Query No. 48

Subject: Accounting treatment for Energy Service Project i.e. Solar Power Projects under Ind AS framework.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the Company') is 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 AS) notified by the Ministry of Corporate Affairs. Debt securities issued by the Company are listed on the Bombay Stock Exchange.

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.

2. Audit query para, raised by the Comptroller and Auditor General of India (CAG) audit team is as below:

(I) 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.

(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.

3. *Brief of the issue raised:*

The Company has installed various ESCO Projects (Solar Projects) 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

[1] Opinion finalised by the Committee on 17.1.2024.

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

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

Solar Power Projects

Sr.	Particulars	Description
a.	Type of Businesses	Solar Power Projects
b.	Life of Project	***25 years –*** Life of the project here does not correspond with the actual expected useful life of the power plant, but with the mutual agreed upon tenure of the project as per the agreement with the customers.
c.	Revenue Generation	The Company has installed the projects at various sites. The revenue generation is based on the actual number of units generated at per unit rate mentioned in the Power Purchase Agreement (PPA). In case the customer does not off-take the units generated, the Company has the right to sell the power through open access mechanism.
d.	Performance Obligations	The objective of solar plants constructed by the Company is to generate and supply solar power to the respective customers and customer is not involved in operation and design of the power plants. *Based on above analysis, the performance obligation as identified in the contract is supply of solar power to the customer.*
e.	Trade practice	This is a greenfield project where equipments are mounted on land or rooftops and energy generated is fed into the grid; and the assets are capitalised in books of account.
f.	Test to rule out 'Lease'	**i) Identified Asset:** Assets once installed at a customer's location become implicitly specified and the Company does not have substantive substitution rights as the assets are located at the premises of the customer. Therefore, *an identified asset exists.* **ii) Economic Benefits:** 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 realised from a commercial transaction with a third party. All the outputs produced from these assets flow to the single customer (DISCOM), therefore, *this condition is met.* **iii)Right to direct the use of identified asset:** ***The customer has the right to direct how and for what purpose the asset is used throughout the period of use.*** No, since the Solar Power Plants are installed to deliver a predefined output in terms of electricity generation. ***How and for what purpose the asset is used are pre-determined:*** ***(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.*** No, the assets are operated by the Company directly and the

		customer has no right to operate. ***(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.*** No, the customer has no role in designing the product. ***(c) The customer can change how and for what purpose the asset is used throughout the period of use.*** No, the customer has no right to change the purpose the asset is used. In view of the above, *the third condition is not met.* Since all three conditions do not meet, the solar power plant does not qualify as lease and should not be accounted for in line with Ind AS 116, 'Leases'. **Detailed Explanation:** Under this condition, how and for what purpose decisions relating to the use of assets (rights to change the type of output, when/ where/ whether the output is produced, and quantity of output produced) are pre-determined. The design and installation of the individual solar power plant is decided by the Company, and the customer is not involved in design and installation other than specifying quantum of pre-defined guaranteed power generation (capacity utilisation factor (CUF)) from the panels. Also, the Company is required to operate/ maintain the solar plant to deliver the agreed levels of output and there is no involvement of the customer in operation/ maintenance of solar panels. The agreement with client is regarding sale/ purchase of power generated at an agreed rate and any shortfall/ excess generation shall be a loss/ gain to the Company. *Therefore, the Company has the right to direct the use of solar plant assets to achieve the generation and thus the arrangement is not covered under the scope of Ind AS 116.*
g.	Accounting Treatment	The ESCO assets installed deliver long-term benefits to the Company in form of revenue recognised over the life of the project. 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 assets are accumulated and once the completion certificate is received from the client, the cost so accumulated is capitalised and the revenue invoicing is started. The land required for installation of these solar projects is received from customer (DISCOM) on lease for a period of 25 years on a nominal lease rental of Re. 1 only.

(Emphasis supplied by the querist.)

4. *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, '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 in previous section, 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 from Customers'.*

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

Further, Ind AS 16, 'Property, Plant and Equipment (PPE)' 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.

(Emphasis supplied by the querist.)

5. The querist has separately supplied the following additional information:

(i) The Company has executed the PPA with the customer (DISCOM) for setting up 200 MW decentralised solar projects and subsequent sale of electricity generated from these projects to the DISCOM for a period of 25 years, wherein the land will be provided by the customer (DISCOM) for setting up the projects.

(ii) With regard to determination of tariff, the querist has informed that the tariff between the Company and DISCOM was mutually negotiated and thereafter approved by the State Electricity Regulatory Authority (SERC). The SERC may be approached for seeking relief under 'Change in Law' clause of PPA or any other clause as per PPA.

(iii) Typically, the actual expected useful life of the solar project is more than 25 years depending upon the operation and maintenance of the projects. The estimated operational lifespan of a PV module is about 30-35 years, although some plants may produce power for much longer periods. As per PPA, the Company is required to operate and maintain the projects for 25 years and sell electricity for this period to the respective customer (DISCOM) at the rate initially agreed and approved by the SERC. After completion of project period i.e., 25 years from commercial operation date (COD), the Company should extend the PPA with the customer at the rate mutually agreed between parties and approved by the SERC. Alternatively, the project assets are required to be handed over to the customer (Refer clause no. 2.2) without any consideration to the Company.

(iv) With regard to early termination of the Agreement, the querist has informed that if the Company stops supplying power or makes any other default in the Agreement, the only right available with the DISCOM/ procurer is to terminate the contract. The DISCOM does not have any other option, e.g., it cannot force the Company to honour the contract and supply power. There is no penalty or other consequences on the Company. Further, DISCOM will pay to the Company for the services received till the end date of the

termination, including the unamortised project cost incurred by the Company. Essentially, it means that the DISCOM has to compensate the Company for work done and costs incurred up to the point the agreement is terminated.

Further, while the Power Purchase Agreement (PPA) doesn't explicitly mention asset transfer as part of termination, the Company agrees that handing over the project to DISCOM after receiving termination payments, including unamortised project costs, seems logical. Same shall be taken up through mutual discussion with DISCOM and if required, the Company will seek necessary guidance from the SERC to ensure a smooth and compliant resolution.

In case of early termination on account of DISCOM's event of default, the Company shall be free to sell the contracted capacity/asset to any third party of its choice with the consent of the DISCOM.

(v) With regard to movability of the plant/infrastructure for relocation, the querist has informed that the decentralised solar plants are integrated into the DISCOM-owned land through permanent civil foundations, with the civil structure securely mounted on the ground alongside essential accessories. The plants are connected to the DISCOM grid through dedicated distribution/power evacuation lines. It is important to note that relocating the plants would incur additional costs and losses. The reinstallation process at a new location necessitates dedicated lands, various logistical challenges, and new regulatory approvals, which are typically not readily granted. Displacing and relocating the plants would also disrupt the existing grid.

(vi) With regard to the Company's ability or right to sell or pledge the assets/infrastructure, the querist has submitted that in line with PPA clause no. 18.2.1, the Company may pledge the assets/infrastructure only for borrowing money to finance the project. However, the Company has to follow the PPA executed with DISCOM.

It is pertinent to note here that the Company has been able to raise funds by issue of bonds and raised long term loans by providing its fixed assets (including solar plant), from different banks and financial institutions over the years which have been secured by way of a first pari-passu charge on the Company's entire movable fixed assets. Based on the financial model prepared by the Company, the Company considers a debt equity ratio of 80:20.

(vii) Public-private - It is submitted that the Company *is not a private sector entity*. The Company is a joint venture (JV) of four central public sector enterprises (CPSEs) under the administrative control of the Ministry of Power.

(viii) The Company's obligations: The Company is a super-energy service company (ESCO), which enables consumers, industries and governments to effectively manage their energy needs through energy efficient technologies. The objective of solar plants constructed by the Company is *to generate and supply solar power to the respective customers and customer is not involved in operation and design of the power plants.* This is a greenfield project where equipments are mounted on land and energy generated is fed into the grid. As per the Agreement, responsibilities of the Seller (the Company) are as follows:

(a) As per clause no. 3.1 (a) of the Agreement, Seller (the Company) is responsible at its risk and cost for designing, engineering, supply, construction, erection, testing, commissioning, and O&M of 200 MW solar power plant projects in accordance with *applicable law, State Grid Code etc.*
(b) Further, Seller is also responsible to *obtain and maintain necessary insurance* policies during the term of this agreement (clause no. 3.1 (c)).
(c) Seller is also responsible for *owning the power projects throughout the term of agreement* free and clear of encumbrances (clause no. 3.1 (e)).

(ix) DISCOM's obligations:

(a) As per clause no. 3.2 (b) of the Agreement, Procurer (DISCOM) has an obligation to offtake and purchase the total electricity generated by Seller (the Company) from the small solar power plants. Energy generation revenue from DISCOM is secured by means of an unconditional, revolving and irrevocable letter of credit (LC) as per clause no. 13.2.1.
(b) Further clause no. 3.2 (u) allows Seller (the Company) to avail *accelerated depreciation* benefit for any or all the projects commissioned under this Agreement.
(c) As per clause no. 3.2 (v), in case of privatisation/ liquidation of the Procurer (DISCOM), the agreement shall remain valid, and all the obligations shall remain valid between Seller and thereto in-charge agency/ company.

(x) Insurance:

PPA also mentions that Seller (the Company) *shall effect and maintain at its cost and expense, throughout the term of PPA, insurance* against such risks and primary beneficiary, seller (the Company), will receive proceeds against such risks.

(xi) Sale and purchase of solar energy:

(a) As per article 10 of the PPA, Seller (the Company) shall sell and deliver and Procurer (DISCOM) will purchase and accept all of the solar energy of the facilities.

(b) The purchase of energy by procurer and seller under the PPA shall be in the *nature of firm purchase.*

(c) Seller shall be *responsible for all electric losses, transmission and ancillary service arrangements* required to deliver solar energy on firm transmission basis (clause 10.1)

The revenue generation is based on the actual number of units generated at per unit rate mentioned in the PPA. The objective of solar plants constructed by the Company is to generate and supply solar power to the respective client and client is not involved in operation and design of the power plants. Based on above analysis, the performance obligation as identified in the contract is supply of solar power to the client.

(xii) Control/ maintenance

The assets are *operated by the Company directly and the customer has no right to operate. The customer has no role in designing the product. The customer has no right to change the purpose of the asset being used.*

Under this condition, how and for what purpose decisions relating to the use of assets are pre-determined (rights to change the type of output, when/ where/ whether the output is produced, and quantity of output produced). The design & installation of the individual solar power plant is decided by the Company, and the customer is not involved in design & installation other than specifying quantum of pre-defined guaranteed power generation (CUF) from the panels. Also, the Company is required to operate/ maintain the solar plant to deliver the agreed levels of output and there is no involvement of the customer in operation/ maintenance of solar panels. The Agreement with client is regarding sale/ purchase of power generated at an agreed rate and any shortfall/ excess generation shall be a loss/ gain to the Company.

Further as per article 11 of the PPA, Seller covenants to operate the facilities as integrated part of the Procurer system/ grid. When forced outages occur, Seller shall notify the Procurer of existence, nature and expected duration of the forced outage. Similarly, in case any forced outage on account of grid instability, failure, etc., Procurer shall inform about such outage to Seller.

B. Query

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

(a) 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.

(b) In case, the answer to the (a) above is in 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 solar power 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, depreciation or amortisation of the asset recognised, impact of accelerated depreciation benefit for accounting purposes, 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/ revised from time to time. Furthermore, the Committee has expressed the opinion in the context of Agreement between the Company and the customer (DISCOM), as supplied

by the querist in respect of solar power project and not in respect of any other Agreement/Project.

8. The Committee notes the following salient features of the Power Purchase Agreement between the Company and the customer (DISCOM):

"Each of the "Procurer" and "Seller" are individually referred to as "Party" and collectively to as the "Parties"

WHEREAS:

...

b) The Company (SELLER) desires to interconnect the facilities with the DISCOM Grid and sell and deliver to PROCURER at the Interconnection point, 100 % of the solar energy produced by the facilities from the date of commissioning of the Solar Projects.

c) Procurer (DISCOM) has agreed to purchase total electricity annually generated from approx. 200MW small Solar PV based power plants within PROCURER substations for 25 years.

d) The Solar Power Producer (SELLER) has agreed to sign this Power Purchase Agreement with Procurer for sale of Solar PV Power generated from small Solar PV based power plant for 25 years as per the terms and conditions of this Agreement."

"1.2.5 An "encumbrance" shall be construed as a reference to a mortgage, charge, pledge, lien or other encumbrance securing any obligation of any person or any other type of preferential arrangement (including, without limitation, title transfer and retention arrangements) having a similar effect;"

"ARTICLE 2: TERM OF AGREEMENT

…

2.2 Term of Agreement:

…

The extension or renewal of PPA after expiry of term of agreement should be mutual consented. *If not renewed up to maximum 3 months post expiry of PPA, the project assets after expiry of term of agreement shall be handed over to procurer* i.e. DISCOM.

2.3 Early Termination:

…

2.3.2 Notwithstanding to anything contained under this agreement, in case of early termination whether for convenience or default, Procurer will pay to SELLER for

the services received till the end date of the termination, including the umamortised project cost incurred by SELLER.

2.4 **Survival:**

The expiry or termination of this Agreement shall not affect any accrued rights, obligations and liabilities of the Parties under this Agreement, nor shall it affect the survival of any continuing obligations for which this Agreement provides, either expressly or by necessary implication, which are to survive after the Expiry Date or termination including those under, Article 14 (Force Majeure), Article 16 (Events of Default and Termination), Article 17 (Liability and Indemnification), Article 19 (Governing Law and Dispute Resolution), Article 20 (Miscellaneous Provisions), and other Articles and Schedules of this Agreement which expressly or by their nature survive the Term or termination of this Agreement shall continue and survive any expiry or termination of this Agreement."

"ARTICLE 3: ROLES & RESPONSIBILITIES IN DEVELOPMENT OF THE PROJECT

3.1 SELLER's Obligations:

The SELLER undertakes to be responsible, at SELLER's own cost and risk, for:

a) Designing, engineering, supply, construction, erection, testing, commissioning and O&M of up to 200 MW of small solar power plant projects in accordance with the applicable Law, the State Grid Code, the terms and conditions of this Agreement and Utility Practices; and

…

h) To commission the small solar PV power plants as per the capacities available at the substations of MSEDCL; and

…

3.2 PROCURER's Obligations:

…

b) Off-take and purchase the total electricity generated by SELLER from the small solar power plant(s)

…

e) Providing encumbrance free developed plot/land to SELLER on lease basis at rate of Re.1/per substation/ per year for a period of 27 years. The period of lease can be extended further as mutually agreed; and

…

s) PROCURER shall agree to make the payment to SELLER as per the terms and conditions of this PPA; and

t) PROCURER to facilitate with local Govt. bodies for Exemption of all fees/ charges/ cess levied by any Govt. authority including the Local Govt. Bodies (Panchayat) for 25 Years as per the Government Resolution (GR) published by GoM time to time.

…"

"ARTICLE 4: FACILITY DESCRIPTION:

4.1 Summary Description:

SELLER shall construct, own, operate and maintain the Facilities, consisting of Solar PV panels and associated equipment having installable capacity at PROCURER substation(s) as indicated in the "**Schedule 1**" to this Agreement which includes a complete written description of the Facility, including identification of the solar PV technology and other equipment and components that make up the Facilities.

…

4.2 Location of the Facilities

The facilities shall be located on the Sites and shall be identified as small Solar PV power Plants. …"

"ARTICLE 5: INTERCONNECTION AND EVACUATION

…

5.2 Evacuation:

5.2.1 The responsibility of getting connectivity with the transmission system owned by the DISCOM(s) will lie with the PROCURER. The cost of the transmission line up to "the interconnection point" shall be borne by the SELLER.

…

5.3 Purchase and sale of Contracted Capacity:

5.3.1 Subject to the terms and conditions of this Agreement, the SELLER undertakes to sell to Procurer and Procurer undertakes to pay Tariff for all the energy at the interconnection point up to the Contracted Capacity. Total Projects commissioned by the seller at PROCURER substations will operate within a CUF range of 23% to 12% calculated for all the project sites (cumulative capacity of the installed projects). However, year on year degradation of solar Panels as per MNRE standards shall follow.

5.3.2 Procurer is obligated to purchase maximum energy (403 MUs) for 200 MW capacity corresponding to 23% CUF only at the interconnection point. However, any excess energy generated over and above the 23% CUF from the cumulative installed capacity shall be purchased at 100% of the tariff rate by the PROCURER. In case of non supply of minimum energy 210 Mus corresponding

to 12% CUF by Seller, the shortfall of MUs (below 12% CUF), PROCURER shall be compensated at a rate of solar REC, however the upper limit on the rate of Solar RECs shall be limited as per the tariff in this PPA.

5.3.3 **Repowering:**

The Seller may repower the capacity of solar power project with the consent of the procurer and is to be done by the seller himself. But the Procurer is obligated to purchase the power equivalent to committed CUF only."

"5.5 Acceptance/Performance Test:

Prior to synchronization of the Project, the SELLER shall be required to get the project certified for the requisite acceptance/performance test as may be laid down by an agency identified by the PROCURER to carry out testing and certification for the solar power projects. …"

"ARTICLE 7: DISPATCH

7.1 Dispatch

The Project shall be required to maintain compliance to the applicable Grid Code requirements and directions, if any, as specified by PROCURER from time to time."

"ARTICLE 10: SALE AND PURCHASE OF SOLAR ENERGY

a. At COD, SELLER will sell and deliver and PROCURER will purchase and accept all of the Solar Energy of the Facilities at the Points of Delivery, subject to the terms and conditions of this Agreement. PROCURER will pay to SELLER for the Solar Energy as metered at the Point of Delivery at the fixed tariff as per clause 10.b.

b. The Tariff applicable for entire period of the agreement i.e. 25 years from COD shall be as per the table below:

Particulars	Tariff Period	Levellised Tariff (INR/kWh)
Solar PV	25 years	3.00

c. The purchase of energy by PROCURER from SELLER under the PPA shall be in the nature of firm purchase. There shall be no restriction on the supply of energy Units by SELLER to PROCURER, except for force majeure conditions."

"ARTICLE 11: OPERATIONS AND MAINTENANCE

…

b. SELLER covenants to operate and maintain the Facilities in safe and reliable operating condition and in compliance with Standard Utility Practices and within the specified voltage and frequency ranges. However, security for the solar power plant by means of existing security staff at substations shall be provided by

PROCURER. Any loss or damage to the solar power plant due the negligence or existing security staff will be at the risk and cost of PROCURER and SELLER will be compensated for such losses or damages by PROCURER.

…

d. SELLER will devise and implement a plan of inspection, maintenance and repair of the Facilities and the components thereof in order to maintain such equipment in a safe and reliable operating condition and in accordance with Standard Utility Practices, and shall keep records with respect to such inspections, maintenance and repairs."

"ARTICLE 13: PAYMENT

13.1 Payment of Monthly Bills:

13.1.1 The Procurer shall pay the amount payable under the Monthly Bill on the Due Date to such account of the Seller, as shall have been previously notified to the Procurer in accordance with Article 10."

"ARTICLE 18: ASSIGNMENTS AND CHARGES

18.1 Assignments:

This Agreement shall be binding upon, and inure to the benefit of the Parties and their respective successors and permitted assigns. This Agreement shall not be assigned by any Party other than by mutual consent between the Parties to be evidenced in writing:

- Provided that, such consent shall not be withheld if the Seller seeks to transfer to any affiliate all of its rights and obligations under this Agreement.
- Provided further that any successor(s) or permitted assign(s) identified after mutual agreement between the Parties may be required to execute a new agreement on the same terms and conditions as are included in this Agreement.
- Provided that, [Procurer] shall permit assignment of any of SELLERs rights and obligations under this Agreement in favour of the lenders to the SELLERs, if required under the Financing Agreements.

18.2 Permitted Charges:

18.2.1 Neither Party shall create or permit to subsist any encumbrance over all or any of its rights and benefits under this Agreement other than for securing the financing for the project."

9. Before examining the applicability of Ind AS 116 and other standards, 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."

Scope

"4 This Appendix gives guidance on the accounting by operators for public-to-private service concession arrangements.

5 This Appendix applies to public-to-private service concession arrangements if:

(a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and

(b) the grantor controls–through ownership, beneficial entitlement or otherwise–any significant residual interest in the infrastructure at the end of the term of the arrangement.

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."

"AG1 Paragraph 5 of Appendix D specifies that infrastructure is within the scope of the Appendix when the following conditions apply:

(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.

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

AG3 For the purpose of condition (a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, contract or regulator, for example by a capping mechanism. However, the condition shall be applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, shall be ignored. Conversely, if for example, a contract purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.

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."

(Emphasis supplied by the Committee.)

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 key 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.

10. The Committee notes that one of the major contentions of the querist is that the Company is not a private sector company and, therefore, it does not satisfy the primary condition of being a 'private sector entity' as mentioned in Appendix D to Ind AS 115. In this regard, the Committee notes from the above-reproduced requirements of Appendix D to Ind AS 115 that the same *typically* and not necessarily involves a private sector entity and is applicable to accounting for the concession arrangement *irrespective of the identity of the party that operates the services.* Thus, the requirements of Appendix D are applicable to even a public sector entity undertaking the activities of an operator.

Also, the Committee notes that Ind AS are applicable to all companies under the Companies Act 2013, irrespective of their shareholding by a private player or government body. The Committee is of the view that nature of operations and substance of contractual arrangement will decide applicable standard and not shareholding.

Therefore, the Committee is of the view that in the extant case, for application of Ind AS, the Company should be treated as similar to a private sector entity only and accordingly, the arrangement in the extant case would be considered within the scope of Appendix D to Ind AS 115.

In this context, the Committee also notes that in the extant case, DISCOM (Customer) has signed an Agreement with the Company to procure power from small solar power based plants to be developed by the Company within DISCOM's substation premises, which then will be further supplied to public at large and thus, obligation of the Company under solar power project may be considered as 'public service'.

11. 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 DISCOM (together with the SERC acting as a regulator for approving the tariff mechanism) controls or regulates the type of infrastructure and services to be provided by the Company, to whom it must be provided and at what price, under the terms and conditions of the agreement. Therefore, this criterion is met in the extant case.

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 term of the Agreement is for 25 years and as per clause 2.2 of the Agreement, after the expiry of term of the Agreement, if the same is not renewed up to maximum 3 months, the project assets after expiry of term shall be handed over to the Procurer (DISCOM). 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 procurer/customer (grantor).

The Committee further notes that as per the Application Guidance on Appendix D (paragraph AG4), for the purpose of condition 5(b) of the Appendix D, 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. Here, the Committee notes that the term 'pledge' is used where physical transfer of possession of the asset to the pledgee is involved. In the extant case, though the Company is using the term 'pledge', it seems to be providing the assets/infrastructure as a security for borrowing money to finance the project; without physical transferring the possession of the asset to the pledgee. Further, on a reading of Article 18.2.1 read with clauses 1.25 and 2.4 of

the PPA (reproduced above) and the facts supplied by the querist, it appears that the rights of the DISCOM (grantor) and obligations under the PPA shall not be affected even on pledge of the Company's rights to the lenders. Therefore, the Committee is of the view that the grantor controls the residual interest in the extant case.

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

12. Further, the Committee notes that Ind AS 116, 'Leases', 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 in the extant case does not apply.

13. 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 should not recognise ESCO assets (solar power plants/equipments) as property, plant and equipment (PPE).

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, 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 solar power plant. 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.

Furthermore, the Company should also provide disclosures as required under Appendix E, 'Service Concession Arrangements: Disclosures' to Ind AS 115.

14. 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 balances of assets, liabilities and equity for the earliest period presented are adjusted. The Company's current accounting of the ESCO project/assets (viz. solar power plants/equipments) as property, plant and equipment is inappropriate for the reasons mentioned in paragraphs 9 to 13 above. Therefore, 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.

D. Opinion

15. 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/assets (viz. solar power plants/equipments) as property, plant and equipment is inappropriate, as discussed in paragraphs 9 to 13 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 14 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 14 above.

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