

Query No. 13

Subject: Recognition of Leased Project Assets as Identified Assets as per Ind AS 116.¹

A. Facts of the Case

1. A Corporation (hereinafter referred to as ‘the Corporation’ or ‘the Company’) is a Public Sector Undertaking (PSU) under the administrative control of the Ministry of Railways (MoR) with 86.36% of equity being held by the Government of India (GoI). The Corporation was set up on 12th December, 1986 as the dedicated financing arm of the Indian Railways for mobilising funds from domestic as well as overseas capital markets. It is also registered as Systemically Important Non-Deposit taking Non-Banking Financial Company (NBFC – ND-SI) and Infrastructure Finance Company (NBFC- IFC) with the Reserve Bank of India (RBI). In more than 30 years of its existence, the Company has played a significant role in supporting the expansion of the Indian Railways and related entities by financing a significant proportion of its annual plan outlay.

2. The primary objective of the Corporation is to meet the predominant portion of ‘Extra Budgetary Resources (EBR)’ requirement of the Indian Railways through market borrowings at the most competitive rates and terms. The Company’s principal business therefore is to borrow funds from the financial markets for acquisition / creation of assets which are then leased out to the Indian Railways under finance lease arrangements.

3. The querist has stated that the Company has adopted the Companies (Indian Accounting Standards) Rules, 2015 (as amended) with the date of transition as 1st April 2017. All its leases, as a Lessor, in the past have been classified as finance leases in accordance with Indian Accounting Standard (Ind AS) 17 / Ind AS 116, ‘Leases’.

4. The Company (hereinafter also referred to as ‘the Lessor’) had entered into a Memorandum of Understanding (MoU) on May 23, 2017 with the Ministry of Railways, Government of India (hereinafter referred to as ‘the Lessee’) for financing of certain infrastructure projects. Subsequently, this MoU has been amended vide a fresh MoU dated 2nd March 2021 but effective from 1st May 2020. Accordingly, pursuant to the MoU dated May 23, 2017 and March 02, 2021, the Company has agreed to lease out the said ‘Infrastructure Assets’ to the MoR and the MoR has agreed to take the same on lease subject to the detailed terms and conditions.

5. The Lease Agreement has been executed on 28th March 2022 for leasing of the identified project assets with the MoR. It has been structured keeping in view the route of ‘Finance Lease’ available with the Company. This Lease Agreement has been duly vetted by the Ministry of Railways as well as the Ministry of Law. The Schedule I of Lease Agreement, explicitly provides the details of the railway projects/assets and nature of assets created (under ‘Plan Head’) which are being leased to the MoR. The Company does not have any substitution right over these assets as envisaged under Ind AS 116. Further, the assets or proportion of assets listed in the Schedule I represents the entire capacity of the asset. It thereby provides the MoR with the right to obtain all the economic benefits from the use of the asset.

¹ Opinion finalised by the Committee on 8.5.2023.

6. The querist has further stated that the said assets listed in Schedule I have been identified by the Lessee. Lessee has given acknowledgement that the ‘Identified Project Assets’ are in accordance with the parameters as desired by Lessee. Lessor in no way can substitute these assets. All the economic benefits from the project assets flow to MoR only. Accordingly, these assets are identified assets as per provisions of Ind AS 116. Hence, the Lease Agreement executed complies with all the requirements of Ind AS 116 to classify it as finance lease and which has to be recognised, measured, presented and disclosed as per Ind AS 116.

7. The querist has also stated that being a PSU, the Company is also subject to regular annual audit by the Comptroller & Auditor General of India (C&AG). The C&AG during the course of their audit have observed that in their view, the project assets mentioned in the agreement do not qualify to be ‘Identified Asset’ as per paragraph 9 of the Ind AS 116.

Accounting treatment being followed by the Company for funding of Project Assets to the MoR prior to execution of Lease Agreement

8. The pre-lease disbursements including interest accrued on it are accounted for as a financial asset (classified under ‘other financial assets’ as ‘Project Infrastructure Asset’ under Finance Lease Arrangement/Advance funding against projects). The same has been accounted for in line with an earlier opinion received by the Corporation from the Expert Advisory Committee (EAC) (published as Query No. 1 of the Compendium of Opinions, Volume XL (Part II)). Accordingly, the under-construction assets are not recognised in the books as work in progress (WIP).

In the earlier opinion to the Corporation on ‘Classification of Advances for Infrastructure Projects to be leased’, the EAC opined that, the classification of the pre-lease disbursements including interest accrued on it as ‘Other financial assets’, as presented by the Company was appropriate. The Opinion also stated that “...It is only after the commencement of lease, the pre-lease disbursement shall be considered for valuation of ‘Finance Lease Receivable’, considering it as advance paid to the developer for construction of the asset. ...”

9. The querist has reproduced the relevant paragraphs of Indian Accounting Standard (Ind AS) 116, ‘Leases’ as under:

“9 At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs B9–B31 set out guidance on the assessment of whether a contract is, or contains, a lease.”

“B9 To assess whether a contract conveys the right to control the use of an identified asset (...) for a period of time, an entity shall assess whether, throughout the *period of use*, the customer has both of the following:

- (a) the right to obtain substantially all of the economic benefits from use of the identified asset (...); and
- (b) the right to direct the use of the identified asset (...).”

The querist has mentioned that it is not in dispute that the MoR (a) has right to obtain substantially all of the economic benefits from the use of the asset and (b) has the right to direct the use of the asset.

As per paragraph B13 of Ind AS 116, “An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer”.

Further as per paragraph B20 on ‘Portions of assets’, “A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it *represents substantially all of the capacity of the asset* and thereby provides the customer with the *right to obtain substantially all of the economic benefits* from use of the asset”.

(Emphasis supplied by the querist.)

10. Briefly, the matter has been illustrated by the querist as under:

- MoR decides to develop/construct an infrastructure asset, say, railway track of 200 km between locations A and B costing Rs. 500 crores out of which MoR share is 20% and balance 80% is developed/constructed by the Company. This 80% is then leased to MoR in its entirety. However, out of 200 km, it cannot be physically identified as to which 20% is constructed/owned by MoR and which 80% is constructed/owned/finance leased by the Company.

In the present case, the Company has leased to MoR, its entire share of asset owned/constructed by it to MoR. The entire capacity of the asset also gets leased to the MoR by the Company. This 80% is an identified asset. MoR owns 20% of the asset is of no significance for the purpose of definition of ‘identified assets’ so far as the Company is concerned.

In the querist’s opinion, all the conditions of Ind AS 116 for an asset to be an ‘identified asset’ stands complied with. The Company has no substitution rights. The entire capacity of identified asset is leased to MoR. MoR is provided with all the rights to obtain substantially all of the economic benefits from the use of the asset. The project assets are identified assets which are leased to MoR under finance lease arrangement as per Lease Agreement entered between MoR and the Company.

B. Query

11. On the basis of above, the Expert Advisory Committee is requested to give its opinion as to:

- (i) Whether each of the project assets as specified in Schedule I of the Lease Agreement is an identified asset and a lease exists which has to be accounted for as per Ind AS 116.
- (ii) If not, what further details should be incorporated in the said Lease Agreement so that each of these project assets are identified assets and a lease exists which has to be accounted for as per Ind AS 116.

C. Points considered by the Committee

12. The Committee notes that the basic issues raised by the querist relate to whether each of the specified project assets are identified asset and lease arrangement exists as per Ind AS 116. The Committee has, therefore, considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, classification as finance lease or operating lease by the lessor, examining whether the Company is acting as an agent or principal under the said arrangement, accounting for assets under construction, recognition and measurement of lease asset/receivable, recognition and measurement of interest earned on pre-lease disbursements, accounting for borrowing costs on funds borrowed, accounting treatment under Ind AS 17, whether the asset constructed is PPE for the Company, whether the arrangement falls under the ambit of 'Service Concession Arrangements' as per Appendix D to Ind AS 115, 'Revenue from Contracts with Customers' etc. Further, the Standards referred to in the opinion are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended or revised from time to time.

At the outset, the Committee understands from the Facts of the Case that infrastructure asset(s), say, railway track of 200 km between locations A and B is being developed/constructed, in which, say, MoR's share is 20% and the balance 80% is owned by the Company. This 80% is then leased to MoR in its entirety. Hence, the Company has leased its entire share of asset owned/constructed by it to the MoR and the entire capacity of the asset is being used by the MoR either through ownership or lease from the Company. The Committee has, therefore, considered the issue only in this scenario, and has not considered other scenarios which may arise, such as, the Company has not leased its entire share of asset owned/constructed by it to the MoR and the entire capacity of the asset is not being used by the MoR. For the purpose of this query, the Committee has also assumed that the Company is acting as a principal under the arrangement, the asset constructed is PPE for the Company and the arrangement does not fall under the ambit of 'Service Concession Arrangements' as per Appendix D to Ind AS 115, 'Revenue from Contracts with Customers.'

13. The Committee notes that Ind AS 116, 'Leases' and 'Basis for Conclusions' on International Financial Reporting Standard (IFRS) 16, 'Leases' (which is the corresponding International Standard of Ind AS 116), issued by the International Accounting Standards Board (IASB) states as follows:

“9 At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. ...”

“Identified asset

B13 An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.

Substantive substitution rights

B14 Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset

throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

- (a) the supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
- (b) the supplier would benefit economically from the exercise of its right to substitute the asset (ie the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset)."

"B19 If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

Portions of assets

B20 A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset."

Basis for Conclusions on IFRS 16, 'Leases'

"Identified asset

BC111 The first requirement for a contract to meet the definition of a lease in IFRS 16 is that a customer should control the use of an identified asset. The requirement for an identified asset is substantially the same as the requirement in IFRIC 4 for the contract to depend on the use of a specified asset. It is important to know what the asset is in order to assess whether the customer has the right to control the use of that asset and, for example, to determine which asset finance lessors should derecognise. Nonetheless, when assessing at the inception date whether there is an identified asset, an entity does not need to be able to identify the particular asset (for example, a specific serial number) that will be used to fulfil the contract to conclude that there is an identified asset. Instead, the entity simply needs to know whether an identified asset is needed to fulfil the contract from commencement. If that is the case, then an asset is implicitly specified. IFRS 16 clarifies that an asset can be implicitly specified at the time that the asset is made available for use by the customer."

The Committee notes from the above that under Ind AS 116, an arrangement contains a lease if there is an identified asset. An asset may be explicitly specified in a contract or it can also be identified by being implicitly specified at the time that the asset is made available for use by the customer. Further, BC 111 explains that when assessing at the inception date, whether there is an identified asset, an entity does not need to be able to identify the particular asset (for example, a specific serial number) that will be used to fulfil the contract to conclude that

there is an identified asset. Instead, the entity simply needs to know whether an identified asset is needed to fulfil the contract from commencement. If that is the case, then an asset is implicitly specified.

In this regard, the Committee notes that the Project Lease Agreement defines the Infrastructure assets as assets that are developed/created/installed under the agreement as part of railway project listed in Schedule I. Schedule I to the Project Lease Agreement submitted by the querist enlists the Railway Projects or National Projects executed under Extra Budgetary Resources - Institutional Finance (EBR-IF) during 2015-16 or National Projects 2018-19. The list identifies the name and detail of the project assets that are the subject matter of the Lease Agreement as well as the Company's share in the project/assets. The Committee also notes that in the extant case, the Company has leased its entire share of asset owned/constructed by it to MoR and the remaining portion of the asset is owned by MoR itself. Thus, the MoR gets the entire capacity of the asset through lease and ownership and the same will be used by the MoR throughout the period of use. The Committee further notes the following relevant clauses from the Project Lease Agreement:

- Clause B7 of the Project Lease Agreement inter alia states that “The Lessee acknowledges, represents, declares, agrees and confirms that- (i) The Infrastructure Assets is of the required size, design capacity and construct suitable for its purpose and is selected by the Lessee relying entirely on its own judgment and not on statements or representation if any, made by the Lessor or its agents or servant. Further, the Lessor is not dealing in the constructions of the Infrastructure Assets and has not made or given... any representation, warranty or condition or any statement relating to the Infrastructure Assets or its fitness or quality or otherwise”.
- Further Clause B4 (ii) of the Agreement states that the Lessee shall make payment in respect of Infrastructure Assets without any deductions or abatement whatsoever irrespective of whether the Infrastructure Asset is, inter alia, taken off the line owing to total loss/ damage caused for any reason whatsoever. Clause B4(vi) states that in the event of loss /damage of the Infrastructure caused due to accident, fire, etc. the same shall be borne by the Lessee. In case of total loss/damage, the Lessee shall have the option to pay to the Lessor the depreciated value of the Infrastructure asset mutually agreed upon between the Lessee and the Lessor.
- Further, as per Clause B10, if at any time during the currency of the Agreement, the lessor terminates its operations, the ownership of the Infrastructure assets shall stand transferred to the Lessee at mutually agreed price.

From the above clauses, the Committee notes that the infrastructure assets leased out under the Agreement are of required size, design capacity and construct, suitable for the purpose of the lessee and are selected by the lessee. Further, it appears from the MoU and the Lease Agreement that all development work of the infrastructure asset is undertaken by the lessee itself (though for and on behalf of the Company). This indicates that the asset has been explicitly designed and built as per the requirements of the lessee and the same is also acknowledged by the lessee.

14. The Committee further notes that as per paragraph B14 under Ind AS 116, even if the asset is specifically identified, a customer does not have the right to use the identified asset, if at inception of the contract, a supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive when both of the following conditions are met:

- the supplier has the practical ability to substitute alternative assets throughout the period of use (e.g. the customer cannot prevent the supplier from substituting an asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
- the supplier would benefit economically from the exercise of its right to substitute the asset (ie the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

In this regard, the Committee notes from Clause B7(i) of the Project Lease Agreement that the lessor, i.e., the Company does not appear to be dealing in construction of infrastructure assets and therefore has not given any representation, warranty, condition or statement relating to the infrastructure assets or fitness or quality. Further, it is noted from various clauses of the Agreement that the Company being lessor in the extant case does not have the right of substitution even in case of loss, damage etc. to the asset and the same is ultimately sold or transferred to the lessee. Therefore, the above conditions under paragraph B14 of Ind AS 116 are also not fulfilled. Moreover, none of the clauses in the Agreement suggests that the Company has any substitution rights during the tenure of the Agreement and thus, the Company in the extant case does not have the substantive right to substitute the asset(s) throughout the period of use as per the requirements of Ind AS 116. Therefore, the asset specified in the lease will be used to fulfil the contract in the extant case. Hence, even though the asset(s) may not be physically distinct, the Committee is of the view that the asset(s) is(are) implicitly specified and is(are) identified asset(s) under Ind AS 116; and the arrangement is, or contains, a lease (provided it meets the other conditions for lease).

15. With regard to other conditions for classification as lease, the Committee notes from paragraph 9 of Ind AS 116 reproduced above that **“A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration”**. As to whether the contract in the extant case conveys the right to control the use of the identified asset, the Committee notes that Ind AS 116 states as follows:

“B9 To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs B13–B20) for a period of time, an entity shall assess whether, throughout the *period of use*, the customer has both of the following:

- (a) the right to obtain substantially all of the economic benefits from use of the identified asset (as described in paragraphs B21– B23); and
- (b) the right to direct the use of the identified asset (as described in paragraphs B24–B30).”

“B21 To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realised from a commercial transaction with a third party.

B22 When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a customer's right to use the asset (see paragraph B30). For example:

- (a) if a contract limits the use of a motor vehicle to only one particular territory during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle within that territory, and not beyond.
- (b) if a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle for the permitted mileage, and not beyond.”

“Right to direct the use

B24 A customer has the right to direct the use of an identified asset throughout the period of use only if either:

- (a) the customer has the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs B25–B30); or
- (b) the relevant decisions about how and for what purpose the asset is used are predetermined and:
 - (i) the customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
 - (ii) the customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.”

From the above, the Committee notes that a customer's right to control the use of an identified asset depends on its right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use. In this regard, the Committee notes that the Project Lease Agreement submitted by the querist states as follows:

- As per Clause B3(a), the Lessor has agreed to give and the Lessee has agreed to take on Lease, the Infrastructure Assets as detailed in Schedule I to this Agreement for the Lease Period as detailed in Schedule II subject to the terms and conditions, covenants and stipulations contained herein and in the schedules hereunder.
- As per Clause B4 (ii), the lessee shall make such payment in respect of all the infrastructure asset as specified in Schedule I.
- As per Clause B5(b) (iv), the Lessee shall use and operate the Infrastructure Assets in a normal way and maintain the same in good working condition and repair at its own cost and expenses in conformity with the instructions in the relevant operational manual and standard maintenance practices.

In the extant case, the Company has leased its entire share of asset owned/ constructed by it to MoR and the remaining portion of the asset is owned by MoR itself. Therefore, the MoR gets

the entire capacity of the asset through lease and ownership. Thus, the lessee (customer) has the exclusive right to use the asset throughout the lease period. Further, as discussed in paragraph 13 above, since in the extant case, the asset has been developed considering the requirements of the lessee, it provides the customer or the lessee with the right to obtain substantially all of the economic benefits from use of the asset. Also, since the asset has been explicitly designed and built as per the requirements of the lessee and lessee also has the right to use and operate the identified asset, it can be concluded that the lessee or the customer has the right to direct how and for what purpose the asset is used throughout the period of use.

Accordingly, the Committee is of the view that the Project Lease Agreement in the extant case conveys the right to control the use of an identified asset for a period of time in exchange for consideration and therefore, is or contains a lease as per the requirements of Ind AS 116. The Committee is of the view that since in the arrangement in the extant case, the lessee, viz., MoR has the right to control the use of an identified asset throughout the period of use, it would be inappropriate to conclude that the contract does not contain a lease on the ground that lessee has rights to a non-physically distinct portion of an underlying asset. In the extant case, since under the lease arrangement, the MoR has the right to substantially all of the economic benefits from the use of the underlying asset(s) and can also unilaterally direct its (their) use, the same is or contains a lease.

D. Opinion

16. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 11 above:

- (i) Each of the project assets as specified in Schedule I of the Lease Agreement is an identified asset, as discussed in paragraphs 13 and 14 above. Since the Lease Agreement conveys the right to control the use of identified assets for a period of time in exchange for consideration, a lease exists as per Ind AS 116, for reasons mentioned in paragraph 15 above.
- (ii) This issue does not involve any accounting and/or auditing principle and therefore, cannot be answered by the Committee.
