

Query No. 22

Subject: Accounting of amount incurred on rehabilitation and resettlement Scheme including development of infrastructural facilities.¹

A. Facts of the Case

1. A Government of India company (hereinafter referred to as ‘the company’) is engaged in the construction and operation of power plants in the country. The company has also diversified into renewable power generation, coal mining and oil & gas exploration etc. The company is registered under the Companies Act, 2013 and being an electricity generating company, is governed by the provisions of the Electricity Act, 2003. The company prepares its annual financial statements as per the provisions of the Companies Act, 2013. The company has implemented Indian Accounting Standards (Ind ASs) during the financial year 2016-17 with the transition date as 1st April, 2015. The company is listed with the BSE Ltd. and the National Stock Exchange of India Ltd. (NSE).

2. The company is functioning in the regulated environment. The tariff for sale of energy from its stations is determined by the Central Electricity Regulatory Commission (CERC) following the cost plus basis approach. Tariff for sale of energy in case of a thermal/hydro power generating station comprises of two components, namely, annual capacity (fixed) charges and energy (variable) charges. The capacity charges mainly consist of interest on loan capital, depreciation, return on equity, normative operation and maintenance expenses, interest on working capital etc. and to a large extent depend on the admitted capital cost of a generating station. The energy charges are computed on the basis of norms specified for station heat rate, auxiliary power consumption, cost of fuel etc. as applicable.

3. The company is involved in the construction of power projects. The company has ambitious expansion and diversification plans for the future and aims to be a 1,30,000 MW company by the year 2032. Further, it intends to diversify by way of providing backward and forward integration. As a part of its diversification plans, it has entered into renewable power generation, coal mining and oil & gas exploration sectors.

4. For construction of power projects, large tracts of land are required. The land is acquired from the State Governments and/or the private land owners through the concerned State Government as per the applicable provisions of the Land Acquisition Act, 1894/The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. The land acquired from the State Governments is normally on long term lease basis while the land acquired from the private land owners is on freehold basis. The estimated amounts payable towards acquisition of land including the estimated amount payable to the project affected persons (PAPs) under rehabilitation and resettlement (R&R) schemes are indicated in the Feasibility Report (FR) or Detailed Project Report and approved by the Board of Directors of the company before taking up the project.

5. Land Acquisition for the Power Projects

a) Land acquired from the State Government:

The amount paid to the State Government towards transfer of land or diversion of forest land, e.g. land premium, compensatory afforestation, cost of trees, catchment area treatment and rim plantation, etc. is treated as cost of land.

b) Land acquired from private parties:

¹ Opinion finalised by the Committee on 17.10.2018.

The acquisition of private land in India is regulated through the provisions of Land Acquisition Act, 1894/The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. The acquisition of private land is to be done through the State Government of the State where the project is being set up.

As per the said Act, the compensation payable to the persons whose land has been acquired (land loser) is determined by the Land Acquisition Officer (LAO) appointed by the State Government Authorities. The possession of the land is handed over to the company by the respective LAO upon payment of the prices determined by the LAO.

c) Rehabilitation and resettlement in respect of land acquired:

In addition to the above, the company is also obliged to carry out rehabilitation and resettlement (R&R) scheme of the project affected persons (PAPs) in line with the R&R policy announced by the respective states. Several states have come out with policies on R&R. These legislations and policies are binding on the land acquisition in that particular State. As per these legislations/policies, a R&R Plan is formulated in consultation with the State or the Local Bodies of the State for the land losers and for the area where the land acquisition has taken place.

As per the R&R Plan, apart from the land compensation amount already received from the LAO, the PAPs are entitled to provision for homestead land, assistance for self-relocation, assistance for livelihood restoration, training for self-employment, infrastructural facilities, such as, education, health, other periphery development activities, etc. to provide PAPs a reasonable living standard. Further, the State Governments require various works to be undertaken by the land requisitioner to develop surrounding area where the project is proposed to be set up. State Governments sometimes make few community development activities essential and a pre-requisite to setting up of a project in their State; and agree to book the cost incurred on such activities as part of R&R Plan for capitalisation.

6. Guidance available for accounting of cost associated with acquisition of land:

a) Paragraph 16 of Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment' provides as follows:

“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.”

(Emphasis supplied by the querist.)

- b) Relevant Opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) (Query No. 31 of Volume XXVIII of Compendium of Opinions) on ‘Provision towards resettlement and rehabilitation schemes’:

“13. In the present case, as far as the obligating event for the rehabilitation/resettlement measures, such as those mentioned in paragraph 5I, 5II, and 5III are concerned, it appears to the Committee that the obligating event for the same arises as soon as the land is acquired from the project affected persons. This is so, even if the PAPs may not have fulfilled the necessary conditions for becoming individually entitled to receive the money, because, as far as the company is concerned, upon acquisition of land from the PAPs it becomes liable to pay to the PAPs collectively. Accordingly, a provision in respect thereof, on the basis of best estimate of the expenditure required to settle the obligation, should be made on the acquisition of land from the project affected persons irrespective of fulfilment of various conditions by PAPs. *With respect to the infrastructural facilities mentioned in paragraph 5 IV also, the point of time at which the provision should be made in the books of account would depend on the obligating event, which in the view of the Committee, is the acquisition of land by the company. The event of acquisition of land from the PAPs makes the company liable to provide the infrastructural facilities even though the contracts may not have been awarded for execution of those works....*”

(Emphasis supplied by the querist.)

- c) Clarification of Ind AS Transition Facilitation Group (ITFG) - Bulletin No. 11 (Issue No. 8)

Issue 8: ABC Ltd is setting up a new refinery outside the city limits. In order to facilitate the construction of the refinery and its operations, ABC Ltd. is required to incur expenditure on the construction/development of railway siding, road and bridge. Though ABC Ltd. incurs (or contributes to) the expenditure on the construction/ development, it will not have ownership rights on these items and they are also available for use to other entities and public at large. Whether ABC Ltd. can capitalise expenditure incurred on these items as property, plant and equipment (PPE)? If yes, how should these items be depreciated and presented in the financial statements of ABC Ltd.?

Response: Paragraph 7 of Ind AS 16 states that “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.”

Further paragraph 9 of Ind AS 16 provides that, “This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity’s specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value.”

Paragraph 16 of Ind AS 16, inter alia, states that the cost of an item of property, plant and equipment comprise 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.

In the given case, railway siding, road and bridge are required to facilitate the construction of the refinery and for its operations. *Expenditure on these items is required to be incurred in order to get future economic benefits from the project as a whole which can be considered as the unit of measure for the purpose of capitalisation of the said expenditure even though the company cannot restrict the access of others for using the assets individually. It is apparent that the aforesaid expenditure 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.*

(Emphasis supplied by the querist.)

In view of this, even though ABC Ltd. may not be able to recognise expenditure incurred on these assets as an individual item of property, plant and equipment in many cases (where it cannot restrict others from using the asset), expenditure incurred may be capitalised as a part of overall cost of the project. From this, it can be concluded that, in the extant case the expenditure incurred on these assets, i.e., railway siding, road and bridge, should be considered as the cost of constructing the refinery and accordingly, expenditure incurred on these items should be allocated and capitalised as part of the items of property, plant and equipment of the refinery.

...”

7. *Accounting for land acquired by the company:*

Keeping in view the above, the amounts paid/payable towards land cost to the land owners, cost of R&R Plan including the cost of infrastructural facilities and other directly attributable expenses in relation to the acquisition of land are capitalised as land cost by the company. Similarly in the case of leasehold land acquired from the Government, compensatory afforestation, green belt development and loss of environment value etc. are also capitalised.

8. a) The company is setting up a Super Thermal Power Project of 1,600 MW (800x2) in Odisha State. At present the project is under construction.
- b) Total land required for the project was 1,814.20 acres. The land consists of 1,361.36 acres of private land, 369.71 acres of Government land and 83.13 acres of forest land. Out of the private land, about 1,361.30 acres of private land, 296.37 acres of government land and 34.47 acres of forest land has been acquired and capitalised in the books of account of the company.
- c) Acquirers of the private land in the State of Odisha are required to comply with the provisions of ‘Odisha Resettlement and Rehabilitation Policy, 2006’ (hereinafter referred as ‘Odisha R&R Policy’). Copy of the policy has separately supplied by the querist for the perusal of the Committee.
- d) The important and relevant provisions of the Odisha R&R Policy have been reproduced by the querist as below:

Paragraph 2(ii): “It shall apply to all those projects, for which acquisition of private land under Land Acquisition Act, 1894 or under any other laws for the time being in force or proclamation inviting objections in case of Government land is notified.”

Paragraph 3(o): ““**Rehabilitation & Periphery Development Advisory Committee (RPDAC)**” means the Committee constituted by the Government under relevant provisions of this Policy by Government to look after rehabilitation and periphery development matters.”

Paragraph 8: “Resettlement and Rehabilitation Plan:

Based on the list approved by Government and option of displaced families, Resettlement and Rehabilitation Plan shall be prepared by the Collector for resettlement and rehabilitation after due consultation with displaced communities in the manner determined by the Government. Such plan should address the specific needs of the women, vulnerable groups and indigenous communities. *The same will be placed before the RPDAC for approval. ...*”

Paragraph 15: “Periphery Development:

The Project Authorities shall be responsible for periphery development as decided by the RPDAC within the guidelines issued from time to time by the State Government.”

(Emphasis supplied by the querist).

As is clear from the above, every company acquiring land in the State of Odisha is required to prepare and implement a Rehabilitation & Resettlement Plan (R&R Plan) as per the directions of the RPDAC constituted by the Government of Odisha.

- e) As per the Odisha R&R Policy, RPDAC was constituted for finalisation of R&R Plan for the Power Project. While formulating the R&R Plan for the Power Project, the Government of Odisha required the company to construct a medical college and hospital near the project. Reference is invited to the following important issues highlighted in the letter dated 10th May, 2012 of the Minister of Power, Government of India (GoI) addressed to the Chief Minister of Odisha (copy of letter has been separately supplied by the querist for the perusal of the Committee):

“(i) ...

(ii) As requested by Government of Odisha, the company agreed to set up a Medical College and Hospital at Sundargarh with 400 bed which could be upgraded to 500 bed subsequently. The State Government will provide land for the same and will also run the Medical College and Hospital.

(iii) ...

(iv) ...

(v) Government of Odisha agreed to hand over the land expeditiously for the project of the company and also agreed to expedite the required clearances and processing of forest clearance for the plant as well as coal blocks so that the company could develop the mine along with the project.

...”

- f) Further, the obligation of the company to construct the medical college and hospital was included by the RPDAC in the R&R Plan of the Project. The following was recorded in the minutes of the meeting of RPDAC held on 28th April, 2012 (copy of the minutes has been separately supplied by the querist for the perusal of the Committee):

“3) Establishment of Medical College:

The company reiterated its commitment to set up a Medical College at Sundargarh. It was decided that requisition of land for the Medical College will be submitted by the company to the Collector, Sundargarh by end of May, 2012. Collector indicated that suitable site has also been selected for the said purpose. The company also clarified that the management of Medical College will not be done by them and the concerned authorities should finalise modalities.”

- g) Based on the above, an MOU for setting up a medical college and hospital was signed between Government of Odisha and the company dated 13th December, 2013 (copy of MOU has been separately supplied by the querist for the perusal of the Committee). Paragraphs 1(b) and 2 of the MOU, inter alia, provide as under:

Paragraph 1(b)

“In accordance with the background, objectives and purposes, as described above both parties agreed to establish and cooperate for establishment of a Medical College & a 500 bedded Hospital and for that both parties have identified synergies in their respective objectives and are desirous of working in concert to better realize their objective in the State of Odisha.”

Paragraph 2(ii)

“The FIRST PARTY (Government of Odisha) also agrees to allow the SECOND PARTY (the company) to *book the accrued capital expenditure on the setting of this Medical College & Hospital as part of the cost of R&R Plan for its upcoming power project in the District of Sundargarh, (Odisha).*”

(Emphasis supplied by the querist)

Paragraph 2(iii)

“The FIRST PARTY (Government of Odisha) shall provide adequate suitable land, free of cost and free of all encumbrances for the purpose of creation of infrastructure.”

Paragraph 2(vi)

“The SECOND PARTY (the company), after the completion of the infrastructure shall hand over all the assets and liabilities created for the Medical College and Hospital to the FIRST PARTY (Government of Odisha).”

Paragraph 2(vii)

“The FIRST PARTY (Government of Odisha) shall take up the responsibility or run the Medical College and Hospital.”

- h) It is clear from the above, that the company agreed to construct the medical college and hospital in connection with the setting up of project. As clearly mentioned in the MoU, the setting up of the medical college and hospital was part of R&R plan for its upcoming Super Thermal Power Project in the district of Sundargarh, Odisha.
- i) In line with the Odisha R&R Policy, R&R Plan was formulated and approved by RPDAC at its third meeting held on 3rd March, 2014. Subsequently, the expenditure for implementation of R&R plan was approved by the Board of Directors of the company.

The brief details of the R & R Plan for the Power Plant are as under:

Sl. No.	Particulars	Amount (crore)
1.	R&R Grants / Resettlement colony	136.80
2.	Community development activities in project affected villages, block and other places	46.00
3.	Medical college and hospital	417.77
4.	Polytechnic college	12.50
5.	Future miscellaneous R&R and other works provision	81.70
	Total	694.77

- j) It is pertinent to mention here that the company agreed for construction of medical college and hospital due to its requirements of land in the state of Odisha. Had the company not set up the power plant in the state of Odisha, the company would not have agreed for constructing any such medical college and hospital. As the above expenditure on R&R plan is directly attributable to acquisition of the land for the Project of the company, the related expenditure has been capitalised as a part of land cost and the future economic benefits from such expenditure shall flow to the project in the form of return on equity.
- k) During supplementary audit of accounts of the company for the year 2016-17, the Office of the Comptroller and Auditor General of India (C&AG) principally agreed with the accounting for R&R plan as part of land cost. They also desired that the accounting for the expenditure on R&R Plan capitalised as part of land cost be confirmed from the Expert Advisory Committee of the ICAI.

B. Query

9. In the facts and circumstances stated above, opinion of the Expert Advisory Committee is sought on the following issues:

- (i) Whether the accounting treatment followed by the company of capitalising the expenditure on R&R Plan including construction of the medical college and hospital as part of land cost is in order.
- (ii) If answer to (i) above is in negative, what should be the appropriate accounting for expenditure on R&R Plan (including construction of the medical college and

hospital) for acquisition of land for the power projects considering the fact that the company is working in the regulated environment?

C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query relates to whether the accounting treatment followed by the company of capitalising the expenditure on R&R plan including construction of the medical college and hospital (MCH) as part of land cost, is in line with the requirements of Ind ASs. The Committee has, therefore, considered only this issue, and has not examined any other issue that may arise from the Facts of the Case, such as, whether the land procured from the Government on long term lease should be treated as an operating or finance lease, valuation of non-cash consideration, if any, transferred to Displaced Family (DF) or Project Affect Persons (PAPs), or issues relating to government assistance in the form of transfer of resources in return for compliance with certain conditions relating to the activities of the company, presentation and depreciation of project related assets, etc. Further, the Committee has examined the query only from accounting perspective and not from any other perspective, such as, legal interpretation of various legal enactments, for example, whether the expenditure on R & R activities can be claimed by the company as the expenditure on Corporate Social Responsibility (CSR) activities under section 135 of the Companies Act, 2013, etc. The Committee has also not considered from the perspective of tariff or 'admitted capital cost' as considerations for determination of tariff may be different from accounting considerations, For example, Ind AS 16 requires an entity to capitalise a sum representing initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, in situations where an obligation existed. Ind AS thus envisages capitalisation of expenditure to be incurred even at a future date. However, for purposes of tariff determination, CERC may require otherwise.

11. The Committee notes that the setting up of the Power Project in the extant case is governed by the Odisha R&R Policy 2006, vital features of which are as follows:

- This shall be applicable to all projects for which land is acquired through negotiation under the provisions of this Policy.
- Two separate advisory bodies would be constituted. First is the Compensation Advisory Committee. Second is the Rehabilitation cum Periphery Development Advisory Committee (RPDAC). The objective of RPDAC is to encourage participation of displaced people and their elected representatives in (i) the implementation and monitoring of R&R package, and in (ii) overseeing and monitoring the development of the periphery.
- The types of rehabilitation assistance that can be extended to Displaced Family or Project Affect Persons (DF/PAPs) depend upon the type of the Project, for example, industrial project, mining project, irrigation projects, etc. These include (a) one-time cash assistance, (b) employment, (c) training for self-employment, (d) issue of convertible preference shares in some cases, (e) providing homestead land, (f) assistance for self-relocation, (g) house-building assistance in cash, (h) provision of shops and service units and (i) provision of agricultural land. Depending on the type of Project and the nature of displacement, one or more types of assistance could be extended. In select cases, DF/PAPs can also be granted maintenance allowance (Rs.2000 per month for one year), cash assistance for temporary shed,

and transportation allowance. Special benefits may also be extended to displaced indigenous families and primitive tribal groups in deserving cases.

- The R&R Plan has been prepared within the overall R&R Policy, which under paragraph 8(ii), specifies a condition that “no physical displacement shall be made before the completion of resettlement work as approved by the RPDAC. The certificate of completion of resettlement work will be issued by the Collector.”
- The Project Authorities shall be responsible for *periphery development* as decided by the RPDAC within the guidelines issued from time to time by the State Government.
- The R&R policy defines ‘periphery’ as the District(s) in which a *project* is geographically situated.

The Committee further notes from the Facts of the Case that the expenditure on rehabilitation and resettlement work in the extant case is part of R & R plan of the company which has been formulated and approved by RPDAC under the R & R Policy of the State Government. Thus, apparently, it is a binding ‘obligation’ of the company and a necessary condition under the R&R plan to incur such expenditure.

12. From the above, the Committee notes that R & R work is closely related to the project work; had the company not incurred the cash and non-cash expenditure that is deemed as ‘compensation’, the resettlement work would not have been completed and certified by RPDAC and consequentially completion of project could not have been possible. For example, if physical displacement and clearance of acquired-land had not taken place, possession of land which is one of the requirements for completion of project would not have been possible. The Committee further notes from paragraph 8 (i) above that expenditure on R&R plan in the extant case consists of the expenditure on (i) R & R grants / resettlement colony, (ii) community development activities in project affected villages, block and other places, (iii) Medical college and hospital, (iv) polytechnic college and (v) future miscellaneous R & R and other works provision.

13. Now, the question that arises is whether such expenditure on R & R plan can be capitalised as part of cost of an item of property, plant and equipment (PPE). In this regard, the Committee notes the following paragraphs of Ind AS 16, ‘Property, Plant and Equipment’ as follows:

“15 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its 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.”

The Committee notes from (b) above that only ‘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’ can be capitalised as part of cost of an item of property, plant and equipment. The Committee is of the view that ‘directly attributable’ costs are generally such costs which are necessary and without the incurrence 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. Accordingly, the Committee is of the view that the expenditure on R& R plan in the extant case can be capitalised only if it can be considered as directly attributable cost to the land or the Power Project as a whole (which can be considered as the unit of measure as per the requirements of Ind AS 16). In this context, the Committee is of the view that in the extant case, the resettlement grant/compensation payable to the land owners as a direct consequence of acquisition of land can be considered as directly attributable to the cost of land since the land cannot be acquired without incurring that expenditure and therefore, should be capitalised along with the cost of land. Further, the Committee notes from paragraphs 11 and 12 above that the other expenditure on R & R plan in the extant case is a binding obligation of the company and a necessary condition under the R&R plan approved by RPDAC under the R&R policy of the State. Therefore, such expenditure is closely related to the project work and can be considered as expenditure incurred for developmental activities associated with the Project (and not merely for acquisition of land, which is one of the requirements for the construction of the project). Accordingly, the Committee is of the view that such expenditure can be considered as directly attributable to the Project in the extant case.

14. Specifically, with regard to the expenditure incurred on Medical College and Hospital (MCH) (as the querist has specifically raised issue in this regard), the Committee notes the relevant extracts from the communication issued by the Power Ministry to the State Government (letter dated May 10, 2012), reproduced as below:

- As requested by Government of Odisha, the company agreed to set up a Medical College and Hospital at Sundargarh with 400 bed which could be upgraded to 500 bed subsequently. The State Government will provide land for the same and will also run the Medical College and Hospital.
- Government of Odisha agreed to hand over the land expeditiously for the project of the company and also agreed to expedite the required clearances and processing of forest clearance for the plant as well as coal blocks so that the company could develop the mine along with the project.

15. From the above, although it may appear that a request has been made by the Government for setting up MCH, which is agreed by the company but a careful evaluation of this Communication reveals that the construction of MCH is linked to the Project as a whole, including forest clearances required for the Plant, as well as clearances for the coal blocks. Incidentally, the Committee notes that the Project is coal-based, and but for uninterrupted captive coal supply, the plant would not be able to operate. Accordingly, the Committee is of the view that the substance of the foregoing arrangement – though not explicit in its form -- is that construction of MCH and other developmental activities (other than resettlement grant/compensation, as discussed in paragraph 13 above) are conditions necessary for undertaking the project as a whole; establishment of MCH and setting up of the Power Project are closely

linked to each other, and it cannot be concluded that the latter would have come up independent of or without the former. Therefore, considering the principle of ‘Substance over Form’ as elucidated in the Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards, issued by the ICAI, the Committee is of the view that amounts expended towards these represent costs attributable to the power project as a whole and not merely to acquisition of land. Accordingly, the expenditure incurred on construction of the medical college and hospital (MCH) should be capitalised as part of the project cost and not as part of the cost of land.

D. Opinion

16. On the basis of the above, the Committee is of the opinion that:

- (i) The accounting treatment followed by the company of capitalising the entire expenditure on R&R Plan including construction of the medical college and hospital, as part of land-cost, is not completely appropriate.
- (ii) The resettlement grant/compensation payable to the land owners as a direct consequence of acquisition of land can be considered as directly attributable to the cost of land and, therefore, should be capitalised along with cost of land, as discussed in paragraph 13 above. The other expenditure on R & R plan including expenditure incurred on MCH in the extant case is a binding obligation of the company and a necessary condition of project approval, which is closely related to the project work and can be considered as expenditure incurred for developmental activities associated with the Project (and not for acquisition of land, which is one of the requirements for the construction of the project). Accordingly, such expenditure can be considered as directly attributable to the Project and should be capitalised as part of the project cost, as discussed in paragraphs 13 and 15 above.