Query No. 13

Subject: Accounting treatment of Spectrum Charges, Project Promotion Expenses, and Research & Development Expenditure incurred for construction of High Speed Rail Project by the Company, under Ind AS framework.[1]

A. Facts of the Case

1. A High Speed Rail Project (hereinafter referred to as '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 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 of 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 the Ministry of Railways (MoR) or the Government of India (GoI) or any other such competent authority. The capital cost of the Project is approximately Rs. 1.08 lakh crore. For the total cost of the Project, funds have been arranged by the Company in the form of equity from the MoR and State Governments and in the form of soft loan from Japan International Cooperation Agency (JICA).

2. The Company is incorporated and engaged in one and only activity, i.e., creation of self-constructed asset, i.e., the Project between the two states. The Project includes activities from acquisition of land, earth work, laying tracks, station building, signalling & telecommunication, overhead electric, bridge, tunnels, station, training institute etc.

3. Statutory audit is carried by statutory auditors appointed by the Comptroller and Auditor General of India (C&AG) under section 139 of the Companies Act, 2013 and supplementary audit is carried out by C&AG under section 143(6)(a) of the Companies Act, 2013. During the course of supplementary audit by C&AG, certain observations were made, details of which are as follows:

> *Spectrum Charges, Project Promotion Expenses, Research & Development Expenditure*
>
> The Company has incurred an expenditure of Rs. 73.33 crore up to 31st March 2022 for corporate and project site office which is specifically related to creation of the Project during the construction stage, i.e., pre-commencement period, details of the same are as given below:

Amount (in ₹ crore)

Expense Head	**Amount up to 31st March 2022**
Spectrum Charges	44.02
Project Promotion Expenses	9.26
Research & Development Expenditure	20.05
Total	**73.33**

a. **Spectrum Charges**

[1] Opinion finalised by the Committee on 11.4.2023.

(i) The Project being high speed project requires high speed communication along with the track. Accordingly, co-axile cables shall be placed alongside the project line.

(ii) In order to provide connectivity, dedicated frequency is required to be obtained by the Company. Wireless Planning and Coordination Wing of the Department of Telecom (DoT) is the authority for coordinating and assigning Radio Spectrum in the country for various wireless users. The wireless users are required to pay spectrum charges to Wireless Planning Commission (WPC) for use of allocated spectrum. Spectrum charges include license fee and royalty. For example, all the mobile service providers pay spectrum fees to WPC. Just like any other organisation requiring frequency/spectrum, the Company, also, is required to pay this amount as per the decision letter of WPC to allocate 06 frequencies for the use of the Company's radio equipment.

(iii) Frequencies were obtained on advice and instructions of M/s. J/Japanese side assisting in detailed designs and overall project scheduling work for the Project.

M /s. J vide letter dated 29.03.2017 has informed that:

"M/s J would like to ensure the availability of frequencies for train Radio Systems during the Design Stage, since the selection of frequencies will have a considerable impact on the Design of Systems including arrangement of Repeaters etc*."*

"It is very important that the frequencies are allocated at this time so as to avoid any delay on the system design and overall project schedule of High Speed Trains in India" (a copy of letter has been separately supplied by the querist for the perusal of the Committee).

(Emphasis supplied by the querist.)

(iv) It is clear from the above letter that without getting frequencies, the work of design of systems including arrangement of repeaters was not possible. M/s J has informed that availability of these frequencies need to be ensured for design of base stations, location of repeaters, design of cables and design of mobile stations, etc. following Japanese Shinkansen design. If the availability of these frequencies is not ensured for the Project, all these indicated systems will need to be re-designed. This will be an expensive arrangement after the radio equipments have been manufactured on the proposed frequencies. The radio system is critical for running of high speed trains. If there is any change in the design of the radio system, it will not be proven for high speed railway, and will also be costly and time taking.

In order to avoid any change during manufacturing and installation stage, it is essential that frequency is obtained, ensured and maintained continuously, as these frequencies would be needed even during operation phase. After design and development, the systems will be manufactured, installed and operationalised at site, so the requirement of frequency spectrum is continuous even in operation and maintenance phase of the Project.

(v) All designing of systems is being made considering the dedicated frequency as dedicated to the Company by WPC.

(vi) As per the letter issued by WPC, "In case, period of validity of requested license is more than one year (maximum five years), amount may be paid in advance for entire period of license or annual instalments in advance." As the amount paid remains the same, either the Company pays annually or for five years, the Company has decided to pay annually.

(vii) These spectrum charges are recurrent charges and will be payable as long as the spectrum is kept by the Company. If the spectrum charges are not paid, the earlier payments made by the Company cannot be recovered from WPC as these frequencies have been secured by WPC for the use by the Company, and if the Company does not pay annual charges it will lose the spectrum, which is very difficult to obtain.

(viii) The Company has expended Rs. 44.02 crore as spectrum charges from financial year 2018-19 up to 31st March 2022; year-wise details of payments are as follows:

Amount (in ₹ crore)

S. No.	Financial Year	Amount Paid
1.	2018-19	10.93
2.	2019-20	10.28
3.	2020-21	9.83
4.	2021-22	12.98
	Total	**44.02**

(ix) The Company cannot suspend the payment of spectrum charges. WPC in that case will withdraw its decision to grant license for these critical frequencies which as per Japanese consultant is vital for design of Train radio system and may assign these frequencies to other agencies and in that case, the Company may not secure these frequencies in future as some of the frequency bands have been obtained from the Defence spectrum. This may severely impact the design of Train Radio System which is the most critical system for train operation and safety.

(x) Based on above, it can be concluded that spectrum charges are necessarily required to be incurred during construction of the Project for design works (core activity of the Project). Accordingly, these payments are treated as 'Capital work in progress' since the Project is under construction.

b. <u>Project Promotion Expenses</u>

(i) The Company has incurred total expenditure of Rs. 9.26 crore up to 31st March 2022 towards project promotion expenses since inception of the Company. Details of expenditure (year-wise) are as follows:

Amount (in ₹ crore)

Financial Year	Social Media Team Expenses	Display of Shinkansen Simulator Model in Exhibitions	Sponsorships for various vents	Total
2017-18	-	-	0.35	0.35
2018-19	1.15	1.71	1.42	4.28
2019-20	1.32		0.39	1.71
2020-21	1.35	-	0.02	1.37
2021-22	0.84	-	0.71	1.55
Total	**4.66**	**1.71**	**2.89**	**9.26**

(ii) Shinkansen Simulator was imported for display of simulator model of bullet train during various exhibitions. Since payment was made primarily for presenting it at inauguration ceremony, therefore in books of account, accounting head 'project promotion expenses' as part of 'Capital work-in-progress' was used to record this transaction in financial statements.

(iii) Sponsorship expenses represent expenditure for sponsoring various events wherein the Project can be displayed.

(iv) Expenditure head 'project promotion expenses' is majorly related to handling social media, short film documentary for project etc. The Project is one of the unique projects of the Government of India and in order to execute the Project, Stakeholders' consultations have been conducted at various stages and concerns of these stakeholders have been addressed. At an institutional level, the primary stakeholders not only include the Governments of two states and the Government of India and their concerned Ministries and Departments but also include local bodies, development authorities, utilities, civil and police administration, regulatory authorities, environmental authorities, Archaeological Survey of India (ASI), print and electronic media to name a few.

At micro level, the stakeholders include the project affected persons due to land acquisition. With the progress of projects on ground, stakeholders' engagement requirements are expected to grow. The ongoing construction work of the Project has also impacted local residents which the Company wants to address in a coherent manner. All the important processes including, development and implementation of traffic diversion plans, removal of encroachments, land acquisition, implementing innovative sources of financing, require public awareness and consultation besides engagement and consultation with different agencies/stakeholders involved in the process.

The Company has accordingly carried out activities including social media management etc., which are essential for seamless/timely completion of the Project. It allows the Company to connect to people at ground level while meeting them or carrying out activities for the Project etc. and help avoid general hindrance since stakeholders are already aware about the Project.

(v) The Company is following the same accounting treatment since inception of the Project.

(vi) Since the Company is in the construction stage, i.e., pre-commencement period and these expenditures were necessarily required to be incurred during construction stage, all the above three expenditures were capitalised.

c. <u>Research & Development Expenditure</u>

(i) The Project is one of a kind and the first bullet train project in India.

(ii) In order to understand the technology and alternative methods to be used for construction of the Project, need for specific researches were felt.

(iii) Accordingly, a trust was incorporated i.e., 'H Innovation Centre (HIC)'. This trust works with the various IITs for understanding and developing different alternatives for construction of the Project.

(iv) Accordingly, payments made to HIC are treated as 'Capital work-in–progress' pending capitalisation of assets, i.e., the Project.

(v) Year-wise details of expenditure incurred for research and development (R&D) are as follows:

Amount (in ₹ crore)

Financial Year	Payment to HIC Trust for R&D for the Project
2020-21	3.05
2021-22	17.00
Total	**20.05**

4. *Observations made by Comptroller and Auditor General of India (C&AG):*

Comments of C&AG of India and management replies are as follows:

Provisional Comments	Management's Replies
(i) Other Expenses (Note 24) - Rs. 14.33 crore **Capital Work in Progress (Note 4) – Rs. 10197.28 crore** The above amount of Capital Work in Progress includes Rs. 53.28 crore (current year – Rs. 14.52 crore, previous years – Rs. 38.76 crore) being the amount incurred by the Company towards spectrum charges (Rs. 44.02 crore) and project promotion expenses (Rs. 9.26 crore) up to 31st March 2022.	**<u>Spectrum Charges</u>** **<u>Facts</u>** Frequencies are allocated so as to avoid any delay on the system design and overall project schedule of High Speed Trains in India. Accordingly, frequencies were obtained on advice and instructions of M/s J/Japanese side assisting in Detailed Designs and Overall Project Scheduling work for the Project. M/s J vide letter dated 29.03.2017 has informed that:- "M/s J would like to ensure the availability of frequencies for train Radio Systems during Design Stage, since the selection of frequencies will have a considerable impact on the Design of Systems including

As these expenses are not directly related to construction of the High Speed Rail, therefore, the same should have been charged to the profit and loss account in compliance to paragraphs 16 and 19 of Ind AS 16, Property, Plant and Equipment. This has resulted into overstatement of Capital Work in Progress by Rs. 53.28 crore, overstatement of "Profit before exceptional items & tax" for the year by Rs. 14.52 crore, overstatement of Other Equity by Rs. 38.75 crore and understatement of "Other expenses" by Rs. 14.52 crore. As the above is an error in the financial statements of the Company, therefore, this prior period error should be corrected retrospectively as required under para 42 of Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.	arrangement of Repeaters etc." "It is very important that the frequencies are allocated at this time so as to avoid any delay on the system design and overall project schedule of High Speed Trains in India". It is clear from above letter, without getting frequencies, the work of design of systems including arrangement of repeaters was not possible. On the basis of the above, it can be concluded that spectrum charges are necessarily required to be incurred during construction of the Project for Design works (core activity of Project). Accordingly, frequencies were allocated by DoT, Ministry of Communications, the Government of India and payments are being made. **<u>Reference to Ind AS</u>** Further para 16 of Ind AS 16 provides that "*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."* Accordingly, it can be said that directly related expenditure are those without incurrence of which construction of the project cannot take place. Para 11 of Ind AS 16 describes about the meaning of initial cost as follows: *"Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in*

	excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals.…" **<u>Submissions</u>** 1. Above para clearly provides that the acquisition of some property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. 2. It is submitted that payment made by the Company is not just to procure the frequency of spectrum but also to maintain it during the period of construction to enable it to use these at the time when the Company shall start operating. 3. Assuming that the Company did not make payment to DoT towards annual license fees for spectrum, then these frequencies shall be allotted to another organisation and expenditure incurred by Company towards its entire setup of S&T including cost of repeaters etc. shall be of no use to Company; even operation of the Project was not feasible. Therefore, without incurrence of expenditure towards cost of obtaining and maintaining spectrum, it was not feasible to operate the project. 4. Therefore, it can be said that these expenditure include costs as defined in paragraph 11 of Ind AS 16 to obtain the necessary benefits or to derive future economic benefits from related assets. 5. At the time of initial payment of expenditure, the Company was aware that total cost of spectrum during construction phase shall be not only related to payment of first year of license fees but also to maintain it over a period of construction without using it for communication. Therefore, entire cost payable during construction is considered while making payment and taking economic decision for purchase of spectrum license. It can be understood in different way, as at the time of initial acquisition, the Company

	was aware of total cost of license to be paid over the period of construction and only payments are deferred. 6. Ind AS 16 by way of paragraph 16(c) allows even to capitalise cost of restoration of site considering that entity is aware of cost of restoration while making decision about acquisition of assets, then there is no logic in saying that costs incurred towards obtaining licenses to be used for obtaining spectrum is not directly related to acquisition of assets. On the basis of facts of case and requirements of paragraph 11, 16(b) and 16(c) of Ind AS 16, it can be said that expenditure incurred on spectrum is necessary for bringing the assets to location and condition necessary for it to be capable of operating in the manner intended by management as well as to obtain the economic benefits from another assets. Therefore, the Company has correctly capitalised expenditure of Rs. 44.02 crore in financial statements. **<u>Project Promotion Expenses</u>** **<u>Facts</u>** The Company has incurred total expenditure of Rs. 1.54 crore during the financial year 2021-22 and Rs. 7.72 crore is related to previous financial years towards project promotion expenses since inception of the Company. These expenses represent only 0.02% of expenditure recognised to CWIP during the year and 0.09% of expenses on total CWIP as on 31st March 2022. Expenditure head, Project promotion expenses is majorly related to handling social media, short film documentary for Project etc. The Project is one of the unique projects of the Government of India and in order to execute Project, stakeholders' consultations have been conducted at various stages and concerns of these stakeholders have been addressed. At an institutional level, the primary stakeholders not only include the Governments of two states and the Government of India and their concerned Ministries and Departments but also include local bodies, development authorities, utilities, civil and police administration, regulatory authorities, environmental authorities, ASI, print and electronic media to name a few. At micro level, the stakeholders include the project affected persons due to land acquisition. With the progress of projects on ground, stakeholders' engagement requirements are expected to grow. The ongoing construction work of the Project has also impacted local residents which the Company wants to address in a coherent manner. All the important

	processes including, development and implementation of traffic diversion plans, removal of encroachments, land acquisition, implementing innovative sources of financing, require public awareness and consultation besides engagement and consultation with different agencies/stakeholders involved in the process. The Company has accordingly carried out activities including social media management etc., which are essential for seamless/timely completion of the Project. It allows the Company to connect to people at ground level while meeting them or carrying out activities for Project etc. and help avoid general hindrance since stakeholders are already *aware about the Project.* **<u>Reference to Ind AS</u>** *Paragraph 11 of Ind AS 16 provides that "Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals…"* **<u>Submissions</u>** 1. It is clear from above para that an item although not directly increasing the future economic benefits of any particular item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. 2. It has to be understood that the Company is not engaged in multiple activities, but incorporated with the principal objective to construct the Project. In case construction of the Project was not there, there was no requirement to incur these expenditures. Activities incurred by the Company are not in the nature of general and administrative overheads of the Company, but relates to spreading awareness so that at the time of execution of project, executing team does not face any hurdle, viz., in land acquisition, survey, utility

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<td>shifting and other related Project work etc.

3. Since, the above activities are directly linked to construction of the Project, expenditure incurred has been capitalised with the Project in compliance with paragraph 11 of Ind AS 16.

The Company is following the same practice since inception of Project.</td>
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<td>(ii) Other Expenses (Note 24) - Rs. 14.33 crore
Capital Work in Progress (Note 4) – Rs. 10,197.28 crore
The above amount of Capital work in progress includes Rs. 20.05 crore (current year – Rs. 17.00 crore, previous years – Rs. 3.05 crore) being the Research & Development Expenditure incurred by the Company up to 31st March 2022.

As per paragraph 54 of Ind AS 38, “Expenditure on research (or on the research phase of an internal project) shall be recognized as an expense when it is incurred”.

However, the Company has capitalised the expenditure incurred on Research work instead of recognising the same as expense in the respective year in violation of Ind AS 38.

This has resulted into overstatement of “Capital Work in Progress” by Rs. 20.05 crore, overstatement of “Profit before exceptional items & tax” for the year by Rs. 17.00 crore, overstatement of Other Equity by Rs. 3.05 crore and understatement of “Other expenses” by Rs. 17.00 crore.

As the above is an error in the financial statements of the Company, this prior period error should be corrected retrospectively as required</td>
<td><u>Research & Development Expenditure</u>

<u>Facts and Reference to Ind AS</u>

The Company is engaged in construction of the Project work, as a result of which, a tangible asset shall be constructed, falling within the scope of Ind AS 16.

Paragraph 2 of Ind AS 38 related to its scope provides that: “This Standard shall be applied in accounting for intangible assets, except…”

It is clear that Ind AS 38 is applicable for intangible assets, accordingly items other than intangible assets are not covered by Ind AS 38.

Since the Company is not engaged in development of any intangible asset, requirements of Ind AS 38 are not applicable on this transaction.

Guidance for ‘Property Plant and Equipment’ is provided in Ind AS 16; relevant extract from Ind AS 16 are as follows:

“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. …”

<u>Submissions</u>

The Project is a unique bullet train project which requires specialised skills and techniques. This bullet train project is first project of India. In order to have better, cost efficient, alternative techniques are being used by specialised agencies to identify the methods/techniques/ways for the Project. Accordingly, expenditure incurred is purely towards the improvement of Project which is incidental in nature.

Accordingly, it is clear from the above paragraph that expenditure incurred is purely incidental in nature and hence, should be part of the cost of asset. It is further submitted that the Company is not incurring expenditure</td>
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under paragraph 42 of Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.	for creation of an intangible asset, and therefore, principles of Ind AS 38 are not attracted. Accordingly, the Company has correctly recognised the said expenditure in CWIP. The Company is following the same practice since inception of project.

(Emphasis supplied by the querist.)

5. *Points for consideration of Committee:*

In this whole issue, the Company has also submitted the following points in addition to reply submitted to C&AG for consideration of Expert Advisory Committee (EAC):

(i) The Project is the only project, the Company is presently executing and all the functions of the Company are related to construction of this Project only.

(ii) Spectrum charges are necessarily required to be incurred during construction of project; without these expenditures, system designs are not possible, and therefore, these expenditures during construction have to be capitalised. The querist has separately clarified that obtaining and ensuring frequency spectrum is essential for ensuring the design same as that applicable in Japanese Shinkansen Train Radio Systems as they are essential part of the safety system when trains are running at a very high speed of 320 kmph, but there is no active usage of these frequencies in the design and development stages of the systems/hardware. However, it also needs to be considered that ensuring the frequencies is also essential for delivery/import of these equipments during supply phase of the project. These frequencies will be put in use once the equipments are installed and their testing starts after installation, and after system is commissioned, they are used for ensuring safe running of high speed trains.

(iii) These are the expenditures without incurrence of which the construction of the Project cannot take place and the Project cannot be brought to its working condition.

(iv) These expenses are directly attributable to the Project and are required to be incurred for execution of the Project only, and not otherwise.

B. Query

6. In view of above, the querist has sought the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on the following issues:

(i) Whether accounting treatment of expenditure of Rs. 73.33 crore as spectrum charges (Rs. 44.02 crore), project promotion expenses (Rs. 9.26 crore) and research & development expenditure (Rs. 20.05 crore) up to 31st March 2022, which are incurred for the Project, by the Company, is correct. If not, what should be the treatment as per the applicable Ind AS?

(ii) If there is any different accounting treatment as compared to treatment done by the Company in financial statements, are these changes will be treated as changes in estimate, accounting policy or prior period errors?

C. Points considered by the Committee

7. The Committee notes that the basic issues raised by the querist relate to the accounting treatment of expenditure on spectrum charges, project promotion expenses and research & development expenditure incurred for the Project. The Committee has, therefore, examined only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, consideration of materiality, timing of capitalisation as PPE, accounting for development and implementation of traffic diversion plans, removal of encroachments, land acquisition, implementing innovative sources of financing or any other expense incurred in relation to the Project, measurement of intangible asset (if any), etc. Further, the Standards referred to in the opinion are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015.

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. Similarly, just because the only activity undertaken by the Company at present is the construction activity does not mean that every expense incurred by the Company is directly linked or attributable to the construction activity. The capitalisation of an item of cost to a PPE/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 (Ind ASs), such as, Ind AS 16.

Accounting for Spectrum Charges

8. The Committee notes from the Facts of the Case that the Project being high speed project requires high speed communication along with track and to provide connectivity, dedicated frequency is required to be obtained. The Wireless Planning Commission (WPC) has allocated spectrum to the Company for which it is required to pay spectrum charges. The Company is paying spectrum charges for 06 frequencies allocated for the use of radio equipment which includes license fee and royalty. The Company has obtained the license for five years and has decided to pay annually. The spectrum charges are recurrent charges and will be payable as long as the spectrum is kept by the Company. It is further stated that if the spectrum charges are not paid, the earlier payments made by the Company cannot be recovered from WPC as these frequencies have been secured by WPC for the use by the Company and if the Company does not pay annual charges, it will lose the spectrum, which is very difficult to obtain.

From the above, the Committee notes that in the extant case, the payment of spectrum charges results into a Spectrum License, viz., an intangible asset, to the Company for a certain period of time (5 years) though the payment is made annually. Therefore, the Committee first examines whether such license meets the definition and recognition criteria of an 'intangible asset' as per the requirements of Ind AS 38, 'Intangible Assets', which provide as follows:

> **"An *intangible asset* is an identifiable non-monetary asset without physical substance."**

“An *asset*[2] is a resource:

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.”

“Control

13 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.”

“Future economic benefits

17 The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

Recognition and measurement

18 The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:

(a) the definition of an intangible asset (see paragraphs 8–17); and

(b) the recognition criteria (see paragraphs 21–23).

…”

“21 An intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.”

From the above, the Committee notes that the Spectrum License in the extant case meets the definition of an intangible asset, (i.e., identifiability, control over a resource and existence of future economic benefits) and also the recognition criteria as per paragraph 21 of Ind AS 38. Therefore, the same should be recognised as a separate intangible asset and accounted for as per the requirements of Ind AS 38.

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[2] The definition of an asset in this Standard is not revised following the revision of the definition of an asset in the *Conceptual Framework for Financial Reporting under Indian Accounting Standards* issued in 2021 by the Institute of Chartered Accountants of India. [This footnote was inserted vide Notification No. G.S.R. 419(E) dated 18th June, 2021.]

9. The Committee now examines whether the amortisation of the intangible asset can be capitalised with the cost of the Project or PPE being constructed, considering the requirements of Ind AS 16, 'Property, Plant and Equipment', reproduced below:

> "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."
>
> "16 The cost of an item of property, plant and equipment comprises:
>
> …
>
> (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.
>
> …"

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 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.

In this regard, the Committee notes from the JICC letter dated 29.03.2017 that the Company is required to ensure availability of frequencies for train Radio Systems during Design Stage, since the selection of frequencies will have a considerable impact on the Design of Systems including arrangement of Repeaters etc. and it is important that the frequencies are allocated at this time so as to avoid any delay on the system design and overall project schedule. Also, if the availability of these frequencies is not ensured for the Project, all these indicated systems will need to be re-designed, which will be an expensive arrangement after the radio equipments have been manufactured on the proposed frequencies. The radio system is critical for running of high speed trains; if there is any change in the design of the radio system, it will not be proven for high speed railway, and will also be costly and time taking. Thus, in order to avoid any change during manufacturing and installation stage, it is essential that frequency is obtained, ensured and maintained continuously. The querist has also clarified that obtaining and ensuring frequency spectrum is essential for ensuring the design same as that applicable in Japanese Shinkansen Train Radio System as they are essential part of the safety system and ensuring the frequencies is also essential for delivery/import of these equipment during supply phase of the project.

From the above, the Committee understands that obtaining and ensuring frequency by incurring spectrum charges at an early stage is essential to understand the type/kind of frequencies on the basis of which the design of the radio system, repeaters and other hardwares (which appear to be an integral component of the Project) will be developed, so that subsequently, no changes are required in these systems/hardwares. Thus, it appears that it will be necessary to ensure the availability of frequencies by obtaining spectrum license throughout the construction and these frequencies obtained will be directly and continuously involved during the construction of the Project. Therefore, the Committee is of the view that amortisation of spectrum license during the construction period of the Project can be considered as costs directly attributable to bringing the asset/Project to the location and condition necessary for it to be capable of operating in the manner intended by management and accordingly, should be capitalised with the cost of the asset/Project, as per the requirements of Ind AS 16.

Accounting for Promotional Expenses

10. The Committee notes that promotional expenses in the extant case mainly consist of expenses towards display of Shinkansen Simulator Model in exhibitions, Sponsorships for various events and social media team expenses. With regard to social media team expenses, it is understood that the same is majorly related to handling social media, short film documentary for Project etc. In order to execute the Project, which is one of the unique project of India, stakeholders' consultations are conducted at various stages to address the concerns of various stakeholders including not only Government/ministries and the regulatory authorities at institutional level, but also project affected persons at micro level. Further the Facts state that all the important processes including, development and implementation of traffic diversion plans, removal of encroachments, land acquisition, implementing innovative sources of financing, require public awareness and consultation with different agencies/stakeholders involved in the process and the Company has accordingly carried out these activities including social media management, which are essential for seamless/timely completion of the Project and help to avoid general hindrance since stakeholders are already aware about the Project.

In this context, with regard to accounting treatment of these project promotion expenses, the Committee further notes the following paragraphs of Ind AS 16, 'Property, Plant and Equipment':

> "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."

> "21 Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense."

From the above, the Committee is of the view that the expenses towards display of Shinkansen Simulator Model in exhibitions and sponsorships for various events are of the nature of costs of introducing a new product or service (including costs of advertising and promotional activities) as per paragraph 19(b) of Ind AS 16 reproduced above, which cannot be considered as directly attributable costs to bringing the asset/Project to the location and condition necessary for it to be capable of operating in the manner intended by management. Accordingly, these expenses should not be capitalised with the cost of the Project.

Further, with regard to social media team expenses, the Committee notes that such expenses are normally incurred for creating public awareness and consulting various stakeholders for ensuring smooth execution and seamless construction/completion of the Project so that hurdles like unrest amongst people, strikes, protest etc. and unnecessary increase in the construction cost may be avoided. Thus, although these expenses may be incidental to the Project and may result into some future economic benefits in terms of cost saving, etc., the Committee is of the view that the basic nature of these expenses remain to be that of advertising and promotional activities. Therefore, neither these expenses can be recognised as an intangible asset considering the requirements of paragraph 69 (c) of Ind AS 38 (as reproduced in paragraph 11 below), nor these expenses can be considered as directly attributable to construction activity or to bringing the asset/Project to the location and condition necessary for it to be capable of operating in the manner intended by management in terms of the requirements of Ind AS 16. Accordingly, these expenses cannot be capitalised with the Project and should be expensed as and when incurred.

Accounting for Research and Development Expenditure

11. With regard to accounting treatment of the research and development expenditure incurred by the Company through HIC Trust, the Committee notes the following paragraphs of Ind AS 38, 'Intangible Assets':

"9 Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources such as *scientific or technical knowledge, design and implementation of new processes or systems*, licences, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.

10 Not all the items described in paragraph 9 meet the definition of an intangible asset, ie identifiability, control over a resource and existence of future economic benefits. If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. …"

"21 An intangible asset shall be recognised if, and only if:

(a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably."

“53 If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Research phase

54 No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred.

55 In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Therefore, this expenditure is recognised as an expense when it is incurred.

56 Examples of research activities are:

(a) activities aimed at obtaining new knowledge;
(b) the search for, evaluation and final selection of, applications of research findings or other knowledge;
(c) the *search for alternatives* for materials, devices, products, processes, systems or services; and
(d) the formulation, design, *evaluation and final selection of possible alternatives* for new or improved materials, devices, products, processes, systems or services.

Development phase

57 An intangible asset arising from development (or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale.
(b) its intention to complete the intangible asset and use or sell it.
(c) its ability to use or sell the intangible asset.
(d) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset.
(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

58 In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits. This is because the development phase of a project is further advanced than the research phase.

59 Examples of development activities are:

(a) the design, construction and testing of pre-production or pre-use prototypes and models;

(b) the design of tools, jigs, moulds and dies involving new technology;

(c) the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and

(d) *the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services*."

"69 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In the case of the supply of goods, the entity recognises such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognises the expenditure as an expense when it receives the services. For example, expenditure on research is recognised as an expense when it is incurred (see paragraph 54), except when it is acquired as part of a business combination. Other examples of expenditure that is recognised as an expense when it is incurred include:

(a) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with Ind AS 16. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or business (ie pre-opening costs) or expenditures for starting new operations or launching new products or processes (ie pre-operating costs).

(b) expenditure on training activities.

(c) expenditure on advertising and promotional activities (including mail order catalogues).

(d) expenditure on relocating or reorganising part or all of an entity."

(Emphasis supplied by the Committee.)

From the above, the Committee notes that examples of research activities include activities aimed at obtaining new knowledge or research findings or search for alternatives for new or improved materials, devices, products, processes, systems or services, etc. Further, as per paragraph 9 of Ind AS 38, scientific or technical knowledge, design and implementation of new processes or systems, etc. are few examples of intangible items/resources to which the Standard is applicable. The Committee also notes from the above-reproduced requirements of Ind AS 38 that the expenses incurred on research activities (or on the research phase of an internal project) should be recognised as an expense when it is incurred. However, the expenses incurred on development activities (or during development phase of an internal project) should be recognised as an intangible asset if, and only if, an enterprise can demonstrate that all the conditions mentioned in paragraph 57 of Ind AS 38 are fulfilled. Therefore, before accounting for the expenses, it is essential to understand the nature of these expenses. In this context, the Committee notes from the Facts of the Case that the expenditure was incurred (though through the HIC Trust) to understand the technology and alternative methods to be used for construction of the project. Further, it is also stated in the Facts of the Case that the expenditure is incurred to identify the methods/techniques/ways for the project in order to have better, cost-efficient, alternative techniques.

Thus, the Committee is of the view that at present, the nature of activities is to search for and evaluation of various alternative ways/methods/techniques to be used for construction of the Project. Thus, these are in the nature of analysis and study, which appear to be similar to the kind of activities undertaken in research phase as per the examples of research activities given in paragraph 56 of Ind AS 38, reproduced above. Further, since at this stage, it cannot be demonstrated that an intangible asset exists that will generate probable future economic benefits, this expenditure should be recognised as an expense when it is incurred. Even if it is considered in terms of an expenditure incurred in relation to the Project, as being contended by the querist, the Committee is of the view that although research and development activities are incidental and occur in connection with the construction or development of the Project, since the results of the research are unknown and it is not certain whether the same will be used in the construction/development activities, these activities cannot be considered as necessary to bring the Project to 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. Therefore, such expenditure cannot be capitalised as per the requirements of Ind AS 16 and accordingly, should be recognised as an expense, as and when incurred.

12. The Committee is of the view that in the extant case, since in respect of the spectrum charges, promotional expenses and research and development expenditure, the Company did not follow the above-mentioned requirements of Ind AS 16 and Ind AS 38, as discussed above, the same should be rectified in the current reporting period, considering it as an accounting error, as per the following requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

> **"*Prior period errors* are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:**
>
> **(a) was available when financial statements for those periods were approved for issue; and**
>
> **(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**
>
> **Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud."**
>
> "41 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).
>
> **42 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:**
>
> **(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or**

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”

D. Opinion

13. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 6 above:

(i) *Spectrum Charges:*

The accounting followed by the Company with regard to the Spectrum charges is not correct. In the extant case, the payment of spectrum charges results into an intangible asset to the Company, which should be accounted for as per the requirements of Ind AS 38. Further, it appears that it will be necessary to ensure the availability of frequencies by obtaining spectrum license throughout the construction and these frequencies obtained will be directly and continuously involved during the construction of the Project. Therefore, amortisation of spectrum license during the construction period of the Project can be considered as costs directly attributable to bringing the asset/Project to the location and condition necessary for it to be capable of operating in the manner intended by management and accordingly, should be capitalised with the cost of the asset/Project, as per the requirements of Ind AS 16, as discussed in paragraphs 8 and 9 above.

Promotion expenses

The accounting followed by the Company with regard to promotion expenses is not correct. The expenses towards display of Shinkansen Simulator Model in exhibitions and sponsorships for various events are of the nature of costs of introducing a new product or service (including costs of advertising and promotional activities) as per paragraph 19(b) of Ind AS 16 and accordingly, these expenses should not be capitalised with the cost of the Project. Further, with regard to social media team expenses, although these expenses may result into some future economic benefits in terms of cost saving, etc., the basic nature of these expense remain to be that of advertising and promotional activities. Therefore, neither these expenses can be recognised as an intangible asset considering the requirements of paragraph 69 (c) of Ind AS 38, nor these expenses can be considered as directly attributable to construction activity or to bringing the asset/Project to the location and condition necessary for it to be capable of operating in the manner intended by management in terms of the requirements of Ind AS 16. Accordingly, these expenses cannot be capitalised with the Project and should be expensed as and when incurred, as discussed in paragraph 10 above.

Research and Development expenses:

The accounting followed by the Company with regard to Research and Development expenses is not correct. Since at this stage, it cannot be demonstrated that an intangible asset exists that will generate probable future economic benefits, this expenditure should be recognised as an expense when it is incurred. Further, although research and development activities are incidental and occur in connection with the construction or development of the Project, since the results of the research are unknown and it is not certain whether the same will be used in the construction/development activities, these activities cannot be considered as necessary to bring the Project to 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. Therefore, such expenditure cannot be capitalised as per the requirements of Ind AS 16 and accordingly, should be recognised as an expense, as and when incurred as discussed in paragraph 11 above.

(ii) Since in respect of the spectrum charges, promotional expenses and research and development expenditure, the Company did not follow the requirements of Ind AS 16 and Ind AS 38, the same should be rectified in the current reporting period, considering it as an accounting error, as per the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', as discussed in paragraph 12 above.

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