 3 to 5 years after commencement of commercial production, and this practice is usually followed by most well-managed companies even though, for Income-tax purposes, preliminary expenses within prescribed limits can be amortized over ten years. It is recommended that no change is necessary in the existing practice in regard to these expenses, and the present practice may therefore continue both from an accounting point of view as well as from a tax point of view. However, members would be well advised to impress upon their clients that it is good corporate and financial practice to write-off these expenses within as short period as possible after commencement of commercial production and, in any case, it is advisable that this period should not exceed 3 to 5 years.

3. Preliminary Project Expenditure

3.1 Under this classification would be included the expenditure incurred in connection with the work of preparing the project report, conducting feasibility studies, preliminary financial studies, land surveys, location studies, etc. as well as the expenditure involved in connection with preliminary negotiations with foreign collaborators and with the Government for the purpose of arranging for various industrial and other licences, etc.

3.2 The suggested accounting treatment of the foregoing types of expenditure is discussed below:

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(a) The cost of preparing the project report as well as the cost of conducting feasibility studies, land surveys, location studies, etc., is definitely related to the overall cost of the project and can be regarded as an addition to the total construction cost of the project. It is therefore recommended that expenditure of this type may be capitalised as part of the total construction cost of the project. The position would be the same whether the expenditure is directly incurred by the company itself or is paid by the company either to its promoters or collaborators or to outside professional or other agencies. The apportionment of this cost as an addition to the cost of various capital assets etc., is considered in a later paragraph which deals generally with the problem of the apportionment of indirect construction costs and indirect capital expenditures against the cost of individual assets.

(b) From a purely theoretical standpoint, it may be disputed whether it would be appropriate to accord the same treatment to the costs and expenditures incurred in connection with preliminary financial studies as well as in connection with preliminary negotiations with foreign collaborators and with the Government for the purpose of obtaining the various industrial and other licences. In practice, however, it should be recognised that these costs and expenses are also incurred directly in connection with the project and are definitely related to the project. Without incurring these expenses, it would not be possible for the project to be commissioned, far less completed. Also, in actual practice, it may be very difficult to segregate these expenses from the sum total of the various indirect expenses incurred during the construction stage of the project and, even if segregated, it is unlikely that these expenses would represent a significant proportion of the total construction cost. It is therefore recommended that these expenses should also be capitalised as part of the total construction cost.

3.3 In a fast growing company, preparations for several projects will usually, be in hand at the same time. Some of the projects may not reach a successful stage. The cost of project reports, feasibility studies, preliminary financial studies, etc., relating to projects which prove infructuous, should not be added to the cost of successful projects but should be aggregated under a separate head and written off against revenue over a period of

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three to five years. The recommendation contained in paragraph 3.2 above, applies only to costs incurred in respect of projects which ultimately succeed.

4. Financial Expenses

4.1 These expenses would include interest charges and commitment fees on loans, as well as expenditure incurred for preparing and issuing loan agreements and other documents including debentures, trust deeds in favour of lenders, mortgage and hypothecation deeds, etc.

4.2 For the sake of a better understanding of the problem, it may be clarified that the expression "commitment fees" refers to the charges which are sometimes stipulated to be payable to the lenders between the date loan agreement is finalised and the date the loan or any part thereof is actually taken by the company. The full interest charges begin to accrue in favour of the lender only from the date the loan is actually taken, but, in the meantime, the lender is committed to keeping in readiness the funds which he has agreed to lend. For this service, the lender sometimes charges a commitment fee, which is at a rate much lower than the full interest charges and which is, quite often, based on the difference between the full interest charges on the loan and the interest which the lender can earn during the period before the loan is availed of by a temporary or short-term investment of funds.

4.3 There is no doubt that interest charges and commitment fees incurred after the date of commencement of commercial production should be treated as revenue expenditure in the normal way. However, during the period of construction, both these charges would represent indirect construction expenditure and should be added to the total capital cost of the project. (This view has already been accepted by the Institute vide paragraph No. 3.25 of the Statement on Auditing Practices). These remarks would apply with particular force in the case of loans which have been taken for the purchase of capital assets or for incurring capital expenditure. It is possible that the accounting treatment suggested in this paragraph may appear to be slightly controversial and unorthodox from a purely theoretical standpoint but, on practical considerations, the suggested treatment is probably fair and is also probably the most appropriate choice out of various alternatives, each of which is bound to be subject to some practical or theoretical objection. This view has now been accepted by the Supreme Court of

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India in the case of Challapalli Sugars Ltd. V. C.I.T. (1975) 98 ITR-167 (S.C.). With regard to interest charges and commitment fees on loans taken specially and exclusively for the purpose of providing working capital, the treatment suggested above may not be proper and, in this case, it will be more appropriate to transfer the interest charges and commitment fees during the period of construction to a separate account which is carried forward in the balance sheet under the group heading of "Miscellaneous Expenditure" until it is subsequently written-off to profit and loss account after the commencement of commercial production, over a period not exceeding 3 to 5 years.

4.4 It may be emphasised that the accounting treatment suggested in the foregoing paragraph would apply only to actual interest charges and commitment fees. It would not apply to any notional or imputed interest charges which are not actually incurred. For example, it would not be appropriate to compute the notional interest on the share capital during the period of construction and charge the same as an addition to the construction cost. The only exception to this would be in a case where interest is actually paid on share capital during the period of construction under Section 208 of the Companies Act, 1956, in which case, as mentioned in that Section, such interest charges can be capitalised as part of the construction cost or as part of the cost of the relevant plant and equipment.

4.5 Although it is stated in paragraph 4.3 that the interest charges on loans taken for the purpose of providing working capital cannot logically be treated as capital expenditure and added to the cost of fixed assets as an indirected charge relating thereto, these remarks would not apply to the case of a loan which is taken partly for the purpose of providing working capital and partly for the purpose of financing capital expenditure. In that case, the total amount of the loan should be reasonably apportioned between working capital and fixed capital expenditure; the interest during the construction period on the latter portion can be treated as indirect capital expenditure and added to the cost of the relevant fixed assets, in the same manner as is suggested in the early part of paragraph 4.3.

4.6 The costs and charges incurred for preparing and issuing loan agreements and other documents including debentures, trust deeds in favour of lenders, mortgage and hypothecation deeds, etc., are sometimes written off to profit and loss account, whereas in other cases, especially if the amount involved is heavy, the total amount is carried forward on the

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balance sheet as an item of "Miscellaneous Expenditure" and is written-off to revenue over a period of years. These alternative methods of accounting apply where such costs and charges are incurred after the commencement of commercial production. In the latter case, that is, where the total amount of such costs and charges are treated as deferred revenue expenditure, it is recommended that they should be written off to revenue as soon as possible and, in any case, over a period not exceeding 3 to 5 years. Where however such charges are incurred during the period of construction, it is suggested that they should be capitalised in the same manner as interest charges.

5. Indirect Expenditure Incidental and Related to Construction

5.1 This paragraph deals with the bulk of the indirect expenditure which would be incurred by a project during its construction period, with the exception of the various other expenditures which are considered in separate paragraphs of this Note. A characteristic of this type of expenditure is that, for a running concern it would be of a revenue nature. However, because the expenditure is incurred during the construction period and because during that period, the expenditure is indirectly related to construction and is incidental thereto, it should be capitalised as part of the construction cost.

5.2 The following list of some of the possible items of expenditure which would qualify for inclusion under this heading is by no means exhaustive but is merely illustrative of the type of expenditures which are discussed in this paragraph:—

(a) Expenditure on employees who are either assigned to construction work or to supervision over construction work including salaries, provident fund and other benefits, staff welfare expenses, etc.

(b) Expenditure on technical and other consultants.

(c) General administrative and office expenditure which is indirectly related or incidental to construction, including, as may be appropriate, stationery and printing, rent, rates and taxes, postage and telegrams, travel and conveyance etc.

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(d) Appropriate insurance charges.

(e) Appropriate expenditures on maintenance and operation of vehicles.

(f) Appropriate expenditures in connection with temporary structures and service facilities built or acquired specially for the purpose of construction (see paragraphs 9.4 and 9.5 of this Note).

(g) Preliminary project expenditure to the extent to which it *is* capitalised as part of the construction cost (see paragraph 3 of this Note).

(h) Financial expenses including interest and other similar charges (see paragraph 4 of the Note).

(i) Depreciation on fixed assets as well as on temporary structure and other facilities used during the period of construction (see paragraph 9.4 and 9.5 of this Note).

(j) Expenses on test runs (see paragraph 11 of this Note).

(k) Expenses on land grading and levelling (see paragraph 9.6 of this Note).

5.3 In actual practice, it will be a matter for careful consideration whether a certain revenue type expenditure is to be included under the heading of indirect expenditure related and incidental to construction, or whether it would be more appropriate to treat it as an item of other indirect expenditure not related to construction and therefore not qualifying for ultimate inclusion in the total construction cost. Some indication of the principles to be applied is given in the discussion contained in this paragraph which relates to the indirect expenditure which can be capitalised as part of the indirect construction cost, as compared to the discussion in the immediately succeeding paragraph (paragraph 6) which deals with indirect expenditure which is not related to construction and which should not therefore be capitalised as part of the indirect construction cost. In actual practice, however, the dividing line will always be very thin.

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6. Other Indirect Expenditure not Related to Construction

6.1 This heading refers to various items of indirect expenditure incurred by a project during its construction period, which are not related either directly or indirectly to the work of construction, but which are incurred mainly in preparation for the work which will be undertaken after the project commences commercial production.

6.2 Expenditure under this head would include expenses in connection with staff training programmes, as well as expenditure relating to the work of preparing for the production activities which are soon to commence. For example the concern would naturally have to recruit and train its sales staff and its general office staff well in advance of the date of commercial production. It may also have to send a few selected trainees overseas, especially if there is a foreign collaborator involved in the project who has undertaken to provide such training abroad. Expenses will also be incurred in connection with the salaries of employees who are appointed ahead of the date of production but whose work involves no connection, direct or indirect, with the work of construction, for example, employees of the sales department, publicity and public relations departments, etc. The concern may also engage in advance publicity campaigns in the press and otherwise in order to popularise itself and its products, well in advance of the date it goes into production.

6.3 Indirect expenses of the type discussed in this paragraph cannot be regarded as part of the incidental cost of construction, because as explained above, they are not related either directly or indirectly to the work of construction. At the same time, since these expenses are incurred during the preproduction period, they cannot be written off to revenue. The only alternative, therefore, is to treat such expenses as deferred revenue expenditure to be carried forward on the balance sheet under the general heading of "Miscellaneous Expenditure". They should, however, be written off to revenue as soon as possible after the commencement of commercial production and, in no case, should the period of such write-off extend beyond a reasonable period of time—say three to five years, depending upon circumstances.

7. Corporate Expenses

7.1 If a new project is constituted in the corporate form, it will incur certain expenses during its pre-production or construction period simply because it is constituted as a company.

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7.2 Expenses of this type would include Directors' fees—especially their sitting fees or meeting fees and travelling expenses—expenditure of the secretarial department and the share registration department, charges paid to outside professional or other agencies entrusted with the work of handling share issues or share transfers, etc. Fees or other remuneration paid to whole-time, managing or technical directors would not be included under this head but would have to be considered as part of the indirect expenditure during construction which have already been discussed in paragraph 5 above.

7.3 Expenditure of this type has no connection with construction and cannot therefore be capitalised as an indirect cost of the construction. Since this expenditure cannot also be written off to revenue during the pre-production period it may be treated in the same manner as the other indirect expenditure discussed in paragraph 6—namely, it may be treated initially as deferred revenue expenditure to be shown in the Balance Sheet under the group heading of "Miscellaneous Expenditure" and written off as soon as possible in the same manner as is suggested above in paragraph 6.3 relating to other indirect expenditure.

8. Income During the Construction or Pre-Production Period

8.1 It is possible that a new project may earn some income from miscellaneous sources during its construction or pre-production period. Such income may be earned by way of interest from the temporary investment of surplus funds prior to their utilisation for capital or other expenditure or from sale of products manufactured during the period of test runs and experimental production. Such items of income should be disclosed separately either in the profit and loss account, where this account is prepared during construction period, or in the account/statement prepared in lieu of the profit and loss account, i.e., Development Account/Incidental Expenditure During Construction Period Account/Statement on Incidental Expenditure During Construction (Refer to para 14.7). The treatment of such incomes for arriving at the amount of expenditure to be capitalised/ deferred, has been dealt with in para 15.2.

8.2 The question relating to tax liability on the income during the construction or pre-production period needs to be considered. Necessary provision for such liability should be made in the accounts.

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9. Capital Expenditure During the Construction or Pre-Production Period

9.1 The expenditure during the construction or pre-production period which is directly of a capital nature can be further classified as follows:

(a) Advance payments to contractors for construction work.

(b) Construction work-in-progress.

(c) Purchase or acquisition of fixed assets during the construction period.

(d) Cost of structure, facilities, etc. constructed or acquired during the construction period for use in the construction.

(e) Land, and expenditure on land.

In addition, there may be expenditure that goes waste e.g., when a machine gets heavily damaged and becomes useless.

Each of the foregoing classifications is considered in greater detail in the subsequent paragraphs.

9.2 (a) Sometimes, payments are made to contractors as advances from time to time or in accordance with the specific terms of the contract. This is particularly true in the case of construction contracts which are executed on the basis of a so-called "turn-key" agreement. However, in addition to"turn-key" contracts, advance payments made to contractors may be a feature of other types of contracts as well. In all such cases, until the contract is completed and the constructed project handed over by the contractor, several payments are made to the contractor by way of advances to enable the contractor to meet his various financial commitments. In the books of account of the company making such payments, they should be treated as advance payments until the contract is completed, at which time the total of the advance payments made can be adjusted against the final contract price. Having regard to the nature and purpose of the advance, it would be preferable for a fair presentation to disclose it in the balance sheet as a separate item under the heading "Fixed Capital Expenditure" rather than under "Loans and Advances". Alternatively, if the Company prefers to classify the advances to contractors under the heading "Loans

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and Advances" this should be described clearly in such a manner so as to indicate that the advances are of a capital nature and represent advance payments to contractors for construction work. However, irrespective of the method which is adopted in classifying the advances on the balance sheet, they should not be segregated or classified against any specific "Fixed Assets" until the construction work is completed and the title to the property constructed or delivered by the contractor has passed to the purchaser. The same considerations would also apply where the construction work is sub-divided among a number of contractors—the principal consideration being, to treat such payments as advances until the project under construction is completed and the property therein passes from the contractor to the company as the owner. In certain construction contracts, the total amount payable to the contractor or contractors is fixed, whereas in other types of arrangements, the total amount is determined by reference to calculations of the contractor's cost plus an agreed margin of profit, or other similar calculations. Where the total contract consideration is fixed lump sum, and the contract embraces the acquisition or construction of several units of plant and machinery, this should be apportioned on a reasonable basis amongst the various components. Such apportionment, however, is important and essential not only because it is necessary to record separately the value of the different units of fixed assets, but also because the rate of depreciation for each of those units would be different both from the tax point of view as well as from the point of view of corporate accounting. Wherever possible; this apportionment should be made on the basis of the data furnished by the contractor himself, failing which the apportionment would have to be made by the Board of Directors on any other reasonable basis which may be proper and appropriate in the circumstances. It is suggested that in cases where the apportionment is not made on the basis of the data furnished by the contractor himself, or on the basis of any other objective evidence, the financial statements should contain a note indicating briefly the manner in which the total consideration has been apportioned over the various units of fixed assets.

9.2 (b) Advance payments to contractors should be made with due regard to the normal considerations of internal control. When the terms of the contract arc specific and explicit, the advance payments should naturally be made on the basis of the contract terms. Where the contract indicates that advance payments are to be made, but does not specify the amount

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and frequency of such payments, it is for the Company's directors to establish a suitable procedure in order to ensure that advance payments are not made recklessly, in excess of the progress of the work, thereby making it difficult for the company to retain ultimate control over the contractor. In most cases, a fair arrangement requires that advance payments may be made on the basis of work completed as determined under the joint certificate of the engineers from both sides after keeping a reasonable margin. However, this cannot be taken as a hard and fast rule and, within the normal limitations of internal conlrol and contractual terms, each case should be considered on its own merits.

9.3 In complicated projects, the principal construction work relating to the plant and machinery is usually of a highly technical nature and, as such, it is usually assigned to a specialised contractor to whom advances are paid from time to time which are adjusted at the end of the construction in the manner suggested in the immediately preceding paragraph. In addition, in such cases, it is frequently found that the company itself undertakes directly the construction of the non-technical aspects of the project with such local outside help as may be necessary. For example, in a project involving the construction of a complicated chemical plant, the work of constructing the plan itself may be entrusted to specialised contractors with expert technical know-how in the subject. However, in addition to the construction of the chemical plant which needs specialised know-how, the project would also require the construction of employee housing, railway sidings, roads in the factory area, various utility and service facilities, etc., which the company may either construct on its own or whose construction may be entrusted by the company to various local contractors acting under the supervision of the company's own engineers. In such a case, the expenditure on the latter items of construction work should be shown in the accounts suitably classified under the general caption. "Construction work-in-progress'' or some other similar caption while the advances paid to the principal contractor for the construction of the chemical plant would continue to be treated in the manner as suggested in the preceding paragraph. Where local construction work of a subsidiary nature is carried out by the company in the manner indicated in this paragraph, it is necessary to recognise that the company may incur certain common expenses which would have to be suitably apportioned over the various units of the local construction work. For example, the company may engage the services of a firm of consulting engineers to supervise the local construction work in which case the fees and expenses paid to them

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may have to be apportioned suitably over the various items involved, such as employee housing, railway sidings, roads within the factory area, utility and service facilities, etc.

9.4 In addition to any local construction work of the nature mentioned in the preceding paragraph, it is almost inevitable that the company will purchase various items of fixed assets during its construction or pre-production period. The commonest example of such a purchase would be the purchase of automobiles, transport equipment, furniture and fixtures, and office equipment, etc. Such assets would be required from the very inception of the company even before the company enters its productive stage. It is extremely likely that all or some of the fixed assets purchased during the construction period may be actually or indirectly utilised in the work of construction, in which case the appropriate depreciation charges during the period in which they are utilised in the work of construction should be treated as part of the indirect construction expenditure and dealt with in the manner suggested in paragraph 5 of this Note which deals with the treatment of indirect expenditure during construction. For example, earth-moving equipment, tractors and heavy motorised equipment purchased during the period of construction may be utilised directly for the purpose of construction. To a lesser extent, motor cars and office equipment may also be utilised for the purpose of the construction work, though indirectly. If some equipment purchased during the period of construction has been utilised only partly for purposes of construction, a part of the depreciation thereon, on the basis of a suitable proportion, should be capitalised as an indirect expenditure incurred during the construction period. Thereafter, the total cost of the equipment purchased during the construction period less the depreciation charged during that period should be carried forward to the production period so that the accounts of the production period would begin with the depreciated value of such equipment, which would then be further depreciated in the normal way.

9.5 Where the work of construction is likely to be prolonged, it is inevitable that certain facilities would have to be acquired or constructed especially for the purpose of the construction. In some cases, these facilities can be used with suitable adjustments after the commencement of production, whereas in other cases, they would have to be scrapped or dismantled after completion of construction. For example, if the construction work has to be undertaken at a fairly remote place, it may be necessary to construct temporary housing for the workers who will be engaged on the

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construction work. In most cases, the housing which is constructed for this purpose will be of a temporary nature and would, in all probability, be much in excess of the company's requirements after it commences production. Similarly, it may be necessary to provide temporary water connections and electricity supply during the period of construction which are intended to be dismantled and disconnected after permanent arrangements are made for the company's water and electric power requirements. It may also be necessary to purchase or acquire equipment especially for the purpose of construction—for example, earth-moving equipment, cranes, cement batching and mixing equipment, etc. It is suggested, that in such cases, the proper procedure would be initially to capitalise the cost of all such temporary facilities and equipment. Logically, depreciation should be charged on such facilities and equipment during the period of construction, but in actual practice this may not always be possible because of the difficulty involved in ascertaining the fair amount of such depreciation. Therefore, a more convenient method in practice would be initially to capitalise the full cost of such temporary facilities, services and equipment and thereafter to credit against this cost the residual or scrap value thereof at the end of the construction period. In those cases where the temporary facilities and equipment are sold or scrapped or are intended to be sold or scrapped at the end of the construction period, the value to be credited would be the actual or estimated sale value or scrap value. Where, however, the assets are intended to be taken over by the company for use in production at the end of the construction period, the value to be credited would have to be estimated on some reasonable basis. Thereafter, the initial cost of the temporary facilities and equipment less the value credited at the end of the construction period, should be treated as an element of the indirect cost of construction and dealt with accordingly in the manner suggested in paragraph 5 of this Note, dealing with the subject of indirect expenditure during construction. In effect, what this means is that the depreciation in the value of the temporary facilities and equipment used during the construction period would be charged to the cost of construction.

9.6 The expenditure on land would represent an clement of cost common to all new capital projects—large or small. The matter, however, is not entirely simple and therefore some elaboration is necessary. Obviously, any consideration paid directly for the purchase of land would have to be capitalised and accounted for separately as the cost of land. In a large number of cases, the land is not purchased outright but is acquired with the help of various Government agencies under the relevant laws relating to land acquisition, which aim at enabling essential industries to obtain land at a reasonable cost without the risk of being, in effect "black mailed"

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by a few landholders who refuse to sell their property, thereby defeating the purpose of acquiring other tracts of land adjacent to, or surrounding, that property. Where the land is acquired in this manner, the cost of acquisition would usually represent deposits paid to, or through, the relevant Collector or other Government agency. The amounts so paid may be shown in the balance sheet as cost of land, provided that, in appropriate circumstances, a suitable note is given indicating that the cost of land represents the value of deposits paid up to date for land acquisition purposes, which would be adjusted when the final value of land is determined and the title to land is transferred to the company. In addition to the actual cost of land, various expenses may be incurred in connection with the land which should also be capitalised. These expenses would include the following: —

(a) Legal costs, stamp duties and fees, etc.

(b) Cost of measuring the land, investigating its title, etc.

(c) Cost of acquiring trees and other structures which stand on the land, even though they may not be of any ultimate use to the new project and may in fact have to be demolished in order to clear the land for construction.

(d) Expenditure on grading and levelling the land in order to make it fit for construction.

(e) Expenditure on land surveys.

As regards items (a) and (b), they would invariably have to be capitalised as part of the cost of land. As regards item (c), it any of the structures standing on the land have been, or can be, utilised for the purpose of the project, the estimated apportioned value of that structure should be capitalised separately from the value of the land, otherwise the total value paid for the land including that structure may be regarded as part of the cost of land. For example, if the total amount paid for a piece of land is, say, Rs. 10 lakhs, and the land so purchased has a warehouse standing on it, it would be necessary to determine whether or not the project intends to utilise that warehouse or whether it intends to demolish it before constructing on the land. In the latter case the total consideration of Rs. 10 lakhs would have to be treated as the cost of land. On the other hand, in

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the former case, a suitable estimate would have to be made of the value of the warehouse. Assuming such value to be Rs. 1 lakh, it would be appropriate to capitalise Rs. 9 lakhs as the cost of land and separately capitalise Rs. 1 lakh as the value of the warehouse to be included under the caption of "Factory Buildings". As regards (d), i.e., the expenditure on levelling and grading the land, it is submitted that this can be treated as an indirect cost of construction rather than as an additional cost relating to the land itself, having regard to the primary purpose for which this expenditure is incurred. Wherever possible, the expenditure on levelling, clearing and grading the land should be related with, and added to, the cost of the particular buildings or other structures which stand on each particular piece of land. Where this is not practicable, the total expenditure on levelling, clearing and grading the land may be apportioned among the different buildings and structures standing on the land in the ratio of the respective areas occupied by each such building or structure, or in any other suitable ratio. What is stated above in this context is not intended to imply that only that portion of the expenditure on levelling, clearing and grading the land can be capitalised, as an indirect cost of construction, which relates to the area of the land actually occupied by a building or other structure. It is recognised that, in practice, it may not be possible to occupy the entire land area by constructing a building or other structures thereon. If the entire land is reasonably occupied by buildings and other structures and if the expenditure on levelling, clearing and grading the land is reasonably incurred for the purpose of the construction, such expenditure can be treated entirely as an indirect cost of construction and capitalised as part of the cost of the buildings or other structures. However, any part of the expenditure on levelling, clearing and grading the land which is incurred for purposes of landscaping or for any other purposes, not connected with the construction of the project, should be treated as part of the cost of land. As regards (e) it is suggested that the expenditure on land surveys should be treated as part of the preliminary project expenditure and capitalised as an element of indirect construction cost in the manner discussed in paragraph 3 of this Note.

9.7 Reference has been made in the earlier paragraphs of this section to expenditure incurred on construction under agreements with contractors. There are a few specific matters and problems which may arise in connection with construction contracts and the expenditure incurred thereon which are considered below:

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(a) It is possible that, in addition to constructing the plant or other structures, the contractors may also agree to render other services. For example, the contractors may agree to supply technical know-how, train the technicians of the purchasing company, and provide credit facilities to the purchasing company by way of deferred payment terms in connection with the purchase cost under the contract. In such cases, the value of the additional services rendered by the contractors should be separated from the cost of the construction and accounted for accordingly. This would present no problem if the contract itself stipulates a separate consideration for the construction as well as for each such specific service. However, if the contract consideration is not so specified, the lump sum consideration would then have to be apportioned between the construction cost and the value of each such specific service in some suitable manner which is appropriate in the circumstances of the case. The basis of such apportionment should preferably be indicated in a footnote to the financial statements. In the example given above, the consideration, if any, which is paid separately for the value of the technical know-how supplied by the contractors, would have to be accounted for, depending on the nature of the technical know-how which is supplied. If the technical know-how which is supplied by the contractors relates to the construction of the plant, it may be added to the value of the plant. The only question in that case would be the apportionment of the total consideration for such technical know-how among the different units of the plant which are constructed by utilising the know-how. Such apportionments can be made in any suitable manner. Wherever possible, in making the apportionment, regard should be had to any data which may be supplied by the contractors and which may indicate a suitable basis for apportionment. Failing any such data, the apportionment may be made on the basis of the value or cost of the different units which are constructed or on the basis of the approximate time spent by the contractors in designing the construction of each unit, or on any other suitable basis. Care should be taken, however, to ensure that no part of the value of the technical know-how relating to construction is apportioned to any unit of construction which has not involved the utilisation of such

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know-how. If, on the other hand, the technical know-how which is supplied relates to productive facilities and processes, the value would have to be treated initially as an item of deferred revenue expenditure to be amortised in suitable instalments after the commencement of production, preferably over a period not exceeding 3 to 5 years after the commencement of production. Any consideration paid separately to the contractors for training the technicians of the purchasing company would have to be treated also as deferred revenue expenditure in the manner suggested in paragraphs 6.2 and 6.3 of this Note. Any expenditure by way of interest charges on the credit facilities provided by the contractor would have to be treated in the manner suggested in paragraph 4 of this Note, which deals in some detail with the various items of financial expenses.

(b) In several contracts for construction, there is a stipulation which requires the purchasing company to pay separately the various reimbursable expenses of the contractor—such as customs duty, clearing and forwarding charges, ocean freight, railway freight, etc. The payment of many of these charges would be made in composite amounts and it would be necessary to apportion such payments among the different units of construction—either on the basis of contract allocation wherever possible or, in the alternative, on some other suitable basis.

(c) The purchasing company would also often need to maintain an establishment at the port of entry in order to deal with clearing and forwarding matters and the cost of such establishment would similarly have to be apportioned over the various units of construction in some suitable manner.

(d) Another common charge requiring similar apportionment would be the fees payable to the overall consulting or supervising engineers, if any.

(e) Several construction contracts contain a price escalation clause which operates under different circumstances. If any circumstances have arisen under which this clause would operate, the additional amount under the price escalation clause which is paid or payable on the basis thereof, would have to

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be apportioned over the different units of construction—either on the basis of direct allocation or in any other suitable manner.

(f) Also, construction contracts—especially with foreign contractors—sometimes provide for payments to be made free of income tax or payments to be made in an amount which after deducting income tax, would leave a net residue with the (foreign) contractor of a stated amount. In such cases, care should be taken to ensure that the gross amount payable under the contract is apportioned over the various units which are constructed.

9.8 During the course of construction of a big project, some losses are bound to occur. To an extent the losses may be treated as normal and added to the cost of the project. For instance, a wall may have to be pulled down and rebuilt. The total cost then can be capitalised. However, to the extent the loss is avoidable and results from inefficiency, mischief or an accident it should not be treated as part of the cost of the project. The amount of such a loss should be segregated and written off when production commences, over a period of three to- five years.

10. Capital Expenditure not Represented by Assets

Sometimes, circumstances force a project to incur capital expenditure which is not represented by any specific or tangible assets. For example, a project may have to pay the cost of laying pipelines in order to facilitate the supply of its products or raw materials to or from a seaport, but the Port Trust or other similar authorities may insist that the pipelines belong to them even though the cost thereof is paid by the company. In other cases, a project may have to agree with a local authority to pay the cost or part of the cost of roads to be built by that authority in the vicinity of the project for the purpose of facilitating the business of the project. In this case also, the capital expenditure incurred by the project for this purpose would not be represented by any actual assets, since the roads would remain the property of the relevant State authorities even though the whole or a part of their cost may have been defrayed by the company in order to facilitate its business. In all such cases the expenditure so incurred would have to be treated in the books of account as a capital expenditure. There seems to be no valid objection to disclosing the same in the balance sheet under the general heading of “Capital Expenditure” subject to two

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conditions. In the first place, the description of the specific item on the balance sheet should be such as to indicate quite clearly that the capital expenditure is not represented by any assets owned by the company. In the second place, the capital expenditure should be written off over the approximate period of its utility or over a relatively brief period not exceeding five years, whichever is less. In fact, having regard to the nature of the expenditure and the purpose for which it is incurred, it is suggested that it would be more appropriate and realistic to classify such expenditure in the balance sheet under the heading of "Capital Expenditure" rather than either, write-off the expenditure to revenue or classify the expenditure under the heading of "Miscellaneous Expenditure" or "Deferred Revenue Expenditure".

11. Expenditure on Start-up and Commissioning of the Project

11.1 After the plant has been constructed and the project has been completed in all respects it is usually tested and adjusted for commercial production before it is finally commissioned. Several items of expenditure are necessarily incurred in the process of starting the plant, adjusting it, and experimenting with and adjusting the plant for commercial production. The expenditure incurred during this period and in this process would include the salaries or fees of consulting engineers, travelling expenses in connection with visits by engineers and technicians to the plant, as well as the cost of raw materials and stores consumed in the process of test runs.

11.2 As a general rule, it would be correct to capitalise all expenses incurred during this period and in connection with the process of start-up and commissioning of the plant, for two reasons. In the first place, such expenses would be incurred in order to bring the plant up to the stage at which it can commence commercial production. In the second place, this expenditure would normally be incurred before the plant is taken over. On both these considerations, it would be fair and correct to capitalise the expenditure incurred on start-up and commissioning the plant. The expenditure so incurred may be capitalised in the same way as other indirect construction expenditure.

11.3 Sometimes, the agreement with the contractors responsible for constructing the plant stipulates that the plant will not be finally taken over until after the guarantee period has been satisfactorily completed. In most cases, the guarantee period would be completed several months after the commencement of commercial production. Obviously, in such cases, it

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would not be fair to continue to capitalise the expenses incurred after the commencement of commercial production merely because the guarantee period has not been completed, and therefore the property in the plant has not been finally transferred to the purchasing company. In such cases, the general rule should be followed which is, that all expenditure of a revenue nature incurred after the date when the plant is ready to commence commercial production should be written off as revenue expenditure.

11.4 During the period of test runs and experimental production it is quite possible that some income will be earned through the sale of the merchandise produced or manufactured during this period. The sale revenue should be set off against the indirect expenditure incurred during the period of test runs and treated as suggested in para 15.2.

12. Date of Commencement of Commercial Production

12.1 In any project which involves lengthy construction period, it is extremely important to be very specific about the selection of a "cut-off date", based on the date when the project is officially recognised as being ready for commercial production. In theory, it may appear to be a relatively simple matter to select this date, but in actual practice, many complications may arise owing to the fact that there is often an intervening period between the date when the plant is finally completed and commissioned and the date when commercial production actually begins. This intervening period is due to the time taken up in completing the various tests and experiments which are usually necessary before commercial production can begin as well as the time which is sometimes lost because all requisite permissions from Government Departments and all necessary service facilities such as water and electric power are not ready and available on the date when the plant is completed and commissioned.

12.2 In several cases, guidance may be available in selecting the official date of commencement of production by reference to the date of the inauguration ceremony as well as by reference to the date which is publicly and officially announced by the company as the date on which it has commenced commercial production. It should be borne in mind, in this connection, that "commercial production" is a term of somewhat wider import than the mere term "production". Even during a period of test runs and experimentation, a plant may be engaged in actual production, but

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until the test runs are completed and the plant is properly adjusted on the basis thereof, it may not be said to be ready for "commercial production". The term "commercial production" refers to production in commercially feasible quantities and in a commercially practicable manner.

12.3 As discussed in other paragraphs of this Note, various expenditures of a revenue nature which are incurred during the construction period are either capitalised as part of the indirect cost of construction, or are carried forward as deferred revenue expenditure as may be appropriate. However, from the moment the plant is completed and commissioned and is ready for commercial production, all expenditures of revenue nature must be charged to the profit and loss account. It is for this reason that it is so important to determine the "cut-off date" based on the date when the plant is ready for commercial production, with a great degree of precision.

12.4 It is important to note in this connection that what is significant for this purpose is the date when the plant is ready for commercial production and not the date when the plant actually commences commercial production. Therefore, if a plant had been completed and commissioned and is ready for commercial production, but the company for some reason or other, does not start commercial production immediately thereafter, the expenditure incurred during this intermediate period must be treated as revenue expenditure and cannot be capitalised. This follows from an important rule, both in accounting principle as well as in economic theory. The rule is that only those expenses should be capitalised as part of the cost of an asset which relate to the acquisition or construction of that asset or which add anything to the value or utility of that asset. When a plant has once been completed and is ready for commercial production, the expenditure incurred during the intervening period of delay in actually commencing commercial production is neither related to the acquisition or construction of the fixed assets nor does it add to the value or utility thereof—consequently, it must be written off as revenue expenditure and cannot be capitalised.

12.5 As regards the general principles which would assist in the determination of the appropriate date when a company can be said to be ready to commence business, guidance can be obtained from several decided tax cases which are relevant because the consideration under which a new project can be said to have been set up or established so that it is ready to commence business are almost identical for tax purposes as well as for

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accounting purposes. The following general principles emerge from a consideration of some of the decided tax cases on this subject.

(a) The expression "set-up" as applied to a new project for tax purposes is identical with the expression "ready to commence business."

(b) The setting up of a new business or a new project represents a stage which is anterior to the actual commencement of business.

(c) There is a clear distinction between commencement of business and setting up a business; what is important is the date on which the business is set up rather than the date on which the business is actually commenced.

(d) When an undertaking is established and is ready to commence business, it may be said that it has been set up.

(e) There may be an interval of time between the setting up of a business and actual commencement of business, in which case all expenses incurred during this interval of time would be permissible deductions for tax purposes—and would also have to be treated as revenue expenses for accounting purposes.

(f) The expression "set up" as used in the Income and Wealth Tax Acts with reference to a new undertaking means that the undertaking is complete and ready to be commissioned and ready to commence business. It is implied in this that the factory must have been erected and the plant and machinery installed, before the business can be said to have been set up, but it is not essential that the business should have been actually commenced. It is also not essential that the factory should have actually functioned or gone into production.

The aforesaid principles are based on the following tax decisions:

(1) Western India Vegetable Products Limited v. C.I.T. 26 1TR-151 (Bombay).

(2) C.I.F. v. Sarabhai Sons Ltd. 90 ITR-318 (Gujarat).

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(3) Sarabhai Management Corporation Ltd. v. C.I.T. 102 ITR-25 (Gujarat).

(4) C.W.T. v. Ramaraju Surgical Cotton Mills Ltd, 63 ITR-478 (S.C.).

(5) Travancore Cochin Chemicals Pvt. Ltd. v. C.W.T. 65 ITR-651 (S.C.).

13. Interval Between Establishing of a Business and the Commencement of Actual Production

13.1 As indicated in paragraph 12, a new project can be treated as having arrived at the revenue earning stage as soon as it is ready to commence commercial production, that is as soon as it is established and is ready for commercial production. However, there is often an interval of time between the date a project is completed and commissioned and is ready for production and the date when commercial production actually begins. The question which is discussed in this paragraph relates to the treatment of the expenditure incurred during this period.

13.2 In the normal course, the interval of time between the date a project is commissioned and is ready for production and the date that commercial production actually begins should be very brief. However, several factors sometimes operate to make this interval of time very prolonged and this is especially so in India because of the multifarious list of regulations to be complied with before commencing production as well as the acute shortage of basic materials and services. For example, the fact that certain licences may have not been obtained in time from a Government or local authorities may hold up commercial production. In other cases, the plant may be commissioned and completed and may be ready in all respects to commence production, but there may be delay in obtaining the power line or the water supply. Sometimes, one project is linked to another in such a way that it relies on the latter for its supply of raw materials. This is particularly the case with the chemical and process industries. For example, a fertiliser plant may be established as part of a large petro-chemical complex. One of the essential raw materials for making fertilisers may be derived from the petro-chemical complex. In such a case, even if the fertiliser plant is complete in all respects and is commissioned for commercial production, it cannot actually commence production until the petro-chemical complex has been completed, it will thus be appreciated that circumstances can

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arise in which the interval of time between the completion of the plant and its readiness for commercial production and the time when commercial production actually commences will be very prolonged indeed. During such an interval of time, it is inevitable that the normal running expenses will continue to be incurred.

13.3 Having regard to the consideration outlined in paragraph 12 which deals in some detail with the date of commencement of commercial production, it would follow that all expenses of a revenue nature incurred after the date when the plant is completed and commissioned and is ready for commercial production or, to put it differently, all expenses of a revenue nature incurred after the date when the business has been set up or established would have to be charged to the profit and loss account and can no longer be capitalised, even though commercial production has not actually commenced. There is no reason to depart from this principle even in a case where there is a prolonged interval of time between the date of setting up or establishing a business and the date on which it actually commences commercial production.

13.4 If commercial production is considerably delayed, the problem which would arise is that there would be no income during the period of such delay while, on the other hand, the expenditure of a revenue nature incurred during this period would have to be charged to the profit and loss account as mentioned above. If the period of delay in commencing commercial production is extremely prolonged, the only possible concession which may be made is that the expenditure incurred during this period can be treated as deferred revenue expenditure, to be amortised over a period not exceeding 3 to 5 years after the commencement of commercial production. This procedure is not, however, recommended as a matter of general policy or practice, but may be resorted to only in those exceptional cases where fairly heavy revenue expenditure is incurred during a prolonged period of delay in commencing commercial production. In any case, it would be completely wrong to treat such expenditure as capital expenditure since it does not add in any way to the value or cost or utility of the plant and other manufacturing facilities which have already been constructed but which have remained idle due to delay in commencing commercial production.

13.5 After commercial production has been commenced, it is customary to provide depreciation on fixed assets for the full annual period

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disregarding any short periods during the year when particular assets have remained idle due to various reasons. This is only a rule of practical convenience but the application of the rule also takes into consideration the fact that an asset does depreciate to some extent even during idle periods and also, when fixing the depreciation rate, some regard is usually given to the fact that there will inevitably be a few idle periods when the particular plant or machinery will not remain in use. However, if there is delay in commencing commercial production, it is suggested that it would not be necessary to provide depreciation on fixed assets during this period. In other words, it would be necessary to provide depreciation on fixed assets only as from the date when commercial production is actually commenced.

14. Disclosure in Financial Statements

14.1 The method of disclosure of the expenditure incurred during the construction period, in the financial statements prepared during that period would obviously depend on the nature of those expenses. In certain cases, no difficulty would arise and the disclosure would be made in accordance with generally accepted accounting principles.

14.2 As regards advances to contractors pending completion of the construction work, reference may be made to the detailed discussion in paragraph 9.2(a) of this Note which indicates the manner in which such advances, should be disclosed in the financial statements.

14.3 It is suggested that, in a large number of cases, it would be appropriate to indicate the following items in the balance sheet under the general heading of "Fixed Assets" :—

(a) Fixed assets actually purchased during the construction period less depreciation thereon, which may be described in a separate Schedule annexed to the balance sheet (see paragraph 9.4 of this Note)—this would also include land and expenses on land (see paragraph 9.6 of this Note).

(b) Construction work-in-progress—to be described either on the balance sheet itself by reference to relevant headings or in a separate Schedule annexed to the balance sheet (see paragraph 9.3 of this Note).

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(c) Cost of temporary structures and other facilities erected or acquired specially for the purpose of construction (see paragraph 9.5 of this Note) — these items would continue to appear on the balance sheet until end of the construction period when they would either be transferred to the general fixed assets of the company if absorbed by the company for use in its operations, or the temporary structures and other facilities would be sold or scrapped if no longer required.

(d) Incidental and indirect expenditure relating to construction (see paragraph 5) — this would also include preliminary project expenditure to the extent to which it is capitalised as part of the total construction cost as well as financial expenses in the way of interest charges etc. which are similarly capitalised (see paragraphs 3 and 4 of this Note).

14.4 It would be appropriate to indicate the following items in the balance sheet under the general heading of "Miscellaneous Expenditure" or "Deferred Revenue Expenditure" as may be appropriate:—

(a) Corporate expenses—including preliminary expenses, formation expenses, expenses in connection with issue of shares and debentures, expenses of the share registrar's department, expenses in connection with the issue of public documents such as prospectus, directors' sitting fees and travelling expenses, etc. (see paragraphs 2 and 7 of this Note).

(b) Preliminary project expenditure to the extent, it is not considered to be a part of the indirect construction expenditure (see paragraph 3 of this Note).

(c) Financial expenses including interest and other similar charges, to the extent that they are not capitalised as part of the indirect cost of construction (see paragraph 4 of this Note).

(d) Indirect expenditure not related to construction (see paragraph 6 of this Note).

14.5 Income during the construction or pre-production period should be shown separately in the financial statements (see paragraph 8.1 of this Note). However, contributions made by Governmaent or other parties toward

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expenses shown under each of the headings and sub-headings as suggested in the above paragraphs can be deducted therefrom. It is suggested that such deductions should be shown separately in the financial statements.

14.6. As indicated elsewhere in this Note, almost all the expenditure during the period of construction would be either capitalised or would be treated as deferred revenue expenditure, to be amortised in suitable annual instalments extending over a period of 3 to 5 years after the commencement of production. On the other hand, there would be little or no revenue, or income during the construction period and such income, of a minor nature, which may be earned during this period, can be adequately accounted for in the manner suggested in paragraph 15.2 of this Note.

14.7. There is some doubt on the question whether or not a company is obliged to prepare a profit and loss account during the period of construction when it is not in fact engaged in any revenue operations. In view of the requirement of Section 210 (3) of the Companies Act, every company has to prepare its profit and loss account from the date of incorporation. However, to prepare a profit and loss account during the period of construction might be somewhat misleading as it may give an impression to the lay shareholder that the company was engaged in revenue operations during this period and has incurred a substantial loss in those operations. It is true that the requirements of Part II of Schedule VI to the Companies Act relating to disclosure of specific items of expenditure have to be complied with. However, these requirements can be adequately complied with if the relevant items of expenditure requiring specific disclosure are suitably disclosed under the heading "Development Account", "Expenditure During Construction Account", "Statement of Incidental Expenditure During Construction" or by any other suitable name. This practice has also been recommended by the Department of Company Affairs, Government of India, as per their circular No. 2/17/64, dated 29th January, 1964 which is given in Appendix B.

Where the aforesaid practice is followed, it is desirable that a note be inserted in the financial statements explaining the reason for not preparing a profit and loss account. It appears that this would represent reasonable compliance with the legal requirements, since, the specific disclosure requirements of Schedule VI, Part II are complied with. Whether the disclosure should be made in the conventional profit and loss account form or through an account/statement as per the recommendation made in

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the above paragraph, is a matter for each company to decide. In this connection, it may be noted that Schedule VI, Part II of the Act only contains disclosure requirements and does not prescribe specific form of profit and loss account unlike Schedule VI, Part I which does so for the balance sheet.

14.8 Reference has been made in this Note to a number of cases where it may be appropriate to treat certain expenditures incurred during the construction period as "deferred revenue expenses". It is necessary that the financial statements should disclose the amount and brief details of the expenses which have been deferred indicating the extent to which they have been written off to profit and loss account. In appropriate cases, it may also be necessary to give a note indicating the reasons and basis for the deferral of expenses.

14.9 Normally, it should not be necessary to disclose in the Schedule of fixed assets the extent to which the cost of the various assets is comprised of direct capital expenses and allocated indirect expenses respectively, since the latter are also ultimately treated as capital expenses forming part of the cost of the relevant assets. In appropriate cases, however, a note may be given indicating the basis of allocation of indirect expenses incurred during the period of construction — especially if the indirect expenses form a sizeable proportion of the total capital expenditure.

14.10 Illustrative specimen statements are given in Appendices at the end of this book.

15. Allocation of Indirect Capital Expenditure to Specific Asset Heads

15.1 Mention has been made in earlier paragraphs of this Note to the various items of indirect expenditure which may be capitalised. In particular, attention is drawn to the undernoted paragraphs which deal with different items of indirect expenditure which may be capitalised as part of the cost of construction.

Paragraph 3 — relating to Preliminary Project Expenditure.

Paragraph 4 — relating to Interest Charges and other Financial Expenses.

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Paragraph 5 — relating to Indirect Expenditure Incidental to Construction.

Paragraph 9.5 — relating to expenditure on Temporary Structures and Service Facilities Built or Acquired Specially for the purpose of Construction.

Paragraph 9.4/5— relating to Depreciation on Fixed Assets as well as on Temporary Structures and other Facilities used during the period of Construction.

Paragraph 9.6 — relating to the Expenditure on Land Grading and Levelling.

Paragraph 11 — relating to Expenditure on Test Runs.

15.2 From the total of the aforesaid items of indirect expenditure would be deducted the income, if any, earned during the period of construction, provided it can be identified with the project.

15.3 While the construction work is in progress, the various items of indirect capital expenditure may be carried forward to be ultimately included as part of the indirect cost of construction. It is not necessary to make any attempt to apportion the various items of indirect capital expenditure to any specific asset or assets while the construction work is still in progress. However, after the construction work is completed, it will be necessary to tackle the problem of the specific allocation of the total indirect capital expenditure to the various individual asset or assets.

15.4 The First principle to be borne in mind is to exclude from such allocation those assets which have not benefited from the indirect capital expenditure, as well as those capital assets to which the indirect expenditure is not at all related. For example, in most cases, capital expenditure on land would not be affected by any of the items of indirect capital expenditure and it would therefore be inappropriate to add to the value of the land any element representing the indirect capital expenditure incurred during construction. Similarly, in several cases, many of the items of indirect capital expenditure would not be related to the cost of the buildings constructed for the project. For example, it is unlikely that the technical consultants engaged to assist on the construction of a complex project would have devoted any portion of their time to the construction of buildings

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which may therefore have been left entirely to local contractors—in which case it would not be appropriate to add to the cost of buildings any element of indirect capital expenditure which represents the expenditure on technical consultants.

15.5 It follows from what is stated above that the first step in allocating the indirect expenditure during construction would be to prepare, in as much detail as may be possible, a statement indicating the various items of fixed assets which have not benefited from certain specific items of indirect capital expenditure. Another statement should be prepared analysing the indirect capital expenditure in as much detail as possible after which an attempt should be made to indicate against each item of indirect capital expenditure the specific assets or group of assets to which that expenditure was related. For example, if an oil refinery is being constructed, it is possible that one of the items of indirect expenditure would represent, say, the expenditure on welding consultants engaged specially for the construction of storage tanks. In that case, when analysing the total indirect capital expenditure, care should be taken to state against the item relating to the expenditure on welding consultants the fact that this expenditure was incurred exclusively for the construction of storage tanks. If this is done, it would follow logically that certain items of indirect capital expenditure can be allocated straightway to those specific assets or groups of assets to which they are related. It would also follow from the method suggested above that inappropriate allocations of indirect capital expenditure would be avoided. For example, in the illustration given above, the indirect expenditure incurred on welding consultants would not be apportioned indiscriminately to all items of fixed assets, if the method suggested above is adopted.

15.6 On the actual allocation of indirect capital expenditure, it is impossible to be dogmatic or to make any specific pronouncements. Much would depend upon the circumstances of each case as well as the total amount of the expenditure to be allocated. If the total of the indirect expenditure is a relatively small amount, elaborate methods of allocation need not be adopted. On the other hand, if the total indirect capital expenditure is relatively significant, greater care should be taken to select a suitable basis of allocation, otherwise, the total asset values would not be realistic. Basically, the problem should be solved in the manner suggested above - which is to allocate, as far as possible, items of indirect capital expenditure to those specific asset or assets to which they are related.

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15.7 In a large number of cases of indirect capital expenditure, it would obviously be impossible to link the expenditure to any specific asset or assets. In that case, it is suggested that the indirect expenditure may be allocated having regard to various applicable considerations, some of which are suggested below:

(a) Some items of indirect capital expenditure may be susceptible to allocation on the basis of analysis of time spent on different items of construction by designated groups of personnel, for example, the indirect expenditure representing the clement of cost incurred on technical consultants for different items of construction.

(b) In other cases, a more suitable method of allocation would be obtained by reference to the cubic or tonnage measurement of different items of construction. For example, the indirect expenditure which is incurred in connection with civil engineering work can be allocated quite appropriately on the basis of the cubic measurement of the buildings or other structures. On the other hand the indirect expenditure involving freight and clearing charges can be appropriately allocated to different assets on the basis of tonnage measurements.

(c) As already suggested earlier in paragraph 9.6 relating to the indirect expenditure on land grading and clearing, the indirect expenditure incurred on grading and clearing the land may be allocated to the different structures which stand on the land, in proportion to the respective area occupied by the various structures.

15.8 The considerations suggested in the preceding paragraph are obviously illustrative rather than exhaustive and, in each particular case, the allocation of indirect capital expenditure would have to be made on the basis of the consideration which is most suitable bearing in mind, however, the fact that too meticulous an attention to this problem is not called for. Any method of allocation is bound to be somewhat arbitrary and the time and expenditure incurred in the process of allocation should not be disproportionate.

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

16. Expansion of Existing Projects

16.1 The major part of this Note is devoted to a consideration of the accounting problems relating to new capital projects while they are in the stage of construction. Somewhat similar accounting problems are also encountered by an existing enterprise when it embarks on a programme of capital expansion concurrently with current production.

16.2 It is suggested that the following guidelines may be regarded as the basis of determining the correct accounting treatment in the case of a project which carries out a programme of capital expansion concurrently with normal production:-

(a) All direct expenditure must be capitalised in the normal way.

(b) The indirect expenditure which is capitalised should be restricted to the additional expenditure, if any, incurred as a result of capital expansion and construction. In other words, the indirect expenditure which is capitalised should be limited to the marginal increase in such expenditure involved as a result of capital expansion. It would not be correct or appropriate to capitalise indirect expenditure on a pro rata basis as that would have the effect of reducing the charge to current revenue for the indirect expenditure which would have been incurred in connection with the normal revenue operations in any case, even in the absence of any capital expansion plans. To put it differently, indirect expenditure should be marginally capitalised so as to ensure that current revenue does not suffer as a result of any additional indirect expenditure incurred because of construction. On the other hand, it is not intended that current revenue should actually benefit by reason of the capital expansion project which is what would happen if indirect expenditure is capitalised on a *pro rata* basis.

17. Summary of Conclusions and Recommendations

17.1 A characteristic of large capital projects is that they usually involve a prolonged period of construction during which the projects incur various items of direct as well as indirect expenditure while, at the same time, it may also earn some income from miscellaneous sources during its construction phase. An accounting problem is posed with regard to the

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treatment of expenditure incurred and income earned during the construction period (paragraph 1).

17.2 As regards the preliminary corporate expenses incurred by a new project — such as company formation expenses, expenses in connection with the issue of shares and debentures, etc.—it is suggested that the present practice may continue. Consequently, such expenses should be carried forward on the balance sheet and shown under the group heading of "Miscellaneous Expenditure", but they should be written off within a period of three to Five years after commencement of commercial production (paragraph 2).

17.3 It is recommended that the preliminary project expenditure incurred in connection with the preparation of the project report, conducting feasibility studies, surveys, etc., should be capitalised as part of the indirect construction cost. From a practical point of view it is also suggested that the same treatment should be accorded to the expenditure incurred in connection with preliminary studies and preliminar negotiations with foreign collaborators and government authorities (paragraph 3).

17.4 It is recommended that the interest charges and commitment fees incurred during the construction period on loans and other forms of borrowing, should be treated as part of the indirect construction cost, if the loan or other borrowing was taken or incurred for the purpose of financing the construction of the project (paragraph 4.3).

17.5 If the loan or other form of borrowing was taken or incurred for the purpose of providing working capital, the interest and other charges thereon during the period of construction may be treated as deferred revenue expenditure, to be written off to revenue over a period of three to five years after commencement of production. In case a loan has been taken jointly for the purpose of financing the construction and for working capital, the interest and the commitment charge should be apportioned on a reasonable basis. The portion relating to financing of construction should be capitalised and the other should be treated as deferred revenue expenditure to be written off over a period of three to five years after production commences (paragraphs 4.3 and 4.5).

17.6 The same treatment should be accorded to the various costs and charges incurred for preparing the loan agreements and other documents

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as is given to the interest and commitment fees incurred on the loan during the construction period (paragraph 4.6).

17.7 Notional or imputed interest charges, which are not actually incurred, should not be capitalised (paragraph 4.4).

17.8 As regards the indirect expenditure incurred during the construction period, it is recommended that it should be capitalised as part of the indirect construction cost to the extent to which the expenditure is indirectly related to construction or is incidental thereto (paragraph 5.1). The different kinds of expenditure which may qualify for inclusion as indirect capital expenditure are given in paragraph 5.2 by way of examples of such expenditure.

17.9 As regards other indirect expenditure incurred during the construction period which is not at all related to the construction activity nor is incidental thereto, it is recommended that such expenditure should be treated as deferred revenue expenditure and written off to revenue within a period of three to five years after commencement of production. Examples of such expenditure are given in paragraph 6.2.

17.10 It is recommended that a similar treatment should also be accorded to various "corporate expenses" incurred during the construction period (paragraph 7).

17.11 During the construction period, a project may earn income from miscellaneous sources—for example, interest income, income from hire of equipment or assets and income from sale of products manufactured during the period of test runs and experimental production. It is recommended that where such income can be identified with the project, it should be deducted from the total of the indirect expenditure so that only the net amount of the expenditure is capitalised or treated as deferred revenue expenditure, as the case may be (paragraph 15.2). In either case, consideration may have to be given to the question of providing for the income tax liability on such income (paragraph 8.2).

17.12 Advance payments and other similar payments to contractors during the period of construction should not be segregated or classified against any specific "Fixed Assets" until the contract has been completed and the property handed over by the contractor to the purchaser so that legal title to the fixed assets has passed to the purchaser. In the meantime, advance

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payments to contractors should be shown separately in the balance sheet as such, either under the general heading of "Fixed Capital Expenditure" or as a separate item under the general heading of "Loans and Advances" with a clear indication that the advance is of a capital nature for pending construction work [paragraph 9.2(a)].

Reasonable control should be exercised over advance payments to contractors in order to insure that such payments are covered by the terms of the contract. Where the terms of the contract are not explicit, advance payment should not ordinarily exceed the value of completed work after retaining a reasonable margin [paragraph 9.2(b)].

17.13 In the case of a composite construction contract—especially a "turnkey" contract—for a fixed total amount of consideration, it will be necessary, at the end of the construction, to apportion the total contractual value between the various units of plant and assets represented thereby. Such apportionment should be made on the basis of data furnished by the contractor himself, if possible; otherwise, on the basis of any other available evidence [paragraph 9.2(a)].

17.14 Capital expenditure incurred directly by the project itself on incomplete construction work should be shown in the balance sheet as "construction work in progress" or under a similar caption (paragraph 9.3).

17.15 Where the total construction work is spread over more than one contractor or where part of the construction work is handled through contractors while a part thereof is undertaken directly by the project itself, it will be necessary to apportion on a suitable basis certain common expenses incurred in connection with the construction — for example, fees and expenses of consulting engineers, customs duties, freight and clearance charges, expenses of the establishment maintained at the port of entry, etc. [paragraphs 9.3 and 9.7(b), (c) and (d)].

17.16 Any complete units of fixed assets purchased or acquired during the construction period should be shown in the accounts as "fixed assets" or "capital expenditure" — for example, transport equipment, furniture and fixtures, and office equipment (paragraph 9.4).

17.17 Similarly, it would be appropriate to capitalise the value of any facilities or equipment which have been acquired or built specially for the

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purpose of construction—for example, temporary housing for construction labour, temporary warehouses for construction stores, temporary water and power connections, and purchase of construction equipment such as cranes, earth moving equipment, etc. (paragraph 9.5).

17.18 It is recommended that depreciation should be charged during the construction period on any items of fixed assets or temporary construction facilities used during the period of construction. Such depreciation may be charged either by applying the normal depreciation rates to the original cost of such assets or, in the alternative, the depreciation may be charged indirectly by capitalising the difference between the original cost of the equipment or facilities and the sale or scrap value thereof at the end of the construction. The latter method is particularly appropriate in the case of special construction equipment and temporary construction facilities. In either case, the depreciation provided during the construction period should ordinarily be treated as part of the indirect construction cost and capitalised accordingly. If any item of fixed assets used during the construction period is retained by the project for use after production, the residual book value of such assets should be depreciated in the normal way after commencement of production (paragraphs 9.4 and 9.5).

17.19 In several cases, the land required for a new capital project is acquired with the help of government authorities under the relevant land acquisition laws. In such cases, the total amount of deposits paid for acquisition of land pending completion of land ‘acquisition proceedings may be shown in the balance sheet as “cost of land” rather than “deposits” — subject to suitable disclosure as to the absence of title as well as of the fact that the land cost represents deposit payments which are subject to suitable adjustment after determination of the final land value (paragraph 9.6).

17.20 Legal costs, stamp duties and fees’, cost of measuring the land and investigating its title, etc., should invariably be capitalized as part of the cost of the land (paragraph 9.6).

17.21 The value of any structures purchased together with the land may be segregated and capitalised separately from the cost of the land, if it is intended to retain the structure for use in the operations of the project after it commences production. If this is not intended and if the structures purchased with the land are to be demolished for the purpose of construction, the entire value paid for the land, including the structures

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purchased along with the land, should be capitalized as the cost of the land itself [paragraph 9.6(c)].

17.22 If the operation of levelling, clearing and grading the land is undertaken principally for the purpose of construction, the cost of such levelling, clearing and grading may be capitalised as an indirect element of the construction cost, in which case it may be apportioned between the different buildings and structures standing on the land in the ratio of the respective areas occupied by such buildings and structures (paragraph 9.6).

17.23 Abnormal losses, resulting from inefficiency, mischief or accidents should not be capitalised but should be written off over a period of 3 to 5 years against revenue when production commences (paragraph 9.8).

17.24 Sometimes, capital expenditure is incurred which is not represented by any specific assets. Examples of such expenditure are given in paragraph 10. It is recommended that such expenditure may be shown in the balance sheet under the heading of "capital expenditure" with suitable disclosure (paragraph 10).

17.25 It is recommended that the expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, may be capitalised as an indirect element of the construction cost. However, the expenditure incurred over a prolonged guarantee period during which the plant is commercially operated cannot be capitalised and must be treated as revenue expenditure even though the contract may stipulate that the plant will not be finally taken over until after the satisfactory completion of the guarantee period (paragraph 11).

17.26 It is extremely important to fix a specific date representing the dale when the plant has been completed, set up and is recognised as being ready for commercial production. For this purpose, the term "commercial production" refers to production in commercially feasible quantities and in a commercially practicable manner. Consequently, it is not sufficient if the plant is ready for experimental production on a limited scale. With reference to the determination of the specific date when the plant can be said to be ready for "commercial production", some guidance may be obtained from the several decided tax cases on this subject (paragraphs 12.1, 12.2 and 12.5).

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17.27 All expenses incurred after the date when the plant is ready for commercial production should be charged to the profit and loss account as revenue expenses—with the exception only of those expenses which are directly of a capital nature. This accounting treatment is also applicable during the period when the plant is ready for commercial production even though actual commercial production has been delayed for some reason. Sometimes, there may be considerable delay between the date when the plant is ready for commercial production and the date of actual commencement of production. Such prolonged delay may occur due to several possible factors. If the period of delay in commencing production is extremely prolonged, with the result that there is no matching income to set-off the revenue expenditure incurred during this period, it may be permissible to treat such expenditure initially as "deferred revenue expenditure" to be written off within a period of three to five years after commencement of production. In all cases of normal delay in commencing commercial production, however, expenses of a revenue nature incurred during the period of delay should be debited to profit and loss account. It would not be necessary, however, to provide any depreciation on fixed assets until after the date when they are first utilized in the company's operations. Consequently, it would not be necessary to provide any depreciation on fixed assets during the period of delay in commencing production, if the fixed assets have not actually been utilised during this period (paragraphs 12.3, 12.4 and 13).

17.28 If a company's financial statements are prepared during the period when the company is still engaged in the construction of its project, some consideration would have to be given to the question of appropriate disclosure in those financial statements (paragraph 14.1).

17.29 The cost of all incomplete construction work executed by the company itself should be shown under the general heading of "Construction Work-in-progress'' with suitable sub-headings to describe the various items. Any completed units of fixed assets actually purchased or acquired during the construction period should be shown in the normal way as "Fixed Assets" after providing for appropriate depreciation thereon. In the case of temporary structures and other facilities erected or acquired specially for the purpose of construction, as well as in the case of special construction equipment, the cost thereof should be shown in the balance sheet as part of the company's "Fixed Assets". It would be necessary to indicate whether such assets as stated in the balance sheet as "at cost" or "at cost less

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depreciation". In some cases, it may be appropriate to state the value of such assets in the balance sheet as "at cost" where the ultimate intention is to determine the depreciation of such assets at the end of the construction period by measuring the difference between the original cost of such assets and their saleable or scrap value at the end of the construction. In that case, the description of such assets in the balance sheet as "at cost" should be clarified by a suitable disclosure of this fact (paragraph 14.3).

17.30 During the period of construction, a company may incur several expenses of a revenue nature. In some cases, such expenses would be treated as indirect or incidental expenses relating to construction whereas in other cases, if the indirect expenses do not relate and are incidental to construction, they may be treated as "Deferred Revenue Expenditure". There may also be cases of various corporate expenses, formation expenses, etc., which are treated as "Preliminary Expenses". The Statement of Incidental Expenditure During Construction for the periods covered should give details of expenses as per Part II of Schedule VI to the Companies Act (paragraphs 14.4, 14.5, 14.6 and 14.7).

17.31 It is also recommended that, in appropriate cases, the financial statements should disclose the amount and brief details of "Deferred Revenue Expenses" indicating the reasons and basis for the deferral of such expenses. The financial statements should also disclose, in appropriate cases, the basis of allocation of indirect capital expenses to the various units of plant and machinery, buildings, etc.—especially if the direct construction expenses form a sizeable proportion of the total capital expenditure (paragraphs 14.8 and 14.9).

17.32 The allocation of indirect capital expenditure to specific asset heads would have to be made bearing in mind a few general principles. Such allocation should be made only after the construction work has been completed and no attempt should be made to allocate indirect capital expenditure to specific asset heads while the construction work is still in progress. Wherever possible, specific items of indirect expenditure should be allocated directly to related asset heads. In those cases where such direct allocation is not possible, it will be necessary to have recourse to indirect allocation. Even in such cases, however, care should be taken to exclude from such allocation those assets or groups of assets which have not benefited from any particular item of indirect capital expenditure, as well as those fixed assets to which a particular item of indirect expenditure is not at all related having ascertained and identified the various items of

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indirect expenditure against the various asset heads or groups of assets to which they may be related, the actual process of such indirect allocation may be accomplished by one of several methods, taking care to select the method which is most appropriate to a particular case. For example in some cases the indirect allocation may be made on the basis of time analysis whereas in other cases, a more suitable method of allocation would be obtained by reference to the cubic, tonnage or area measurements of the different items of construction. Failing any such appropriate basis of allocation, the indirect expenses may be apportioned by reference to the total direct capital costs of the different items of fixed assets (paragraph 15).

17.33 When an existing enterprise carries out a programme of capital expansion concurrently with normal production, all direct capital expenditure must be capitalised in the normal way. As regards indirect expenditure, only that portion ol such expenditure should be capitalised which represents the marginal increase in such expenditure involved as a result of capital expansion. It would not be appropriate in such a case to capitalise indirect expenditure on a *pro rata* basis (paragraph 16).

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APPENDICES

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

Appendix A

BALANCE SHEET AS

LIABILITIES	Rs.	Rs.	Rs.
SHARE CAPITAL			
Authorised			
15,00,000 Equity Shares of Rs. 100/- each		15,00,00,000	
Issued			
7,00,000 Equity Shares of Rs. 100/-each		7,00,00,000	
Subscribed			
7,00,000 Equity Shares (previous year 6,96,805) of Rs. 100/- each issued for cash	7,00,00,000		
Less: Calls in arrears	3,19,500	6,96,80,500	
Add: 3,195 Equity Shares of Rs. 100/- each. Rs. 25/- paid on application and forfeited		79,875	6,97,60,375
RESERVES AND SURPLUS			
General Reserve			
Income during construction period less tax provision			51,347
LOANS			
Secured Loans			
From Banks against equitable Mortgage of Immovable Properties			13,50,00,000
Unsecured Loans			
Loans and Advances from others			4,35,00,000
CURRENT LIABILITIES AND PROVISIONS			
A. Current Liabilities		1,09,42,380	
Sundry Creditors			
B. Provisions			
Provision for Contingencies		19,191	1,09,61,571
29-39 Carried over			25,92,73,293

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AT 31ST AUGUST, 1977

		Rs.	Rs.	Rs.
ASSETS				
FIXED CAPITAL EXPENDITURE				
(a)	**Complete Assets**			
	As per Schedule 'A' attached		59,13,671	
(b)	**Incidental Expenditure during Construction**			
	As per the Incidental Expenditure During Construction Account/ Statement of Incidental Expenditure During Construction		1,59,55,987	
(c)	**Construction Work in Progress**			
	As per Schedule (B) attached		4,99,93,589	
(d)	**Advances to Construction Contractors**		15,94,77,909	
	Less : Motor vehicles handed over as per last account		(50,109)	23,12,91,047
INVESTMENTS				
	Shares in Employee's Consumer Co-operative Society Ltd. at cost (unquoted)			5,000
CURRENT ASSETS, LOANS AND ADVANCES				
A.	**Current Assets**			
	Stock of Raw Material at cost		48,66,314	
	Stock of goods produced during test runs at Raw Materials cost		1,85,111	
	Stores, Spares and Equipment		85,34,820	
	Sundry dues receivable considered good		60,479	
	Carried over		1,36,46,724	23,12,96,047

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

BALANCE SHEET AS

LIABILITIES	**Rs.**	**Rs.**	**Rs.**
Brought forward			25,92,73,293

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

AT 31ST AUGUST, 1977

	ASSETS		**Rs.**	**Rs.**	**Rs.**
	Brought Forward			1,36,46,724	23,12,96,047
	Cash Balance on Hand				
	Cash, Cheques and Stamps			38,124	
	Bank Balances				
	On Current Account				
	With Scheduled Banks in India		79,95,880		
	Call and Time Deposits with Scheduled Banks in India		20,00,000	99,95,880	
B.	**Loans and Advances**				
	Loans (unsecured and interest free) to Employees' Cooperative Credit Society Ltd.		6,000		
	Advances to contractors		24,000		
	Other advances		1,99,425		
	Deposits		6,91,983		
	Prepaid Expenses				
	Process Royalties	5,71,857			
	Other expenses	50,573	6,22,430		
	Advance Tax Paid		1,42,694	16,86,532	2,53,67,260
	MISCELLANEOUS EXPENDITURE				
	Preliminary Expenses			24,25,279	
	Share Issue Expenses			1,29,708	
	Share Registrar's Fees and Expenses			54,999	26,09,986
					25,92,73,293

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

INCIDENTAL EXPENDITURE DURING CONSTRUCTION ACCOUNTS
(for the year ending 31st August 1977)

	Rs.		Rs.
Amount brought forward	78,64,144	Rent receipts	350
Staff Salaries	6,56,415	Recoveries from use of vehicles	4,582
Staff Welfare expenses	15,819	Interest received	1,37,457
Expenditure under Technical Services Agreement	18,26,101	Differenc in exchange	20,665
Travel and conveyance (including Rs. 2,968 previous year Rs.34,608 towards travel expenses of Directors for attending Board Meetings)	41,612	Income from cultivation in Estate	11,144
Stationary and printing	44,858	Receipts from water supply	47,543
Rent	11,192	Amount to be carried forward	1,59,55,987
Power and Electricity	45,057		
Rates and Taxes	2,565		
Import Licence Fees	5,435		
Postage, Telephone, Telegrams and Communications	22,141		
Bank charges	22,019		
Insurance	35,831		
Vehicle operating expenses (including insurance Rs. 1,451 previous year Rs. 3,028)	27,732		
Depreciation of vehicles	24,062		
Other Depreciation	17,349		
Loan commitment fees and interest paid to banks	39,20,062		
Audit fee (not including Rs. 500 (previous year Rs. 500) for other services and Rs. 4805 (previous year Rs. 277) for expenses	6,000		
Estate cultivation and caretaking expenses (including salaries and wages Rs. Nil, previous years Rs. 4372)	17,204		

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

Miscellaneous Expenditure	35,870	
Services and facilities built only for construction :		
Temporary Power Supply	12,043	
Landing Jetty	49,698	
Perimeter Survey	3,296	
"Two Mile Access Road"	13,28,902	
Expenses for Testing Equipment	1,42,321	
	1,61,77,728	1,61,77,728

The above information can also be given in vertical form by preparing a Statement of Incidental Expenditure During Construction as shown on the next page.

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

STATEMENT OF INCIDENTAL EXPENDITURE DURING CONSTRUCTION FOR THE YEAR ENDED 31st AUGUST, 1977

Expenditure	
Amount brought forward	78,64,144
Staff salaries	6,56,415
Staff Welfare Expenses	15,819
Expenditure under Technical Services Agreement	18,26,101
Travel and conveyance (including Rs. 2,968 previous year Rs. 34,608 towards travel expenses of Directors for attending Board Meetings)	41,612
Stationery and Printing	44,858
Rent	11,192
Power & Electricity	45,057
Rates and Taxes	2,565
Import License Fees	5,435
Postage, Telephones, Telegrams and Communications	22,141
Bank Charges	22,019
Insurance	35,831
Vehicle Operating Expenses (including insurance Rs 1,451: previous year Rs 3,028)	27,732
Depreciation of vehicles	24,062
Other Depreciation	17,349
Loan commitment fees and interest paid to banks	39,20,062
Audit fee (not including Rs. 500 (previous year Rs. 500) for other services and Rs. 4,805 (previous year Rs. 277) for expenses)	6,000
Estate cultivation and caretaking expenses (including salaries and wages Rs. Nil. Previous year Rs 4,372)	17,204
Miscellaneous Expenditure	35,870
Service and facilities built only for construction:	
Temporary Power Supply	12,043
Landing Jetty	49,658
Perimeter Survey	3,296
"Two Mile" Access Road	13,28,902
Expenses for Testing Equipment	1,42,321
	1,61,77,728

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

Incomes	
Rent receipts	350
Recoveries from use of vehicles	4,582
Interest received	1,37,457
Difference in exchange	20,665
Income from cultivation in Estate	11,144
Receipts from water supply	47,543
	2,21,741
Amount to be carried forward	1,59,55,987

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

FIXED CAPITAL

Nature of Assets	Total Cost upto 1-9-1976	Additional during the year ended 31-8-1977	Total Cost 31-8-1977
	Rs.	Rs.	Rs.
Land			
(a) General Refinery Site	42,97,291	—	42,97,291
(b) Pipelines	8,00,000	—	8,00,000
(c) Two-mile road	3,00,000	—	3,00,000
Transport Equipment	2,98,814	29,920	3,28,734
Furniture and Fittings	1,00,353	1.35,755	2,36,108
Office and Miscellaneous Equipment	78,984	21,993	1,00,977
Library	5,070	879	5,949
Total	58,80,512	1,88,547	60,69,059
Previous Year	28,99,403	29,81,109	58,80,512

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

EXPENDITURE **SCHEDULE 'A'**

Depreciation provided upto 31-8-1976	Depreciation provided for year ended 31-8-1977	Total Depreciation provided upto 31-8-1977	Net value of Fixed assets as on 31-8-1977	Figures as on 31-8-1976
Rs.	Rs.	Rs	Rs	Rs.
—	—	—	42,97,291	42,97,291
—	—	—	8,00,000	8,00,000
—	—	—	3,00,000	3,00,000
83,572	24,516	1,08,088	2,20,646	2,15,242
12,476	10,908	23,384	2,12,724	87,877
17,507	5,798	23,305	77,672	61,477
422	189	611	5,338	4,648
1,13,977	41,411	1,55,388	59,13,671	57,66,535
65,719	48,258	1,13,977	57,66,535	28,33,684

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

SCHEDULE 'B'

CONSTRUCTION WORK-IN-PROGRESS
(UNDERTAKEN BY THE COMPANY ITSELF)
AS AT 31ST AUGUST 1977

	Rs.	Rs.
Housing and Township		39,97,979
Roads, Bridges and Culverts	15,32,500	
Less: Two-mile road transferred to incidental expenditure during construction	13,28,902	2,03,598
Railroad	—	1,28,23,027
Pipelines	—	1,45,51,615
Plant and Machinery	—	1,33,86,086
Sundry unallocated expenditure to be transferred to various assets	—	36,16,402
Process Utility and Tank area base preparation cost	—	28,58,217
Railroad Loading Facilities	—	8,99,822
Truck Loading Facilities	—	4,55,462
Piping on Dock	—	3,01,381
Total	Rs.	4,99,93,589

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

Notes: attached to, and forming part of, the Statement of Account

(i) *Land*

These accounts include advance payments so far made for acquiring land through the State Government in the total amount of Rs. 47,63,845/- (excluding Rs. 3,00,000/- for two mile refinery access road), out of which the statement received from the District Collector indicates that the amounts disbursed by him upto June 30, 1977 aggregate to Rs. 44,61,585/-. The statements for July and August 1977 have not been received from the Collector. The land acquisition proceedings are still in progress and it is possible that further claims may be made upon the Company resulting in further liability to the Company. The amount, if any, which may be involved in such further liability cannot be determined at present. Pending completion of the land acquisition proceedings, title deeds are not presently available for all the land acquired for the Company.

(ii) *Incidental Expenditure During Constniction Account/Statement on Incidental Expenditure During Construction*

It is the Company's intention to capitalise the major part of this expenditure when commercial operations begin. The amount to be capitalised or treated as deferred revenue expenditure will be determined in accordance with the accepted accounting principles.

(iii) *Profit and loss account*

The Company has prepared the Statement of Incidental Expenditure During Construction/Incidental Expenditure During Construction Account instead of a Profit and Loss Account. The necessary details as per Part II of Schedule VI to the Companies Act, 1956, have been disclosed in the said Statement/Account.

(Withdrawn vide 280th Council Meeting held on August 7-9, 2008)

APPENDIX B

Copy of the Circular letter No. 2/17/64-PR dated 29.1.1964, issued by the Deptt. of Company Affairs
Section 210 — Account — Clarification

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.