

## Chapter 2

# Property, plant and equipment – Directly attributable expenses

### This article aims to:

Discuss the key elements of cost of property, plant and equipment and the guidance provided a recent Expert Advisory Committee (EAC) opinion of the ICAI.

Ind AS 16, *Property, Plant and Equipment* provides guidance on the accounting of Property, Plant and Equipment (PPE). Generally, for many companies PPE is a significant item on the balance sheet, Therefore, it is important that capitalisable costs are appropriately identified and the cost of the same is recognised over the period which reflects its utilisation for the financial performance to be reflective of the use of the PPE.

Cost of an item of PPE includes its net purchase price (including taxes), directly attributable expenditure to bring it to its intended use and estimated restoration cost (where applicable). While identification of net purchase price may involve very little judgement, identification of directly attributable expenditure requires a deeper understanding of the asset's intended use and the nature of the expenditure.

In this article, we discuss a recent EAC opinion<sup>1</sup> which elaborates principles of Ind AS 16 while recognising directly attributable expenses to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

### Directly attributable expenditure

Measurement of an asset includes all 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 (its intended use).

The following are the types of directly attributable expenses:

- costs of employee benefits incurred by the company for employees working directly in the construction or acquisition of an item of PPE, costs of site preparation; initial delivery and handling costs
- installation and assembly costs
- costs of testing whether the asset is functioning properly; and fees paid to professional consultants assisting in the asset's installation.

Directly attributable expenditure need not necessarily be external or incremental. For example, cost of employees who are on the payroll of an entity and were fully engaged in installing an item of PPE is a directly attributable expenditure (for the period of installation), and so should be capitalised as part of the PPE.

Expenditure necessary in ensuring that the PPE is capable of operating in the manner intended by management could include a wide range of costs which needs to be assessed for each case based on its facts and circumstances.

A recent EAC opinion considered a query on accounting treatment of manpower cost of an entity that is in a project construction and implementation phase. The main aspect considered in the query relates to the manpower cost of the Chief Financial Officer (CFO) and Accounts Officer while the project is in construction and implementation phase. In this case, the company intended to capitalise 85 per cent of the cost of the manpower cost of its Accounts Officer and CFO to the capital work-in-progress.

1. EAC opinion 'Allocation of manpower cost during project implementation phase' published in The Chartered Accountant, December 2021 issue



The EAC pointed out that ‘directly attributable costs are generally such costs which are necessary to enable the construction activity, i.e. those costs are directly related to the construction activity and without incurrance of which the asset cannot be brought to the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, the employee benefit expenses arising directly from the construction or acquisition of the PPE/project, such as employee costs of an entity’s own employees, workers, labourers, engineers, architects, etc. engaged in the construction activity should only be capitalised and the rest should be charged to the Statement of Profit and Loss.

Generally, an Accounts Officer is engaged in overall book keeping and accounting related activities and CFO of an organisation is involved in overall

finance related activities of the company as a whole. Therefore, normally these activities cannot be considered to be arising directly from the construction or acquisition of PPE/project and the costs thereof cannot be considered to be a directly attributable cost of the project/PPE. Generally, such costs are in the nature of administration and general overheads and should, ordinarily, not be capitalised with the item of PPE.

### Application of judgement

In certain situations, some of the roles and responsibilities of the Accounts Officer could be undertaken in connection with the construction or acquisition of Project/PPE. Examples of such activities could include evaluation of tenders, procurement of various capital equipment, participating in price negotiation with bidders, help in

arranging debt financing, etc. The EAC pointed out that it is a matter of judgement in the specific facts and circumstances whether certain expenses could be considered as ‘directly attributable’ in the context of Ind AS 16.

In this case, although some of the activities of the Accounts Officer could be in connection with the construction/acquisition of Project/PPE, the cost incurred cannot be completely considered to be arising directly from construction or acquisition of the PPE/project. Therefore, to the extent, such costs are directly attributable to bringing the PPE/project to the location and condition necessary for it to be capable of operating in the manner intended by management, should be capitalised to the PPE/project by the company and the rest should be charged to the Statement of Profit and Loss.

Similarly, the activities of the CFO would need to be analysed and if they are in the nature of administrative and general overheads then they are not costs of an item of PPE and should be charged to the Statement of Profit and Loss.

In certain exceptional situations if a company is able to clearly demonstrate that the employee costs of the Accounts Officer and CFO are directly attributable costs for bringing the PPE/project to the location and condition necessary for it to be capable of operating in the manner intended by the management, then these can be capitalised. However, in order to determine a ratio/proportion of such expenses that could be capitalised, the company would need to consider the nature of expenses/activities and the extent to which these are directly attributable as per the requirements of Ind AS 16 based on the specific facts and circumstances and using proper rationale.