Treatment of expenditure incurred by the company on roads for transportation of coal

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

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') was incorporated under the Companies Act, 1956 on 3rd April, 1992 after taking over of assets and liabilities of a company, S Limited in respect of mines in the state of Orissa. 100% of its equity is held by an another company, C Ltd. and its nominees. The main objective of the company is to produce coal and its sale/despatch to various customers.
2. The querist has stated that during the year 2014-15, the company had revenue from operations of ₹11668.48 crore and profit before tax was ₹5314.24 crore. The balance sheet as at 31.03.2015 and profit and loss statement for the year 2014-15 has been supplied by the querist for the perusal of the Committee. It has 10 (ten) operating areas and each area is having number of mines. Most of the mines are opencast mines. One area Basundhara is situated in Sundargarh district, Orissa, which is very remote and 40 k.m. away from district city Sundargarh. It has no railway connectivity. This area has at present two operating mines Basundhara (West) open-cast and Kulda open-cast having last year's (2014-15) production of 37.23 lakh tonnes and 48.04 lakh tonnes, respectively. The surrounding areas are coal bearing and having huge future prospects. Siarmal and Garjanbahal are future approved projects in this area having projected annual production of 400 lakh tonnes and 100 lakh tonnes respectively. The rail connectivity between Jharsugada and Sardega (Basundhara area) is under construction.
3. The querist has further stated that due to non-availability of rail connectivity, despatch is done through road transport to nearest Kanika railway siding which is around 27 k.m. away from mines. The existing two lane road from Banki Bahal to Kanika railway siding through which coal is transported, is also extensively used by local villagers for transportation/communication purpose. This mixed traffic of local people with cycles, motor cycles, four wheelers, etc. along with coal loaded trucks and dumpers is causing inconvenience, traffic jams and is also causing regular accidents due to which blockage of roads and damage of vehicles are common phenomena in this road. The average coal transportation from mines of basundhara area is approximately 18000 tonnes per day. In future, there will be more coal transportation to liquidate more production. Hence, there was a business necessity and compulsion to widen this road to liquidate the coal stock and to maintain continuity of production. This road belongs to Works Department of the State Government. To find a solution to the management problem of transporting the coal, the company had a MOU dt. 07.05.2013 with the Works Department, Government of Odisha, for widening of two lane road to four lane from Banki Bahal to Kanika railway siding and for construction of two other roads.
4. The querist has also stated that the District Collector vide order dt. 12.08.2013 restricted movement of commercial vehicles from Banki Bahal to Kanika siding from 9 AM to 5 PM in compliance of order of Hon'ble High Court of Odisha dt. 12.07.2013. Further, the High Court directed to construct four lane road from Banki Bahal to Kanika Siding to avoid traffic congestion (copy of letter enclosed).
5. Accounting policies of the company for booking of development and prospecting and boring are enumerated below:
   (1) Development:
   Expenses net of income of the projects/ mines under development are booked to Development Account and grouped under capital work-in-progress till the projects/ mines are brought to revenue account. Except otherwise specifically stated in the project report to determine the commercial readiness of the project to yield production on a sustainable basis and completion of required development activity during the period of construction, projects and mines

under development are brought to revenue considering the following criteria:

(a) From beginning of the financial year immediately after the year in which the project achieves physical output of 25% of rated capacity as per approved project report, or

(b) 2 years of touching of coal, or

(c) From the beginning of the financial year in which the value of production is more than total expenses.

- Whichever event occurs first.

(2) Prospecting & Boring and other Development Expenditure:

The cost of exploration and other development expenditure incurred in one 'Five year' plan period will be kept in capital work-in-progress till the end of subsequent two 'Five year' plan periods for formulation of projects, before it is written-off, except in the case of blocks identified for sale or proposed to be sold to outside agency which will be kept in inventory till finalisation of sale. Prospecting, boring and development expenditure are amortised from the year when the mine is brought under revenue in 20 years or working life of the project whichever is less.

6. The querist has also stated that based on the Memorandum of Understanding (MOU) with Works Department and since this is a deposit work, the company's management approved an estimate for widening of two lane road to four lane from Banki Bahal to Kanika railway siding (25.75 k. m.) for ₹266.50 crore with an instruction that the related expenditure to be booked under 'Intangible Assets' to be amortised every year. Accordingly, the deposits made to Works Department as per MOU during the year 2014-15 amounting to ₹39.43 crore was shown as 'Intangible Assets under construction' - Note 10(C) forming part of balance sheet (line item–Development) as at 31.03.2015. As per article 2.7 of the MOU, after completion of the projects, the roads shall be maintained by the company. While approving the proposal, it was observed by the management that neither the land to be acquired for widening the road nor the road will be the property of the company and these will remain the property of the Works Department, Government of Odisha with the company's responsibility to maintain the road as per MOU. The proposed deposit work will facilitate unrestricted movement of coal laden trucks (in terms of timing) and the nearby villagers will also be beneficiaries.

7. During supplementary audit conducted by the Comptroller and Auditor General of India (CAG) under section 143(6) of the Companies Act, 2013, the booking of expenditure incurred during the year 2014-15 and its debit to intangible asset under construction were questioned and the management gave an assurance to CAG that the related matter would be referred to the Institute of Chartered Accountants of India for its perusal and valued opinion.

8. According to the querist, the management debited this expenditure to intangible asset on reasoning that the benefit of this expenditure will accrue to the entity for periods beyond one year and by MOU, the company gets an unrestricted right to use this asset by incurring annual running repair and maintenance expenditure. The future running repair and maintenance expenditure will be booked to revenue account to get a fair view of profit for the years.

B. Query

9. Based on the facts and the analysis as above, the querist has sought the opinion of the Expert Advisory Committee on the treatment of above expenditure.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised by the querist relates to whether expenses incurred for widening of two lanes road to four lanes road, which is not owned by the company can be recognised as intangible asset. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, propriety of accounting policy for development, prospecting and boring expenses, accounting treatment of expenses on coal blocks, treatment of future running repair and maintenance expenditure incurred on roads, etc.

11. The Committee notes from the Facts of the Case that the company has two operating mines in Basundhara Area, from where the company produces coal for its sale/despatch to various customers. However, due to non-availability

of rail connectivity, despatch of coal is done through road transport (two lane road), where there is some restriction of movement of commercial vehicles. Therefore, the company has entered into an MoU with the Works Department, Govt. of Odisha, for widening of the existing two lanes to four lanes. As per the querist, in future, there will be more coal transportation to liquidate more production and hence, there is business necessity and compulsion to widen this road to liquidate the coal stock and to maintain continuity of production. However, the land on which the road is situated and the road will be the property of the Works Department, Government of Odisha. Now, the issue is whether expenses incurred for widening of two lanes road to four lanes road can be recognised as intangible assets in the books of the company. In this context, the Committee notes the following paragraphs from AS 26:

> ***"6.1 An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes.***
> ***6.2 An asset is a resource:***
> ***(a) controlled by an enterprise as a result of past events; and***
> ***(b) from which future economic benefits are expected to flow to the enterprise."***
> "14. An enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. ..."

From the above, the Committee notes that an expenditure incurred by an enterprise can be recognised as an asset only if it is a 'resource *controlled* by the enterprise'. Thus, it is the control over the resource that is important for recognising an expenditure as an asset. The Committee further notes that as per paragraph 14 of AS 26, an enterprise controls an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. In this regard, the Committee notes from the Facts of the Case that the neither the land to be acquired for widening the road nor the road will be the property of the company. These will remain the property of the Works Department, Government of Odisha, with the company's responsibility to maintain the road as per the MOU. Further, it is noted that the querist has stated that the nearby villagers will also be beneficiaries. From this, it appears that although the work of widening the road will facilitate unrestricted movement of coal for the company, the company does not enjoy control in terms of restriction of access of others to the benefits arising from the widened road facility. Therefore, the Committee is of the view that the expenditure incurred on widening and construction of road on the land which is not owned by the company does not meet the definitions of the terms 'asset' and 'intangible asset'. Accordingly, such expenditure cannot be capitalised as an intangible asset.

D. Opinion

12. On the basis of the above, the Committee is of the opinion that the expenditure incurred for widening of two lanes road to four lanes road cannot be capitalised as an intangible asset, as discussed in paragraph 11 above.

1	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on January 11, 2016. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty four volumes. A CD of Compendium of Opinions containing thirty four volume has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.in.

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Low self-esteem is like driving through life with your hand-brake on. - Maxwell Maltz