

Query No. 21

Subject: *Accounting treatment of infrastructural development cost incurred by an entity, under Ind AS framework.*¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a special purpose public company established by the Government of Karnataka (represented by Karnataka Industrial Acquisition and Development Board or ‘KIADB’) and the Government of India (represented by National Industrial Corridor Development and Implementation Trust or ‘NICDIT’). The primary objective of the Company is to implement the National Industrial Corridor Programme of the Government and to develop the Tumakuru Node of Chennai Bengaluru Infrastructure Project. As per the National Industrial Corridor Programme, the Government aims to develop industrial cities which can compete with best manufacturing and investment destinations in the world.

2. The querist has stated that as per the shareholders agreement, it was mutually agreed upon that the project would be equally financed by both the shareholders, i.e., Government of Karnataka and Government of India. Accordingly, the KIADB on behalf of the Government of Karnataka has contributed approximately 1668 Acres of land and NICDIT has contributed money equivalent to the value of land on behalf of the Government of India. Subsequent to obtaining both the land and financial contribution, the Company would develop basic infrastructure facilities such as roads, electricity, water, sewage etc. and provide the same to the industrial units for establishment of factories.

3. In compliance with rules and regulations prevalent in the state of Karnataka for the transfer of the industrial land, a lease agreement for a period of 99 years was executed in favour of the Company and the possession of the land was handed over to the Company. As per the terms of the lease agreement, the lessee was entitled to exercise an option for further extending the lease terms for two terms of 99 years each. Subsequent to amendment in policy for allotment of industrial land by the Government of Karnataka, the tenure of the lease agreement between the Company and KIADB was amended from 99 years to 2 years. Further, the Company intends to register the land in its own name at the end of two years.

4. The Company, subsequent to obtaining the land on lease, has commenced development works such as laying of roads, building drainage systems, establishment of transformers, power transmission lines, providing water connectivity and other facilities (‘infrastructural facilities’). The cost for carrying out development of infrastructural facilities would be incurred by the Company. As per the shareholders agreement between KIADB and NICDIT, the Company is entitled to recover both the land cost and cost incurred for facilities development from its customers. However, the Company will not transfer the ownership of common infrastructural facilities such as roads, drainage systems, electricity transmission infrastructure etc. to the customers but would include the cost of development in determination of price for transfer of industrial land. On completion of development of infrastructural activities, the Company would collect fees from occupants of the industrial township for maintenance of the infrastructure facilities.

¹ Opinion finalised by the Committee on 6.9.2024.

Accounting treatment in books of account

5. The querist has stated that Company at present has applied lease accounting as per Indian Accounting Standard (Ind AS) 116, 'Leases' on land obtained on lease from the Government and recognised both Right of Use (RoU) Asset and Lease Liability. As the Company intends to exercise the purchase option available under the revised policy for allotment of industrial land and sell the same to its customers, the leasehold land was disclosed as inventory in the Balance Sheet as per paragraph 47 of Ind AS 116.

6. The querist has further stated that the cost incurred by the Company on development of infrastructural facilities was disclosed under the head 'inventories' due to the following reasons:

- (a) As per Ind AS 2, 'Inventories', inventories are assets that are held for sale in the ordinary course of business. The main objective of the Company is development of leasehold land and sale of the same to industrial undertakings. As per paragraph 47 of Ind AS 116, the Company has an option to disclose the leasehold assets under the same line in which they would be included if they were owned. As the Company's main objective is development and sale of industrial land, the lease hold land was disclosed as inventories in the Balance Sheet.

Further, as per paragraph 10 of Ind AS 2, the cost of inventories shall include costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location. Hence, development costs were disclosed under inventories because as per the shareholders agreement, the Company was required to provide land with basic infrastructural facilities and not merely land to industrial undertakings.

- (b) Further, as per the shareholders agreement between KIADB and NICDIT, the principal business of the SPV shall include preparation of master plan, undertake construction works, maintenance of Industrial Township and sale, lease, sub-lease of land in a manner which the Company deems fit. Hence, both the land and development cost were classified under inventories in the balance sheet.
- (c) As the Company is entitled to recover the cost incurred on facilities development from customers and intends to exercise this option, the Company has disclosed the amount of expenditure incurred on development of infrastructure facilities as inventories.

7. However, during the review of accounts for the financial year (F.Y.) 2023-24, the statutory auditor issued a qualification in the independent auditors report and mentioned that disclosure of cost of development of infrastructural facilities under inventories has resulted in overstatement of inventories and understatement of lease hold asset. According to the querist, the reason behind this assessment that infrastructural facilities must be disclosed as leasehold asset may be due to the following reasons:

- (i) the Company is not transferring the ownership of infrastructural facilities to its customers.
- (ii) the Company is earning income by collecting maintenance fees for upkeep of the infrastructural facilities.

B. Query

8. In view of the above facts, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) whether the method of presentation of cost of infrastructure facilities under the head inventory until the date of completion of development and transfer is appropriate, or whether,
- (ii) the Company should disclose the cost of development of infrastructure facilities as investment property as the Company is going to earn maintenance income, or whether,
- (iii) the Company should include the cost of development of infrastructure facilities as leasehold asset as per the direction of the Comptroller and Auditor General of India (C&AG).

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to accounting treatment of infrastructural development cost incurred by an entity, such as, roads, electricity facilities, water and sewage facilities etc. (hereinafter referred to as 'infrastructure facilities') on the land transferred to it by KIADB as per shareholders agreement (SHA) subsequent to the amendment in policy for allotment of land by the Government of Karnataka. 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, accounting for land contributed by the KIADB and funds contributed by NICDIT, accounting for transfer of industrial land to the customers including presentation of such land in the financial statements of the Company, fees for maintenance received from occupants, accounting in the financial statements of KIADB and NICDIT, etc. The opinion expressed hereinafter is in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended from time to time. Further, the opinion is purely from accounting perspective and not from the perspective of legal interpretation of shareholders agreement, lease agreement(s), State policy for allotment of land, etc.

At the outset, the Committee notes that the querist had earlier referred another query to EAC earlier containing, inter alia, an issue with regard to presentation of land received by the Company from KIADB. In that case, on a perusal of the Lease Agreement including Supplementary Lease Agreement and Shareholders Agreement, the Committee had opined that in substance, the Company appears to have 'control' over the land leased/provided to it by the KIADB. The said arrangement was in-substance purchase of land; and accordingly, the requirements of Ind AS 116 would not be applicable on the transfer of land to the Company by KIADB.

In the extant case, based on the above-mentioned opinion, the Committee has proceeded on the premise that the land on which the infrastructure facilities have been developed by the Company is 'controlled' by the Company and therefore, the question of inclusion of the cost of development of infrastructure facilities as leasehold asset does not arise. Further, the Committee notes that in the earlier query as aforementioned, another issue was also raised with regard to classification of land under development, wherein the Committee had inter alia opined that the Company will have to make a judgement based on its own facts and circumstances and intention

to hold the land, so as to determine whether it would be appropriate to classify the same as inventories under Ind AS 2 or as investment property under Ind AS 40, 'Investment Property'.

10. With regard to the issue raised in this query, The Committee notes the following relevant clauses of the shareholders agreement (SHA) between KIADB and NICDIT:

“2.1.1 The industrial Township shall mean and include the construction, development, operation and maintenance of the Industrial Township, including ... Facilities Development, Trunk Infrastructure and Strategic Projects, ...”

“3.2.1 The principal business of the SPV shall be to implement the Industrial Township, Trunk Infrastructure and the Strategic Projects, in accordance with the Scope of Projects and the provisions of this Agreement (“**Principal Business**”). Accordingly, the Principal Business shall include preparation of the Master Plan, undertaking by itself or through other Persons the Construction Works, operation and maintenance of the Industrial Township, Trunk Infrastructure and the Strategic Projects, including for the avoidance of doubt, provision of Urban Services, collection of Fee, and such other matters incidental thereto or necessary for the performance of any or all of the SPV’s obligations under this Agreement.”

“3.2.5 Subject to and in accordance with the provisions of this Agreement, ... the Grant hereby granted shall ... entitle the SPV to undertake development, construction, operation and maintenance of Industrial Township, Trunk Infrastructure and Strategic Projects on the Site ... and to exploit such development for commercial purposes (the “**Facilities Development**”) which shall, ... include the right to sell, lease, sub-lease or license any or all parts thereof, demand and collect Fee and undertake such other activities incidental thereto or necessary for the same, in the manner SPV deems fit. ... Facilities Development shall include development and construction of residential, commercial and industrial assets, including support infrastructure for the same.”

“3.6 Facilities Development

3.6.1 The SPV shall undertake the Facilities Development on the Site specified in **Schedule- A**, and to exploit such development for commercial purposes with the right to sell, lease, license any or all parts thereof and demand and collect Fees and undertake such other activities incidental thereto or necessary for the same, as specified in Clause 3.2.5.

3.6.2 The development and maintenance of infrastructure such as roads, electric supply, water supply, sewerage and drains as part of the Facilities Development, shall be undertaken or caused to be undertaken by the SPV ...

...

3.6.4 Taxes and Revenues

(a) The SPV shall be entitled to recover Fee from the Users of the Facilities Development.

...”

From the above, the Committee notes that as per SHA, various types of infrastructure facilities are required to be constructed/developed, such as roads, electric supply infrastructure, water supply infrastructure, sewerage and drains, etc. which shall also be operated and maintained by the Company and for which the Company is entitled to charge user fee from the users of these infrastructural facilities.

The Committee further notes from the facts supplied by the querist that the Company is entitled to recover both the land cost and cost incurred for facilities development from its customers. However, the Company will not transfer the ownership of common infrastructural facilities such as roads, drainage systems, electricity transmission infrastructure etc. to the customers but would include the cost of development in determination of price for transfer of industrial land. On completion of development of infrastructural activities, the Company would collect fees from occupants of the industrial township for maintenance of the infrastructure facilities.

11. With regard to accounting treatment of cost incurred for development of infrastructure facilities, the Committee notes that the first issue to be examined in the extant case is whether an individual asset (tangible or intangible) comes into existence and may be recognised in respect of such expenditure. In this regard, the Committee notes the definition of ‘asset’ and requirements with regard to ‘control’ from Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS), issued by the Institute of Chartered Accountants of India (hereinafter referred to as ‘Conceptual Framework’) and Ind AS 38, ‘Intangible Assets’ as follows:

Conceptual Framework

“4.3 An asset is a present economic resource controlled by the entity as a result of past events.

4.4 An economic resource is a right that has the potential to produce economic benefits.”

“4.20 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.”

“4.23 For an entity to control an economic resource, the future economic benefits from that resource must flow to the entity either directly or indirectly rather than to another party. This aspect of control does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances. Instead, it means that if the resource produces economic benefits, the entity is the party that will obtain them either directly or indirectly.”

Ind AS 38

“An asset is a resource:

- (a) controlled by an entity as a result of past events; and**
- (b) from which future economic benefits are expected to flow to the entity.”**

“Control

- 13 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. The capacity of an entity to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.”

From the above, the Committee notes that in order to meet the definition of an asset, the entity must have the power or present ability to obtain the future economic benefits flowing from the underlying resource and to restrict or prevent the access of others to those benefits. The Committee further notes the following requirements of Ind AS 16, ‘Property, Plant and Equipment’:

“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.”**

“Elements of cost

- 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.”

From the above, the Committee notes that in the extant case, the future economic benefits in the form of user charges from the infrastructure facilities constructed, as mentioned in paragraph 10 above seem to arise exclusively to the Company and it has the power or present

ability to restrict or prevent the access of others to those benefits through ownership of these facilities. Further, the cost incurred can also be measured reliably and therefore, the same meets the recognition criteria of property, plant and equipment and thus, should be recognised as an individual item of PPE as per the principles of Ind AS 16. However, if there is any expenditure incurred on development of such facilities that is not directly attributable to bringing these assets to the location and condition necessary for them to be capable of operating in the manner intended by management, the same would need to be expensed in the Statement of Profit and Loss unless it can be considered as part of the cost of another asset, for example, if the expenditure pertains to cost of development of industrial land to be sold/leased to industrial users, the Company should evaluate whether it can be considered as cost of inventories or cost of investment property to be recognised by the Company as per the requirements of Ind AS 2, 'Inventories' and Ind AS 40, 'Investment Property' (as mentioned in paragraph 9 above).

12. The Committee also wishes to mention that just because the Company is able to recover the cost of development of infrastructure facilities through sale or otherwise transfer of developed industrial plots of land (inventories) to industrial units/customers does not mean that the same can be automatically included as the cost of inventories. For inclusion as part of the cost of inventories, the expenditure should meet the requirements of Ind AS 2.

D. Opinion

13. On the basis of the above and subject to paragraph 9 above, the Committee is of the opinion that in the extant case, since the future economic benefits in the form of user charges from the infrastructure facilities constructed appears to arise exclusively to the Company and it has the power or present ability to restrict or prevent the access of others to those benefits through ownership of these facilities; and since the cost incurred can also be measured reliably, the expenditure incurred meets the recognition criteria of property, plant and equipment and thus, should be recognised as an individual item of PPE as per the principles of Ind AS 16. However, if there is any expenditure incurred on development of such facilities that is not directly attributable to bringing these assets to the location and condition necessary for them to be capable of operating in the manner intended by management, the same would need to be expensed in the Statement of Profit and Loss unless it can be considered as part of the cost of another asset for example, if the expenditure pertains to cost of development of industrial land to be sold/leased to industrial users, the Company should evaluate whether it can be considered as cost of inventories or cost of investment property to be recognised by the Company as per the requirements of Ind AS 2, 'Inventories' and Ind AS 40, 'Investment Property', as discussed in paragraph 11 above.
