

1. Accounting treatment of expenditure incurred on Type Tests Reports under Ind AS framework.

A. Facts of the Case

- A company is into manufacturing of polymer insulators having wide application in power sector.
- The main buyers are State Electricity Boards, Power Grids and all Engineering, Procurement, and Construction (EPC) contractors.
- For getting empanelled with the above said buyers, the polymer insulator suppliers need to get their insulators tested by testing agencies which should be approved by National Accreditation Board for Testing and Calibrations Laboratories (NABL).
- These reports are commonly known as TTR (Type Tests Reports).
- Though the TTR does not mention any validity period but the State Electricity Boards, Power Grid and other vendors do *not* accept any TTR if it is older than five years. (This period of five years has recently been increased to ten years). They put this as one of the conditions for getting empanelled for supply of insulators.
- The tests include testing of insulators on various parameters including climatic conditions, stress test and other technical tests including electrical and mechanical tests.
- Further, if a new range or new variant of insulator are introduced, then all the above set of tests need to get done over that new insulator too.
- Type tests are conducted and the TTR is obtained during the product development stage to meet the prescribed testing requirements and only thereafter the products are marketed to the buyers.
- The products are designed and developed by the Company as per International Electrotechnical Commission (IEC) standards and then, the prototype samples are produced and the samples are type tested in NABL Laboratory before the sale.
- The type test report creates an enduring 'right' that provides access to specified markets/customers.
- The type tests are mandatory to sell the products to customers and utilities. However, same TTR can be used for different customers or set of customers.
- The Company has 100% success rate of the type test reports.
- These tests involve a major expenditure and the Company is expecting to expend further in next five to six months. However, after that, for a gap of few years, there would not be any TTR related expenditure because the report shall be valid for next ten years.
- The auditor of the Company is of the opinion that the entire expenditure should be booked in the year in which it has been incurred considering Indian Accounting Standards (Ind AS) requirements.

- The Company is seeking to spread the above expenditure on testing to next ten years as it shall reap benefits for the same period.

B. Query

- Whether the expenditure on TTR can be spread over ten years instead of booking entirely in the year in which it is incurred.

C. Points considered by the Committee

- At the outset, the Committee understands from the facts supplied that the expenditure on TTR is incurred on testing the new product, viz. polymer insulator (or its new type or variant) during the product development stage so that the product can be sold or marketed to specified customers or market.
- The Committee notes from the requirements of Ind AS 38, 'Intangible Assets' that the prototype (due to knowledge embodied in developing a prototype) can be considered as an internally generated intangible asset.
- Also, *testing of pre-production or pre-use prototype and model* is considered as an example of development activities.
- Further, Committee notes from paragraph 57 of Ind AS 38 that an intangible asset arising from development shall be recognised if, and only if, an entity can demonstrate all of the conditions mentioned therein.
- Furthermore, as per paragraph 65 of Ind AS 38, the cost of an internally generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria.
- Considering the requirements of Ind AS 38, the Committee is of the view that the prototype of new polymer insulator or a new variant thereof can be considered as an internally generated 'intangible asset'.
- Also, type test can be considered as development activity of the prototype. This is so because in the extant case, without successful completion of this test, development of prototype will not be complete and prototype cannot be considered as ready for its intended use/sale. Thus, the type test activity forms an integral part of the development stage itself rather than a post-development or marketing activity.
- The Committee further notes that as per the requirements of Ind AS 38, TTR cost being part of development costs, should be recognised as cost of internally developed intangible asset (viz., prototype), only if during the type test stage, all the recognition requirements in paragraph 57 of Ind AS 38 are satisfied.
- Since successful completion of type test will ensure that the Company shall be able to sell/market the product developed and considering the 100% success rate of TTR, all the conditions in paragraph 57 of Ind AS 38 will be met at this stage, such as, the criterion of technical feasibility of completing the intangible asset, how the intangible asset will generate probable future economic benefits, etc.
- The Committee also notes that paragraph 66 of Ind AS 38 requires the cost of an internally generated asset to comprise all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in the manner intended by management.
- **Since obtaining the TTR is a mandatory step for demonstrating compliance with the prescribed technical requirements and for preparing the developed prototype capable of being used or sold in the intended market, the expenditure incurred on such testing is directly attributable to the development of the prototype and shall form part of cost of intangible asset (viz., prototype of polymer insulator).**
- **Further, subsequent to recognition, at each reporting date, the cost of the intangible asset (prototype) so developed shall be amortised, considering its useful life (rather than the validity of the TTR, which may be considered as one of the factors in determining useful life of prototype) as per the requirements of Ind AS 38.**

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2. Presentation of Advance given for construction of Office Space.

A. Facts of the Case

- A Company applied for procurement of floor space through E-Auction in the Commercial Complex constructed by N Ltd.
- The space was allotted to the Company vide allotment letter dated 21st Nov 2022.
- The payment for the said procurement was to be made in 13 installments with first 8 installments due on time basis, while the remaining 5 installments to be made on the basis of completion of milestones specified in the allotment letter.
- The Company had made payment of 12 installments, and only final installment was

pending which was to be made within 60 days of offer of possession.

- In the month of December 2024, the Company received offer of possession from N Ltd.
- The Company requested N Ltd. to revoke the possession letter citing issues pending on the end of N Ltd., relating to lifts, washrooms, water supply, seepage, safety hazards, etc.
- Based on the Company's request, N Ltd. withdrew the offer letter in the month of February 2025. No further payment was made by the Company during financial year (F.Y.) 2024-25 to N Ltd.

Accounting Treatment and Presentation done by the Company

- The Company has recognised such 'Advance Payment to N Ltd.' under the sub-heading of 'Capital Advances' under heading of 'Other Non-Current Assets' based on the provisions of the Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 which inter alia states as follows:

  > "Capital Advances are not to be classified under Capital Work in Progress, since they are specifically to be disclosed under other non-current assets."
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  > "Capital advances are advances given for procurement of Property, Plant and Equipment including bearer plants, … Typically, companies do not expect to realise them in cash. Rather, *over the period*, these get converted into Property, Plant and Equipment … respectively, which are non-current assets. Hence, capital advances should be treated as other non-current assets irrespective of when the Property, Plant and Equipment … are expected to be received."

- According to the Company, the allotment letter specifically mentioned that the allottee (the Company) is a purchaser of specified built-up area, and has only rights of the purchased freehold specific built-up area and not control over construction of the aforementioned building. *Accordingly, the amount paid by the Company to N Ltd. is towards procurement of the floor space, and not towards construction.*
- As given in the Guidance Note, capital advances can be given for assets which are built over a period of time, and it is not mandatory for asset to be created at a specific point in time. Therefore, advance given for procurement of built-up area is a part of capital advance.

Comptroller and Auditor General of India's (C&AG's) Observation

- "…capital advance is overstated and capital work in progress is understated … payments are being made on the achievement of specific milestone basis as mentioned in the allotment letter….As per the Guidance Note on Terms used in Financial Statements, … term "Capital Work-in-progress" is Expenditure on capital assets which are in the process of construction or completion. Since … the Company is making milestone payment; therefore, it should have been booked in CWIP instead of advance …".

B. Query

- Whether such advance payments form part of 'Capital Advances' to be shown under the heading of 'Other Non-current Assets'; or such advance payments should be included under Capital Work-in-Progress; or any other presentation as EAC may consider appropriate in the case.

C. Points considered by the Committee

- The Committee notes that in the extant case, N Ltd. does not transfer the undivided share in land and building corresponding to the unit sold in the complex individually; rather, it transfers the combined item.
  - Thus, it cannot be said that the Company has obtained undivided share in the land on issuance of allotment letter.
  - Further, it is presumed from the facts supplied that N Ltd. is not undertaking the construction activity as an agent on behalf of the Company along with the other buyers/allottees.
- The Committee notes from Note 6 of the General Instructions for Preparation of Balance Sheet under Division II of Schedule III to the Companies Act, 2013 and Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 as follows:
  - Capital advances are to be disclosed under 'Other non-current assets'.
  - Capital advances are advances given *for procurement* of property, plant and equipment (PPE) including bearer plants, etc. which are *non-current assets*.
  - Thus, until the underlying non-current asset is recognised in the financial statements, the advance is treated as capital advance.
- The Committee further notes that although Schedule III and the Guidance Note require

separate presentation of PPE and capital work-in-progress (CWIP), recognition and measurement of CWIP (which is a PPE under construction) is dealt with under Ind AS 16 as these are tangible items.

- As per the requirements of Ind AS 16 (paragraph 7), an item of PPE can be recognised as an *asset* if, and only if: (a) it is probable that future economic benefits associated with the item will flow to the entity; and (b) the cost of the item can be measured reliably.
- To better understand and apply the above recognition requirements of Ind AS 16, the Committee also notes the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS) as follows:
  - Only items that meet the definition of an asset are recognised in the balance sheet (paragraph 5.6).
  - For recognition as an asset, the entity should be able to control the economic resource, viz., a right having the potential to produce economic benefits.
  - The Conceptual Framework links the recognition of an asset with control over economic resource having future economic benefits.
  - Therefore, the Committee is of the view that in case of procurement, an asset viz., PPE, should be recognised when control is transferred to the purchaser.
  - Thus, with regard to conversion from capital advance to the underlying non-current asset, what is relevant is when the Company obtains 'control' of the property being purchased/ procured.
  - Since the property in the extant case is being constructed over time, it is relevant to understand whether the Company obtains the control of the property over the construction period as and when the asset (viz., property) is created or only when the construction is complete.
  - If the Company controls the asset that is being constructed or created (for example, the part-constructed real estate property) as it is created/constructed, the Company should recognise the underlying asset as and when the asset is so created or constructed.
  - Further, since during that period, the asset is under construction and not complete in all respects for it to be in the location and condition necessary for it to be capable of operating in the manner intended by management, as per the requirements of Ind AS 16, the same should be presented as capital work-in-progress.
- As far as 'control' is concerned, the Committee further notes from the requirements of Conceptual Framework as follows:
  - An entity controls an economic resource or asset if it has the present ability to direct its use and obtain the economic benefits that may flow from it (such as, through sale or pledge of the partly constructed real estate unit, in the extant case).
  - The Committee is of the view that whether and when the 'control' of under-construction unit is transferred from seller to buyer is a matter of judgement in the specific facts and circumstances, including the terms and conditions of the arrangement, the rights and obligations of the parties, the legal framework governing such arrangements etc.
- **Thus, in the extant case, on exercise of the judgement, if it is concluded that the Company obtains through ownership or otherwise, control of under-construction property as and when the construction takes place, it should present the same as capital work-in-progress (CWIP). However, if the Company does not obtain control of the under-construction property as and when the construction takes place, the same should be presented as capital advance.**
- **Further, the CWIP to be recognised should represent the value of partly constructed unit controlled by the Company and should not include any advance in relation to the construction which is yet to take place. The payments made should be treated as capital advance only for such advance, in respect of which the Company is yet to obtain control of the asset.**

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3. Accounting treatment of land purchased under a ninety-year lease deed, as per Ind AS 116.

A. Facts of the Case

- A Company acquired a plot under a 90-year lease deed executed with the New Okhla Industrial Development Authority (hereinafter referred to as 'NOIDA Authority').

- The Company expects the lease to be renewed upon expiry, in line with prevailing practices of the Authority.
- The plot is retained for the Company's own office and business purposes, with no intention of sale or transfer.

Important clauses in Lease Deed and Contextual Note provided by the Querist:

- *Clause 4: In addition to the premium of plot, lease rent @ 2.5% of the premium per annum shall be payable in advance* – Apart from premium, the Company made a One Time Lease Rent payment, which covered the entire lease rent obligation in advance.
- *Clause 8: The Lessee shall have to complete the building within five years from the date of allotment or four years from the date of the possession whichever is less. No further extension shall be allowed* – The Lessee has to complete building within five years from the date of allotment or four years from the date of possession whichever is less. However, the land remained vacant and not built upon within the stipulated period and therefore, the Company had to pay *extension charges* multiple times.
- *Clause 14: The Lessee may with the previous permission, mortgage the Demised Premises for raising loans and in the event of foreclosure of the mortgage, the Lessor shall be entitled to claim and recover such percentage as decided by the Lessor of the unearned increase in the value of Demised Premises and Lessor shall have the pre-emptive right to purchase the mortgaged or charged property* – The Company has *never mortgaged the said land* and has no intention of mortgaging or exiting the property.
- *Clause 18 and 19: Lessee will not assign, relinquish, sublet, transfer etc. without previous permission of Lessor. That every transfer, assignment, relinquishment, mortgage or subletting of the whole of the Demised Premises or building or both shall be subject to the transferee, assignee or the sublessee being bound by all covenants and conditions and being answerable to the Lessor in all respect* – The Company has never attempted to exit, assign, or transfer the demised premises by any means.

CAG Observation during Supplementary Audit

- Audit observed that the Company has not recognised the Right-of-Use (ROU) asset and lease liability in its financial statements, as per Ind AS 116. Instead, the Company has shown the leasehold lands under 'Property, Plant, and Equipment' and is charging depreciation on them. Thus, the accounting treatment of leased assets was not in compliance with provisions of Ind AS 116.

B. Query

- Will provisions of Ind AS 116 as to creation of Right to Use Assets be applicable on the above land?

C. Points considered by the Committee

- The Committee notes that in case of long-term leases or right of use arrangements, an important aspect to be examined is whether the arrangement or contract grants rights that represent in-substance purchase, viz., transfers control of the underlying asset (irrespective of the legal title) or only right to control the use of the asset throughout the arrangement/contract is being transferred. If former is the case, viz., the transferee obtains control of the asset, the same should be accounted for as per Ind AS 16, 'Property, Plant and Equipment'.
- The Committee notes from the requirements of Ind AS 115 that control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from the asset.
- Similarly, as per the Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS), an entity controls an economic resource or asset if it has the present ability to direct its use and obtain the economic benefits that may flow from it. An entity has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party's activities.
- The Committee notes from the arrangement between the Company and NOIDA Authority that the lessee has been granted the right to use the demised premises for a period of ninety years for construction/erection of building or other facilities upon payment of premium and annual lease rent. Further, it can also assign, relinquish, sublet, transfer or part with possession of any portion of the land and building thereon or cause any sub-division thereof with the previous permission of Lessor.
- Therefore, it can be said that the Company has the right to deploy it in its activities, or to allow another party to deploy it in that other party's activities; and thus, the Company has the present ability to direct the use of the land for the period of ninety years.
- However, the Committee notes that such right is subject to various conditions contained in the lease deed, such as, the right to transfer, assign, sublet etc. is subject to prior permission of the lessor and

subject to such terms and conditions as the lessor may determine.

- Further, the lessee may mortgage the demised premises only with prior permission of the lessor and, in the event of foreclosure of the mortgaged property, the lessor is entitled to claim and recover a specified share in the unearned increase in the value of the land and also has a pre-emptive right to purchase the property.
- Additionally, the lessee is required to use the land only for the specified purpose and in accordance with the plans, building regulations and directions of the lessor, and non-compliance with the prescribed conditions may result in cancellation of the lease and resumption of possession of the demised premises by the lessor.
- In view of the above conditions governing the use and transfer of the land, the Committee is of the view that it cannot be said that all of the remaining or future economic benefits associated with the underlying land will entirely flow to the Company. The Company has merely the right to significant economic benefits from *the use of the asset* and not *from the asset* (which include right to sell etc.).
- Also, considering the various restrictions, the Company in the extant case is not exposed to significant risks and rewards of ownership. Accordingly, the Committee is of the view that the land cannot be considered to be *controlled* by the Company.
- The Committee is also of the view that accounting is based on the current rights and obligations arising from the contractual arrangement and not merely on the basis of general practices. Usage or intention regarding usage of a resource/asset for a specified purpose does not determine control over that resource/asset.
- Further, the manner or timing of payment of lease rent does not change the nature of the arrangement.
- The Committee is of the view that payments of extension charges indicate continuation of the lease arrangement and support the view that the Company does not exercise absolute control over the present use (or non-use) of the asset.
- The Committee also notes that the lease deed permits mortgage only with prior permission of the lessor and subject to specified conditions, including the lessor's entitlement to a share in the unearned increase in the value of the land and a pre-emptive right to purchase the property in certain circumstances. Accordingly, the ability to mortgage the demised premises under such conditions cannot be considered as having ownership over the land.
- At present, the land given to the Company is a leasehold land and there are no documents or evidence to substantiate that the land will be converted into freehold.
- Even assuming that the land will be converted into freehold land in future, for the reasons already given above, at present, there is no control of the land by the Company. Accordingly, the land in the extant case cannot be recognised as property, plant and equipment under Ind AS 16.
- The Committee further examines the issue as to whether the lease or right of use of land in the extant case can be considered as a 'lease' within the scope of Ind AS 116 and notes that a contract contains lease only if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration.
- In the extant case, the identified asset is a specific plot of land. The lease arrangement is for a defined period of 90 years, which satisfies the requirement of 'a period of time'.
- Further, the Company has been granted the right to use in exchange of consideration that has been paid in the form of upfront premium and stipulated lease rentals.
- The Company is permitted to construct and use the land for its purposes in accordance with the approved plans and conditions specified in the lease deed.
- Accordingly, the Company can obtain economic benefits from the use of the land during the lease term and has the ability or right to direct the manner in which the land is used, subject to specified conditions in the Lease Deed.
- The arrangement does not transfer ownership of the land; rather, it grants a right to use the underlying asset for a period of time.
- The lease deed contains clauses relating to lease rent, cancellation, reversion, etc., which are consistent with a lease arrangement rather than a sale.
- **Accordingly, the Committee is of the view that the contract in the extant case conveys the right to control the use of an identified asset (land) for a specified period in exchange for consideration and, therefore, the arrangement is in the nature of a lease within the scope of Ind AS 116, 'Leases'.**

(For complete text of the Opinions, please refer the link: https://www.icai.org/post/eac-opinions-published-in-journal)

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