

Should co-payment on prolongation costs be capitalised?

In June 2020, MOF and BCA issued a joint advisory to Government Procuring Entities (GPEs) on ex-gratia co-sharing of costs arising from project delays due to the Circuit Breaker (CB), Extended CB and till the approval to resume works is obtained (“prolongation costs”).

As part of the Government’s support under the Fortitude Budget to co-share additional costs incurred by contractors, GPEs shall co-share, on an ex-gratia basis, 50% of the prolongation costs, capped at 1.8% of the awarded contract sum. This applies to public sector construction works with on-going main contracts and tenders closed on or before 1 June 2020.

Examples of eligible prolongation costs include, but are not limited to, plant and equipment-related rental and maintenance costs, site maintenance costs, and other preliminaries e.g. storage costs for materials, equipment and fitting out works, extension of project insurance and performance bonds etc.

According to SB-FRS 16 paragraph 16, only costs which are *directly attributable* to bringing an asset to the location and condition necessary for it to be capable of operating in the manner intended by management should be capitalised as part of the asset cost.

Examples of directly attributable costs stated in SB-FRS 16 paragraph 17 include costs of site preparation, initial delivery and handling costs, installation and assembly costs, costs of testing whether the asset is functioning properly, costs of employee benefits arising directly from the construction or acquisition of the asset etc. Examples of costs that are not costs of an item of PPE (as stated in SB-FRS 16 paragraph 19) include administration and other general overhead costs.

SB-FRS 16 paragraph 21 further states that related expenses of incidental operations which occur in connection with the construction or development of an asset, but are not necessary to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, are recognised in profit or loss and expensed off.

Applying the above SB-FRS accounting principles and with reference to the examples given by MOF and BCA in their Joint Advisory on what constitutes prolongation costs, AGD's view is that the prolongation costs incurred on affected construction works during the CB period are not costs which are directly attributable to the construction/development of the asset, as they are mainly equipment and site maintenance and storage costs incurred during the CB period to ensure that the construction/development of affected assets can continue after approval to resume works is obtained. *These costs would not have been incurred if the stop-work order was not issued.* Thus, the prolongation costs should not be capitalised as part of the cost of the assets being constructed.

The above represents AGD's professional views and should not be taken as a pronouncement by a standard-setter. Accordingly, our views as set out above is non-binding, and Statutory Boards should discuss and agree with your auditors on the accounting treatment.