

Query No. 18

Subject: *Classification of Rail Corridor Asset in the books of account of the Company as tangible/intangible asset and its depreciation/amortisation.*¹

A. Facts of the Case

1. A Memorandum of Understanding (MoU) was signed between the Government of Chhattisgarh (GoCG), SE Limited and I Limited on 3rd November, 2012 to create project specific Special Purpose Vehicle (SPV) in the State of Chhattisgarh for developing the rail network. Subsequent to the signing of MoU, a Company (hereinafter referred to as 'the Company'), being a subsidiary of SE Limited has been incorporated on 12-03-2013 as a special purpose vehicle under the joint venture model of Public-Private-Partnership (PPP) policy of Ministry of Railways (MoR). The querist has stated that SE Ltd. is a wholly owned subsidiary of C Limited. Accordingly, C Ltd. is the ultimate holding company of the Company.

2. The Company, being a joint venture company of SE Limited, I Limited and the Government of Chhattisgarh (represented by State Industrial Development Corporation (SIDC)) was incorporated for developing the rail network and to facilitate coal traffic movement from Kharsia to Dharamjaigarh upto Korba with a spur from Gharghoda to Gare-Pelma Block in Northern part of Chhattisgarh to meet the logistic challenges foreseen on account of coal evacuation and to meet the growing coal needs of the country. Ministry of Railways (Government of India) has notified the East Rail Corridor in the State of Chhattisgarh as a 'Special Railway Project' to provide national infrastructure for a public purpose and directed for acquisition of land under the Railways Act, 1989.

3. The Company has been formed with equity contribution from SE Ltd., I Ltd. and GoCG. The role of promoters is to bring the necessity of rail infrastructure and its establishment to a common platform so that the desired objective can be achieved by an association for a limited period. While discharging the promoters' role, SE Ltd. looks for eco-friendly coal evacuation process through rail, I Ltd. shares the technical expertise to move on the rail, and GoCG provides the government land required for the project.

4. Project Execution Agreement

The querist has stated that for undertaking the construction of the Rail Corridor, the Company has executed the Project Execution Agreement with I Ltd. on 18th January, 2014 having domain expertise on execution of railway projects to act as a Project Management Consultant for undertaking the construction work of the proposed rail project in two phases i.e., Kharsia to Dharamjaigarh along with a spur from Gharghoda to Donga Mahua and three Feeder Lines at Chhal, Baroud and Dharamjaigarh in the first phase and subsequently, from Dharamjaigarh to Korba in the second phase.

5. The scope of work to be carried out by I Ltd. as per the Agreement includes the activities like route selection, land acquisition, detailed survey work, project costing, preparation of feasibility/bankability report to establish the project cost, compilation of land data feasibility study, resettlement and rehabilitation (R&R) works, recurring assistance in R&R activity, preparation of detailed project report (DPR), construction & completion of rail

¹ Opinion finalised by the Committee on 11.10.2022.

network, arrangements under Concession Agreement, clearance and diversion of forest land for the purpose of project as per the provisions of Forest Conservation Act, 1980 etc.

6. *Concession Agreement*

6.1 The Company has executed the Concession Agreement with South East Central Railway (SECR) (Zonal Railway) on 12-06-2015 to be read with Addendum and Corrigendum to the Concession Agreement executed on 21-03-2017. This Agreement defines the roles and obligations of the Ministry of Railways (MoR) and the Company, including revenue sharing. It is an important milestone in the execution of the project. Concession Agreement will also facilitate in arranging commitment from the banks/ financial institutions for achieving financial closure.

6.2 A Brief of Concession Agreement is defined as under:

1. Objective - To Build, Operate and Maintain an Approved Rail System
2. The Concessionaire - A nominee of the Indian Railways (the Company)
3. Period of Concession - 30 years including construction period extendable by 5 years
4. Revenue Sharing - Normally 50% freight revenue collected by Railways from customers with the Concessionaire i.e., the Company (User Fee)
5. Land Acquisition - Under the Indian Railways Act at the cost of Concessionaire
6. Land Cost - Non-interest-bearing deposit with Railways till termination
7. Completion - Can be done in Phases at the cost of Concessionaire
8. Target Traffic - To achieve agreed Net Tonne Kilometre (NTKM) over the period of concession i.e., 30 years
9. Maintenance - Either by MoR or Concessionaire at the cost of Concessionaire
10. Security - To be ensured by Concessionaire
11. Insurance - To be ensured during Concession Period by Concessionaire
12. Operation - By Railways
13. Supervision - Through Independent Engineers

6.3 *Obligations of Concessionaire*

To Build and Maintain the Rail System during Concession Period
Acquire the Site (Land) for Rail System
Execute and procure execution of the Escrow Agreement and Substitution Agreement
Procure applicable permits
Execute and deliver to MoR, the Financing Agreements and to deliver to MoR, the Financial Package and Financial Model

6.4 *Obligations of Ministry of Railways*

Provide reasonable support in procuring applicable permits
Provide Railway Land and Right of Way
Undertake interconnection of Rail System with the Rail Network
Pay the User Fee to the Concessionaire
Provide a timely supply of sufficient number of rakes, wagons, locomotives and other rolling stock
Support, cooperate with and facilitate in the implementation and operation of the

Project
Safety Certificate and Commercial Service Certificate

6.5 *Relevant Clauses of Concession Agreement are as under:*

As per clause 3.1.1 of the Concession Agreement entered with the Ministry of Railways (through SECR), the Company has received by way of *exclusive right, license and authority* to construct, operate and maintain the rail system, excluding performance of the Reserved Services, for a period of 30 (thirty) years commencing from the Appointed Date and the Concessionaire has accepted the Concession and agreed to implement the project subject to and in accordance with the terms and conditions of the Concession Agreement. (Emphasis supplied by the querist.)

Clause 3.1.3 of the Agreement states that:

“Subject to and in accordance with the provisions of this Agreement, the Concession hereby granted shall oblige or entitle (as the case may be) the Concessionaire to:

- (a) Right of Way, access and license to the Site for the purpose of and to the extent conferred by the provisions of this Agreement;
- (b) finance and construct the Rail System;
- (c) operate and maintain the Rail System;
- (d) receive the User Fee from MOR for using the Rail System or any part thereof;
- (e) perform and fulfil all of the Concessionaire's obligations under and in accordance with this Agreement;
- (f) bear and pay all costs, expenses and charges in connection with or incidental to the performance of the obligations of the Concessionaire under this Agreement; and
- (g) neither assign, transfer or sublet or create any lien or Encumbrance on this Agreement, or the Concession hereby granted or on the whole or any part of the Rail System nor transfer, lease or part possession thereof, save and except as expressly permitted by this Agreement or the Substitution Agreement.”

Clause 3.2 of the Concession Agreement relating to ‘Railway Administration’ states that:

“The Parties agree that the Concessionaire shall be deemed to be a Railway Administration (*as defined in the Railways Act, 1989*) for the purpose of construction, operation and maintenance of the Rail System, and shall exercise the rights and perform the obligations of the Railway Administration as specified under the provisions of the Railways Act, 1989, however, such rights and functions shall at all times be subject to the provisions of this Agreement.”

Clause 10.2 of the Concession Agreement relating to ‘License, Access and Right of Way’ states that:

“10.2.1 MOR hereby agrees to grant to the Concessionaire access to the Site for carrying out any surveys, investigations and soil tests that the Concessionaire may deem necessary prior to the commencement of the Construction Period, it being expressly agreed and understood that MOR shall have no liability whatsoever in respect of survey, investigations and tests carried out or work undertaken by the Concessionaire on or about the Site pursuant hereto in the event of Termination or otherwise.

10.2.2 In consideration of the Concession Fee, this Agreement and the covenants and warranties on the part of the Concessionaire herein contained, MOR, in accordance with the terms and conditions set forth herein, hereby grants to the Concessionaire, commencing from the Appointed Date, leave and license rights in respect of all the land (along with any buildings, constructions, construction materials or immovable assets, if any, thereon) comprising the Site which is described, delineated and shown in Schedule-A hereto , on an “as is where is” basis, free of any Encumbrances, to develop, operate and maintain the said Licensed Premises, together with all and singular rights, liberties, privileges, easements and appurtenances whatsoever to the said Site, hereditaments or premises or any part thereof belonging to or in any way appurtenant thereto or enjoyed therewith, for the duration of the Concession Period and, for the purposes permitted under this Agreement, and for no other purpose whatsoever.

10.2.3 The licence, access and right of way granted by this Agreement to the Concessionaire shall always be subject to existing rights of way and the Concessionaire shall perform its obligations in a manner that existing lanes, if any, along the alignment of or across the Rail System or an alternative thereof are open to road traffic at all times during the Construction Period.

10.2.4 It is expressly agreed that the licence granted hereunder shall terminate automatically and forthwith, without the need for any action to be taken by MOR to terminate the licence, upon the Termination of this Agreement for any reason whatsoever. For the avoidance of doubt, the Parties expressly agree that notwithstanding any temporary or permanent structures erected on the Site by the Concessionaire or its sub-licensees, the licence in respect of the Site shall automatically terminate, without any further act of the Parties, upon Termination of this Agreement.”

From the above clauses of the Concession Agreement, the Company (the concessionaire or the operator) has been formed as a special purpose vehicle (SPV) of SE Ltd., I Ltd. and State Industrial Development Corporation for development of rail corridor for transportation of coal in the Mand-Raigarh Coalfields region of Chhattisgarh. The said Concession Agreement with the Ministry of Railways through SECR provides the Company an exclusive right, license and authority to construct operate and maintain rail system. The Company is entitled to receive 50% of revenue apportionment from freight operation on rail system.

7. *Accounting Policy of the Company:*

➤ Property, Plant & Equipment:

Land

Land is carried at historical cost. Historical cost includes expenditure which is directly attributable to the acquisition of the land like, rehabilitation expenses, resettlement cost and compensation in lieu of employment incurred for concerned displaced persons etc.

Value of land acquired by Ministry of Railways (MoR) for the project at the cost of Company shall remain as a non-interest-bearing refundable advance till the termination of Concession period and it includes cost of acquisition, cash rehabilitation expenses, resettlement cost and all other incidental expenses incurred for the acquisition of project land as provided in the Concession Agreement.

Rail Corridor Asset

Expenses incurred by the Company on certain activities which are essential for construction, operation and maintenance of the Rail System of the Company are recognised as Rail Corridor under Construction till Commercial Operation Date (CoD). After CoD, including Stage-wise CoD, the assets are classified as Rail Corridor and depreciated/ amortised based on the Agreed Targeted Traffic based on the Concession Agreement. Accordingly, Rail Corridor is being shown under the head 'Property, Plant & Equipment' and is being depreciated on the basis of Progressive Target Traffic.

➤ Commercial Operation:

The project is brought to revenue; when commercial readiness of a project to yield revenue on a sustainable basis is established on the basis of Certification by Commissioner of Railway Safety (CRS) as per the Concession Agreement or by any other Authority as per rules and regulations of MoR/SECR for the project including stage-wise certification, if any.

On being brought to revenue, the assets under capital work in progress are reclassified as a component of property, plant and equipment under the nomenclature "Rail Corridor". Rail Corridor is amortised from the year when the Rail Corridor is brought under revenue in the total NTKM (Target Traffic) to be achieved as per the Concession Agreement to be read with Addendum and Corrigendum to the Concession Agreement.

8. *Stage-wise Commercial Operation Notification:*

Financial year (F.Y.) 2019-20:

With the issuance of Notification by GM/SECR vide Memorandum dated 28.09.2019 wherein approval was accorded for the operation of Goods Trains with diesel traction on the newly constructed BG Track from Kharsia to Korichhapar (42.569 Km length), the Company created the Rail Corridor Asset to the tune of Rs. 583.34 crore as on 31-03-2019.

F.Y. 2020-21:

Subsequently, with the completion of other necessary works on the Commissioned section, Rs. 108.60 crore worth of Assets were added to the Rail Corridor Asset during F.Y. 2020-21. The Total Book Value of Rail Corridor stood at Rs. 691.94 crore.

F.Y. 2021-22:

During F.Y. 2021-22, CE/Con-I/Bilaspur/SECR vide Memorandum dated 22.06.2021 has approved the operation of Goods Trains with diesel traction on the newly constructed BG Track from Korichhapar to Dharamjaigarh (42.569 Km – 73.519 Km in length).

As on 31.12.2021, Rail Corridor Asset in the form of Property, Plant & Equipment to the tune of Rs. 950.17 crore has been created.

The movement of asset, 'Rail Corridor' under the head 'Property, Plant & Equipment' since inception till 31.12.2021 is shown in the below table:

(Figures in Rs. crore)

Sl. No.	Description	Rail Corridor Asset	Depreciated on	Carrying Value
1	Opening Balance as on 01-04-2019	-	-	-
2	Addition During the Year	583.34	0.19	-
3	Closing Balance as on 31-03-2020	583.34	0.19	583.16
4	Opening Balance as on 01-04-2020	583.34	0.19	583.16
5	Addition During the Year	108.59	0.65	-
6	Closing Balance as on 31-03-2021	691.94	0.84	691.10
7	Opening Balance as on 01-04-2021	691.94	0.84	691.10
8	Addition During the Period	258.83	0.57	-
9	Closing Balance as on 31-12-2021	950.17	1.41	948.76

9. *C&AG Accounts Audit for F.Y. 2020-21*

During the audit of accounts for F.Y. 2020-21 by the Comptroller and Auditor General (C&AG), the C&AG officials raised remarks on the creation of 'Rail Corridor' asset and its method of depreciation. The Accounts Audit Memo issued by C&AG and the reply furnished by the management are as under:

“Accounts Audit memo: 6

Balance Sheet

Note 3: Property, Plant and Equipment Rs. 70057.46 lakh

The above includes an amount of Rs. 69110.48 lakhs towards asset capitalized pertaining to rail corridor which includes various assets which are having significant value and should be depreciated considering separate useful life.

As per Ind AS 16, “Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately”. An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also

depreciates separately the remainder of the item. The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

Thus, it was observed that following assets grouped under rail corridor have been depreciated considering useful life based on progressive target traffic i.e. revenue generated during the year whereas, each assets are having separate useful life and having significant value and should be depreciated accordingly:

Particulars	Carrying amount as 31.03.2021 (Rs. in lakh)	Useful life (in years)	Depreciation as at 31.03. 2021 (Rs. in lakh)
Bridges	13826.17	30	643.99
Earthworks & Bridges	28465.19	30	1217.70
Station Building	1749.19	30	81.47
Ballast	1481.74	10	207.05
Sleeper	3878.27	20	270.96
Rails	10439.00	20	729.34
Signaling & Telecommunication works	2096.85	9	325.56
Electrical works	7257.95	10	1014.18
Total	69194.36		3114.78

Further, Ind AS 16 also states that “A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset”. Therefore, management should specifically present useful life of the asset based on its useful life and not on revenue basis. Hence, in the books, the total depreciation has been provided amounting to Rs. 83.88 lakh as at 31st March 2021 whereas, the depreciation should have been charged for Rs. 3114.78 lakh. Thus, there is short charging of depreciation by Rs. 3030.90 lakh (Rs. 3114.78 lakh - Rs. 83.88 lakh).

The building has been depreciated considering useful life based on the project life whereas, the useful life should be specifically mentioned in the Accounting Policy. It was also observed that in the accounting policy, it is mentioned that the commercial operation of the company is yet to begin whereas, the commercial operations have commercial operation date as on 12.10.2019.

Thus, non-accountal of the above considering separate useful life has resulted into overstatement of Property, Plant & Equipment and profit for the period from continuing operations and understatement of Depreciation by Rs. 3030.90 lakh.

Management Reply to Accounts Audit memo: 6

“The Company is a Special Purpose Vehicle constituted under the Participative Policy of Indian Railways, 2012 established for implementing the East Rail Corridor Project in the State of Chhattisgarh. The Project is being implemented based on the Joint Venture (JV) model of PPP projects under Concession Agreement (CA) with MoR.

Pursuant to the Concession Agreement entered into between SECR and the Company, Ministry of Railways through SECR has given the Company, the concession by way of

exclusive right, license and authority to construct, operate and maintain the rail system. By virtue of said concession, the Company shall have the right to use the site as a sole licensee and the Company would be under legal obligation to transfer the entire rail system to the Railways upon termination of the Concession Agreement.

It is pertinent to mention here that the model Concession Agreement applicable in case of SPVs derive its genesis from the BOT Model applicable for road projects. In case of road projects created under Build, Operate and Transfer (BOT) Model, or any other form of Public Private Partnership (PPP) route in case of road projects, Schedule II of the Companies Act, 2013 allows revenue-based amortization of the Assets i.e., Depreciation on the Asset created is based on Projected Revenue from Toll Collection till the end of the concession period. The amortisation amount or rate is such as to ensure that the whole of the cost of the asset is amortised over the concession period.

Following the similar method of charging Depreciation in case of BOT projects, the Project Assets (Rail Corridor) created by the Company (SPV) under the PPP Policy, 2012 (similar to BOT model) depreciation has been charged on the Assets based on the Targeted NTKM to be achieved by the Company till the end of Concession Period which is 30 years at present.

In respect of charging depreciation on the Project Assets, the Company has suitably incorporated the Accounting Policy which is reproduced hereunder:

“Expenses incurred by the Company on certain activities which are essential for construction, operation and maintenance of the Rail System of the Company are recognised as Rail Corridor under Construction till Commercial Operation Date (CoD). After CoD, including Stage wise CoD, the assets are classified as Rail Corridor and depreciated/ amortised based on the Agreed Targeted Traffic based on the Concession Agreement.”

In view of the above, the depreciation charged by the Company till date, i.e., Rs. 83.88 lakh is in line with the applicable provisions of the Companies Act, 2013.

In view of the facts stated above, the Company has noted the observations of C&AG and intends to refer the matter to C Ltd. through SE Ltd. for further directives and based on the directives received from C Ltd./SE Ltd., suitable treatment shall be carried out in the financial statements for F.Y. 2021-22.

In respect of charging depreciation on Building (other than Project Assets), policy of amortisation is life of the project and the disclosure has suitably been provided in Note-3 “Property, Plant & Equipment” that the Office Building taken on Outright basis from SIDCL is being depreciated considering the useful life of 30 years.

It is also to state that the Commercial Operation Date (COD) of the entire project is 30.09.2021. However, based on commissioning of 0 km - 45 Km section of Rail Line on 12.10.2019, it is considered as part commissioning of the project.

It is hereby assured that suitable changes shall be incorporated in the Accounting Policy.

In view of the above submissions, this audit para may kindly be dropped.”

During the Accounts Audit Meeting held between the C&AG Officials and the management on 16-06-2021, it was decided that management will take the views from the Ministry of Corporate Affairs and the Institute of Chartered Accountants of India (ICAI) through SE Ltd. /C Ltd. (holding company) for necessary treatment of depreciation on the assets pertaining to rail corridor.

This is to state that the Scheduled Commercial Operation Date of the entire Project is now 30.09.2022.

10. *Current Financial Year 2021-22: Observations of Statutory Auditors:*

During the current financial year, M/s ABC has been appointed as the statutory auditors of the Company for F.Y. 2021-22 wherein, the statutory auditors have conducted the limited review of financial statements for the half year ended 30-09-2021. In the Limited Review Report of 30-09-2021, without qualifying the Report, the statutory auditors have highlighted the following under the head 'Other Matters' which is reproduced as under:

- “1. The Company has been formed as a Special Purpose Vehicle of SE Ltd., I Ltd. and SIDC for development of rail corridor for transportation of coal between Kharsia and Dharamjaigarh districts of Chhattisgarh. As per clause 3.1.1 of the Concession Agreement entered with Ministry of Railways (through SECR), the Company has received by way of *exclusive right, license and authority* to construct, operate and maintain the rail system, excluding performance of the reserved services, for a period of 30 (thirty) years commencing from the Appointed Date.

The said Agreement is in the nature of Service Concession Agreement as prescribed under Appendix D to Ind AS 115, 'Service Concession Arrangements'. As per Clause 17 of the said Appendix, the right to construct, operate and maintain rail infrastructure should be recognized as an Intangible Asset instead of Property, Plant and Equipment and should be amortized over Targeted Traffic Method expected on Rail System over the period of license. Further, at each year end Management should revisit the expected traffic and make necessary adjustments so as the whole cost of rail infrastructure is amortized over license period.

Management has assured us that the matter shall be taken up with its Holding Company, SE Ltd. and necessary changes in classification and disclosures shall be made in the financial statements of ensuing Quarter.” (Emphasis supplied by the querist.)

11. Upon the remarks of the statutory auditors, the Company has gone through Appendix D to Ind AS 115. The important highlights are:

Appendix D to Ind AS 115 gives specific guidance on the accounting by the operator for service concession arrangements. 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.

Paragraph 11 of the said Appendix D provides treatment of the operator’s rights over the infrastructure as under:

“11 Infrastructure within the scope of this Appendix shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.”

Paragraphs 14-19 of the said Appendix D provide recognition criteria of the ‘construction service’ provided by the Operator or Concessionaire which is being reproduced hereunder:

“14 The operator shall account for construction or upgrade services in accordance with Ind AS 115.

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 license) 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.

19 The nature of the consideration given by the grantor to the operator shall be determined by reference to the contract terms and, when it exists, relevant

contract law. The nature of the consideration determines the subsequent accounting as described in paragraphs 23–26 of this Appendix. However, both types of considerations are classified as a contract asset during the construction or upgrade period in accordance with Ind AS 115.”

Schedule II of the Companies Act, 2013 also allows charging depreciation (including amortisation) on the basis of revenue method in case of intangible assets (Toll Roads) created under ‘Build, Operate and Transfer’, ‘Build, Own, Operate and Transfer’ or any other form of public Private partnership route in case of road projects. However, in case of intangible assets under the revenue-based method, amortisation is provided based on proportion of actual revenue earned till the end of the year to the total projected revenue from the intangible asset expected to be earned over the concession period. Total projected revenue should be reviewed at the end of each financial year and should be adjusted to reflect the changes in earlier estimate vis-à-vis the actual revenue earned till the end of the year so that the whole of the cost of the intangible asset is amortised over the concession period.

This is to reiterate that Clause 23.1 of the Concession Agreement provides that MoR shall pay to the Concessionaire (the Company) a sum equal to 50% (fifty percent) of the revenue apportionment from freight operations on the Rail System, determined in accordance with Inter Railway Financial Adjustment Rules, as the User Fee for using the Rail System.

B. Query

12. In view of the above submissions, the querist has sought the opinion of the Expert Advisory Committee of the ICAI on the following issues:

Whether the Company should continue the practice of classifying ‘Rail Corridor’ under Property, Plant & Equipment and the method of depreciation based on Targeted Traffic Method expected on Rail System over the period of license.

or

as opined by C&AG during the accounts audit, to classify the ‘Rail Corridor’ into the separately identifiable assets and then depreciate the individual separately identifiable assets considering the useful life of individual assets.

or

to classify the ‘Rail Corridor’ assets as a ‘Right to Use Asset’ under ‘Intangible Asset’ and continue the depreciation of assets based on Targeted Traffic expected on Rail System over the period of license and changing of Nomenclature from depreciation of ‘Rail Corridor’ to amortisation of ‘Right to Use Asset’ as opined by the statutory auditor during the Limited Review Report of September, 2021.

C. Points considered by the Committee

13. The Committee notes that the basic issues raised in the query relate to the accounting for the cost incurred on the Rail Corridor by the Company, particularly, the applicability of Appendix D, ‘Service Concession Arrangements’ to Ind AS 115, ‘Revenue from Contracts with Customers’ and the appropriateness of the method of depreciation/amortisation thereof. The Committee has, therefore, considered only these issues and has not considered any other issue that may arise from the Facts of the Case, such as, accounting for cost incurred on acquisition of land, detailed application of Appendix D, accounting for revenue sharing arrangement, depreciation on assets other than project assets, timing of capitalisation of

project assets and when these are available for use, accounting for project consultancy by I Ltd., accounting in the books of joint venturers or parent company, accounting for the service concession arrangement, etc. Further, the Committee has examined the issue only from accounting perspective, considering the requirements of Indian Accounting Standards (Ind ASs), notified under Companies (Indian Accounting Standards) Rules, 2015 and has not examined the legal or regulatory aspects arising from the Concession Agreement referred to by the querist. The Committee presumes from the Facts of the Case that the Company in the extant case is acting independently and not merely as an agent on behalf of the grantor.

14. The Committee notes the following requirements of Appendix D, 'Service Concession Arrangements' to Ind AS 115, 'Revenue from Contracts with Customers':

- "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.)

The Committee notes from the above that an arrangement within the scope of Appendix D to Ind AS 115 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. Further, a feature of these service arrangements is the public service nature of the obligation undertaken by the operator, i.e., the services related to the infrastructure to be provided to the public, *irrespective of the identity of the party that operates the services*.

In the extant case, although the Concession Agreement has been entered into between the Ministry of Railways and the Company, which is owned by Government companies, the Committee is of the view that the Appendix D would still be applicable even if it is ultimately controlled by the government, as the Company is providing the services related to the infrastructure (viz., rail corridor) to be provided to the general public; and is presumably acting independently and not as an agent on behalf of the grantor in respect of service concession arrangement (as mentioned in paragraph 13 above).

15. The Committee notes that the Concession Agreement with the MoR contains the following key terms and conditions:

- The Company has received an exclusive right, license and authority to construct, operate and maintain the Rail System, excluding performance of the Reserved Services, for a period of 30 years commencing from the Appointed Date and the Concessionaire hereby accepts the Concession and agrees to implement the Project subject to and in accordance with the terms and conditions set forth herein. (Clause 3.1.1)
- The Company is obliged or entitled to: (a) Right of Way, access and license to the Site for the purpose of and to the extent conferred by the provisions of this Agreement; (b) finance and construct the Rail System; (c) operate and maintain the Rail System; (d) receive the User Fee from MoR for using the Rail System or any part thereof; (e) perform and fulfil all of the Concessionaire's obligations under and in accordance with this Agreement; (f) bear and pay all costs, expenses and charges in connection with or incidental to the performance of the obligations of the Concessionaire under this Agreement; and (g) neither assign, transfer or sublet or create any lien or Encumbrance on this Agreement, or the Concession hereby granted or on the whole or any part of the Rail System nor transfer, lease or part possession thereof, save and except as expressly permitted by this Agreement or the Substitution Agreement. (Clause 3.1.3)
- The MoR is entitled to step into the project Agreements, at its sole discretion, in substitution of the Company in the event of termination or suspension. (Clause 5.2.5)
- The Company shall not undertake or permit any change in ownership, except with the prior written approval of the MoR. (Clause 5.3.1)

- It is expressly agreed that the licence granted hereunder shall terminate automatically and forthwith, without the need for any action to be taken by MoR to terminate the licence, upon the Termination of this Agreement for any reason whatsoever. For the avoidance of doubt, the Parties expressly agree that notwithstanding any temporary or permanent structures erected on the Site by the Concessionaire or its sub-licensees, the licence in respect of the Site shall automatically terminate, without any further act of the Parties, upon Termination of this Agreement. (Clause 10.2.4)
- The MoR, inter alia, undertakes to provide reasonable support and assistance to the Company; provide Railway Land to the Company, and undertake interconnection of the Rail System; and pay User Fee to the Company. (Clause 6.1.2)
- During the construction phase, the Company shall maintain, at its cost, the existing roads along the alignment of the Rail System (Clause 12.4.1)
- The MoR shall inter alia perform the following services at the Rail System: locomotion of trains, fixing of tariff for movement and handling of any traffic of Rail System; booking and delivery of Consignments; deputation of necessary staff, etc. (Clause 17.1.1)
- MoR shall retain 50% of the revenue apportionment from freight operations on the Rail System on account of cost incurred by MoR towards provision of Reserved Services, overhead cost, central charge and all costs incidental thereto (Clause 17.1.2)
- The Company undertakes that it shall, inter alia, at all times, during the Term: make the Rail System available to MoR and the Railway Staff for provision of Reserved Services; comply with all the rules and regulations prescribed by MoR; provide support and cooperation to MoR and Railway Staff. (Clause 17.6)
- In consideration of the grant of the Concession, the Company shall pay to MoR by way of concession fee a sum of Re. 1 per annum during the Term of this Agreement. (Clause 22.1.1)
- MoR shall pay to the Company 50% of the revenue apportionment from freight operations on the Rail System. (Clause 23.1.1)
- Upon Termination on expiry of the Concession period by efflux of time, no Termination Payment shall be due and payable to the Concessionaire, provided that in the event any Project Assets, essential for the efficient, economic and safe operation of the Rail System, shall have been acquired and installed after the 15th anniversary of the COD, with prior written consent of MoR, a Termination Payment equal to 80% of the Adjusted Depreciation Value of such Project Assets shall be made by MoR to the Company. (Clause 30.3.4)

Based on the above, the Committee notes that, under the Concession Arrangement, the MoR (the grantor) controls and regulates what services must be provided using the Rail System. The MoR also controls to whom the services must be provided using the Rail System and also determines the tariff, i.e., at what price the services are to be provided. Therefore, the criterion in paragraph 5(a) of Appendix D to Ind AS 115 is satisfied. Further, the MoR also controls significant residual interest in the Rail System at the end of the term of the Concession Agreement. Therefore, the criterion in paragraph 5(b) of Appendix D to Ind AS 115 is also satisfied. Therefore, the Committee is of the view that Appendix D to Ind AS 115 is applicable.

16. The next issue relates to classification of the consideration for the operator's construction services. In this regard, the Committee notes the following from the Appendix D to Ind AS 115 and Basis for Conclusions for International Financial Reporting Standards Interpretations Committee (IFRIC) Interpretation 12, 'Service Concession Arrangements', issued by the International Accounting Standards Board:

Appendix D

- “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.”

Basis for Conclusions

- “BC36 The IFRIC observed that the contractual rights that the operator receives in exchange for providing construction services can take a variety of forms. They are not necessarily rights to receive cash or other financial assets.
- BC37 The draft interpretation proposed that the nature of operator’s asset depended on who had the primary responsibility to pay the operator for the services. The operator should recognise a financial asset when the grantor had the primary responsibility to pay the operator for the services. *The operator should recognise an intangible asset in all other cases.*” (Emphasis supplied by the Committee.)

In the extant case, as per Clause 17.1.2 read with Clause 23.1.1 of the Concession Agreement, MoR (grantor) shall pay to the Company, 50% of the revenue apportionment from freight operations on the Rail System. Thus, the Company’s cash flows are dependent on usage of the system and the grantor neither contractually guarantees to pay the operator (the Company), specified or determinable amounts nor any shortfall between amounts received from users of the public service and specified or determinable amount. Therefore, in the extant case, the Company does not have an unconditional right to receive cash or other

financial asset and, accordingly, the Concession Agreement does not result in a financial asset for the Company; rather, it would result in an intangible asset for the Company.

17. With regard to the method of amortisation used by the Company, the Committee is of the view that since the concession arrangement in the extant case results into an intangible asset for the Company, the requirements of Ind AS 38, 'Intangible Assets' in respect of amortisation shall be applicable in the extant case. In this context, the Committee notes that Ind AS 38 provides as follows:

“7AA The amortisation method specified in this Standard does not apply to an entity that opts to amortise the intangible assets arising from service concession arrangements in respect of toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period as per the exception given in paragraph D22 of Appendix D to Ind AS 101.”

“Useful life

88 An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. ...”

“94 The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. ...

95 There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors.”

“Amortisation period and amortisation method

97 The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. ... The amortisation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. ...

98 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period, unless there is a

change in the expected pattern of consumption of those future economic benefits.

- 98A There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed. This presumption can be overcome only in the limited circumstances:
- (a) in which the intangible asset is expressed as a measure of revenue, as described in paragraph 98C; or
 - (b) when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.
- 98B In choosing an appropriate amortisation method in accordance with paragraph 98, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (i.e. time), as a number of units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortisation, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits.
- 98C In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortisation. For example, an entity could acquire a concession to explore and extract gold from a gold mine. The expiry of the contract might be based on a fixed amount of total revenue to be generated from the extraction (for example, a contract may allow the extraction of gold from the mine until total cumulative revenue from the sale of gold reaches Rs.2 billion) and not be based on time or on the amount of gold extracted. In another example, the right to operate a toll road could be based on a fixed total amount of revenue to be generated from cumulative tolls charged (for example, a contract could allow operation of the toll road until the cumulative amount of tolls generated from operating the road reaches Rs.100 million). In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortising the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortisation is to be determined.”

“Review of amortisation period and amortisation method

- 104 The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial**

year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. ...”

The Committee further notes that Schedule II to Companies Act, 2013 states the following:

“3²[(ii) For intangible assets, the relevant Indian Accounting Standards (Ind AS) shall apply. Where a company is not required to comply with the Indian Accounting Standards (Ind AS), it shall comply with relevant Accounting Standards under Companies (Accounting Standards) Rules, 2006], except in case of intangible assets (Toll Roads) created under ‘Build, Operate and Transfer’, ‘Build, Own, Operate and Transfer’ or any other form of public private partnership route in case of road projects. Amortisation in such cases may be done as follows ...”

Furthermore, the Guidance Note on Accounting for Depreciation in Companies in the context of Schedule II to the Companies Act, 2013, issued by the Institute of Chartered Accountants of India (ICAI) states the following:

Intangible Assets

“42. The Ministry of Corporate Affairs (MCA), vide its notification G.S.R. 237 (E) dated March 31, 2014, made amendments to clause (ii) of paragraph 3 of Schedule II with regard to amortisation of intangible assets. Through the amendments, the MCA provides that revenue-based methodology ‘**may be**’ used for amortisation of intangible assets (**Toll Roads**) created under ‘Build, Operate and Transfer’(BOT), ‘Build, Own, Operate and Transfer (BOOT)’ or any other form of public private partnership (PPP) route in case of road projects.

43. The words ‘**may be**’ used in clause (ii) of paragraph 3 of Schedule II indicates that revenue-based amortisation as provided in Schedule II is optional and not mandatory. Moreover, the option is available only for intangible assets arising from toll road projects. Therefore, a company can follow a basis other than revenue-based amortisation for intangible assets arising from toll road projects. Intangible assets other than those arising from toll-roads should be amortised in accordance with Accounting Standards (AS) 26, *Intangible Assets*, notified under the Companies (Accounting Standards) Rules, 2006.”

Ind AS 101 states the following:

“D22 A first-time adopter may apply the following provisions while applying the Appendix D to Ind AS 115:

- (i) Subject to paragraph (ii), changes in accounting policies are accounted for in accordance with Ind AS 8, ie retrospectively, except for the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.
...”

² Substituted for “(ii) For intangible assets, the provisions of the accounting standards applicable for the time being in force shall apply” vide Notification No. GSR 1075(E), dated 17-11-2016, w.r.e.f. 1-4-2016.

On a harmonious reading of the above requirements, the Committee notes that, the option in Schedule II to the Companies Act, 2013 permitting use of revenue-based amortisation method for BOT road projects does not apply in case of Ind AS compliant companies. This exception only applies to companies following Companies (Accounting Standards) Rules, 2021³. However, paragraph 7AA of Ind AS 38 read with paragraph D22 of Ind AS 101 provides an exemption to a first-time adopter of Ind AS to continue with the policy adopted for amortisation of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. The Committee is of the view that such option under Schedule II as well as under Ind AS 101 are only applicable in case of intangible assets arising from toll road projects and not for any other projects. Accordingly, these options cannot be extended to railway infrastructure in the extant case.

18. With regard to amortisation of intangible asset in the extant case, the Committee notes the following paragraphs from the Concession Agreement:

EFFECT OF VARIATIONS IN TRAFFIC GROWTH

24.1 Effect of variations in traffic growth on the Concession Period

24.1.1 The Parties acknowledge that the total NTKM during the Concession Period as [on the effective date] is estimated to be 123825.88 MTKm (the “**Target Traffic**”).

24.1.2 In the event that, as on expiry of 25th (twenty fifth) year after Appointed Date the actual NTKM shall have fallen short of the Target Traffic by more than [4% (four per cent)] thereof or exceeded the Target Traffic by more than [4% (four per cent)] thereof, the Concession Period shall be deemed to be modified in accordance with Clause 24.2. For the avoidance of doubt, in the event of any Dispute relating to actual NTKM, the Dispute Resolution Procedures shall apply.

24.2 Modification in the Concession Period

24.2.1 Subject to the provisions of this Clause, in the event actual NTKM shall have fallen short of the Target Traffic, then for every 2% (two per cent) shortfall or part thereof as compared to the Target Traffic, the Concession Period shall be increased by 6(six) months or part thereof; provided that such increase in Concession Period shall not in any case exceed 5 (five) years.

24.2.2 Subject to the provisions of Sub-clause 24.1.1 above, in the event actual NTKM shall have exceeded the Target Traffic, then for every 2% (two per cent) excess or part thereof as compared to the Target Traffic, the Concession Period shall be reduced by 6 (six) months or part thereof; provided that such reduction in Concession Period shall not in any case exceed 5 (five) years."

³ In respect of accounting period(s) commencing on or after April 1, 2021, Companies (Accounting Standards) Rules, 2006 (as amended from time to time) have been superseded by Companies (Accounting Standards) Rules, 2021.

The Committee notes that under Ind AS 38, there is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. In the extant case, the term of the Concession Agreement is fixed (though in terms of a range of period depending upon achievement of the target traffic) and the Company's right to operate the rail line system is not based on a fixed total amount of revenue to be generated from tariff charged. Therefore, revenue is not established as the predominant limiting factor in the contract for the use of the intangible asset. Therefore, criterion (a) in paragraph 98A of Ind AS 38 is not met in the extant case. Criterion (b) of paragraph 98A is also not satisfied as, even in case of nil revenue in a period during the concession period due to no traffic (for example, due to maintenance work), there would still be consumption of economic benefits (the concession right) from the perspective of the Company, for example, due to efflux of time.

19. The Committee notes that the Company is following depreciation policy based on the Agreed Targeted Traffic based on the Concession Agreement. The Committee notes that as per the requirement of Ind AS 38, the amortisation method is to be selected on the basis of the expected pattern of consumption of the expected future economic benefits embodied in the asset over its useful life. Further, the useful life is influenced by both the economic and legal factors and it cannot exceed the period of contractual or legal rights. In the extant case, if the Company achieves the Target Traffic before/after the originally stated concession period of 30 years, the concession period is reduced/increased as per clause 24.1 of the Concession Agreement. The Committee notes that even though, to some extent, the length of concession period depends upon achievement of target traffic mentioned in the Agreement, the concession period or the period for the use of intangible asset is not solely or primarily dependent on the traffic as the concession period (as mentioned in clause 24.2.1 and 24.2.2 of the Concession Agreement) cannot be more or less than 5 years of the total originally stated concession period of 30 years. Although the target traffic may extend or shorten the concession period by a maximum period of 5 years, concession period is still fixed in terms of a range of period and the consumption of economic benefits from the intangible asset by the Company is uniform throughout such period. For instance, if the target traffic is achieved in say over 20 years, still the Company has the right over the intangible asset for another 5 years. Similarly, if the target traffic is not achieved even after 35 years, the right over intangible asset shall not be carried beyond 35 years. Thus, although target traffic may be used as one of the factors while determining (estimating) the useful life initially and for the annual review of the remaining useful life of the intangible asset (as per paragraph 104 of Ind AS 38) in the extant case, the same cannot be considered as the sole basis of amortisation of the intangible asset.

Therefore, the Committee is of the view that the Company's current depreciation/amortisation method, which appears to be based solely on targeted traffic, is not in compliance with the requirements of Ind AS or Schedule II for the reasons mentioned above. The Company should determine and follow an appropriate amortisation method in accordance with the requirements of Ind AS 38 based on the estimated useful life of the intangible asset falling within the range of the term of the Concession Agreement and should be reviewed annually for any change in the useful life.

20. The Committee also wishes to point out that since the Company's accounting treatment in the extant case is not in accordance with the accounting treatment discussed above, the Company should rectify the same in accordance with the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' considering it as a prior period error.

D. Opinion

21. The Company's current classification of rail system infrastructure and method of depreciation/amortisation is not in compliance with the requirements of Ind AS.

Appendix D to Ind AS 115 is applicable to the Concession Agreement with MoR for reasons mentioned in paragraphs 14 and 15 above. Under the said Appendix, the Concession Agreement would result in intangible asset for reasons mentioned in paragraph 16 above. The Company should accordingly apply the recognition and measurement requirements of the Appendix. The Company's current depreciation/amortisation method based on target traffic is not in compliance with the requirements of Ind AS or Schedule II to the Companies Act 2013, for the reasons mentioned in paragraphs 17 to 19 above. The Company should determine and follow an appropriate amortisation method in accordance with Ind AS 38, as discussed in paragraph 19 above.
