Opinion

Accounting Treatment of Expenditure Relating to Employee Benefits Expenses, Rent Expenses, Travelling Expenses and House-keeping Expenses which are Compulsorily Required to be Incurred for Construction of the Project

A. Facts of the Case

1. The querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) on accounting treatment of expenditure relating to employee benefits expenses, rent expenses, travelling expenses and house-keeping expenses which are compulsorily required to be incurred for construction of High Speed Rail project by the company, which as per the querist, are directly related expenditure and without incurrence of which construction of rail project cannot take place.

2. The querist has informed that the project was approved by the Cabinet on 09.12.2015 and thereafter, a public limited company (hereinafter referred to as 'the company') was incorporated in India under the provisions of the Companies Act, 2013 on 12th February 2016, with the object to plan, design, develop, build, commission, maintain, operate and finance high speed rail services between the State of Maharashtra and State of Gujarat and/or any other area either on its own or by taking over or leasing or otherwise by any other model and build new transit route of any mode or a combination of mode with all attendant infrastructure facilities, as may be approved by Ministry of Railways (MoR) or Government of India (GoI) or any other such competent authority. The capital cost of the project is approximately ₹ 1.08 lakh crores. For the total cost of the project, funds have been arranged by the company in the form of equity from MoR, Government of Gujarat, Government of Maharashtra and in the form of soft loan from Japan International Cooperation Agency (JICA).

3. The querist has stated that as per Indian Accounting Standard (Ind AS) 101, 'First-time adoption of Indian Accounting Standards', the company being covered under phase-II of roadmap issued by the Ministry of Corporate Affairs (MCA) prepared its first Ind AS financials for the financial year (F.Y.) 2017-18 with the balance sheet as on 31.03.2017 for comparative period.

4. The company is incorporated and engaged in one and the only activity of creation of self-constructed asset, i.e., Bullet Train Project between the State of Maharashtra and State of Gujarat. The Project includes activities from acquisition of land, earth work, laying tracks, station building, signalling & telecommunication, overhead electric, bridge, tunnels, station, training institute etc. During the financial year 2017-18, the registered office/head office of company at New Delhi and site offices in the states of Gujarat and Maharashtra have been taken on rent; and all the project executing team including directors are sitting at the head office and site offices and executing their work from respective locations.

5. During the financial year 2017-18, the company has spent ₹ 1964.44 lakh as employee benefit expenses and other expenses for corporate and project site office which are specifically related to the creation of the Project. Out of these, details for ₹ 1720.98 lakh, as given below, has been referred for the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI):

Expense Head	Amount (₹ in lakh)
Employee Benefit Expenses	999.52
Rent Expenses	332.27
Travelling Expenses	261.57
Housekeeping Expenses	127.62
Total	1720.98

Details of Employee Benefit Expenses:

S.No.	Department	No. of Employees	Amount (₹ in lakh)	Role/Responsibilities
1	Managing Director	1	49.09	Managing Director of the company is engaged in managing all day-to-day activities related to the construction of the project by the company. He is fully involved in project related activities like co-ordinating with various government agencies at apex level for the purpose of land acquisition, utility shifting, environmental clearance and a host of other key activities critical for successful completion of the project. Besides this, his precious time is also spent on co-ordinating with JICA, Ministry of Finance, Ministry of Railways and National Institution for Transforming India (NITI Aayog) to resolve many important issues including raising of funds/loans as per the project requirement.
2	Company Law	2	12.70	The company secretary of the company is responsible for ensuring compliance with statutory and regulatory requirements of the company.
3	Finance department including director finance	7	79.38	The company has not started its operation and it is under the construction stage, which requires huge planning in terms of management of resources. Finance department is responsible for the following functions: ➢ Finalisation of tender documents (Standard Biding Documents) ➢ Bid Process Management (including bid costing, tender evaluation and finalisation) ➢ Contract Management (including payments, variation and contract closing) ➢ Estimating and Costing including rate analysis ➢ Annual Budgeting ➢ Taxation ➢ All aspects related to corporate financing ➢ Financial aspects of service matters etc.
4	Human Resource (HR) Department	4	37.67	HR Department is involved to look after various functions of human resource management, such as, recruitment, training & development, compensation management, performance management & employee welfare etc. For the purpose of executing the project and its monitoring, various levels of technical/non-technical executives are required to be deployed in various site offices. The entire process of recruitment, their training and development in India as well as overseas is being coordinated by Human Resource Department. The compensation system and other welfare measures are being dealt centrally for all the employees involved in the execution of the project. Since the requirement of manpower for the execution of the project and its O&M activities is huge, the recruitment process will be carried out continuously in a phased manner.

5	Project Associated Departments	82	820.68	Project Associated departments are responsible for following functions: ➢ Railway Civil /Pway/ Electrification/ S&T/Rolling Stock /Mechanical and all associated works, i.e., supervision of design and build works related to bridges, viaducts, tunnels, traction sub-station, distribution sub-station, transmission lines, overhead equipment line, rolling stock etc. ➢ Land acquisition and environment clearance related matters. ➢ Construction, testing, commissioning and monitoring, safety and quality assurance. ➢ Contract management, tendering interface and other maintenance /field/ specific special works.
	Total	96	999.52	

Details of rent expenses, travelling expenses and housekeeping expenses

During the financial year 2017-18, the company has taken three offices on rent, i.e., head office in New Delhi and site offices in the states of Gujarat and Maharashtra.

- The company has incurred ₹ 332.27 lakhs as rent expenses out of which ₹ 270.51 lakhs is related to the head office where project executing team including directors are sitting, ₹ 12.98 lakhs is related to the Gujarat site office and ₹ 48.77 lakhs is related to the Maharashtra site office of the company.
- Project executing team including directors are sitting at the head office and site offices and executing their work from respective locations.
- Rent expenses incurred for the site offices are directly related to the project. Rent expenses of head office, travelling expenses and housekeeping expenses have been bifurcated into different departments as given below:

S. No.	Department	Rent Expenses	Travelling Expenses	Housekeeping Expenses
		Amount in Lakhs (Amount allocated based on no. of Employees)		
1	Managing Director	2.82	2.39	1.33
2	Company Law	5.64	4.78	2.66
3	Finance department including director finance	19.73	16.73	9.31
4	Human Resource Department	11.27	9.56	5.32
5	Project Department	231.06	228.11	109.01
		270.51	261.57	127.62

6. The querist has further informed that the company has capitalised the expenses given above as incidental project expenditure under the head capital work in progress (CWIP) in Note No. 4 of the financial statements. The same is also stated in accounting policy No.2.6 which is reproduced below:

   "Expenditure which can be directly identified with the Project undertaken by the company is debited to 'Capital

Work in Progress' under 'Direct Project Expenditure'. Indirect expenditure in the nature of employee benefits and indirect expenditure directly related to the project has been charged to project."

Observations made by Comptroller and Auditor General (C&AG)

7. The Comptroller and Auditor General of India (C&AG) has made some observations that, as per Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment', paragraph 19 (d), CWIP should not include administrative costs and other general overhead costs. As per balance sheet, CWIP includes an amount of ₹ 1964.44 lakh (₹ 999.52 lakh for employee benefit expense + ₹ 964.92 lakh for other expenses) which should have been charged to the statement of profit and loss. This has resulted in overstatement of CWIP by ₹ 1964.44 lakh and overstatement of profits to the same extent.

Management Reply

8. The management reply to CAG is as follows:

Paragraph 19(d) of Ind AS 16 is applicable in the case of a company already operating and now going for expansion, either by new facility (paragraph 19(a)) or new products or service (paragraph 19(b)) or business in new location (paragraph 19(c)). In these three situations, paragraph 19(d) becomes relevant that does not allow administrative costs and general overhead costs to be added in CWIP. In the case of the company, none of the sub-clauses of paragraph 19 from (a) to (c) are applicable and, therefore, sub-clause (d) as referred in the CAG observation is not applicable.

Since the company is engaged in self-construction of the asset, i.e., 'Bullet Train Project' (project), paragraph 22 of Ind AS 16 is relevant, which is reproduced hereunder:

> "22. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see Ind AS 2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self constructing an asset is not included in the cost of the asset. ..."

Since the company is self-constructing assets, therefore as paragraph 22 states, its cost of assets will be recognised as in case of assets being constructed for sale. Paragraph 22 mentions Ind AS 2, which means costs that are taken to measure inventory, will be taken in case of self-constructed assets.

As per paragraph 10 of Ind AS 2, 'Inventories', the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Paragraph 15 of Ind AS 2, 'Inventories' states that other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

As per paragraph 16 of Ind AS 16, elements of cost are as follows:

"16 The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period."

Paragraph 16 of Ind AS 2 states as follows:

"16 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs."

Further, Question 10 of Educational Material on Ind AS 16, issued by the erstwhile Ind AS Implementation Committee of the ICAI states that general overhead costs are not costs of an item of property, plant and equipment unless if it can be clearly demonstrated that they are directly attributable to construction.

The answer to Question 10 above envisages a situation that may demand inclusion of general overhead cost as part of the cost, which is the case of the company. In the case of the company, because of self-constructed assets, cost is to be recognised by inclusion of administrative costs and other general overhead costs. Therefore, administrative costs and other general overhead costs become directly attributable to be part of self-constructed assets of the company.

Specifically, in respect of the cost mentioned in CAG observation;

- ₹ 999.52 lakh for employee benefit expense:

As per paragraph 17 (a) of Ind AS 16, costs of employee benefits (as defined in Ind AS 19, *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment is an example of directly attributable costs.

In the case of the company, no employees would have been employed if the assets under construction, for which CWIP is recognised was not the objective; since the company is for creation of one asset, that is, Bullet Train, it has no other activities, employees are not required except for this project.

- ₹ 964.92 lakh for other expenses: (Query for EAC opinion is raised for ₹ 721.46 lakh for three major expenses)

Paragraph 22 of Ind AS 16 states that the cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see Ind AS 2). Paragraph 16 of Ind AS 2 states that administrative overheads should be excluded from the cost of inventories that do not contribute to bringing inventories to their present location and condition.

Other expenses like rent, maintenance of head office, travels, training all are only for one project, i.e., bullet train project; there are no other activities of the company. These expenses would not have been incurred if bullet train project was not the objective of the company.

Therefore, in view of the requirements of paragraph 22 of Ind AS 16, the company has rightly charged general and administrative overheads to the CWIP.

Assurance given by the company to C&AG

9. The company has given assurance to the Principal Director (Commercial Audit), Member Audit Board-I, Delhi which is reproduced below:

> "Regarding expenditure of ₹ 1964.44 incurred for employee benefit expense and for other expenses (administrative and other general costs) during construction phase, it is assured that the complete accounting treatment on the above expenditure shall be referred to the Expert Advisory Committee of the Institute of Chartered Accountants of India."

Points for consideration of the Expert Advisory Committee

10. In this whole issue, the company also submits the following for consideration of the Expert Advisory Committee:

    (i) Rail Project is the only project, the company is presently executing and all the functions of the company at corporate office /site offices are related to this single project only.

    (ii) These are the expenditure without incurrence of which the construction of the rail project cannot take place and the project cannot be brought to its working condition.

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(iii) These expenses are directly attributable to rail project and are required to be incurred only for execution of the rail project and not otherwise.

B. Query

11. Accordingly, the opinion of the Expert Advisory Committee of the ICAI has been sought as to whether the accounting treatment of the said employee benefits expenses ₹ 999.52 lakhs, rent expenses ₹ 332.27 lakhs, travelling expenses ₹ 261.57 lakhs and house-keeping expenses ₹ 127.62 lakhs which are incurred for rail project, as disclosed by company, is correct. If not, what should be the treatment in the opinion of the Committee as per Ind AS 16, Property, Plant and Equipment and other applicable Indian Accounting Standards?

C. Points considered by the Committee

12. The Committee notes that the basic issue raised in the query relates to accounting treatment of employee benefits expenses, rent expenses, travelling expenses and house-keeping expenses incurred for the rail project. The Committee has, therefore, considered only these issues and has not examined any other issue(s) that may arise from the Facts of the Case, such as, accounting of any other expense incurred by the company in relation to the project, allocation of expenses to various departments, accounting treatment of soft loan and equity received by the company, etc. Further, the Committee, while expressing its opinion, has not examined the accuracy of numerical data/figures of various items of cost/expenditure presented by the querist.

13. At the outset, the Committee wishes to point out that various expenses are incurred during construction period. However, it is not necessary that all expenses incurred during construction are eligible to be capitalised to the project/ asset being constructed. The capitalisation of an item of cost to a fixed asset/project depends upon the nature of such expenses in relation to the construction/ acquisition activity in the context of requirements in this regard laid down in the applicable Indian Accounting Standards. Further, the Committee also wishes to state that just because the only activity being undertaken by the company at present is the construction of the rail project does not mean that all the costs incurred by the company are directly attributable costs of rail project in accordance with the requirements of Ind AS 16.

14. With regard to the issues raised in paragraph 11 above, the Committee notes the following paragraphs of Ind AS 16, Property, Plant and Equipment, notified under the Companies (Indian Accounting Standards) Rules, 2015:

"16 The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17 Examples of directly attributable costs are:

(a) costs of employee benefits (as defined in Ind AS 19, *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any

items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees."

"19 Examples of costs that are not costs of an item of property, plant and equipment are:

(a) costs of opening a new facility;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(d) administration and other general overhead costs.

20 Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:

(a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

(b) initial operating losses, such as those incurred while demand for the item's output builds up; and

(c) costs of relocating or reorganising part or all of an entity's operations."

From the above, the Committee notes that the basic principle to be applied while capitalising an item of cost to a property, plant and equipment (PPE) is that it is directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The Committee is of the view that 'directly attributable' costs are generally such costs which are necessary to enable the construction activity, i.e. these costs are directly related to the construction activity and without the incurrence of which the asset cannot be brought to the location and condition necessary for it to be capable of operating in the manner intended by management. Accordingly, the Committee is of the view that the expenditure on employee benefits, rent expenses, travelling expenses and house-keeping expenses incurred by the company can be capitalised only if these can be considered as directly attributable cost to bringing the bullet train project or the related asset(s) to the location and condition necessary for it (them) to be capable of operating in the manner intended by the management.

15. The Committee further notes that paragraph 19 of Ind AS 16, as reproduced above states that administration and other general overhead costs are examples of the costs that are not costs of an item of property, plant and equipment. In this connection, the Committee wishes to point out that the contention of the querist relating to applicability of paragraph 19(d) of Ind AS 16 is not correct. Paragraph 19 (d) is applicable to all the entities irrespective of whether it is a new one or an existing one.

16. The Committee also notes that the querist has contended in the Facts of the Case that since paragraph 22 of Ind AS 16 (that deals with the cost of a self-constructed asset) mentions Ind AS 2, costs that are taken to measure inventory, will be taken in case of self-constructed assets. In this regard, the Committee wishes to state that paragraph 22 of Ind AS 16 is applicable when the self-constructed asset is also produced/made by the company for sale in its normal course of business and therefore, only in such cases, principles of Ind AS 2 can be applied. Thus, principles of Ind AS 2 cannot be applied in all cases of self-constructed assets. In this context, the Committee also wishes to mention that considering the requirements of Ind AS 16, administrative and general overhead expenses should, ordinarily, not be capitalised with the item of PPE, however in certain exceptional cases where it can be

clearly demonstrated that these are directly attributable to construction (as discussed above), such costs can be capitalised.

17. With regard to employee benefit expenses, the Committee notes that paragraph 17 of Ind AS 16 gives examples of directly attributable costs and it includes costs of employee benefits (as defined in Ind AS 19, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment. Therefore, the Committee is of the view that the employee benefit expenses arising directly from the construction or acquisition of the project should only be capitalised and rest should be charged to the statement of profit and loss as and when incurred. Considering the details of expenses provided, the Committee is of the view that employee benefit expenses in respect of project associated departments are apparently directly attributable costs (as discussed in paragraph 14 above) and can accordingly be capitalised with the cost of the project. In respect of employee benefit expenses of finance department, the Committee is of the view that normally the costs incurred by finance department are not directly attributable costs, but are considered as administration and general overheads and therefore, should not be capitalised. However, in certain rare/exceptional circumstances, where and to the extent, the finance department is engaged in the construction activities, the same may be considered as directly attributable costs and can accordingly be capitalised. Similarly, employee benefit expenses of Managing Director are normally of the nature of administration and general overheads and should, ordinarily, not be capitalised with the item of PPE, however in certain exceptional cases where it can be clearly demonstrated that these are directly attributable to construction, these can be capitalised. Further, the employee benefit expenses of HR department and company law department cannot be considered as directly attributable costs.

18. With regard to rent expenses, the Committee notes that it includes rent of site offices (2 offices) and head office. The Committee is of the view that generally there is direct relation between the site office and the construction activity and thus the rent expense in relation to site offices may be considered as directly attributable cost and therefore, can be capitalised to CWIP till the time the item of property, plant and equipment is in the location and condition necessary for it to be capable of operating in the manner intended by the management. With regard to rent of head office, the Committee is of the view that head office is generally used for the overall supervision, strategic planning and other related activities which are not directly related to construction as such and therefore, the rent expense of head office should not be considered as cost of the project. However, if the project execution related activities are also being performed at head office resulting into 'directly attributable costs' as discussed in paragraph 14 above, and these can be ascertained on a reasonable and reliable basis, then only to that extent, rent should be capitalised as the cost of the project.

19. With regard to travelling expenses, the Committee is of the view that these are required to be examined keeping in view the nature and purpose of such expenses and the extent to which these expenses are directly attributable to the construction of the train project. For example, travel expenses of Managing Director, are normally for general and administration purposes and ordinarily, should not be capitalised, however in certain exceptional cases where it can be clearly demonstrated that these are directly attributable to construction, these can be capitalised. Thus, in the extant case, the accounting treatment of travelling expense would depend upon whether or not the same is directly attributable to the construction of the project for bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

20. With regard to housekeeping expenses, the Committee is of the view that these expenses are purely in the nature of administration expenses, as given in paragraph 19(d) of Ind AS 16, which cannot be considered as 'directly attributable cost' of construction of

the rail project and therefore, these cannot be capitalised as cost of an item of property, plant and equipment.

D. Opinion

21. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

(a) As discussed in paragraph 17 above, employee benefit expenses in respect of project associated departments are apparently directly attributable costs (as discussed in paragraph 14 above) and can accordingly be capitalised with the cost of the project. In respect of employee benefit expenses of finance department, normally the costs incurred by finance department are not directly attributable costs, but are considered as administration and general overheads and therefore, should not be capitalised. However, in certain rare/exceptional circumstances, where and to the extent, the finance department is engaged in the construction activities, the same may be considered as directly attributable cost and can accordingly be capitalised. Similarly, employee benefit expenses of Managing Director are normally of the nature of administration and general overheads and should, ordinarily, not be capitalised with the item of PPE, however in certain exceptional cases where it can be clearly demonstrated that these are directly attributable to construction, these can be capitalised. Further, the employee benefit expenses of HR department and company law department cannot be considered as directly attributable costs.

(b) The rent expense in relation to site offices may be considered as directly attributable cost and can be capitalised to CWIP till the time the item of property, plant and equipment is in the location and condition necessary for it to be capable of operating in the manner intended by the management, as discussed in paragraph 18 above. The rent expense of head office should not be considered as cost of the project. However, if the project execution related activities are also being performed at head office resulting into 'directly attributable costs' as discussed in paragraph 14 above, and these can be ascertained on a reasonable and reliable basis, then only to that extent, rent should be capitalised as the cost of the project.

(c) As discussed in paragraph 19 above, travelling expenses are required to be examined keeping in view the nature and purpose of such expenses and the extent to which these expenses are directly attributable to the construction of the train project.

(d) As discussed in paragraph 20 above, the housekeeping expenses are purely in the nature of administration expenses as given in paragraph 19(d) of Ind AS 16, which cannot be considered as 'directly attributable cost' of construction of the rail project and therefore, these cannot be capitalised as cost of an item of property, plant and equipment.

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 April 09, 2019. 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 six volumes. A CD of Compendium of Opinions containing thirty six volumes 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. ■