



ACCOUNTING AND COMPANY LAW

N. A. SHAH **BULLETIN**

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EXECUTIVE SUMMARY

- **Accounting**

- The Institute of Chartered Accountants of India (ICAI) has issued an expert advisory opinion on capitalization of interest cost during pre-operative period of the project.

As per the opinion, the Company needs to evaluate its own facts and circumstances related to project and determine that whether the time taken by the plant can constitute 'substantial period of time' to determine whether plant is qualifying asset or not in accordance with AS 16 Borrowing Cost. As per AS 16, ordinarily a period of 12 months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case.

Further, interest incurred during pre-operative period should be capitalised only for the period when activities that are necessary to prepare the asset for its intended use or sale are in progress and when other conditions as prescribed in AS 16 are fulfilled.

- **Company Law**

- Ministry of Corporate Affairs (MCA) has amended the provisions to provide further relaxations to government companies and companies with charitable objects in respect of certain procedural matters.
- MCA has provided further relaxations to as regards compliances with Companies Act requirements to private companies and start-ups. Refer separate bulletin "Alert on Companies Law Volume XXI" on this subject circulated by us. Summary of changes are given below:
 - Cash flow statement is not required to be prepared by start-up company
 - Exemptions to start-up company and private companies from certain procedural provisions in respect of acceptance of deposits
 - Small company need to disclose only aggregate remuneration drawn by the Directors and not required to disclose remuneration of other KMPs.
 - Relaxation given to start-up company in respect of signing of annual return in case there is no company secretary
 - Exemption from reporting IFC to One Person Company, Small Company and Private Company (subject to threshold limits of turnover and borrowing)
 - No. of board meetings reduced to 2 from 4 in case of start-up company

- In case of private company, interested director to be considered for the purpose of quorum after disclosure of his interest.
- In respect of exemption to private companies from the requirement of rotation of auditors, threshold limit of share capital is increased from Rs. 20 crores or more to Rs. 50 crore or more. Other condition with respect of borrowings remains unchanged.

1. Accounting

1.1 Expert Advisory Opinion

Capitalisation of interest cost as per Accounting Standard (AS) 16 – Borrowing Costs

a. Facts of the case

- A company has set up a new plant to manufacture auto components at capital expenditure of Rs. 418 million approx. which includes cost of Building improvement, Plant & Machinery, Furniture and Vehicles. Entire capital expenditure is funded through term loan from bank.
- Standard time required from ordering the machines to installation and commissioning including customer audit and to make the plant ready for manufacturing is around 8-10 months. Plant setup involves setting up of cutting and crimping machine, conveyor and assembly line for wiring harness and plant utilities, compressor, floor painting etc. after the building is completed and handed over. Further, Company also got the customization of building taken on lease to make it suitable as per the Company's requirement. Overall project completion period including the construction of the building as per customized requirement is 18 months.
- Company is of the opinion that standard time of 8-10 months taken to set up a plant should also be considered to meet the criteria of qualifying assets as per AS 16 and all the assets installed in the said plant can be treated 'qualifying assets' under AS 16.

b. Query

- Whether the assets procured and installed in the plant would be treated as 'qualifying assets' under the AS 16 as the project completion (including construction of building) has taken period of 18 months, and
- Whether the interest of Rs. 4.9 million incurred during the pre-operative period in procurement of the assets needs to be capitalised.

c. Points considered by the Committee

- The committee has considered only above issues raised and other issues like accounting of lease of building, accounting of lease rent during project under execution etc. are not considered.

- The committee notes that the plant in the extant case consists of various assets acquired by the company at different points of time and the Company is considering the plant/entire setup as single qualifying asset for capitalisation of borrowing cost. The committee is of the view that Company should evaluate whether other assets of the plant can be considered to be ready for its intended use only when the plant is ready for its intended use. If they are ready for its intended use before plant is ready for use than it should be considered as a separate qualifying asset provided it meets definition of qualifying assets as per AS 16.
- The Committee notes paragraph 3.2 and paragraph 5 of AS 16. As per AS 16, ordinarily a period of 12 months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of facts and circumstances of the case. Thus, standard doesn't specify exact period.
- Accordingly, the committee is of the view that the determination of 'substantial period of time' is a matter of judgement, which the management should exercise and the auditor should verify in the specific facts and circumstances of the case considering various factors, such as, nature of the asset, nature of the construction activity, normal time that the asset necessarily takes technologically and commercially to get ready for its intended use, etc.
- Committee is of the view that considering that time taken from the order till capitalisation of the plant is around 8-10 months which is shorter than 12 months, Company should evaluate its own facts and circumstances and determine whether time taken by the plant constitutes substantial period of time. The committee notes that inclusion of time taken for customization of building for the purposes of determination of qualifying asset depend on the specific facts and circumstances of the case considering various factors.
- The Committee further noted para 14 and 16 of AS 16. Expenditure on the qualifying asset and payment of borrowing costs are not sufficient enough to capitalize the borrowing costs. The activities that are necessary to prepare the asset for its intended use or sale should also be in progress so as to satisfy the conditions for capitalization.
- The Committee is of the view that 'activities necessary to prepare the asset for its intended use or sale' are the activities which lead to any active development/construction of the asset that lead to change in the asset's condition/location. Accordingly, the various activities in the

extant case, for example, customer trial and audit, should be carefully analyzed to determine whether these meet the above-mentioned criteria considering various factors, such as, whether any modifications are required after customer trial and audit leading to change in the asset's condition, etc.

d. Opinion

- The Company should evaluate facts and circumstances considering various factors as discussed above and determine whether the time taken by the plant can constitute 'substantial period of time' and on that basis, whether the plant is a qualifying asset or not.
- Interest incurred during the pre-operative period should be capitalized only for the period when the activities that are necessary to prepare the asset for its intended use or sale are in progress and when other conditions for capitalization of borrowing costs as per AS 16 are being fulfilled.

2. Company Law

2.1 Amendments to relaxation given to Government Company

- Exemption given from retirement of two-third or more of total number of directors has been relaxed for Government Company

Old requirement	New requirement
Applicable to	Exemption is extended to
i) Government Company in which entire paid up share capital is held by Central Government, State Government or both	i) Government Company in which not less than 51% of paid up share capital is held by Central Government, State Government or both
ii) Subsidiary of Government Company (covered (i) above) provided Government Company is holding entire share capital of subsidiary company	ii) Subsidiary of above Government Company (requirement of holding entire share capital has been deleted)

- Power is given to tribunal for compromise or to make arrangements with creditors & members u/s 230, to enforce compromise or arrangement u/s 231 and merger & amalgamation of companies u/s 232 of the Companies Act, 2013 has been given to Central Government.

- It is prescribed that exceptions, modifications and adaptations given to Government Companies from various provisions of act under notification no. G.S.R. 463(E) is applicable only if Company has not defaulted in filing financial statements and annual return with Registrar.

2.2 Amendments to relaxation given to companies with charitable objects

- Exemption is given to the Company regarding appointment of individual as director and requirement of minimum individual director on board as has been withdrawn.
- Condition of minimum interest rate for giving loan u/s 186 is not applicable to the Company in which 26% or more of paid up share capital is held by Central Government or one or more State Government or both provided it is for funding Industrial Research and Development Project.
- It is prescribed that exceptions, modifications and adaptations given to Companies (with charitable objects) from various provisions of act under notification no. G.S.R. 466(E) is applicable only if Company not defaulted in filing financial statements and annual return with Registrar.

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