

Query No. 28

Subject: Accounting Treatment for ESCO Project i.e. Electric Vehicle Charging Infrastructure (EVCI) under Ind AS framework.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a public sector company engaged in providing energy efficiency services and has entered into various agreements with its customers through 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 ASs) notified by the Ministry of Corporate Affairs. Debt securities issued by the Company are listed on Bombay Stock Exchange.

The Company has been installing 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.

2. Audit query paragraph, raised by the Comptroller and Auditor General of India (C&AG) audit team is as below:

- (a) Paragraph 61 of Ind AS 116, ‘Leases’ states 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.
- (b) 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.

3. *Brief of the Case*

The Company has installed ESCO Project, viz., Electric Vehicle Charging Infrastructure (EVCI) 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

¹ Opinion finalised by the Committee on 29.8.2023.

contracts were evaluated to ensure that the accounting treatment adopted for such agreements provides a true and fair presentation of such business transactions.

A summary of project (EVCI) enlisting various important terms of the agreements and the accounting treatment that the Company has adopted for the project are presented below:

4. E-Vehicle Charging Infrastructure (EVCI)

Sr.	Particulars	Description
a.	Type of Businesses	E-Vehicle Charging Infrastructure (EVCI)
b.	Life of Project	10 Years - Life of the project does not correspond with the actual expected useful life of the charging stations, but with the mutual agreed upon tenure of the project as per the agreement with the customers.
c.	Revenue Generation	The electric charging services are provided to various consumers of electric vehicles and there is no specific agreement with any of the customers. The ownership of assets remains with the Company and regular repair and maintenance costs are incurred thereon.
d.	Performance Obligations	The Electric Vehicle (EV) Charging Units have been installed with an objective to provide electric charging services to various consumers of electric vehicles. The ownership of charging stations lies with the Company only which are installed on leasehold land obtained from State ULBs or local bodies. Based on the above analysis, the performance obligation as identified in the contract is supply of power to E-vehicles through electric charging infrastructure to the customers.
e.	Trade practice	EV infrastructure is generally installed at locations identified with city municipal corporations for charging of EV and the assets are capitalised in the books of account.
f.	Test to rule out 'Right to Control'	<p>i) Identified Asset: Charging stations installed by the Company becomes identified assets once those are mounted on the location identified in the agreement. There is no restriction on replacing the charging stations with another assets, but the same would result in incurring unnecessary cost for the Company. Therefore, an identified asset exists.</p> <p>ii) Economic Benefits: Revenue from charging stations is recovered from multiple customers who are using electric vehicles. Therefore, there is no single customer who is getting economic benefits (i.e., e-vehicle charging) generated by the charging stations.</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> No, since the EV Charging Stations are installed to deliver a predefined output in terms of electricity generation. <i>How and for what purpose the asset is used:</i> <i>(a) 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</p>

		<p>has no right to operate.</p> <p>(b) 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.</p> <p>No, the customer has no role in designing the product.</p> <p>(c) The customer can change how and for what purpose the asset is used throughout the period of use.</p> <p>No, the customer has no right to change the purpose the asset is used.</p> <p>In view of the above, the third condition is not met. Since all the three conditions do not meet, EV Charging Infrastructure does not qualify as lease and should not be accounted for in line with Ind AS 116.</p>
g.	Accounting Treatment	<p>The ESCO assets installed deliver long-term benefit to the Company in the 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. interest during construction and incidental expenses (overheads) directly attributable to such installation of ESCO asset are accumulated and once the completion certificate is received from the client, the cost so accumulated is capitalised and the revenue invoicing is started.</p>

The querist has separately informed that the tariff or price charged from ultimate customers (using EVCI) is charged as per the Company's own financial model, which includes the calculation of all relevant factors of the Company's operations. The Guidelines issued by the Ministry of Power regarding 'clarification on charging infrastructure for Electric Vehicles with reference to the provisions of the Electricity Act, 2003' have also been provided by the querist in this regard. The Guidelines, inter alia states, "The charging of battery essentially involves utilization of electrical energy for its conversion to chemical energy, which gets stored in the battery. Thus, the charging of battery of an electric vehicle by a charging station involves a service requiring consumption of electricity by the charging station and earning revenue for this purpose from the owner of the vehicle. The activity does not in any way include sale of electricity to any person as the electricity is consumed within the premises owned by the charging station, which may be connected to the distribution system or otherwise for receiving electricity. By the same logic, the activity does not involve further distribution or transmission of electricity."

The querist has also informed that as per the signed agreement between the Company and the Client and as per Request for Proposal (RfP), the Charger's life with operation, maintenance and AMC is for 10 years only; and after 10 years, the remaining useful life will be decided by maintenance of Chargers beyond the period of 10 years by taking timely AMC and corrective measures to the operational chargers. As per mutual consent of the Company and client and as per chargers' status/ condition with its infrastructure, the extension of agreement can be reviewed.

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 which defines terms of Ind AS 116, 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 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 in previous section, no such risks are transferred, but the contract is focused on delivering pre-defined 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 customer 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.

B. Query

6. On the basis of above, the opinion of the Expert Advisory Committee is sought on the following issues:

- (i) Whether the existing accounting treatment followed by the Company for 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.
- (ii) In case, the answer to the (i) above is in negative then,
 - (a) What accounting treatment should be adopted to ensure true and fair presentation of the ESCO projects being executed by the Company?
 - (b) 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 expenditure incurred on ESCO Project, i.e., Electric Vehicle Charging Infrastructure (EVCI), which comprises of charging units and other related infrastructure. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, recognition of revenue and application of requirements of Ind AS 115, accounting for the location or land provided by the customer (NOIDA) to the Company for installation of charging units and related infrastructure, etc. The Committee has only examined the issue from accounting perspective and has not examined the regulatory or legal requirements 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 (State ULBs or local bodies), as supplied by the querist in respect of Electric Vehicle (EV) Charging Units and not in respect of any other Agreement/Project. At the outset, the Committee notes that charging infrastructure, charging units and chargers have been used interchangeably and they mean one and the same thing only.

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

“ELECTRIC VEHICLE CHARGING UNIT AS A SERVICE AGREEMENT

This Agreement for setting up Electric Vehicle (EV) Charging Units and related Infrastructure for electric vehicle charging... between the Company ... and **New Okhla Industrial Development Authority** (herein after referred to as NOIDA), a body corporate constituted ... for setting up Electric Vehicle Charging Infrastructure in NOIDA area.”

“Article 2

...

2.3 This Agreement shall remain in full force and effect for a minimum period of one-twenty (120) months from the agreement date, unless mutually extended or unless earlier terminated in accordance with the terms of this Agreement.

Article 3

RIGHT TO ACCESS AND USE

Subject to the Company’s compliance with its obligations in this Agreement, State ULBs or local bodies hereby grant access to and use of Location as specified under Article 7.5 and the Company hereby accepts to procure, install, maintain and operate the Charging Units and Related Infrastructure, for the duration of the Term of the Agreement, unless terminated earlier in accordance with the terms herein contained. State ULBs or local bodies and the Company unequivocally and irrevocably agree (unless mutually agreed otherwise) that the Location shall only be used for the purposes of undertaking the activity mentioned as per this Agreement and for no other purpose till the Term of the Agreement.

Article 4

CONSIDERATION

The Company shall share revenue of INR 1.00 per kWh (inclusive of applicable taxes) on actual power consumption basis from the Public EV Charging Stations in lieu of land rentals with State ULBs or local bodies. The Company and State ULBs or local bodies could jointly review the revenue sharing proposition annually for any changes and could be agreed upon on mutual terms.

Article 5

SCOPE OF THE PROJECT

5.1 Project Title

The Project shall be known as the “Installation of Charging Units and Related Infrastructure in NOIDA Location” (the “Project”).

...

5.7 Rights, Title and Interest

The ownership, rights and title of the Project shall vest with the Company for the entire Term of the Agreement. After the Term of Agreement, the ownership, rights and title to the Project, pursuant to this Agreement shall be agreed mutually between the Company and State ULBs or local bodies. After the Term of the Agreement, State ULBs or local bodies may provide a notice and the Company shall execute to remove the Charging units and Related Infrastructure and return the Location in its Original Condition to the extent feasible.

5.8 Re-location of Charging Units

In the event that NOIDA requests the Company to relocate the Charging Units (at any time during the term of the Agreement), then the Company shall evaluate this request and respond within 90 days’ from the date of receipt of written request from Noida. In case the Company agrees such relocation, then NOIDA will reimburse the Company only actual dismantling; transportation and re-installation of charging will be reimbursed to the Company on Mutually agreed terms. ...”

“7.3 The Company shall be solely responsible for (a) all costs and the performance of all tasks required for installation, operation and maintenance of the Charging Units and Related Infrastructure at the Location. However, any removal or relocation if carried at NOIDA request or is attributable to NOIDA; then NOIDA shall bear only the actual entire cost and expense for such removal or relocation, ; (b) ensuring that the design, construction, operation and maintenance of the Charging Units and Related Infrastructure are in compliance to applicable laws, including those relating to safety, public health and environment; (c) ensuring that the performance of the tasks required for installation, operation and maintenance of the Charging Units and Related Infrastructure does not cause any damage to the Location, including any damage to a public property or any property of a third party therein.”

“7.6 The Company shall be solely responsible for day to day operation and maintenance of the Charging Units and Related Infrastructure.”

“8.1 NOIDA shall not cause any interference with the Company’s right to receive continuous and uninterrupted access to the Location, passage of Electric Vehicles and supply of electricity at all times during the Term of the Agreement.”

“8.4 NOIDA shall not, directly or indirectly, cause, create, incur, assume or suffer to exist any mortgage, pledge, lien, charge, security interest, encumbrance or claim, on or with respect to the Charging Units and Related Infrastructure.”

“9.1 The Company shall be the exclusive owner and operator of the Charging Units and Related Infrastructure, including any part thereof, installed by the Company

and shall own any benefits derived therefrom including benefits from Environmental attributes during the Term of the Agreement.

...

9.3 After the Term of the Agreement, the ownership of Charging units and Related Infrastructure shall retain with the Company.”

“13.1 Termination

This Agreement may be terminated by a Party:

(i) if the Party in default is in material breach of any of its obligations under this Agreement, and not cured such breach within the stipulated time lines for the Cure Period; written notice thereof;

(ii) Party becomes the subject of a petition in bankruptcy or any other proceeding related to insolvency, receivership, liquidation or an assignment for the benefit of creditors- as per terms of Event of Default;

...

13.2 Exit Management

1. Exit management procedure shall be applicable in the following situations or scenarios:

a) Mutual Concurrence:

Wherein Parties mutually agree that the entire Project shall be handed over to NOIDA, subject to payment to unamortized value of asset at the time of transfer.

b) Termination:

Wherein, the Agreement is terminated pursuant to terms of the Agreement (regardless of the party in default), subject to payment of balance amount of investment along with loss of profit made by the Company at the time of transfer.

2. Exit Management Procedure shall be as follows:

a) Pursuant to 13.2 (a) the Company shall include handover of complete charging network, including handover of all stakeholder data. All software solutions, system licenses offered in the Agreement shall be handed over in a manner that do not restrict any usage/access of any kind of functionality

b) Pursuant to 13.2 (b)

The Company shall remove the Charging Units and other infrastructure (created by the Company) at its own cost and NOIDA will ensure that the Company is provided with all the necessary permission to enter the Location. NOIDA will ensure that the Company or the Company’s representative will have peaceful access to the location without any hindrance, whatsoever.

...”

9. From the above clauses, the Committee understands the following:

- The Company is to procure, install, maintain and operate the Charging Units and Related Infrastructure at its own cost, for the duration of the Term of the Agreement, which at present is 120 months or 10 years unless mutually extended or terminated earlier in accordance with the terms of the Agreement.
- The Company shall share revenue from the Public EV Charging Stations with the customer only in lieu of land rentals, i.e., for the right of use of land or location charges and there is no other consideration that is flowing from the Company to the customer in respect of charging units and other related infrastructure.
- Tariff is charged as per the Company’s own-financial model, which includes the calculation of all relevant factors of the Company’s operations, which indicates that the price is not specified/regulated by the customer/State ULB (NOIDA) or any regulatory body.
- The ownership, rights and title of the Project shall vest with the Company for the entire Term of the Agreement and after the Term of Agreement, the ownership, rights and title to the Project shall continue to be with the Company unless otherwise agreed mutually between the Company and State ULBs or local bodies, pursuant to this Agreement. After the Term of the Agreement, State ULBs or local bodies may provide a notice and the Company shall execute to remove the Charging units and Related Infrastructure and return the Location in its Original Condition. However, as per clause 9.3, after the Term of the Agreement, the ownership of Charging units and Related Infrastructure shall remain with the Company.
- Further, the Company shall be the exclusive owner and operator of the Charging Units and Related Infrastructure and any benefits derived therefrom including benefits from Environmental attributes during the Term of the Agreement will flow to the Company.
- As per Exit Management clause, which is applicable on mutual concurrence or earlier termination, if it is mutually agreed in future to transfer or hand over the Project to NOIDA, i.e., the customer, the same is subject to payment of unamortized value of asset at the time of transfer. Whereas, if the Project is earlier terminated due to material breach of obligations by any of the Party or on insolvency/bankruptcy of the parties, the Company shall remove the charging units and other infrastructure.

From the above, the Committee notes that at present, the term of the Project is 10 years unless the term is extended, which is not yet decided. After the term of the Project/agreement of 10 years or in case of early termination, the Charging units and Related Infrastructure will continue to be under ownership of the Company. During the project term, the infrastructure/Project is owned, operated and controlled by the Company and all the economic benefits from the same flow to the Company.

Further, any control over the infrastructure in terms of the price to be charged from the ultimate users of the infrastructure is also not exercised by the customer/NOIDA. Thus, it can be concluded that infrastructure/asset created is not controlled by the customer; rather is controlled by the Company itself.

10. In the above context, the Committee notes that Ind AS 16 states as follows:

“Property, plant and equipment are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and**
- (b) are expected to be used during more than one period.”**

“7 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.”**

“10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. ...”

“16 The cost of an item of property, plant and equipment comprises:

- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.**
- (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.**
- (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.”**

“Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.”

“Useful life is:

- (a) the period over which an asset is expected to be available for use by an entity; or**
- (b) the number of production or similar units expected to be obtained from the asset by an entity.”**

“50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

51 The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*”

From the above, the Committee notes that PPE are tangible items that are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and are expected to be used during more than one period. Further, the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. In the extant case, as discussed earlier, infrastructure/asset is owned, operated and controlled by the Company and all the economic benefits from the same flow to the Company. Such infrastructure is also expected to be used during more than one period. Therefore, the Committee is of the view that the charging units and other EVCI assets meet the definition of property, plant and equipment under Ind AS 16 and therefore, should be accounted for as property, plant and equipment. Further, as per the requirements of paragraph 16 of Ind AS 16, the cost of item of PPE shall comprise its purchase price and any cost directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management along with the initial estimate of the costs of dismantling and removing the item and restoring the site. Thus, in the extant case, the Company should capitalise the PPE as per the above-mentioned requirements of Ind AS 16.

Further, as per the requirements of Ind AS 16 relating to subsequent measurement, these assets shall be depreciated over their estimated useful lives and not based on the life of the project as per the Agreement (viz., tenure of the Agreement). Also, as per the requirements of Ind AS 16, useful life shall be reviewed at least at each financial year-end.

D. Opinion

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

- (i) The charging units and other EVCI assets meet the definition of property, plant and equipment (PPE) under Ind AS 16 and therefore, in the extant case, the Company should capitalise them as PPE as per the requirements of Ind AS 16, as discussed in paragraphs 8 to 10 above. Further, as per the requirements of Ind AS 16, the assets should be depreciated based on their estimated useful life and not based on the life of the project as per the Agreement (viz., tenure of the Agreement); and the useful life shall be reviewed at least at each financial year-end, as discussed in paragraph 10 above.
- (ii) In view of (i) above, this question does not arise.