

Query No. 16

Subject: *Accounting for Concession Agreement.*¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the company’) is a public limited company registered under the Companies Act, 1956. The entire equity of the company is held by the Ministry of Railways (MOR). The company was set up as a special purpose vehicle (SPV) to implement the Project of design, construction and commissioning of New Railway and the operation, maintenance and repair of the New Railway and the signaling and communication centre (including the control centre) during the operation period.

2. For the said purpose, the Ministry of Railways has entered into a Concession Agreement dated 28th February 2014 and an Addendum to the Concession Agreement dated 31st March 2014 (hereinafter referred to as ‘Concession Agreement’ or ‘Agreement’) with the company which provides various rights and obligations of the MOR and the company; and the company in terms of the said agreement is to construct and operate dedicated freight corridors in the country.

3. In order to fund the required cost of construction of dedicated freight corridors being a Western Corridor from Jawaharlal Nehru Port Trust, Mumbai to Dadri near New Delhi and an Eastern Corridor from Ludhiana to Dankuni near Kolkata (hereinafter referred to as ‘Corridors’), the company through the Ministry of Railways/ Government of India has tied up with Japan International Cooperation Agency (JICA), a Japanese Funding Agency and the World Bank for funding the project. JICA is providing loan for the Western Corridor and the World Bank is providing loans for the Eastern Corridor. Financing structure of the construction of dedicated freight corridors as per paragraph 5.5 of Concession Agreement is as follows:

(Amount in Rs. crores)

Particulars	Eastern Freight Corridor	Western Freight Corridor	Total
Loan	13,625	38,722	52,347
Equity	13,049	2,680	15,729
Total	26,674	41,402	68,076
IDC	-	5,316	5,316
Total (excluding land)	26,674	46,718	73,392

Ministry of Railways has granted to the company during the concession period, the right to implement the Project subject to terms of Agreement.

4. The querist has stated that the company has incurred Rs. 14,757.08 crores upto 31st March 2018 and shown the same as capital work in progress in the financial statements. The capital work in progress mainly comprises track, earthwork, bridges and other electrical equipment. Further, capital work in progress also includes borrowing costs. These will be accounted for as per accounting treatment prescribed under Indian Accounting Standard (Ind AS) 16, ‘Property, Plant and Equipment’ and Ind AS 23, ‘Borrowing Costs’.

¹ Opinion finalised by the Committee on 21.11.2019.

5. The Concession Agreement between the MOR and the company dated 28th February 2014 provides various rights and obligations of the MOR and the company. The relevant extracts of the said Concession Agreement have been reproduced by the querist as below:

Terms as per Concession Agreement:

Concession Period means the period commencing on the Commencement Date and ending on the earlier of:

- (a) the 30th anniversary of the earlier of:
 - (i) The latest date for completion; and
 - (ii) The Completion Date for the final New Railway Stage, (as extended in accordance with clause 22.5); or
- (b) The date on which this Agreement is terminated.

Terminal Date means the date after the end of the aggregate of the following periods:

- (a) 30 years after Commencement Date; and
- (b) All delay periods accepted by MOR pursuant to clause 14.2(c) or otherwise determined pursuant to clause 33.

5.8 Risks accepted by Ministry of Railways (MOR)

Subject to this agreement and without prejudice to the obligations of the company under the Project documents, the MOR accepts certain risks and obligations, as set out in this agreement, including in relation to:

- (a) a delay in its funding of the MOR loans and other fundings to be made available by it to the company and any corresponding rise in costs;
- (b) a delay in giving, or a failure to give, within a reasonable period any approval required from MOR (subject to the company having complied with all applicable conditions for the grant of such Approvals);
- (c) failure to grant MOR License for all the land required for project at the time such land is required to comply with the Construction programme;
- (d) the Undisclosed interests;
- (e) Pre-existing contamination and MOR subsequent contamination;
- (f) damage to the New railway caused by defective trains run by Authorized Rail Users; (the protocol for establishing the cause/cost of damage, etc. shall be unambiguously stated in the disaster management manual or appropriate manual issued by the company with the approval of MOR);
- (g) loss of traffic or inability to carry traffic as a result of corresponding MOR improvements not being completed as planned.

5.9 Payment of Track Access Charges

MOR shall utilize the company's network and in return shall pay Track Access Charges (TAC) as per Track Access Agreement. TAC so paid shall be deposited in an escrow account to be opened by the company. TAC liability shall be worked out by MOR and provisions shall be made under demand under separate Head.

Track Access Charges means the aggregate of the Fixed Capacity Charges and Variable Charges due and payable or paid to the company under the Track Access Agreement.

5.10 Transfer of Traffic

Subject to fulfillment of the company's obligation by the company, MOR will transfer at least 70% of Traffic Due on to the New Railway in each of the years of the Concession Period. (Emphasis supplied by the querist.)

6.1 The company's fundamental obligations

The company shall, in accordance with the Project Documents and at its own cost and expense:

- (a) assist MOR in the acquisition of land and interests in land in the New Corridor;
- (b) develop the design, construct and commission the New Railway (other than the MOR improvements) during the Construction Period which meets the Minimum Performance Criteria;
- (c) operate, maintain and repair the New Railway during the Operation Period so that the New Railway meets the Minimum Performance Criteria on a continuous basis;
- (d) ...
- (e) ...
- (f) comply with the guidelines, determinations of tariffs and charges and directions of Tariff Regulatory Authority; and
- (g) hand over the New Railway to the MOR on the Handover date.

Handover date means the date on which the concession period ends.

7.7 MOR's right of access

The MOR and any other persons authorized by the MOR may enter the new corridor in accordance with and subject to the conditions contained in the MOR license. MOR shall have the right to provide any new connectivity to New corridor which may be required for any additional line or siding, in consultation with the company.

16.4 Tariff and Track Access Charge

Tariff and Track Access Charge shall be determined by Tariff Regulatory Authority. The parties agree that they shall comply with the guidelines, determination of tariffs and charges and directions of Tariff Regulatory Authority. Till the time Tariff Regulatory Authority is set up, the determination of tariffs and charges shall be undertaken by the company in accordance with the Track Access Agreement and with the approval of MOR.

19.1 The company may undertake Changes

Subject to the clause 19.2, the company may at its own cost and risk undertake Changes to the New Railway from time to time during the Operation Period.

The MOR shall have no obligation whatsoever to pay for or to contribute to the cost of any change including any change required as a result of any increased or different level of rail traffic on the New Railway.

19.2 MOR to approve all Changes

- (a) Subject to the clause 19.2 (b), the company shall not undertake any change pursuant to clause 19.1 unless and until:

- (i) it has given the MOR all the information relevant to the MOR's decision to give or withhold its approval to the Change, including:
 - A. The reasons for, and the purpose of, the proposed Change; and
 - B. The design documentation for the proposed Change; and
 - (ii) the MOR has approved the Change.
- (b) The company shall not be required to obtain the prior approval of the MOR to a Change which is required in the event of an emergency either for safety reasons or in order to protect property. The company shall, however, promptly notify the MOR of the Change after it has been effected.

30.4 No other termination rights

The MOR acknowledges and agrees that it has no right to and shall not terminate this Agreement other than as expressly provided for in clauses 3.5, 30 and 31.

Schedule 4: Early Termination Amount

Relevant extracts

In case the contract is early terminated, the company shall have the right to receive the following amount in accordance with the following formula:

$$ETA = MORD + CBC$$

Where,

ETA= Early termination amount

MORD = MOR loans or loans from World Bank, JICA, etc. that have been directly given to the company on Government guarantee (for the New Corridor and New Railway) outstanding as at the date of termination together with the direct costs of repaying such loans (including break costs);

CBC = the aggregate of following amounts:

- (a) The amount payable in respect of work done under each Construction Contract but not yet paid;
- (b) An amount equal to the reasonable demobilization costs of the company and the Construction companies in respect of the project;
- (c) The aggregate of all payments of items ordered by the Construction Companies to fulfil their obligations under the Construction Contracts to the extent that the orders cannot be cancelled;
- (d) The aggregate of all costs reasonably incurred by the Construction Companies in the expectation of completing the whole of the work under the Construction Contracts;
- (e) The amount payable in respect of indemnifying the Construction Companies for the third-party claims against them which arise as a direct result of the termination of the Construction Contract due to the termination of this Agreement, except to the extent that any such claims are made by sub-contractors on account of indirect or consequential losses such as unearned profit forgone; and
- (f) ...

Relevant Extracts from Track Access Agreement

Clause 2 of Track Access Agreement

TRACK ACCESS RIGHTS

Clause 2.1 of Track Access Agreement

Grant to MOR of Train Paths

- (a) the company grants to the MOR during the Term the exclusive use and availability of the Train Paths and the use of Network for this purpose by Authorized Rail Users upon the terms and conditions set out in this agreement.
- (b) ...

Clause 5.6 of Track Access Agreement

Fixed Capacity Charges

- (a) The MOR shall pay to the company all Fixed Capacity Charges specified in the Charges Schedule and applicable taxes and Duties irrespective of whether or not the MOR uses all or any part of the Network.
- (b) The MOR shall pay all Fixed Capacity Charges at the end of each calendar month (or within such other period as may be agreed between the Parties).

Clause 5.7 of Track Access Agreement

Variable Charges

The MOR will pay to the company all Variable Charges as specified in the Charges Schedule calculated with reference to the actual GTKM carried on the Network and applicable tax and Duties.

Clause 4.1 of Track Access Agreement

The Track Access Charge (TAC) payable by MOR to the company shall be mutually agreed between the parties so as (a) to provide revenue adequate for the company to be a commercially sustainable company earning a reasonable return on investment (revenue adequacy principle) and (b) to incentivize it to handle increments to traffic, maintain agreed performance standards and seek efficiency improvements (incentive principle).

Clauses 5.8 and 5.9 of Track Access Agreement

The level of the Fixed Capacity Charges and Variable Charges shall be reviewed:

- (a) during the construction period on occurrence of each completion date; and
- (b) during the full operation period, at the end of each period of three years after the commencement of full operation period.

6. *Extracts from the company's financial statements:*

“Accounting Policies:

Note 2.1 of the financial statements for the year ended 31st March 2018

e) Property, plant and equipment

Recognition and measurement

- The initial cost of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing an asset to working condition and location for its intended use. In case where the final settlement of bills with contractors is pending, but the asset is complete and ready to use, capitalisation is done on estimated basis subject to necessary adjustment, including those arising out of settlement of arbitration/ court cases, in the year(s) of final settlement.

- Capital Work-in-Progress is carried at Cost. Expenditure during construction net of incidental income is capitalized as part of relevant assets.
- Capital stores are valued on weighted average cost.

If significant parts of an item of property, plant and equipment have different useful lives, then they are accounted for as a separate item (major components) of property, plant and equipment. Any gain on disposal of property, plant and equipment is recognised in profit and loss account.

Subsequent Measurement

Subsequent expenditure is capitalised only if it is probable that the future economic benefits associated with the expenditure will flow to the company.

Depreciation

Depreciation on property, plant and equipment is charged on pro-rata basis from/ upto the date on which the asset is available for use/ disposal.

Depreciation on property plant and equipment is provided as per Para 219 of Indian Railway Finance Code Volume I which specifies the normal life of the various classes of Railway Assets. In case a particular component of property plant and equipment is not available in the said Para 219 of Indian Railway Finance Code, then depreciation on these assets are provided on Straight Line Method using the useful life specified in Schedule II of the Companies Act, 2013 except in case of certain assets, the useful lives have been determined based on technical evaluation done by the management's expert which are lower than those specified by Schedule II of the Companies Act, 2013, in order to reflect the actual usage of the assets.

Property, plant and equipment created on Leasehold Land and Leasehold Premises Improvements are depreciated fully over the residual period of lease of respective Land/ Leasehold Premises or over the life of respective asset as specified in Schedule II of the Companies Act, 2013, whichever is shorter.

Where the life and / or efficiency of an asset is increased due to renovation and modernization, the expenditure thereon along with its unamortized depreciable amount is charged prospectively over the revised / remaining useful life determined by technical assessment.

Where the cost of the depreciable assets has undergone a change during the year due to price adjustment, change in duties or similar factors the unamortized balance of such assets is depreciated prospectively over the residual life of such assets.

Depreciation methods, useful lives and residual values are reviewed in each financial year end and changes, if any, are accounted for prospectively.

Assets purchased during the year costing Rs. 5,000 or less are depreciated at the rate of 100%.”

7. Comptroller and Auditor General of India (CAG) Comments:

During supplementary audit conducted by the Comptroller and Auditor General of India (CAG) under section 143(6) of the Companies Act, 2013 of the accounts of the company for the year ended 31st March 2018, they raised the following preliminary queries and the company's management gave an assurance to CAG that the related matter would be referred to the Institute of Chartered Accountants of India (ICAI) for its perusal and valued opinion:

- a) The company has entered into service concession agreement with Ministry of Railways on 28th February 2014. As per the agreement, the company will

implement the project and operate and maintain the new railway. The concession period is of 30 years excluding construction period. This aspect has not been disclosed by the company in its financial statements. As per Ind AS 11, the company is required to give relevant disclosure regarding construction contracts and as per Ind AS 11 (Appendix B) the disclosure regarding concession agreement is required.

Thus, the notes to the financial statement of the company are deficient as stated above.

b) CWIP: Rs. 14,78,712.22 lakh

The above amount represents the expenditure incurred by the company on construction of Eastern and Western Dedicated Rail Freight Corridor. The company has entered into a Concession agreement with MOR to implement the project and operate and maintain the new railway for a concession period of 30 years. As per the track access agreement, the company will charge track access charges for use of new railway facility. As per Ind AS 11 (Appendix A), the infrastructure created cannot be recognized as property plant and equipment. This can be recognized as either intangible assets or financial assets.

Thus, due to recognition of infrastructure created under concession agreement as Property, Plant and Equipment (Capital work in progress) instead of intangible assets/ financial assets, the property, plant and equipment (Capital work in progress) has been overstated by Rs. 14,78,712.22 lakh and intangible asset/ financial assets (under development) has been understated by the same amount.

8. *Views of the company:*

(a) Extracts from Accounting Standards:

Appendix A, 'Service Concession Arrangements' to Indian Accounting Standard (Ind AS) 11 'Construction Contracts':

"This Appendix is an integral part of Indian Accounting Standard (Ind AS)

Background

- 1 Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.
- 2 In recent times, governments have introduced contractual service arrangements to attract private sector participation in the development, financing, operation and maintenance of such infrastructure. The infrastructure may already exist, or may be constructed during the period of the service arrangement. An arrangement within the scope of this Appendix typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such

an arrangement is often described as a ‘build-operate-transfer’, a ‘rehabilitate-operate-transfer’ or a ‘public-to-private’ service concession arrangement.

- 3 A feature of these service arrangements is the public service nature of the obligation undertaken by the operator. Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:
 - (a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
 - (b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
 - (c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement
 - (d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

Scope

- 4 This Appendix gives guidance on the accounting by operators for public-to-private service concession arrangements
- 5 This Appendix applies to public-to-private service concession arrangements if:
 - (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
 - (b) the grantor controls—through ownership, beneficial entitlement or otherwise — any significant residual interest in the infrastructure at the end of the term of the arrangement.”

Appendix D, ‘Service Concession Arrangements’ to Ind AS 115, ‘Revenue from Contracts with Customers’:

“Background

- 1 Infrastructure for public services — such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks — has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.
- 2 ... An arrangement within the scope of this Appendix typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards,

mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such an arrangement is often described as a ‘build-operate-transfer’, a ‘rehabilitate-operate-transfer’ or a ‘public-to-private’ service concession arrangement.

- 3 A feature of these service arrangements is the public service nature of the obligation undertaken by the operator. Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:
 - (a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
 - (b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
 - (c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.
 - (d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

Scope

- 4 This Appendix gives guidance on the accounting by operators for public-to-private service concession arrangements.
- 5 This Appendix applies to public-to-private service concession arrangements if:
 - (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
 - (b) the grantor controls — through ownership, beneficial entitlement or otherwise — any significant residual interest in the infrastructure at the end of the term of the arrangement.”

(b) Conclusion of the views of the company:

(i) *Ground No. 1*

The Concession Agreement between Ministry of Railways and the company makes it evident that the company is a public sector company and is wholly owned by the Ministry of Railways and therefore, it does not satisfy the primary condition of being a private sector entity mentioned in Service Concession Arrangements as per Ind AS 11, ‘Construction Contracts’ and now Ind AS 115, ‘Revenue from Contracts with Customers’.

According to the querist, the service concession arrangements as per Ind AS 11, ‘Construction Contracts’ and now Ind AS 115, ‘Revenue from Contracts with Customers’ are primarily based on IFRS 15, ‘Revenue from Contracts with Customers’, IFRIC 12, ‘Service Concession

Arrangements’ and SIC 29, ‘Service Concession Arrangements: Disclosures’. Public sector and private sector are two separate nature of entities. Inference can be drawn from International Financial Reporting Standards (IFRSs) and IAS 24 ‘Related Party Disclosures’.

Paragraph 25 of IAS 24, ‘Related party Disclosures’ also gives exemptions to a reporting entity from the disclosure requirements set out in paragraph 18 thereof in relation to related party transactions and outstanding balances (including commitments) with:

- a government that has control or joint control of, or significant influence over, the reporting entity, and
- another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

IAS 24 includes a definition of ‘government’ for the purposes of the partial exemption from the disclosure requirements of IAS 24 for ‘government related entities’. Government refers to government, government agencies and similar bodies whether local, national or international. [Paragraph 9 of IAS 24] A government-related entity is an entity that is controlled, jointly controlled or significantly influenced by a government. [Paragraph 9 of IAS 24]

Similarly, when one looks into the definitions of Government and government-related entity as per Indian Accounting Standard (Ind AS) 24 ‘Related Party Disclosures’, ‘Government’ refers to government, government agencies and similar bodies whether local, national or international and a ‘government-related entity’ is an entity that is controlled, jointly controlled or significantly influenced by a government.

As per paragraph 11 of Ind AS 24, “In the context of this Standard, the following are not related parties:

- (a) ...
- ...
- (c) (i) ...
- (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity,
- ...”

As per paragraph 25 of Ind AS 24, “**A reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and outstanding balances, including commitments, with:**

- (a) a government that has control or joint control of, or significant influence over, the reporting entity; and**
- (b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.”**

Background to the Appendix D, ‘Service Concession Arrangements’ of Ind AS 115, ‘Revenue from Contracts with Customers’, inter alia, states that, “In recent times, *governments have introduced contractual service arrangements to attract private sector participation in the development, financing, operation and maintenance of such infrastructure.* The infrastructure may already exist, or may be constructed during the period of the service arrangement. An arrangement within the scope of this Appendix typically involves a *private sector entity* (an operator) constructing the infrastructure used to provide the *public service* or upgrading it (for

example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time”.

Thus, considering this, as per the querist, generally, an arrangement within the scope of the Service Concession Arrangements as per Ind AS 115 normally involves a private sector operator, who is responsible for rendering public services. Therefore, the operator, who is a private sector entity, is expected to be completely independent of the Government. In certain cases entities which are owned by the Government may also have autonomy to conduct their own affairs so that they act independently of the grantor i.e. Government and not as its agent.

The Concession Agreement has been entered between the Ministry of Railways and the company, which is wholly owned by the Ministry of Railways. Therefore, the first leg of the condition, i.e., Government should be the party that grants the service arrangement (the grantor) is satisfied but the second part of the above-mentioned condition, i.e., to involve a *private sector entity* (an operator) constructing the infrastructure used to provide the public service or upgrading it is not satisfied. Although the company is managed by the Board of Directors and has independent directors, the appointment of directors is done by the shareholders, which is the Ministry of Railways.

Accordingly, in the view of the querist, since the Concession Agreement itself provides that the company is a special purpose vehicle established by the Ministry of Railways (MOR) to implement the Project and operate and maintain the New Railway consistent with the Project objectives and is a railway administration under the Railways Act, 1989, it could be construed that the company’s obligation and rights as per Concession Agreement are towards MOR only and it permits use of track by MOR or authorized rail user on payment of Tariff Access Charges. The MOR vide letter dated 26th November 2018 has also stated that while determining Track Access Charges, there will be no return on equity as long as Indian Railways is a sole user and land lease charges shall be at nominal charges @ Re. 1/-. Therefore, the condition of operator being a *private sector entity and to act independently of the grantor*, i.e., Ministry of Railways *is not satisfied*.

(Emphasis supplied by the querist.)

(ii) *Ground No. 2*

The Background to the Service Concession Arrangements as per Ind AS 115 states that “Infrastructure for public services — such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks — has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.” The examples of service concession arrangements, as per querist, involve water treatment and supply facilities, motorways, car parks, tunnels, bridges, airports and telecommunication networks. *In the above examples, services provided by Railways is not covered in the service concession arrangements* and therefore the provision of freight services to MOR or authorized rail user by the company is outside the scope of the Service Concession Arrangements as per Ind AS 115. (Emphasis supplied by the querist.)

(iii) *Ground No. 3*

Further the meaning of ‘public service nature of the obligation’ is not defined in the Appendix A/D, ‘Service Concession Arrangements’ to Ind AS 11 / Ind AS 115. If as per Service Concession Arrangement, the service has to be ‘public service’ then the definition of public service becomes critical. For a public service obligation to exist, the services offered need not be made available to all the members of the public. Rather, the services need to benefit members of public even if it is to a section of a public. In the view of the querist, providing freight services to MOR or authorized rail user on payment of TAC as per Concession

Agreement *does not constitute a public service* as defined in the Background to the Service Concession Arrangements as per Ind AS 115, *as the service is to the owner of the entity and not to the public at large* on behalf of the grantor viz., MOR even though the owner of the entity (grantor) i.e. MOR is providing public services. (Emphasis supplied by the querist.)

In view of the above grounds, the querist has stated that the company has treated project expenditure incurred of Rs. 14,757.08 crores upto 31st March 2018 as capital work in progress in its financial statements and shall capitalize the same as per the requirements of Ind AS 16, 'Property, Plant and Equipment' and Ind AS 23, 'Borrowing Costs' on completion of the project.

B. Query

9. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India on the following issues:

- (i) Whether the accounting treatment consistently followed by the company in treating expenditure incurred by the company on the project as 'Property, Plant and Equipment' and 'Capital Work in Progress' is in compliance of various applicable Ind ASs notified under the Companies (Indian Accounting Standards) Rules, 2015 read with section 133 of the Companies Act, 2013. If not, what is the appropriate accounting treatment?
- (ii) If not, how the said expenditure is to be treated in financial statements as per various applicable Ind AS and if Appendix D, 'Service Concession Arrangements' to Ind AS 115, 'Revenue from Contracts with Customers' is applicable to the expenditure incurred by the company on the project, whether the same would be treated as an intangible asset or as a financial asset in the company's financial statements.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised in the query relates to the applicability of Appendix D, 'Service Concession Arrangements' to Ind AS 115, 'Revenue from Contracts with Customers' or the erstwhile Appendix A 'Service Concession Arrangements' to Ind AS 11, 'Construction Contracts' to the concession agreement between the company and the MOR and the consequential accounting treatment. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, accounting policy of the company in respect of recognition, measurement (initial and subsequent) and depreciation of 'property plant and equipment' as mentioned in paragraph 6 above, applicability of Appendix C to Ind AS 17 or Ind AS 116 to the arrangement, existence of related party relationship or disclosure of related party transactions and balances under Ind AS 24, etc. Further, the Committee has restricted the opinion only to the accounting under Indian Accounting Standards (Ind ASs), notified under Companies (Indian Accounting Standards) Rules, 2015, as amended, and not looked into the legal or regulatory aspects arising from the concession agreement referred to by the querist.

11. At the outset, the Committee notes that one of the major contention of the querist is that the company is a public sector company owned by the Ministry of Railways, Government of India and therefore, it does not satisfy the primary condition of being a 'private sector entity' as mentioned in Appendix D to Ind AS 115 or Appendix A to Ind AS 11. In this regard, the Committee is of the view that an entity, which is not a public sector entity should be considered as a private sector entity for the purposes of Appendices D and A. While the

Appendices D and A do not define the term ‘Public Sector Entity’, in the view of the Committee, this term is intended to include the type of entities described by the International Public Sector Accounting Standards Board of International Federation of Accountants (IFAC). Therefore, the Committee notes the following description of public sector entities given in the Preface to International Public Accounting Standards, issued by International Public Accounting Standards Board (IPSASB) of International Federation of Accountants (IFAC) of which the ICAI is also a full-fledged member:

Preface To International Public Sector Accounting Standards:

“10. The IPSASs are designed to apply to public sector entities that meet all the following criteria:

- (a) Are responsible for the delivery of services to benefit the public and/or to redistribute income and wealth;
- (b) Mainly finance their activities, directly or indirectly, by means of taxes and/or transfer from other levels of government, social contributions, debt or fees; and
- (c) Do not have a primary objective to make profits.”

From the above, the Committee notes that one of the criteria is that the entity does not have a primary objective to make profits. In the extant case, although at present the company is serving only MoR and receiving track access charges as per track access agreement without any return on equity, it cannot be said that the company does not have any objective to make profit. The Committee is also of the view that mere infusions of funds from Government by means of equity or loan cannot be the only criteria to determine whether an entity is public sector entity or not. Further, the other objective as mentioned by the company in its Memorandum of Association (as available in public domain) also enlists many other type of commercial and profit making activities that the company may undertake in future. Therefore, the Committee is of the view that the company is not a public sector entity envisaged under Appendix and drawing an analogy, it is a private sector entity. Accordingly, the arrangement in the extant case is a public-to-private arrangement.

12. The Committee notes the following requirements of Appendix D to Ind AS 115 and the erstwhile Appendix A to Ind AS 11:

- “2 ... An arrangement within the scope of this Appendix typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time. The operator is paid for its services over the period of the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such an arrangement is often described as a ‘build-operate-transfer’, a ‘rehabilitate-operate-transfer’ or a ‘public-to-private’ service concession arrangement.
- 3 A feature of these service arrangements is the public service nature of the obligation undertaken by the operator. Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:

- (a) the party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
 - (b) the operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
 - (c) the contract sets the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.
 - (d) the operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.
- 4 This Appendix gives guidance on the accounting by operators for public-to-private service concession arrangements.
- 5 This Appendix applies to public-to-private service concession arrangements if:
- (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
 - (b) the grantor controls — through ownership, beneficial entitlement or otherwise — any significant residual interest in the infrastructure at the end of the term of the arrangement.”

(Emphasis supplied by the Committee.)

13. The Committee notes that a feature of service concession arrangements under Appendix D to Ind AS 115 or Appendix A to Ind AS 11 is that the operator is responsible for at least some of the management of the infrastructure and the related services and does not merely act as an agent on behalf of the grantor (paragraph 3(b)). Accordingly, the Committee is of the view that the company should make an assessment in the extant case whether it is acting as an agent or principal in relation to the service concession arrangement. The assessment whether the company is acting as an agent or principal should be made based on the facts and circumstances, including the contractual provisions as stated above and also the guidance provided in Appendix B to Ind AS 115 (paragraphs B34-B38).

14. The Committee further notes that the company should also take into consideration, amongst others, the following facts while making the principal versus agent considerations:

- The company is a special purpose vehicle established by MOR to implement the Project and operate and maintain the New Railway consistent with the Project Objectives and is a railway administration under Railways Act, 1989.
- While determining Track Access Charges, the MOR has also stated that there will be no return on equity as long as Indian Railways is the sole user and land lease charges shall be at nominal rate of Re 1/-.
- Paragraph 1.1 of the Concession Agreement dated 28th February 2014 shared by the querist defines ‘Associates’ as “in relation to a party, an employee, officer, member, *agent*, contractor, consultant or adviser of that party...” and states that MOR and the company will not be associates of each other.

- Paragraph 5.7 of the Concession Agreement states that the company shall have autonomy and independence from MOR in relation to its management of the implementation of the Project and the performance of its obligations and exercise of its rights under the Project Documents.
- There are no private sector funds involved in the construction of dedicated freight corridors. The lenders of the company are international government agencies which may be covered under the definition of ‘government’ under the following definition provided under Ind AS 20, ‘Accounting for Government Grants and Disclosure of Government Assistance’:

“Government refers to government, government agencies and similar bodies whether local, national or international.”

Accordingly, the Committee is of the view that the company shall consider, amongst others, these facts and contractual provisions while making an assessment whether it is autonomous and independent of MOR or is an agent of the MOR. If it is assessed that the company is an agent, the company’s performance obligation under Ind AS 115 may be to arrange services for another party to transfer those services. Further, if it is assessed that the company is acting as agent, the company should also assess whether the assets/infrastructure being constructed are being held on its own or on behalf of the principal, viz., the Government.

15. The Committee further notes that the querist has submitted in Ground No. 2 in paragraph 8(b)(ii) above that the services provided by Railways is not covered as an example in the Background to the Service Concession Arrangements as per Appendix D to Ind AS 115 or Appendix A to Ind AS 11 and therefore the provision of freight services to MOR or authorized rail user by the company is outside the scope of the Service Concession Arrangements as per Ind AS 115/Ind AS 11. In this context, the Committee notes that paragraph 1 of Appendix D to Ind AS 115 or Appendix A to Ind AS 11 states as follows:

“1 Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks—has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.”

The Committee notes that the term ‘infrastructure’ is not used in a restrictive or exhaustive manner in Appendix D to Ind AS 115 or Appendix A to Ind AS 11, but it is an inclusive term which shall encompass any infrastructure, including railway transportation facilities, that is to be constructed or acquired by the operator.

16. The Committee also notes that the querist has submitted in Ground No. 3 in paragraph 8(b)(iii) above that it is providing freight services to MOR or authorized rail user on payment of TAC as per Concession Agreement. The querist has stated that as the service is to the owner of the entity and not to the public at large on behalf of the grantor (MOR), the same does not constitute a ‘public service’ and therefore, Appendix D to Ind AS 115 or Appendix A to Ind AS 11 is not applicable. In this context, the Committee notes that paragraph 3(a) of Appendix D/Appendix A identifies the grantor of a service concession arrangement in terms of a public sector body, including a governmental body or a private sector entity to which the responsibility for the public service has been devolved. Further, while providing guidance as to what constitutes control over services and prices in paragraph 5(a) of Appendix D to Ind AS 115, the Application Guidance on Appendix D (AG2) explains what might be considered as ‘public service’ as follows:

“AG2 The control or regulation referred to in condition (a) could be by contract or otherwise (such as through a regulator), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. In applying this condition, the grantor and any related parties shall be considered together. If the grantor is a public sector entity, the public sector as a whole, together with any regulators acting in the public interest, shall be regarded as related to the grantor for the purposes of this Appendix D.”

From the above, the Committee notes that even if the grantor (who is acting in public interest and provides services to the public) purchases all of the output from the operator, it may be considered as providing public service.

17. The Committee notes that there are two applicability criteria in paragraph 5 of Appendix D to Ind AS 115 or Appendix A to Ind AS 11. The first criterion is whether the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price. In the extant case, the company is providing freight services to MOR or authorized rail user on payment of TAC as per Concession Agreement between the company and MOR. Therefore, in the view of the Committee, the grantor (MOR), through the Concession Agreement, is controlling and regulating the services that the company shall provide, to whom the same is to be provided and the price at which the same is to be provided.

The second criterion in paragraph 5 of Appendix D to Ind AS 115 or Appendix A to Ind AS 11 is whether the grantor controls - through ownership, beneficial entitlement or otherwise - any significant residual interest in the infrastructure at the end of the term of the arrangement.

In the extant case, the Committee notes that the company is obliged to handover the infrastructure to the MOR at the handover date at the end of the concession. Therefore, in the view of the Committee, MOR controls significant residual interest in the infrastructure at the end of the term of the arrangement.

Accordingly, on the basis of above discussion, the Committee is of the view that, unless the company is acting as an agent, Appendix D to Ind AS 115 or Appendix A to Ind AS 11 shall be applicable to the company.

18. If it is assessed that Appendix D to Ind AS 115 or Appendix A to Ind AS 11 is applicable, the next issue relates to classification of the consideration for the operator's construction services for which the following guidance is provided in the Appendix D to Ind AS 115 (Appendix A to Ind AS 11 also contains similar requirements):

“15 If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognised in accordance with Ind AS 115. The consideration may be rights to:

- (a) a financial asset, or
- (b) an intangible asset.

16 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on

the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

- 17 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.
- 18 If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognised initially in accordance with Ind AS 115."

In the extant case, as mentioned in paragraph 5 above, as per clause 5.6 of the Track Access Agreement, which is a part of the Concession Agreement, the MOR shall pay to the company Fixed Capacity Charges as specified in the Charges Schedule irrespective of whether or not the MOR uses all or any part of the network. This means that the company has an unconditional right to receive cash irrespective of the actual usage of the infrastructure. The Committee is of the view that this shall constitute a financial asset as per paragraph 16 of Appendix D to Ind AS 115 or Appendix A to Ind AS 11.

In addition, as mentioned in paragraph 5 above, as per clause 5.7 of the Track Access Agreement, the company is also entitled to variable charges based on the actual usage of the infrastructure. This, in the view of the Committee, shall constitute a right to charge for the use of the infrastructure contingent on the extent of use of the service of the company.

Therefore, the consideration shall be partly financial asset and partly intangible asset in the concession arrangement. The company shall therefore recognize and measure each component separately as per the requirements of Appendix D to Ind AS 115 or Appendix A to Ind AS 11.

19. In case the company assesses that Appendix D of Ind AS 115 is not applicable to it, the Committee further notes that paragraph 4 of Appendix C, 'Determining whether an Arrangement contains a Lease' to Ind AS 17, 'Leases' states the following:

- "4 This appendix does not apply to arrangements that:
 - (a) are, or contain, leases excluded from the scope of Ind AS 17; or
 - (b) are public-to-private service concession arrangements within the scope of Appendix D of Ind AS 115, *Service Concession Arrangements*."

Similarly, Ind AS 116, 'Leases' (which is effective from financial year beginning on or after 1 April 2019) scopes out public-to-private service concession arrangements within the scope of Appendix D of Ind AS 115. Therefore, Appendix C to Ind AS 17 or Ind AS 116 do not apply to arrangements that are within the scope of Appendix D of Ind AS 115. Therefore, in case the company assesses that Appendix D of Ind AS 115 is not applicable to it, it shall assess whether the arrangement with MOR constitutes a lease under Appendix C to Ind AS 17 or Ind AS 116 and shall account for the arrangement accordingly. If it is assessed that the arrangement contains lease, the company (lessor) should classify the lease into finance lease or operating lease based on the criteria laid down in Ind AS 17/Ind AS 116.

Factors such as, the minimum fixed capacity payments from MOR, the company's obligations to handover the infrastructure to the MOR at the handover date at the end of the concession, the company's entitlement in case of early termination, MOR's obligation to divert 70% of the traffic to the company and MOR's risk, etc. as pointed in paragraph 5 above should also

be considered for the purpose of the assessment of whether the arrangement contains lease as well as for the purpose of classification as operating or finance lease. The Committee is further of the view that in case it is assessed that the arrangement contains a lease, till the time, the company does not start lease accounting as per the requirements of Ind AS 17/Ind AS 116, as applicable, the company should consider applicability of the accounting requirements of Ind AS 16, 'Property, Plant and Equipment', based on its own facts and circumstances, for construction of railway tracks/other infrastructure assets.

D. Opinion

20. As mentioned in paragraphs 12-14 above, a feature of service concession arrangements under Appendix D to Ind AS 115 or Appendix A to Ind AS 11 is that the operator is independently responsible for the management of the infrastructure and the related services and does not merely act as an agent on behalf of the grantor. Therefore, the Committee is of the view that the company should evaluate, based on its facts and circumstances, and the indicators provided in Appendix B to Ind AS 115 (paragraphs B34-B38) as to whether it is acting as a principal or an agent on behalf of MOR. Based on the same, if it is assessed that it is not merely acting as an agent for MOR and has significant level of independence in providing the management of the infrastructure and the related services, Appendix D to Ind AS 115 or Appendix A to Ind AS 11 shall be applicable. The consideration, as mentioned in paragraph 17 above, would result in consideration being classified partly as financial asset and partly as intangible asset in the concession arrangement. In that scenario, the current accounting policy of the company to classify and present the expenditure incurred on the project as capital work in progress under Ind AS 16 as mentioned in paragraph 4 above, shall be incorrect.

If it is assessed that it is acting as an agent on behalf of MOR, then Appendix D to Ind AS 115 or Appendix A to Ind AS 11 shall not be applicable. In that case, the company should assess whether its performance obligation under Ind AS 115 may be to arrange services for another party to transfer those services and whether the assets/infrastructure being constructed are being held on its own or on behalf of the principal. Further, in that scenario, the current accounting policy of the company as capital work in progress under Ind AS 16 as mentioned in paragraph 4 above, shall be incorrect.

If it is assessed that Appendix D to Ind AS 115 or Appendix A to Ind AS 11 is not applicable, it should also be assessed as to whether the arrangement with MOR constitutes a lease under Appendix C to Ind AS 17 or Ind AS 116 and if it is assessed that the arrangement contains a lease, the company shall classify the lease into finance lease or operating lease based on the criteria laid down in Ind AS 17 / Ind AS 116, as applicable. Also, in case it is assessed that the arrangement contains a lease, till the time, the company does not start lease accounting as per the requirements of Ind AS 17 / Ind AS 116, as applicable, the company should, based on facts and circumstances, apply accounting requirements of Ind AS 16, 'Property, Plant and Equipment', for construction of railway tracks/other infrastructure assets.