Query No. 10

Subject: Recognition and presentation of non-refundable upfront fee/premium for development of hydro electric project under Ind AS framework.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the Company') is a Central Public Sector Enterprise (CPSE) incorporated with an objective to plan, promote and organise an integrated and efficient development of hydroelectric power. The Company has extended its objective to include development of power in all aspects through conventional and non-conventional sources in India and abroad. The Company's shares are listed in Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). The Company has adopted Indian Accounting Standards (Ind AS) during the 1st Phase, i.e. from April 1, 2016.

2. The Company constructs hydropower projects and operates them on Build, Own, Operate & Maintain (BOOM) basis. Electricity being a regulated product, tariff for each power station is determined by the Central Electricity Regulatory Commission (CERC) based on the CERC Tariff Regulations issued for a period of five years at a time. The currently applicable tariff period is 2019-20 to 2023-24, i.e. 2019-24.

3. Tariff is fixed by the CERC based on the capital cost incurred for the power station. Tariff regulations provide for recovery of costs incurred on running and maintenance of the power station, depreciation of property, plant and equipment, interest on loans and borrowings for construction of the plant and interest on working capital, plus a specified rate of return on equity invested in the plant.

Acquisition of hydro electric projects and Memorandum of Agreement (MoA) signed with the State Government

4. The State Government had earmarked certain projects for allocation to private developers, central sector developers and state sector developers for the development of hydro power projects in the State, which will generate economic activity in the State leading to its growth and will also serve as an engine to achieve the objective of promoting all round development in the State and the country. The Evaluation Committee constituted by the Ministry of Power, Government of India, had evaluated the status of the stalled hydro electric projects in the State which have not been taken forward for a long time after allocation to private developers. The Evaluation Committee has recommended to allot the stalled projects to the earmarked developers for completion at the price arrived at after due diligence by the respective CPSEs.

5. The Company had submitted proposals for acquisition of the following two projects earlier allotted to the private developers:

a) K Project (1800MW)

b) S Project (2000 MW)

[1] Opinion finalised by the Committee on 3.6.2024.

Ministry of Power, Government of India has approved the proposal of the Company for acquisition of the above projects and these projects have been allotted to the Company by the State Government vide letter dated 21/07/2023.

6. A quadripartite agreement was signed between the State Government, the private developer, the Special Purpose Vehicle (SPV) of the private developer and the Company, wherein the private developer and SPV thereof have agreed to transfer these projects to the Company.

7. Thereafter, a Memorandum of Agreement (MoA) has been signed between the Company and the State Government for execution of these projects.

8. As per the Memorandum of Agreement (MoA), the State Government granted permission to the Company to undertake preliminary investigation for preparation of the pre-feasibility report, detailed investigation for the preparation of the pre-feasibility report, detailed investigation for Detailed Project Report (DPR) preparation, financing and subsequent development, commissioning, implementation, operation and maintenance of these projects. The projects shall be implemented by the Company on BOOT (Build, Own, Operate & Transfer) basis for a lease period of 40 years from the commercial operation date (COD). These projects will be reverted back to the State Government on expiry of above lease period, free of cost, in good working condition. However, the Company being a Central Public Sector Enterprise (CPSE), the lease period can be extended beyond 40 years period by the State Government on mutual agreement. The entire cost of investigation, DPR preparation, project implementation and subsequent operation and maintenance of the project will be borne by the Company.

9. Out of the amount paid by the Company to the private developer as consideration for acquisition of these two projects, Rs. 180 crore is towards reimbursement of non-refundable upfront fee/ upfront premium by the private developers to the State Government for allotment of these projects, while the remaining amount was in respect of other assets of these projects taken over from the private developers. As regards reimbursement of the upfront fees, the Minutes of 4th Meeting of the Evaluation Committee also state that the "Terms of Reference of the Evaluation Committee suggests that the payments made to various Government Agencies will be considered on actual basis …"

Requirement of depositing non-refundable upfront fee:

10. As per Clause 9.13 of the State Hydro Power Policy, the developer(s) of viable project(s) shall have to deposit non-refundable 'Upfront Premium' including processing fees as stipulated hereunder:

Project Capacity	Minimum Upfront Premium
25 MW to 99 MW	Rs. 1.00 Lakh per MW
100 MW to 499 MW	Rs. 2.50 Lakhs per MW
500 MW to 999 MW	Rs. 3.50 Lakhs per MW
1000 MW to 1499 MW	Rs. 5.00 Lakhs per MW
2000 MW to 2999 MW	Rs. 6.00 Lakhs per MW
3000 MW and above	Rs. 7.00 Lakhs per MW

11. Accordingly, the private developer which had acquired these two projects had paid Rs. 180 crore to the State Government at the time of acquisition of these projects, which has been reimbursed to the developer by the Company.

Accounting treatment in the books of the Company

12. The querist has stated that the amount of upfront fee/upfront premium paid by the developer to the State Government was for obtaining a right to build and operate the project. This cost is mandatory in nature, without which the project cannot be started. In this regard, Ind AS 16 provides as under:

> **"6** ***Cost is the amount of cash or cash equivalents paid*** **or the fair value of the other consideration** ***given to acquire an asset at the time of its acquisition or construction or,*** **where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Indian Accounting Standards, eg Ind AS 102,** ***Share-based Payment.*****"**
>
> **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."**
>
> "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."
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> (Emphasis supplied by the querist.)

13. According to the querist, payment of upfront fees to the State Government is mandatory to start any activity for development of a hydroelectric project in the State, which applies both to private enterprises as well as central public sector enterprises. Accordingly, the reimbursement of upfront fees as a part of consideration to acquire the project meets the definition of an asset and the said expenditure should be capitalised in accordance with paragraph 16 of Ind AS 16 which states that *"The cost of an item of property, plant and equipment comprises … 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"* . Since the cost incurred (upfront fees) for acquiring the projects could not have been avoided in making the asset ready for use in the manner intended by the management, the upfront fees paid as a part of consideration for acquiring these projects should be capitalised as an

attributable expenditure under CWIP and allocated among the major assets of the projects on completion.

14. It is also stated by the querist that as on date, there is no uncertainty regarding final allotment of the project and works for preparation of DPR of these projects are going on. Once DPR is submitted to the relevant authorities, further activities for environment clearance, techno-economic clearance and final approval from the Government of India for start of construction shall be taken up.

15. The querist has also mentioned that the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) in its opinion on a similar issue finalised on 11.08.2015 (Query No. 11 of Compendium of Opinions Vol. XXXV), had stated that the amount deposited by a developer with the State Government towards non-refundable upfront premium including processing fee for acquisition of the right to construct and operate a hydroelectric project should neither be charged off to expense nor recognised as a part of Capital-Work-In-Progress (CWIP), but rather be recognised as an 'intangible asset under development' under the head 'intangible assets' in the books of account of the company on the following grounds:

(a) If there is no uncertainty regarding final allotment of the project and future economic benefits are expected to flow to the company, non-refundable upfront premium including processing fee should not be considered as the cost of prospecting activities;

(b) The company has been granted an exclusive right to construct, implement and operate the project that shall provide economic benefits to the company from the sale of power generated out of such project on its commissioning. Further, the company had obtained from the Government, only a right to construct, implement and operate a project that will be transferred back to the Government and therefore, the Company should recognise only an intangible asset for such a right following the provisions of Accounting Standard (AS) 26, 'Intangible Assets'.

B. Query

16. In view of above, the querist has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India as to whether the amount paid as reimbursement of upfront premium should be accounted for under 'Capital Work in Progress' or as 'Intangible Asset Under Development'.

C. Points considered by the Committee

17. The Committee notes that the basic issue raised in the query relates to accounting treatment of non-refundable upfront fee/premium paid by the Company as reimbursement to the erstwhile private developer, who had paid such fee to the State Government for allotment of the project in its favour. 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, accounting for lease of land, determination of upfront fee, accounting for various expenditure incurred by the Company on the Project, amortisation/depreciation of asset(s) created under the Project, recognition of revenue from sale of power or electricity, detailed accounting under Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', etc. Further, the opinion expressed hereinafter is purely from accounting perspective and not from the perspective of legal interpretation of MoA or the Hydro Policy, 2008 or the tariff regulations of CERC, or

compliances with any statutory or legal requirements, etc. At the outset, the Committee presumes from the Facts of the Case that the Company in the extant case is not acting as an agent on behalf of the State Government. Further, the Accounting Standards referred hereinafter are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, and as applicable for the accounting year ending on 31st March 2024.

At the outset, the Committee notes that reference to earlier opinion issued on a similar subject has been made by the querist. In this regard, it may be mentioned that the Committee's opinions are based on the specific facts provided to it and may not necessarily apply in scenarios/situations with different facts. Further, the said earlier opinion was from Accounting Standards (AS) perspective and the query raised is from Indian Accounting Standards (Ind AS) perspective. Therefore, the Committee has independently examined the issue referred by the querist in the facts and circumstances given in the extant case and the extent to which the earlier opinion is applicable or relevant has not been examined by the Committee.

18. With regard to accounting for non-refundable upfront premium including processing fee, the Committee is of the view that it is important to first understand the nature of the arrangement under which such deposit was made and the asset, if any, that the Company is acquiring out of such arrangement. In this context, the Committee notes certain clauses of the MoA between the Company and the State Government as follows:

> "WHEREAS pursuant to the said basin-wise indicative list, State Government has approved the allotment of Kamala HEP (1800 MW) to the Company in accordance with the terms and conditions of State Hydro Power Policy 2008 and National Hydro Power Policy as well as subject to terms and conditions of this MOA as provided hereinafter;"
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> "2.3 The project shall be implemented by **the Company** on Build, Own, Operate and Transfer (BOOT) basis for lease period of 40 (forty) years from the commercial operating date (COD). The project shall be reverted to the state government on expiry of above lease period free of cost in good working condition."
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> "2.25 The Company shall be solely and absolutely responsible for liaising with Power Grid Corporation of India Limited (PGCIL) or any other Central Transmission Utility and State Transmission Utility (STU) that may come up subsequently for developing evacuation system for the Project and for timely evacuation of the power from the generating point."
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> "3.4 The ownership and possession of the government land / forest land allotted to the Company on perpetual lease for the Project shall at all times vest in the State and the Company shall have only limited right to use the said land exclusively for the development of the project and for no other purposes. The Company shall not have any right to create any third party right in the project land.
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> 3.5 The annual nominal lease fee shall be as payable by the Company for the project land shall be as per the rate approved by State Government."
>
> "4.5 The provisions of the Electricity Act, 2003 will be diligently adhered to during Implementation and subsequent operation and maintenance of Hydro-Power Station."

"5.4 It shall be the responsibility of the Company for the trading and sale of the power generated from the project. The State will not be in any manner responsible for the sale and trading of the power on behalf of the Company.

5.5 That notwithstanding anything contained anywhere else in this Agreement, after completion of forty (40) years from the Commercial Operation Date the Company being a CPSU the period can be extended beyond 40 years by the state Government on mutual consent and mutually agreed terms & conditions."

"11.3 In the event the contract is terminated or the extension for period requested by the Company is refused, the project shall be reverted to the State on "**as is where is**" basis along with all the reports, other documents etc., free from all encumbrances and liabilities. The State shall have the exclusive right to re-allot the project to any third party free from all encumbrances and any liability of the State towards the Company or any third party for the further development of the project."

The Committee notes from the above and the Facts of the Case that the Ministry of Power, Government of India, has approved the proposal of the Company for acquisition of the above project and the project has been allotted to the Company by the State Government vide letter dated 21/07/2023. Further, the project shall be implemented by the Company on BOOT (Build, Own, Operate & Transfer) basis for a period of 40 years from the commercial operation date (COD) and will revert back to the State Government on expiry of the above period, free of cost, in good working condition. Further, the rates or tariff for power generated are to be charged by the Company from the end users as per the Electricity Act and other guidelines as issued by the CERC.

19. In the above context, the Committee examines the applicability of Appendix D, 'Service Concession Arrangements' to Ind AS 115, 'Revenue from Contracts with Customers' in the extant case and notes the following requirements of Appendix D:

"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."

"15 If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognised in accordance with Ind AS 115. The consideration may be rights to:

(a) a financial asset, or

(b) an intangible asset.

16 The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable

by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

17 The operator shall recognise an intangible asset to the extent that it receives a right (a licence) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.

18 If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognised initially in accordance with Ind AS 115."

"**Intangible asset**

26 Ind AS 38 applies to the intangible asset recognised in accordance with paragraphs 17 and 18 of this Appendix. Paragraphs 45–47 of Ind AS 38 provide guidance on measuring intangible assets acquired in exchange for a non-monetary asset or assets or a combination of monetary and non-monetary assets."

The Committee further notes that the Basis of Conclusion (BC) paragraphs of IFRIC 12, 'Service Concession Arrangements', issued by the International Accounting Standards Board (IASB), corresponding to the above-said Appendix D to Ind AS 115, state as follows:

"BC32 In some circumstances, the grantor makes a non-cash payment for the construction services, ie it gives the operator an intangible asset (a right to charge users of the public service) in exchange for the operator providing construction services. The operator then uses the intangible asset to generate further revenues from users of the public service."

"BC36 The IFRIC observed that the contractual rights that the operator receives in exchange for providing construction services can take a variety of forms. They are not necessarily rights to receive cash or other financial assets.

BC37 The draft Interpretations proposed that the nature of operator's asset depended on who had the primary responsibility to pay the operator for the services. The operator should recognise a financial asset when the grantor had the primary responsibility to pay the operator for the services. The operator should recognise an intangible asset in all other cases."

"BC66 The IFRIC considered when the operator should first recognise the intangible asset. The IFRIC concluded that the intangible asset (the licence) received in exchange for construction services should be recognised in accordance with general principles applicable to contracts for the exchange of assets or services."

The Committee notes from the above that an arrangement within the scope of Appendix D to Ind AS 115 typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it and operating and maintaining that infrastructure for a specified period of time. Further, a feature of these service arrangements is the public service nature of the obligation undertaken by the operator, i.e., the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. In the extant case, although the Agreement has been entered into between the State Government and the Company (which is central public sector enterprise), 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. Accordingly, the Committee is of the view that Appendix D would still be applicable even if the Company in the extant case is ultimately controlled by the government, as the Company is providing the services related to the infrastructure (viz., hydroelectric power) to the general public; and is presumably acting independently and not as an agent on behalf of the grantor (State Government) in respect of the agreement/arrangement. The Committee is of the view that the said agreement is within the scope of Appendix D to Ind AS 115, since;

- Electricity being a regulated product, tariff for the power generated is determined by the CERC based on CERC Tariff Regulations and Electricity Act. Therefore, the criterion in paragraph 5(a) of Appendix D is met; and

- the grantor (State Government) controls through beneficial entitlement the significant residual interest at the end of the concession period of 40 years in the infrastructure (hydroelectric power infrastructure). Therefore, the criterion in paragraph 5(b) of Appendix D is also met.

20. Further, on a perusal of the terms of the MoA between the State Government and the Company for execution of the Project, the Committee further notes that the MoA in the extant case does not grant the Company any unconditional contractual right to receive cash or another financial asset from or at the direction of the State Government for the project construction services; rather it grants to the Company a right to charge tariff to the power users. Since this right to charge purchasers / users is not an unconditional right to receive cash as the same is contingent on the extent that the public purchases or uses the power, the Committee is of the view that the Company in the extant case shall recognise intangible asset as per the requirements of paragraph 17 of Appendix D. Further, the Committee notes that the Company provides construction services to the grantor (State Government) in exchange for this intangible asset. In accordance with Ind AS 115, 'Revenue from Contracts with Customers', the non-cash consideration (i.e. intangible asset) is to be measured at fair value, which is normally determined indirectly by reference to the standalone price of the construction services deleivered (refer paragraphs 66 and 67 of Ind AS 115). The Committee notes that in the extant case, it appears from the Facts of the Case that the payment of the premium to the State Government is a pre-condition to obtain the right to construct and operate the project and the reimbursement of the premium to the erstwhile developer is necessary as a part of overall arrangement with the State Government to acquire such right from the erstwhile developer; therefore, the same shall form part of determination of standalone price of the construction services delivered (as discussed above). Accordingly, the consequential 'intangible asset' would be recognised at the amount including the upfront premium paid as per the above-mentioned requirements of Ind AS 115.

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

D. Opinion

22. On the basis of the above, the Committee is of the opinion on the issue raised in paragraph 16 above that in the extant case, the reimbursement of the premium to the erstwhile developer is necessary as a part of overall arrangement with the State Government to acquire the right to construct and operate the project from the erstwhile developer; therefore, the same shall form part of determination of stand-alone price of the construction service delivered and the intangible asset received in exchange of such construction services measured as per the requirements of Ind AS 115, as discussed in paragraphs 19 and 20 above, Accordingly, the intangible asset would be recognised at an amount including the aforesaid premium paid.

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