Query No. 1

Subject: Accounting treatment of subsequent expenditure as per Ind AS 16, 'Property, Plant and Equipment'.[1]

A. Facts of the Case

1. A Company (hereinafter referred as 'the Company') is a Mini Ratna 'Public Sector Undertaking' and 100% subsidiary of a Government Company. The Company is mainly engaged in mining, production and marketing of raw coal required for power, cement and other sectors. The Company also operates coal washeries to reduce the ash contents of coal and improves its heating value so that cooking washed coal required for steel and another sector may also be produced.

The Company is operating R washery plant. The said washery plant is commissioned in June 1986. The initial design capacity of the said washery is 3.0 Million Tonne per Year (MTY). In washery plant, the capacity of plant is determined on the basis of the capacity of raw coal fed to the said plant for washing. As per the technical evaluation, the useful life of coal washery plant is determined as 15 years.

2. The querist has stated that the washery plant has mainly three sections for its operations known as (a) raw coal section (b) washing section and (c) fine coal section including loading and despatch section. These sections may have following equipments / systems for the proper operation of each section:

(a) *Raw Coal Section*: Receiving Bunker, Aprons, Grizzly, Primary and Secondary Crusher, Sizing screens, Conveyor belts, chutes and motors, etc.

(b) *Main washing Section*: Course and Fine Coal Jigs, Screens, Compressor, pumps, Blowers, Bucket elevators, Chain Conveyor, Motors, Conveyor belts and chutes, etc.

(c) *Loading and Despatch Section:* Hopper, Conveyor belts, Silos, Winch house, chutes, Control Center and Weighbridge, etc.

If a new washery plant of capacity of 3 MTY is constructed presently, it may have total cost estimation of around Rs. 300.00 crore.

3. The R washery plant has completed its useful life in the financial year (F.Y.) 2001-02 and the said plant is still in the operation solely on account of regular maintenance activities carried out by the Company. However, the capacity utilisation of said washery plant was very poor as may be seen from the table-1 given below. There was also increase in breakdown hours as may be seen from the table-2 given below:

Table – 1 (Capacity Utilisation)

S. No.	Year	Capacity of Raw Coal feed to Washery (tonne)	Actual Raw Coal feed (tonne)	% Utilisation

[1] Opinion finalised by the Committee on 22.3.2023.

1.	2016-17	30,00,000	13,94,500	46.48
2.	2017-18	30,00,000	12,79,600	42.65
3.	2018-19	30,00,000	8,52,006	28.40

Table – 2 (Breakdown hours)

S. No.	Year	Maintenance / Breakdown Hrs
1.	2016-17	1,038
2.	2017-18	3,036
3.	2018-19	3,375

4. With an objective to improve capacity utilisation and to minimise the breakdown hours, the Company has appointed X Mine Planning and Design Institute (XMPDI) (a subsidiary of its parent company) to study and prepare a detailed report based on assessment of operational constraints and remedial measures for enhancing capacity utilisation and augmentation of clean coal. The scope of works under this study broadly includes site visit and data collection, performance analysis based on data furnished by washery officials and selection of suitable remedial measures based on thorough inspection of plant both in running and stopped condition along with washery officials as well as in-depth study of the jigs, static thickeners, flotation plant and rotary plough / blade feeders and estimation of cost and submission of report.

5. In October 2019, XMPDI has submitted the study report on the said washery and projected the corrective measures to be undertaken for enhancement of utilisation of plant capacity and the cost estimation works out to be broadly as Rs. 56.19 crore. The activities required to be undertaken are further tabled as below:

Broad Scope of Works

S.No.	Nature of Works	Amount (crore)
1.	Mechanical works	52.84
2.	Electrical works	1.54
3.	Civil works	1.81
	Total	56.19

The section-wise corrective measures (i.e. worn-out parts replacement/renovation of structural, civil and other support system) to be undertaken may be seen from the following table:

Mechanical works:

S.No.	Nature of Works	No. to be revived	Amount (crore)
a)	Washing Section		
	Coarse Coal Jig: Supply of 1 no. Coarse coal Batac jig along with 2 nos. bucket elevators, 1 no. fixed screen, 1 no. blower & 1 no. compressor	1	7.37
	Fine coal Jig: Supply of 1 no. Fine coal Batac jig along with 2 nos. bucket elevators, 1 no. fixed screen, 1 no. Blower, 1 no. compressor	1	6.93

b)	Fine Coal Section		
	Froath Floatation plant with all its accessories including dewatering of concrete by drum filter	1	19.50
	Static thickener complete with drive, rake mechanism, turn table and thickener arm	1	1.40
c)	Other General Works		
	Numerous Pumps Replacement	Numerous	0.52
	Numerous Pumps Valves replacement	Numerous	0.05
	Replacement of MS Pipes	Lot	0.40
	Gear box Replacement	Numerous	0.72
d)	Structural works with Iron and Steel		0.76
	Subtotal a) to d) above		37.65
e)	Erection & Commissioning @ 10%		3.76
f)	Design & Engineering @ 5%		2.07
g)	Other Contingency		1.30
h)	GST		8.06
	Total Cost a) to h)		52.84

Other Electrical and Civil Works:

Electric works of Rs. 1.54 crore mainly included the replacement of control, power cable, motors, power contractor and other miscellaneous items. Whereas, the civil works of Rs. 1.81 crore mainly included revival of 1 no. settling pond, replacement of CGI sheet of conveyor gallery and repairing of R.C.C. beams and columns.

Against the above cost estimation of Rs. 56.19 crore, a tender for the above works was published and the work was awarded to M/s H Pvt. Ltd. with a contract value of Rs. 42.92 crore including GST. The work awarded inter alia includes Design and Engineering, supply and fabrication along with strengthening of existing Civil and Structural Works, Erection, Commissioning, Trial Run, Performance Guarantee Test and Operation and maintenance for 4 years under defect liability period. The detailed scope of works dividing into Mechanical, Electrical and Civil works is further explained in the table below. Till date, the total executed works out of the awarded contract value of Rs. 42.92 crore is around Rs. 28.10 crore.

The summary of bill of quantities (BOQs) or works awarded further may be summarised as under:

S.No.	**Nature of Works**	**No. to be revived**	**Amount (crore)**
a)	Design & Engineering		0.83
b)	Civil, Structural and Development works		0.64
c)	Total mechanical and other works related to washery system		28.04
d)	Electrical works		3.22
e)	Erection, Installation and Commissioning		2.72
f)	Other miscellaneous works including Maintenance completion		0.92
	Sub-total		**36.37**
	GST		6.55
	Total Awarded Cost		42.92

6. In the said case matter, the following information is further submitted:

The awarded works included an amount of Rs. 0.64 crore, which is related to strengthening of existing civil and structural works; hence it may not have any independent identification and its useful life remains aligned with the main equipment. Also, the same is not of a nature, which requires separate regular replacement before the expiration of useful life of main equipment. None of the items executed would have separate useful life as being fixed with the particular capacity of washery plant and moreover, the scale of expenditure on individual system/part/component is insignificant as compared to overall total cost of new washery.

In the matter of component accounting, the relevant paragraphs of accounting policy of the Company regarding Component Approach are reproduced by the querist hereunder:

> "Threshold value of the asset requiring componentisation to be Rs. 10 crore and above as any assets below Rs. 10 crore will not have any material effect on the financial statements.
>
> While considering the threshold value in percentage of cost component to the total cost of the asset, the Company considered that the component having value not less than 20% of the total cost of the asset will be treated as significant and eligible for component accounting, if other conditions are fulfilled."

As such, according to the querist, none of the items of BOQ qualifies for recognition as PPE.

7. Moreover, a particular expense is being incurred to a particular section of an individual item of Property Plant and Equipment (PPE), i.e., say improvement in particular section of washing section/fine coal section/handling and despatch section. As such, the said expenditure is not related to PPE as a whole. Hence, the reliable estimation of the enhancement of life of an item of PPE or PPE as a whole could not be technically established.

Important applicable provisions of Indian Accounting Standard (Ind AS) 16, 'Property, Plant, Equipment' have been reproduced by the querist as under:

> "**Recognition**
>
> **7 The cost of an item of property, plant and equipment shall 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.**
>
> …
>
> 9 This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. …
>
> 10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs

incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. …"

"**Subsequent costs**

…

13 Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67-72)."

Accounting treatment adopted by the Company:

8. The querist has stated that the Company has recognised the incurred cost of Rs. 28.10 crore in the Statement of Profit and Loss considering the following aspects of the transaction:

As the replacement activities undertaken related to a particular section of an item of PPE (Property Plant and Equipment) i.e. say improvement in particular section of washing section / fine coal section / coal handling and dispatch section, hence, the probability of future economic benefits associated with the item as whole (i.e. an asset) could not be established. Moreover, as such, the said expenditure is not related to PPE as a whole. Hence, the reliable estimation of the enhancement of further useful life of whole PPE could also not be technically established.

9. In the matter of component accounting, the relevant accounting policy of the Company regarding accounting for depreciation - Component Approach is reproduced by the querist hereunder:

"Threshold value of the asset requiring componentisation to be Rs. 10 crore and above as any assets below Rs. 10 crore will not have any material effect on the financial statements.

While considering the threshold value in percentage of cost component to the total cost of the asset, the component having value not less than 20% of the total cost of the asset will be treated as significant and eligible for component accounting, if other conditions are fulfilled."

Accordingly, as per the querist, these expenses are required to be expensed in the Statement of Profit and Loss as and when incurred.

The activity undertaken is also not in the nature of replacement required at regular intervals as stipulated in paragraph 13 of Ind AS 16. Further, none of the items executed would have separate useful life as being fixed with the particular capacity of a washery plant or related to structural, civil and other support system's improvement of an asset whose life has already expired. Moreover, the scale of expenditure on individual system / part / component is insignificant as compared to overall total cost of new washery and further, the useful life of the said washery is already expired. Hence, the suitable option available with the Company is to expense the same in the Statement of Profit and Loss in the year of occurrence.

10. The querist has stated that washery has lived its rated life 20 years back and there is no reliable estimation that the said repair will enhance the life of the washery. The activity of repairing is undertaken basically to improve the operation of the washery, because even if the said repair improves the capacity even by 10%, then the actual expenses of Rs. 42.92 crore would be recovered in a very short span of time. Based on the past data, it is expected that the said expenditure would be recovered with in a period of 6 to 9 months post repair.

Guidance is also available from Cost Accounting Standard (CAS) 12 on Repairs and Maintenance Cost, which vide its paragraphs 4.7 and 4.8 provides as under:

> "***4.7 Property, plant and equipment are tangible assets that:***
>
> ***(a) are held for use in the production of goods or supply of services, for rental to others, for administrative, selling or distribution purposes; and***
>
> ***(b) are expected to be used during more than one accounting period.***
>
> ***4.8 Repairs and maintenance cost: Cost of all activities which have the objective of maintaining or restoring an asset in or to a state in which it can perform its required function at intended capacity and efficiency.***"

From the above, it may be seen that CAS-12 has similar definition of PPE aligned with Ind AS 16. However, it requires that cost incurred with an objective of maintaining and restoring of an asset may be required to be charged as repairs and maintenance cost.

Matter of Dispute:

11. During the course of annual accounts' audit, the Comptroller and Auditor General of India (CAG Auditor) observed as follows:

> "XMPDI prepared (October 2019) a study report of R Washery for enhancement of its capacity and life and recommended to expend Rs. 56.19 crore as capital expenditure to enhance its present (as on March 2019) operational capacity from 0.852 MTY to 3 MTY. In commensurate with the above recommendation, the Company awarded the said works at total value of Rs. 42.92 crore (including GST) for installation of Coarse Coal Jigs, Small Coal Jig, Static Thickener and Heavy Media Circuit on Turnkey Basis.
>
> Till March 2022, R Area had paid total Rs. 28.10 crore to the above contractor, as the above expenditure incurred towards capital replacement to enhance the capacity and life of the washery. The amount incurred should be capitalised under CWIP, however the same amount has been treated as revenue expenditure and charged in the Profit and Loss."

However, as per the querist, it is worth to mention that there is no mention in XMPDI report for the enhancement of life of the washery, but the total concept for undertaking the said activity was to restore the degraded capacity utilisation and reduce the duration of maintenance breakdown.

B. Query

12. In view of above, the Company has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India on the following issues:

(i) Whether the accounting treatment extended by the Company for replacement activities and restoration of selected structural, civil and other support system with an aim to improve the operational efficiency and reduction in maintenance / breakdown hours after the useful life of the washery is as per the applicable provisions of Ind AS 16, 'Property, Plant and Equipment' (i.e. the said expenses to be charged as expenses in the Statement of Profit and Loss as and when incurred).

(ii) If not, then, how the said expenditure is to be accounted for and what should be the basis for determination of useful life in the given case for provision of depreciation?

C. Points considered by the Committee

13. The Committee notes that the basic issue raised by the querist relates to the accounting treatment of subsequent expenditure incurred in relation to the R washery plant 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, accounting for regular maintenance activities carried out by the Company, appropriateness of the report shared by XMPDI including estimation, appropriateness of accounting policy of the Company regarding component approach and determination of useful life, depreciation accounting in detail, accounting for any other expenditure incurred by the Company in relation to the plant, consideration of materiality in detail, timing of recognition of expenditure, etc. The Committee has expressed its opinion in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time and not in the context of Cost Accounting Standard as referred by the querist.

Further, since the querist has stated that the activity undertaken is also not in the nature of replacement required at regular intervals as stipulated in paragraph 13 of Ind AS 16, it is presumed that the Company was not required to perform regular major inspections for faults and consequently, no costs for such major inspections/ testing was recognised in the carrying amount of the property, plant and equipment (PPE) and component accounting in respect of such major inspection cost was not necessary. The Committee does not opine in regard to whether in the Facts of the Case, component accounting is necessary or not and presumes from the Facts of the Case that as per the requirements of Ind AS 16, the Company did not follow component accounting in respect of various sections or individual parts or components of the washery plant.

14. At the outset, the Committee notes that the querist has mentioned that the expenditure incurred on individual system/part/component is insignificant as compared to the overall cost of new washery. In this regard, the Committee notes that Ind AS 16 does not prescribe the unit of measure for recognition and states that judgement is required in applying the

recognition criteria to an entity's specific circumstances. Since the Company in the extant case is not following 'component approach' in respect of the individual sections/units/components of the washery plant, it is presumed from the Facts of the Case that washery plant as a whole is considered as a single unit of measure applying the judgement as per the requirements of Ind AS 16, instead of individual parts/components. Therefore, the Committee is of the view that the expenditure incurred in the extant case should be considered from the perspective of aggregate expenditure on washery plant as a whole and not in the context of expenditure incurred on individual components/parts of the washery plant.

15. In the above context, the Committee wishes to point out that though the querist has mentioned that the expenditure incurred on individual system/part/component is *insignificant* as compared to the overall cost of new washery, from accounting perspective, the matter requiring consideration is 'materiality' as defined under Ind AS 1, 'Presentation of Financial Statements'. In this regard, the Committee notes the following requirements of Ind AS 1, 'Presentation of Financial Statements':

> ***"Material:***
>
> **Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.**
>
> Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.
>
> …"

From the above, the Committee is of the view that determination of what is 'material' involves significant judgement considering the nature and/or magnitude/size of the information, assessed not only individually, but also in combination with other information and which could reasonably be expected to influence decisions of primary users of general purpose financial statements. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an entity's financial statements. Consequently, to determine what could be material in a particular situation requires judgement, in the specific facts and circumstances, considering the requirements of Ind AS 1.

Accordingly, the Committee is of the view that whether the aggregate expenditure incurred in the extant case is 'material' as per the requirements of Ind AS 1 or not in the context of the washery plant as a whole should be determined in the specific facts and circumstances. In case, the expenditure is not considered 'material', the same may be recognised in the Statement of Profit and Loss; however, if the expenditure incurred is 'material' as per the requirements of Ind AS 1, then the accounting treatment discussed in subsequent paragraphs should be followed.

16. With regard to accounting treatment of aggregate expenditure incurred in relation to washery plant, which is considered 'material' as per the requirements of Ind AS 1, the Committee notes the following requirements of Indian Accounting Standard (Ind AS) 16:

> ***"Property, plant and equipment* are tangible items that*:***

(a) **are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and**

(b) **are expected to be used during more than one period.”**

“7 **The cost of an item of property, plant and equipment shall 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.”**

“10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. The cost of an item of property, plant and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment, such as depreciation of right-of-use assets.”

“12 Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the ‘repairs and maintenance’ of the item of property, plant and equipment.

13 Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67–72).”

“Elements of cost

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."

"Depreciation

43 Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately."

"Depreciable amount and depreciation period

50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

51 The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*."

"56 The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

57 The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets."

The Committee notes from the above-reproduced requirements of Ind AS 16 that recognition principle as laid down in the Standard is equally applicable to the costs incurred subsequently to add to, replace part of, or service an item of property, plant and equipment (PPE). Thus, any expenditure that meets the recognition criteria under paragraph 7 should be capitalised as part of the cost of PPE and if it does not, it should be recognised in the statement of profit or loss. Further, the Committee notes that as per paragraph 12 of Ind AS 16, expenditure on minor repairs and maintenance, including replacement costs of small parts and cost of day-to-day servicing of the items is to be recognised in profit or loss as and when incurred and only an expenditure that meets the conditions of recognition as per paragraph 7 of Ind AS 16, is recognised in the carrying amount of an item of property, plant and equipment.

17. As far as the recognition criteria under paragraph 7 of Ind AS 16 are concerned, the Committee notes that an item of expenditure shall 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. In this regard, the Committee notes that in the extant case, it is stated that the activity of repairing is undertaken basically to improve the operation of the washery and that even if the said repair improves the capacity by 10%, then the actual expenses of Rs. 42.92 crore are expected to be recovered in a period of 6 to 9 months post repair. Thus, the expenditure incurred will improve the operations of washery and will enhance its capacity. Therefore, the Committee is of the view that it will lead to future economic benefits in terms of improvement in operations and capacity of the washery plant. Further, since the cost incurred can be reliably measured, the recognition criteria under paragraph 7 of Ind AS 16 are met and hence, the Company should capitalise such expenditure as cost of the washery plant.

Further, from the above-reproduced paragraphs 16 and 17 of Ind AS 16 dealing with the items of costs that can be capitalised as part of an item of PPE, the Committee is of the view that in the extant case, only those costs/expenditure that are directly attributable to bringing the various asset(s)/plant to the location and condition necessary for it/them to be capable of operating in the manner intended by management should only be capitalised as part of the cost of asset(s)/plant such as, cost of site preparation, installation, trial run etc.

18. With regard to determination of useful life of the refurbished washery plant, the Committee notes from the work order issued to the contractor, H Pvt. Ltd. that it inter alia states that "Period of Contract shall comprise of 150 Days (Including Trial run and PGT) and it is to be noted that after commissioning of the project, the bidder is responsible for 4 years maintenance of the equipment/system supplied after construction and handing over under the clause of defect liability... ". Further, the defect liability clause states that "Defect Liability will be 48 months. It will commence after commissioning of the project. The Bidder is responsible for four years maintenance of modified section/equipment after trial operation and handing over…"

Thus, H Ltd. has committed to provide operation and maintenance for 4 years under defect liability period, which indicates that the improved asset will atleast be operational for 4 years after the expenses incurred on enhancement/improvement. Therefore, the Committee is of the view that an estimation of life should be made by the Company considering various factors as mentioned in paragraphs 56 and 57 of Ind AS 16, reproduced above including, technical evaluation, past experience, defect liability period, etc. Further, such useful life should be reviewed regularly as per the requirements of paragraph 51 of Ind AS 16, reproduced above. Reference may also be made to the requirements of Schedule II to the Companies Act, 2013 in this regard.

D. Opinion

19. On the basis of the above and subject to paragraph 13 above, the Committee is of the following opinion on the issues raised in paragraph 12 above:

(i) and (ii) The accounting treatment extended by the Company for replacement activities and restoration of selected structural, civil and other support system with an aim to improve the operational efficiency and reduction in maintenance / breakdown hours after the useful life of the washery will not be appropriate as per the requirements of Ind AS 16 'Property, Plant and Equipment', if such expenditure, in aggregate, can be considered to be 'material', as per the requirements of Ind AS 1 in the context of washery plant as a whole, as discussed in paragraphs 14 and 15 above. If the expenditure incurred is material, since it will lead to future economic benefits in terms of improvement in operations and capacity of the washery plant and the cost incurred can be reliably measured, the recognition criteria under paragraph 7 of Ind AS 16 are met; and hence, the Company should capitalise such expenditure as cost of the washery plant.

With regard to basis of determination of useful life, an estimation of life should be made by the Company considering various factors as mentioned in paragraphs 56 and 57 of Ind AS 16, reproduced above including, technical evaluation, past experience, defect liability period, etc., as discussed in paragraph 18 above. Further, such useful life should be reviewed regularly as per the requirements of paragraph 51 of Ind AS 16, reproduced above. Reference may also be made to the requirements of Schedule II to the Companies Act, 2013 in this regard.

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