

Query No. 22

Subject: Accounting treatment for Energy Service Project under Ind AS framework.¹

A. Facts of the Case

1. A public sector company (hereinafter referred to as ‘the Company’) is engaged in providing energy efficiency services and has entered into various agreements with its customers for implementation of various business projects including energy efficient street lights, bulbs and other appliances, advanced metering infrastructure, solar projects, electric vehicle charging infrastructure (EVCI) etc. in exchange of consideration against fulfilling its performance obligations (i.e. providing energy savings/ billing efficiency/ cost savings etc. as per the agreements with the clients). The clients include various Urban Local Bodies (ULBs), Distribution Companies (DISCOMs) and other public/private sector enterprises.

The Company prepares its financial statements in line with the principles laid down by the Indian Accounting Standards (Ind AS), notified by the Ministry of Corporate Affairs. Debt securities issued by the Company are listed on Bombay Stock Exchange.

2. The Company has been installing Energy Service Company (ESCO) projects for the clients and recovers revenue over the life of the project based on a comprehensive financial model that inter-alia incorporates cost of equipment, cost of IDC (Infrastructure Development Components), cost of dismantling, installation and commissioning, finance cost, project monitoring charges and return on equity. The life of the project is determined based on mutual agreement with the client.

3. *Audit query paragraph raised by the Comptroller and Auditor General of India (CAG) audit team is as below:*

(I) Paragraph 61 of Ind AS 116, ‘Leases’ stated that a lessor shall classify each of its leases as either an operating lease or a finance lease. Further, in light of paragraph 63 of Ind AS 116, a lease should be classified as a finance lease if the lease transfers ownership of the underlying assets to the lessee by the end of the lease term or the lease term is for the major part of the economic life of the underlying asset even if the title is not transferred.

(II) However, as per contract agreement signed with the respective customers, either the asset will be transferred to the customer at the end of the contract period; or the assets are held under the lease term for its major useful life. Therefore, the operation of the Company under ESCO model should be classified as finance lease in line with Ind AS 116.

Brief of the Issue raised:

4. The Company has installed ESCO Project (Street Lights) spread across the nation and has entered into agreements with the clients that provide for the payment terms, deliverables, penalty/ liquidated damages, quantity and quality, period and disposal of assets etc. The above arrangements with the client for energy efficiency services are unique in nature and typically observed only in ESCO industry. Thus, these contracts were evaluated to ensure that the

¹ Opinion finalised by the Committee on 31.7.2023.

accounting treatment adopted for such agreements provides a true and fair presentation of such business transactions.

The querist has presented a summary of project (Street Lights) enlisting various important terms of the agreement and the accounting treatment that the Company has adopted for the project as follows:

Street Lighting Projects

| Sr. | Particulars | Description |
|-----|--------------------------|---|
| a. | Type of Businesses | Street Lighting Programme |
| b. | Life of Project | 7 years – Life of the project here does not correspond with the actual expected useful life of the equipment , but with the mutually agreed upon tenure of the project as per the agreement with the customers. There may be instances, where the equipment becomes obsolete before the expiry of the project tenure or keeps performing well even after the expiry of the same. |
| c. | Revenue Generation | The revenue accruing to the Company is linked to the deemed energy savings (performance obligation). |
| d. | Performance Obligations | As per terms of contract, the cost recovery under such contracts is being done by monetising cost savings achieved through retrofitting of conventional streetlights fixtures with LED streetlight fixtures. The purpose of the contract is to provide services in the form of deemed energy cost savings to the customer. This service comprises of supply, installation, warranty, and annual maintenance service all combined, as these goods and services are not distinct in the context of the contract. |
| e. | Trade practice | As per industry practices, old equipment is dismantled at the same time when the new one is being installed and the new assets are capitalised in books of account. |
| f. | Test to rule out 'Lease' | i) Identified Asset: The assets (street lights) are interchangeable/replaceable by the Company to ensure service delivery, at its discretion, as per terms of agreement. However, the cost of replacing such assets will exceed the economic benefits of substitution (other than in case of damage/repair etc.). Thus, the Company's right to substitute the asset is not substantive and therefore, an <i>identified asset exists</i> . ii) Economic Benefits: <i>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. The economic benefits from the use of an asset include its primary output and by-products and other economic benefits from using the asset that could be</i> |

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| | | <p><i>realised from a commercial transaction with a third party.</i></p> <p>The economic benefits from use of an asset include its primary output and by-products and other economic benefits from using the asset that could be realised from a commercial transaction with a third party. All the output produced from these assets in the form of energy savings is flowing to the single customer (ULBs), therefore, this condition is met.</p> <p>iii) Right to direct the use of identified asset: <i>The customer has the right to direct how and for what purpose the asset is used throughout the period of use.</i></p> <p>No, since the lights are installed to deliver a predefined output in terms of energy savings.</p> <p>How and for what purpose the asset is used are predetermined and:</p> <p>(a) <i>The customer has the right to operate the asset throughout the period of use, without the supplier having the right to change those operating instructions.</i> No, the assets are operated by the Company directly and the customer has no right to operate.</p> <p>(b) <i>The customer designed the asset in a way that predetermines how and for what purpose the asset will be used throughout the period of use.</i> No, the customer has no role in designing the product.</p> <p>(c) <i>The customer can change how and for what purpose the asset is used throughout the period of use.</i> No, the customer has no right to change the purpose the asset is used.</p> <p>In view of the above, <i>the third condition is not met.</i> Since all three conditions do not meet, Street Lighting Project does not qualify as a lease and should not be accounted for in line with Ind AS 116.</p> <p><u>Detailed Explanation:</u></p> <p>Under this condition, how and for what purpose decisions relating to the use of assets are (rights to change the type of output, when/ where/ whether the output is produced, and quantity of output produced) pre-determined. Energy savings are initially estimated by the Company basis client's requirements and accordingly, suitable technical specifications/ replacement wattages of lights are decided. As per the agreement with the client, the Company is responsible for ensuring agreed energy saving and maintaining minimum uptime for the streetlights. Once the lights are installed, the operation and maintenance of streetlights is the responsibility of the Company during the project period, thus the Company has control to direct the use of identified assets. The Company decides and controls the hours</p> |
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| | | <p>of operations in line with the agreement and the general guidance issued by Bureau of Energy Efficiency (BEE) in the National Lighting Code. The Company through the CCMS system (installed by the Company, specifically for monitoring) monitors and keeps controls over the energy usage, non-glowing lights etc. which directly affects the ultimate output expected by the client, i.e., energy savings. In the areas where CCMS system is pending to be installed, the Company hires a person/ agency for operating the streetlights manually. The operating instructions are controlled by the Company. Further, the Company is also responsible for managing a complaint handling system for the streetlights and make rectification of defective lights based on public complaints. <i>Thus, the Company has the right to operate the asset in the manner it seems fit to provide agreed energy savings to the client.</i></p> <p><i>Therefore, the Company has the right to direct the use of streetlight and the arrangements are not covered under the scope of Ind AS 116.</i></p> |
| g. | Essence of the agreement | <p>The agreement with the client stipulates various service-level agreements (SLAs) to be fulfilled and the failure may result in levying liquidated damages as provided in the terms of the agreement.</p> <p>Thus, there may be instances where equipments installed under ESCO projects require repair, maintenance, or replacement during the tenure of the project. This feature of the agreement emphasises that notwithstanding the status of the equipment, the essence of the agreement is the <i>service delivery in terms of energy savings to the clients.</i></p> |
| h. | Accounting Treatment | <p>The ESCO assets installed deliver long-term benefits to the Company in form of revenue recognised over the life of the project.</p> <p>The cost of the equipment, dismantling, installation and commissioning, ancillary items consumed during the installation i.e., infrastructure development components (IDC), interest during construction and incidental expenses (overheads) directly attributable to such installation of ESCO asset is accumulated and once the completion certificate is received from the client, the cost so accumulated is capitalised and the energy saving revenue invoicing is started.</p> <p>As described in the Trade Practices section above, the cost of dismantling is also borne by the contractor installing new lights (in this case, ‘the Company’) and capitalised. The recovery, if any, from the sale of dismantled old fixtures is reduced from the new assets being installed.</p> |

(Emphasis supplied by the querist.)

5. *The Issue:*

A. Applicability of Ind AS 116, ‘Leases’

The above arrangements were evaluated for classification under Ind AS 116, ‘Leases’ on first time adoption of the Standard during the financial year (F.Y.) 2019-20.

Appendix A – Defines terms of Ind AS 116, which defines lease as “A contract, or part of a contract, that conveys the right to use an asset (the **underlying asset**) for a period of time in exchange for consideration.”

Paragraph B9 of Appendix B to Ind AS 116 provides certain conditions to identify a lease which are as below:

“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).”

In contrast to above, the core principle of Ind AS 115, ‘Revenue from Contracts with Customers’ is that the revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amounts to which the entity expects to be entitled.

B. Applicability of Ind AS 115, ‘Revenue from Contracts with Customers’

Paragraph 22 of Ind AS 115 states that “**At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall *identify as a performance obligation* each promise to transfer to the customer either:**

- (a) **a good or service (or a bundle of goods or services) that is distinct; or**
- (b) **a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (see paragraph 23).”** *{In this case, provision of energy efficiency services}*

As per paragraph 31 of Ind AS 115, “**An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.**”

To qualify as sale of goods, all risks and rewards attached to the assets must be transferred to the customer, whereas in case of ESCO projects as described above, no such risks are transferred, but the contract is focused on delivering predefined service to the customer, hence qualifies as sale of services.

As contended in the previous section and in view of the above explanation, *the*

Company's various ESCO business assets are not covered under Ind AS 116, but are covered under Ind AS 115, 'Revenue from Contracts with Customers'.

C. Applicability of Ind AS 16, 'Property, Plant and Equipment'

Further, Ind AS 16, 'Property, Plant and Equipment' in its paragraph 7 states, **"The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:**

- (a) it is probable that future economic benefits associated with the item will flow to the entity; and**
- (b) the cost of the item can be measured reliably."**

The Company holds the legal ownership and control over the assets during the project tenure and therefore, has contractual rights to obtain future economic benefits in the form of amounts receivable from the customers under the respective agreements entered with them for implementation of such projects and the cost of the assets is also measurable reliably.

In view of the above, ESCO assets have been correctly capitalised in line with the principles laid down in Ind AS 16.

(Emphasis supplied by the querist.)

B. Query

6. Considering the different modalities of the agreements as described above, opinion of the Expert Advisory Committee is requested on the following points:

- (a) Whether the existing accounting treatment followed by the Company of capitalising the expenditure essentially required for supply, installation and commissioning of the ESCO project and depreciating the same over the life of the ESCO agreement with the client is correct.
- (b) In case, the answer to (a) above is negative then,
 - (i) What accounting treatment should be adopted to ensure true and fair presentation of the ESCO projects being executed by the Company?
 - (ii) What should be the accounting treatment of the assets already capitalised during the previous years and appearing in the fixed asset register of the Company?

C. Points considered by the Committee

7. The Committee notes that the basic issue raised by the querist relates to the accounting treatment of the ESCO projects under Ind AS. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, detailed application of Appendix D to Ind AS 115 including timing and measurement of revenue from ESCO project, measurement of asset (if any) recognised under the arrangement, accounting for cost of dismantling or dismantled assets, etc. The Committee has

only examined the issue from accounting perspective and has not examined the regulatory or legal classification and implications, including those arising under Income-tax Act and Goods and Services Tax Act. Further, the opinion hereinafter has been expressed in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time. Furthermore, the Committee has expressed the opinion in the context of Agreement between the Company and the customer (ULB/Municipal Corporation), as supplied by the querist in respect of Street Lighting Project and not in respect of any other Agreement/Project.

8. The Committee notes that the following are the salient features of the arrangement between the Company and the customer:

- The project implementation will be by the Company and entire upfront capital cost of energy efficiency interventions i.e., upgradation of conventional streetlight fixtures with LED streetlight fixtures including annual maintenance and warranty replacement will be by the Company (Clause 4(i)).
- The Company's annuity and the electricity bill post retrofit (at current tariff) will be less than the current expenditure on energy consumption (based on actual working of fixtures at the current tariff rate) and maintenance charges (Clause 4(iii)).
- The Company shall ensure supply of energy efficient LED streetlight fixtures complete with all accessories, including necessary safety and mounting arrangements. The LED streetlight fixtures will conform to the specifications given in Annexure-I (Clause 4(v)). Annexure I specifies the technical specifications of the luminaries including the recommended range of mounting height of the luminaries; recommended level of illumination; the lamp technology; the overhang; the sitting of luminaire; and, typical specifications of LED street lights.
- Under Clause 5.2, the Company's obligations include project preparation, issuance of bids, evaluation and selection of implementing agency, contract management, implementation including supply and installation and operation and maintenance of the street lights during the contract period.
- Under Clause 6.1, the customer will make payments to the Company as per schedule indicated in Annexure-III. The payment will be determined as per the following principle:
 - (a) All capital costs will be on actuals.
 - (b) The Company's pre-tax return on equity will be 21% per annum.
 - (c) The debt equity ratio will be 80:20.
 - (d) The interest rate on debt will be on actuals subject to a maximum rate of 10%.
 - (e) Project Management charge will be limited to 3% of the capital cost of the project, or actuals whichever is lower and Annual Maintenance Cost will be limited to 4% of capital cost or actuals whichever is lower.

(f) All statutory taxes/duties will be reimbursed by the customer to the Company on actual basis.

- Under Clause 9, the Company shall ensure that for the entire agreement period, the LED streetlight fixtures supplied and installed shall conform to technical standards. The Company shall extend warranty of the LED streetlight fixtures supplied throughout the agreement period (i.e., 7 years) covering any manufacturing defects and high voltage and storage. The Company assures a minimum energy savings of 50% from the existing energy consumption, which will be verified by an independent agency. The Company will maintain all the retrofit LED lights and replace worn out lights during the entire contract period at no additional cost to the customer, including replacement of lights.

Further, the customer shall have exclusive rights over the revenues accruing from Clean Development Mechanism transactions or any carbon credits arising from the project and the Company shall not have any claim over them.

- Under Clause 10, the Company is required to maintain a minimum uptime of retrofit luminaries of 95% excluding the period of non-availability of power supply. The following will be the performance requirement for replacement that the Company agrees to:

(a) to replace the defective/ non burning LED lights within 48 hours of the reported failure. ...

Penalty for non-fulfilment after 48 Hrs is reckoned as follows:

...

In case of default by the Company for maintaining uptime of lights of 95%, a penalty equivalent to 2 times the monetised value of energy savings from the defective/ non burning lamps will be deducted from the Company's monthly payment. The penalty will be reckoned as follows:

...

The Company agrees 50% energy saving with baseline of existing energy consumption of conventional street light fixture assuming 100 % fixtures will be in service. However, if the Company fails to prove 50 % energy saving as above during the verification by independent third party, the Company shall be entitled for penalty for percentage energy reduced below 50, multiplied with prevailing Tariff.

- Clause 12 states that the agreement is deemed to be completed:
 - (i) After 7 years from the date of installation of the equipment by the Company and on receipt of the total project value from the customer, or
 - (ii) On the day the Company receives complete termination payment in terms of Article-15 or Article-17 of this agreement.

- Under Clause 17.2, upon termination by customer on account of default by the Company during period of this agreement, the Company shall not be entitled to receive any payment from the customer by the way of Termination Payment.
- Under Clause 17.3, upon termination of this agreement (which arises due to amendment, cancelation, renegotiation or in case of events of default by the Company or the customer) and payment of Termination Payment to the Company as applicable in full, the customer shall:
 - (a) take control of the project forthwith;
 - (b) take control of all Energy Efficient LED Street Lights as supplied under this agreement

9. Before looking into the applicability of Ind AS 116, the Committee notes the following requirements of Appendix D, ‘Service Concession Arrangements’ to Ind AS 115:

- “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.”

- “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.
- 6 Infrastructure used in a public-to-private service concession arrangement for its entire useful life (whole of life assets) is within the scope of this Appendix if the conditions in paragraph 5(a) of this Appendix are met. Paragraphs AG1–AG8 of the Application Guidance of this Appendix provide guidance on determining whether, and to what extent, public-to-private service concession arrangements are within the scope of this Appendix.”

“AG4 For the purpose of condition (b), the grantor’s control over any significant residual interest should both restrict the operator’s practical ability to sell or pledge the infrastructure and give the grantor a continuing right of use throughout the period of the arrangement. The residual interest in the infrastructure is the estimated current value of the infrastructure as if it were already of the age and in the condition expected at the end of the period of the arrangement.”

“AG6 Conditions (a) and (b) together identify when the infrastructure, including any replacements required (see paragraph 21 of Appendix D), is controlled by the grantor for the whole of its economic life. For example, if the operator has to replace part of an item of infrastructure during the period of the arrangement (eg the top layer of a road or the roof of a building), the item of infrastructure shall be considered as a whole. Thus condition (b) is met for the whole of the infrastructure, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.”

The Committee notes from the above that Appendix D to Ind AS 115 envisages a scenario where an operator provides services under the terms of the contractual arrangement and receives payment for its services over the period of the arrangement. This typically involves the operator constructing or upgrading infrastructure which is used to provide a public service and then being responsible for operating and maintaining that infrastructure for a specified period of time, for which the operator gets the payment. Thus, a feature of these service arrangements is the public service nature of the obligation undertaken by the operator, irrespective of the identity of the party that operates the services. Further, another important feature of these service arrangements is that 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. The Committee notes that these features under the service concession arrangements are different from other service contracts within the scope of Ind AS 115.

The Committee further notes that the first criterion for applicability of Appendix D to Ind AS 115 is that 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

Committee notes that the consideration for the Company's assets and services has been agreed in the LED streetlight project implementation agreement with the municipal corporation/ ULB (the grantor). Further, the nature and scope of the obligations of the Company have been laid down in the agreement. Therefore, the services of the Company related to the infrastructure (LED street light infrastructure), to whom the same have to be provided and at what price are controlled and regulated by the grantor.

The second criterion in paragraph 5 of the Appendix is that the grantor controls, through ownership, beneficial entitlement or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement. In this context, the Committee notes that the arrangement is deemed to be completed after 7 years from the date of installation of the equipment(s) by the Company and the Agreement is silent about any payment after 7 years. Further, as per clause 17.3 of the Agreement, upon termination of the Agreement (which arises due to amendment, cancelation, renegotiation or in case of events of default by the Company or the customer) and payment of Termination Payment to the Company as applicable in full, the customer (grantor) shall take control of the Project forthwith and take control of all Energy Efficient LED Street Lights. Furthermore, CAG has mentioned that as per Agreement, either the asset will be transferred to the customer at the end of the contract period; or the assets are held under the lease term for its major useful life. Thus, it appears that at the end of the contract period, all the equipments installed by the Company, irrespective of their remaining useful life shall be transferred to the customer (grantor).

The Committee further notes that as per the Application Guidance on Appendix D (paragraph AG4), for the grantor to control significant residual interest in the infrastructure at the end of the term of the arrangement, the Grantor should restrict the operator's practical ability to sell or pledge the infrastructure and give the grantor continuing right of use throughout the period. In the extant case, the Company (operator) does not have the practical ability to sell or pledge the underlying assets/equipments and has the continuing right to use them throughout the term of the Agreement. Thus, the Committee is of the view that the customer (grantor) controls the residual interest in the extant case.

Furthermore, as per paragraph 6 of the Appendix, an arrangement where the infrastructure is used for its entire useful life ('whole of life assets') would be within the scope of Appendix D provided conditions in paragraph 5(a) are met. Thus, even though the term of the Agreement in the extant case is for the entire useful life of the assets/equipments installed, condition in paragraph 5 (b) of Appendix D will be met and the arrangement would be within the scope of Appendix D if conditions in paragraph 5 (a) are met.

The Committee also notes that Clause 9 of the Agreement states that the Company shall extend warranty of the LED streetlight fixtures supplied throughout the agreement period covering any manufacturing defects and high voltage and storage. If the luminary fails to the agreed specification, the Company shall rectify or replace it in terms of warranty at its own cost throughout the Agreement Period.

As per paragraph AG6 of the Appendix, under the terms of a service concession arrangement, an operator may be required to replace parts of an item of infrastructure, for example, the top layer of a road or the roof of a building. In these types of arrangements, the item of infrastructure is considered as a whole for the purpose of determining whether the grantor controls any significant residual interest. Thus, condition in 5(b) would be met for the whole of the infrastructure, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part. Since in the extant case, the residual

interest in the final replaced part/asset appears to be controlled by the Customer (i.e. ULB/Municipal Corporation), this condition is also met.

Based on the above, the Committee is of the view that Appendix D to Ind AS 115 is applicable in the extant case.

10. Further, the Committee notes that Ind AS 116 states as follows:

“3. An entity shall apply this Standard to all leases, including leases of *right-of-use* assets in a *sublease*, except for:

...

(c) service concession arrangements within the scope of Appendix D, *Service Concession Arrangements*, of Ind AS 115, *Revenue from Contracts with Customer*; ...”

The Committee notes from the above that Ind AS 116 scopes out the arrangements which are within the scope of Appendix D to Ind AS 115. Therefore, the question of assessment of applicability of Ind AS 116 does not apply.

11. The Committee also notes that as per the requirements of Appendix D, once the infrastructure is within the scope of the Appendix, it is not recognised as property, plant and equipment of the operator because the operator does not have the right to control the asset, but merely has access to the infrastructure in order to provide the public service in accordance with the terms specified in the contract. Instead, the operator's right to consideration is recorded as a financial asset, an intangible asset or a combination of the two. Therefore, the Committee is of the view that the Company shall not recognise the LED assets as property, plant and equipment.

Further, the Committee notes that Appendix D characterises the operators as service providers who would recognise revenue in accordance with Ind AS 115. In this context, the Committee wishes to point out that under the requirements of Appendix D to Ind AS 115, the Company shall *inter alia* assess the following aspects:

- Recognition of the capital expenditure incurred as financial asset or intangible asset or partly both as per the definition and criteria laid down in Ind AS 32 and Ind AS 38;
- Recognition of maintenance and upgradation services towards the upkeep of the LED equipment. The revenue recognition towards upgradation/ maintenance services shall be assessed in accordance with Ind AS 115;
- Recognition of warranty obligation or the contractual obligations to maintain the infrastructure to a specified level of serviceability.

12. The Committee further notes that Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’ states as follows:

“41 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position,

financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

42 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or**
- (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”**

The Committee notes from the above that as per Ind AS 8, material prior period errors are corrected retrospectively by restating the comparative amounts for prior period(s) presented in which the error occurred. If the error occurred before the earliest period presented, the opening balance of assets, liabilities and equity for the earliest period presented are adjusted. The Company’s current accounting of the LED equipment as property, plant and equipment is inappropriate for the reasons mentioned in paragraphs 9 to 11 above. Therefore, the Company shall correct its accounting as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error.

D. Opinion

13. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 6 above:

- (a) The existing accounting treatment followed by the Company of capitalising the expenditure essentially required for supply, installation and commissioning of the ESCO project as property, plant and equipment is inappropriate, as discussed in paragraphs 9 to 11 above.
- (b) (i) For the accounting treatment to be adopted to ensure true and fair presentation of the ESCO projects being executed by the Company, refer paragraphs 9 to 11 above.
- (ii) The Company should correct its accounting as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error, as discussed in paragraph 12 above.