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Editorial



Dear Members & Students;

Greetings

During the month of October 2012 we had organized various special events, for our members like the study circle meetings, and tele-conference on XBRL.

All the programs were great success with good participation of our members and students.

The proposed events and programs for the month of December 2012 are given in the newsletter, please make note of the same and plan your schedule accordingly. Also visit our branch's website www.bbsricai.org for details of various programs.

Your valuable participation is the only motivating factor for us to organize more programs for the betterment of the CA fraternity.

We will not rest until our targets are achieved and will serve a sculpt for others to ensure that together we all can make a significant impact.

To this end we thank all the members whose dedicated efforts and continuous support is generating a powerful synergy to reach a new horizon.

Wishing you all a wonderful month ahead.

CA. Rajendra Kumar Das
Branch Chairman

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MEMBERS' AREA OF INTEREST

Study of an Expert Opinion on

Treatment of preliminary expenses incurred on incorporation of a company

A. Facts of the Case

1. A company was incorporated in May 2008 as a wholly owned subsidiary of a Government of India enterprise under the administrative control of the Ministry of Oil and Natural Gas to implement city gas distribution by participating in the bidding process of Petroleum & Natural Gas Regulatory Board (PNGRB) and also to set up CNG stations across the National Highway Corridor. The company got the authorisation from PNGRB in the 1st round of bidding to implement city gas distribution in four cities. The company's shares are not listed on any stock exchange. The authorized and paid up share capital of the company as on 31.03.2009 are Rs. 200 crore and Rs. 5 lakh, respectively. The company is in the implementation stage of the project of city gas distribution and CNG Corridor Project, and had not started its commercial production till 31.03.2009 and as such, its turnover is nil for the said accounting year.

2. The company has spent an amount of Rs. 1.26 crore towards incorporation expenses during the period 27.05.2008 to 31.03.2009. The querist has stated that since the company has not started commercial production, the 'Statement of Incidental Expenditure During Construction' has been prepared instead of profit and loss account, complying with the specific requirements of Part II of Schedule VI to the Companies Act, 1956, giving suitable disclosure of specific items of expenditure.

3. According to the querist, the amount of Rs. 1.26 crore spent for incorporation of the company (preliminary expenses) was charged to the Statement of Incidental Expenditure During Construction (IEDC) in terms of Accounting Standard (AS) 26, 'Intangible Assets', as these expenditures cannot be treated as intangible assets. The total amount of IEDC consisting of preliminary expenditure and other pre-operative expenses have been allocated to capital work-in-progress (CWIP) on capital outlay basis to be capitalised in future and will become part of fixed assets on capitalisation.

As per the querist, this was done in line with the provisions of paragraph 56 of AS 26 and paragraph 9.3 of Accounting Standard (AS) 10, 'Accounting for Fixed Assets', notified under the Companies (Accounting Standards) Rules, 2006, which according to the querist, state that the expenditure incurred on start-up costs including preliminary expenses can also be treated as a component of cost of fixed assets.



The querist has also stated that start-up cost includes expenses incurred for formation of company (preliminary expenses) as per paragraph 56 of AS 26.

4. The expenditure other than those expenditure which are of capital nature, are booked by the company under incidental expenditure during construction (IEDC) and shown under CWIP. As per the querist, this IEDC forms part of the project cost and on completion of the project is apportioned to ultimate assets on pro-rata basis in compliance with paragraph 9.2 of AS 10.

B. Query

5. The querist has sought the opinion of the Expert Advisory Committee as to whether the accounting treatment of preliminary expenses adopted by the company is in compliance with the existing Accounting Standards and other generally accepted accounting principles. If not, how the same should be treated in the books of account in the current accounting year.

C. Points considered by the Committee

6. The Committee notes that the basic issue raised in the query relates to accounting treatment of expenses incurred on incorporation of the company. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, treatment of other pre-operative expenses which are not incurred on incorporation of the company, etc.

7. The Committee notes paragraph 56 of AS 26 which is reproduced below:

“56. In some cases, expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, expenditure on research is always recognized as an expense when it is incurred (see paragraph 41). Examples of other expenditure that is recognised as an expense when it is incurred include:

(a) Expenditure on start-up activities (start-up costs), unless this expenditure is included in the cost of an item of fixed asset under AS 10. Start-up costs may consist of preliminary expenses incurred in establishing a legal entity such as legal and secretarial costs, expenditure to open a new facility or business (pre-opening costs) or expenditures for commencing new operations or launching new products or processes (pre-operating costs);

(b) expenditure on training activities;

(c) expenditure on advertising and promotional activities; and

(d) expenditure on relocating or re-organising part or all of an enterprise.”

The Committee notes from the above that the start-up costs referred in AS 26 relates to costs of starting up an activity that may include incorporation expenses incurred in bringing an enterprise into existence as a separate legal entity, as well as expenditures for commencing new operations or launching new products. The Standard lays down a general rule that expenses of such nature should be expensed as no intangible asset or other asset is acquired or created that can be recognised, unless such expenditure is required to be capitalised as a part of the cost of a fixed asset as per AS 10. In this regard, the Committee notes the requirements of AS 10 notified under the Companies (Accounting Standards) Rules, 2006, which are contained in paragraph 9.3 of the Standard. The said paragraph is reproduced below:

"9.3 The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalised as an indirect element of the construction cost. ..." (Emphasis supplied by the Committee.)

8. From the above, the Committee is of the view that the above reproduced paragraph of AS 10 refers to those start-up costs which are incurred on the start-up and commissioning of a capital project before the commencement of commercial production, such as, expenditure on test runs, etc., and not on incorporation of the enterprise. Thus, in the view of the Committee, the start-up costs of the nature of incorporation expenses incurred for bringing the enterprise into existence in its corporate form cannot be said to be attributable to bringing an asset/project into existence. Accordingly, the same cannot be capitalised even as an indirect element of cost of the asset/project. Thus, in the view of the Committee, the requirements of AS 26 would apply to the expenditure incurred on incorporation of the company and not the requirements of AS 10. Accordingly, in accordance with AS 26, such expenditures should be expensed by way of a charge to the profit and loss account in the period in which these are incurred. The Committee is of the view that for this purpose, profit and loss account will have to be prepared by the company even before the commencement of commercial operations. Further, since in the year of incurrence, the expenditure on incorporation of the company has been treated incorrectly by the company, the same should be rectified in the current year as a 'prior period item' in accordance with the requirements of Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies'. The Committee notes that paragraph 15 of AS 5 requires that "the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on the current profit or loss can be perceived".

9. The Committee also notes from the Facts of the Case that the querist has also referred paragraph 9.2 of AS 10 for apportionment of the IEDC comprising incorporation expenses to ultimate assets on pro-rata basis (paragraph 4 above). The Committee is of the view that paragraph 9.2 of AS 10 is applicable only when the



expenses are attributable to construction of a project or to the acquisition of a fixed asset or bringing the asset(s) to its(their) working condition. As discussed in paragraph 8 above, the incorporation expenses cannot be said to be related to bringing an asset/project into existence and accordingly, the said paragraph of AS 10 also does not apply in the present case.

D. Opinion

10. On the basis of the above, the Committee is of the opinion that the accounting treatment of preliminary expenses constituting the expenses incurred on incorporation of the company, as adopted by the company, is not in compliance with the existing Accounting Standards and other generally accepted accounting principles. The same should be expensed by way of a charge to the profit and loss account in the period in which the same is incurred.

Since the same has been treated incorrectly by the company in the year of incurrence, it should be rectified in the current year and disclosed appropriately as a prior period item in accordance with AS 5.

FORTHCOMING EVENTS FOR THE MONTH OF DECEMBER 2012						
Day & Date	Programme	Speaker	Venue	Duration	CPE Hours	Fees Rs.
28 TH -29 TH December	National Convention for CA Students	The detailed program shall be dispatched separately thro' e mail.	Hotel Swasti Premium	2 days	NA	300/-

Members are requested to switch of their mobile phones altogether to avoid intimidating electronic signal interference or at the least keep them absolutely in silent mode and avoid angry glares of the audience.

Registration for the Seminars and Workshops will be done up to the maximum seating capacity at the venue. Members are requested to register well in advance to avoid last minute disappointment. Cheque/DD is to be drawn in favour of “Bhubaneswar Branch of EIRC of ICAI” payable at Bhubaneswar.

ON THE LIGHTER SIDE OF LIFE

A patient was at her doctor's office after undergoing a complete physical exam. The doctor said, "I have some very grave news for you. You only have six months to live."

The patient asked, "Oh doctor, what should I do?"

The doctor replied, "Marry an accountant."

"Will that make me live longer?" asked the patient.

"No," said the doctor, "but it will SEEM longer."

Source : Anonymous

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