

Query No. 11

- Subject:** (i) *Accounting treatment of expenditure incurred on the Electrification of Broad-Gauge Rail Line; and*
(ii) *Accounting treatment of Resurfacing Cost.*¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’), was incorporated on 30th May 2000 under the Companies Act, 1956 (now the Companies Act, 2013), having its registered office at New Delhi. It is the first joint venture company of the Ministry of Railways, Government of India, with the equity participation of M/s G Limited. It is a Special Purpose Vehicle (SPV) of Indian Railways (IR) which was created for the purpose of providing a Broad-Gauge rail line connectivity to the P Port from Surendranager (Gujarat) (i.e. Project Railway).

2. *Arrangement of the Company with Indian Railways:*

The Company has a Service Concession Arrangement with Indian Railways by executing the following agreements:

- (i) *Concession Agreement:* The Company had entered into a Concession Agreement with Ministry of Railways (MOR), Government of India on 28th June 2001 for a period of 33 (thirty-three) years (i.e. Concession Period) whereby MOR had conferred concessionaire rights on the Company to provide a Broad Gauge rail line connectivity to Pipavav Port from Surendranager in the State of Gujarat. Under the terms of the Concession Agreement, the Company is a Non-Government Railway Administration in respect of the above rail line (i.e. Project Railway) and is entitled to the rights, obligations and duties of a Railway Administration enumerated in the Railways Act, 1989. The Concession Agreement also entitles the Company to exercise all the rights and authorities vested as the Concessionaire under the Concession Agreement and also to have the exclusive right and authority during the Concession Period to implement the Project. These rights include the rights (Clause 4.2 of the Agreement):
- (a) To develop, design, engineer, finance, market, procure, construct, own and operate the above referred Broad Gauge rail line (i.e. Project Railway), and market freight services for the Project Railway for which the Company shall have the right to appoint, supervise, monitor and control the activities of contractors,
 - (b) To develop additional facilities in the project area, which are in the interest of the Project, whether in terms of additional stations and freight handling facilities, crossing stations, or any other facility for the purpose,
 - (c) To receive its share (from Indian Railways) of the tariff (earning) generated from rail freight traffic originating, terminating and moving on the Project Railway (including haulage charges collected from container operations),

¹ Opinion finalised by the Committee on 12.9.2025.

- (d) To commercially exploit the Project Assets,
- (e) To levy and charge tariffs for container traffic subject to rights of container operations being granted by MOR to the Company.
- (ii) *Lease Agreement:* The Company has also signed a Lease Agreement with MOR whereby MOR has given existing assets (i.e. meter gauge formation, station building etc. that were existing at the time of signing the Concession agreement) to the Company and the land newly acquired by MOR for the purpose of construction of above Broad-Gauge rail line from Surendranager to Pipavav. The Company has been paying lease rent to MOR for these leased assets. Term of Lease Agreement is co-terminus with that of the Concession Agreement.
- (iii) *Construction Agreement:* The Company has entered into the Construction Agreement with Western Railway (a Zonal Railway of the Indian Railways) whereby the Company has appointed Western Railway as contractor to construct above line.
- (iv) *Operation and Maintenance Agreement:* The Company has also entered into the Operation and Maintenance Agreement with Western Railway in February 2003 for carrying out operations and maintenance of Project Railway. The term of the Operation and Maintenance Agreement is coterminous with that of Concession Agreement.

3. *Activities under the Company's Arrangement with Indian Railways:*

- (i) The Company, as the concessionaire, has constructed the Broad-Gauge rail line from Surendranager to Pipavav and has provided rail line connectivity to Pipavav Port. After construction, the above rail line was successfully commissioned in the year 2003 and goods trains had started to run on the above rail line.
- (ii) Newly constructed rail line was taken over by Western Railway for operation and maintenance under the terms of Operation and Maintenance Agreement and Western Railway has been doing the operation and maintenance on the above rail line.
- (iii) Railways performs all activities associated with goods train operations such as booking cargo, charging and collecting rail freight from the customers, issuing railway receipts, dealing with customers, running the goods train on the above rail line etc. Western Railway incurs expenditures for carrying out operations and maintenance (including various need-based activities and making replacement of various items of the Project assets on expiry of their useful lives as per Railways' standards) on the above rail line and the cost of the same is charged by Western Railway to the Company.
- (iv) The Company has also been carrying out the following activities on Project Railway subsequent to its construction, as the need arises:
 - (a) *Creation of additional facilities, line capacity works on the Project Railway:* The Company, exercising rights of concessionaire in terms of the Concession Agreement, has also been creating /developing additional facilities in the

Project Area in the interest of the Project. One of such facilities includes electrification of the above rail line done by the Company during the financial year (F.Y.) 2020-21.

- (b) *Major Replacement works (Resurfacing Cost):* Under the Concession Arrangement with Railways, there is an obligation on the Company to keep the project assets in working condition, including making replacement, as per standards laid down by MOR, of all project assets whose codal lives (i.e. useful lives) expire during the Concession Period. Therefore, the Company has been carrying out the replacement of various items of the Project Railway on expiry of their codal lives within the Concession Period. These activities of Major Replacement works are not frequent/ routine in the nature.

After the end of Concession Period, all the assets created by the Company (within the Project Area) shall revert back to MOR as per the terms of the Concession Agreement.

- (v) *Transactions from the Activities under the Company's Arrangement with Indian Railways*

Following transactions have taken place from the activities carried out under the Arrangement with Indian Railways:

- (i) The Company had initially incurred the cost of construction of above rail line.
- (ii) After construction of above line, share of rail freight earning is accrued to the Company from running of goods train by Indian Railways on the above line. The Company's share of freight earning is worked as per the rules of Indian Railways' Financial Adjustments (i.e. total freight earning is shared by Indian Railways (IR) with the Company in ratio of the distance of the Company line over which goods train runs and total distance run by goods train on the entire rail networks).
- (iii) The Company has been incurring cost of operations and maintenance of the above rail line, which is charged by Western Railway to the Company.
- (iv) The Company has also been paying lease rent charges to Indian Railways for assets initially leased by MOR to the Company under the terms of Lease Agreement.
- (v) Western Railway (WR) makes payment to the Company, its share of freight earning after making deduction of cost of operation and maintenance of the above line on a monthly basis. WR charges lease rent and makes recovery of the same from the Company's share of freight earning on a quarterly basis.
- (vi) Therefore, the Company gets its share of the freight earning from Western Railway on a net basis, i.e. after deduction of cost of operations and maintenance and lease rent charges.
- (vii) The Company also incurs:
 - (a) Expenditure on creation / development of additional facilities on Project Railway and
 - (b) Expenditure on replacement of major items of Project Railway after expiry of codal (useful) lives of these items. These expenditures are not frequent/ routine in nature rather the same are incurred as and when major replacement of various items of Project Railway is due on expiry of their codal lives.

4. *Accounting for Transactions under the Arrangement with Indian Railways:*

The Company has adopted Indian Accounting Standards (Ind AS), notified and made applicable by Government of India under the Companies Act, 2013, for the preparation of the financial statements effectively for the financial year 2016-17 and onwards.

For the purpose of accounting and financial reporting of the transactions arising out of Project Railway, the Company has treated its above arrangement with Indian Railways as Public-to-Private Service Concession Arrangement:

- (i) Up-to 31st March 2018, the accounting principles related to Service Concession Arrangement were dealt with by the Appendix A to Ind AS 11, 'Construction Contracts'. Accordingly, the Company had applied Appendix A to Ind AS 11 (Service Concession Arrangement) for accounting and reporting of transactions in respect of the Project Railway.
- (ii) With effect from 1st April 2018, Government of India had withdrawn Ind AS 11 'Construction Contracts' and Ind AS 18, 'Revenue'; and notified new Ind AS 115, 'Revenue from Contracts with the Customers'. Appendix D to Ind AS 115 deals with 'Service Concession Arrangement'. Accordingly, the Company has applied Appendix D to Ind AS 115 for accounting and reporting of transactions in respect of the Project Railway for accounting periods starting from 1st April 2018.
- (iii) The arrangement of the Company with MOR (Indian Railways) meets all the conditions of Appendix D to Ind AS 115 such as:
 - (a) The MOR (the grantor) controls/ regulates what services the Company (operator) should provide with the Project Railway (i.e. infrastructure) and to whom it must be provided,
 - (b) MOR controls the price to be charged to the customers, as the rail freight tariff is decided and fixed by MOR over which the Company does not have control and
 - (c) MOR also controls residual interest in the infrastructure at the end of the term of the arrangement.
- (iv) Accordingly, the Company has been accounting for the transaction in respect of Project Railway in accordance with Appendix D to Ind AS 115 (Service Concession Arrangement) as under:

(a) Accounting of initial cost of construction of the above rail line:

Paragraph 15 of Appendix D to Ind AS 115 provides that, "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." Paragraph 17 of the Appendix provides that, "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."

On construction of Broad-Gauge rail line (from Surendranager to Pipavav) by the Company, the Company has received right to get share of freight earning from the use of the above rail line by the general public. Rail line constructed by the Company meets the conditions of Service Concession Arrangement. Therefore, the Company has recognised the initial cost of construction of the above Broad-Gauge rail line as 'Intangible Assets' in the books in accordance with Appendix D to Ind AS 115.

The Company has been amortising construction cost of the above rail line in the books equally over useful life (i.e. the Concession Period during which the Company has right to get the share of freight earning from the use of the above line).

(b) Accounting for subsequent expenditure incurred after construction on the above rail line:

- (i) The Company incurs expenditures for routine operation and maintenance of the above rail line and also to keep the rail line at its serviceable level and the same do not result in enhancement of rail line capacity. The Company has been recognising these expenditures as revenue expenditure in the books in the year of incurrence and charge the same to the Statement of Profit and Loss.
- (ii) The Company also incurs expenditure to upgrade the Project Railway or to enhance the line capacity or to create additional facilities on the above rail line which results into the improved train operations or creation of additional feature/ facility on the rail line giving rise to future economic benefits to the Company. The Company has been recognising these expenditures as capital expenditure and the same are added to the initial cost of rail line as intangible asset in the books. After capitalisation, the same are amortised in the books prospectively equally over the remaining Concession period.

5. *Audit of the Financial Statements of the Company by the Office of Comptroller and Auditor of General of India (CAG):*

The financial statements of the Company are subject to supplementary audit by Comptroller and Auditor of General of India (CAG) under section 143(6) of the Companies Act, 2013.

The office of CAG has carried out the supplementary audit of the financial statements of the Company for the financial year 2023-24. During the supplementary audit, the CAG office has given the following Provisional Comment:

Comment No. 1

Comments on profitability

Assets-1. Non-current assets-

(c) Other Intangible assets- Note 4- Rs. 33868.13 lakh

Statement of Profit and Loss

Expenses Rs. 34496.05 lakh

Profit/ (loss) for the period - Rs. 2332.09 lakh

The above head of Other Intangible assets includes Rs. 1205.46 lakh towards additions of Overhead Equipments (OHE) cost of Railway Electrification and other items. As per the Concession Agreement, the Company has no ownership of the railway infrastructure assets created by it. By electrifying the railway line and additionally spending on OHE, there would be no increase in the amount of freight revenue share to be received from MOR.

The Company in its reply has stated that expenditure incurred on electrification of the Company line, gives right to the Company not only to increase its net cash inflow on account of the reduced costs, but also results into improved operations from the use of the electric traction. These benefits are not limited to a particular year; rather the same would be accruing to the Company throughout the concession period. But the Company has not worked any estimated benefit to be accrued to the Company.

Therefore, it should have been charged to the Statement of Profit and Loss as expenses instead of booking the same as intangible assets.

The same is in violation of Appendix D of Ind AS 115, 'Revenue from Contracts with Customers'. This has resulted in overstatement of 'Other Intangible Assets', 'Profit for the year' and understatement of 'Expenses' by Rs. 1205.46 lakh.

In this connection, the quantum of additional future benefits by spending on OHE-RE, if any computed by the Company may be submitted to audit along-with supporting documents.

The Company has submitted a detailed reply on the above Provisional Comment to the CAG office. In context of the above Comment, it is to mention that:

- (a) The Company has carried out rail electrification work on the above rail line and upgraded the same into the electrified rail line. The electrification of the rail line was completed in F.Y. 2020-21 and goods trains started running on the above line in the electric mode of operations (which were earlier running by use of diesel). However, some pending leftover works are being completed by agency.
- (b) Since goods train operations commenced on the above rail line in electric mode in the F.Y. 2020-21, the Company had capitalised the cost of rail electrification work in F.Y. 2020-21 provisionally initially at Rs. 27451.71 lakh in the books as per advices/ information of the expenditures received from the executing agency.
- (c) The Company has been amortising the above capitalised cost in the books over the remaining Concession Period effectively from the date of starting the rail operations in electric mode on the above line.
- (d) The Company has updated the cost of electrification work in the books as per the details of updated expenditures on receipt from the executing agency in respect of rail electrification work, as under:

| Period in which further expenditures are booked | Amounts of further expenditures booked in respect of Rail electrification work | Updated capitalised cost of Rail Electrification Work after booking the further expenditures |
|---|--|--|
| F.Y. 2021-22 | Rs. 1,376.21 Lakh | Rs. 28,827.92 Lakh |
| F.Y. 2022-23 | Rs. 776.58 Lakh | Rs. 29,604.50 Lakh |
| F.Y. 2023-24 | Rs. 1,173.03 Lakh | Rs. 30,777.53 Lakh |

- (e) As seen from the above table, the Company has capitalised Rs. 1173.03 lakh towards the cost of rail electrification work during the current year 2023-24 which is as per the updated information of expenditure received by the Company from the executing agency. The updated capitalised cost of electrification work is being amortised in the books prospectively over the remaining concession period (i.e. useful life).
- (f) Final cost of the work is yet to be ascertained by the agency; therefore, capitalised cost of rail electrification work is subject to adjustments on receipt of the final cost of the rail electrification work from the executing agency. Accordingly, capitalised cost of rail electrification work will be adjusted as per final bill and be amortised prospectively over the remaining concession period. The Company has also appropriately disclosed these facts at Note No. 4 of its financial statements.
- (g) Indian Railways has mission of 100% electrification of rail networks in India. As a part of this mission, the Company's section had also been electrified along-side the IR's network. Electrification of the Company line was essential and is in the overall interest of the Company not only to retain the traffic on the Company line but also to attract more traffic avenues by being compatible with surrounding Electrified rail network of Indian Railways. Without electrification, the Company would have been losing the traffic and cost of operations would be more expensive.
- (h) Clause 4.2(f) of the Concession Agreement between the Company and MOR confers on the Company, "*right to **develop Additional Facilities** in the Project Area, which are in the interest of Project, whether in terms of additional stations and freight handling facilities, crossing stations or any other facility for the purpose*". Accordingly, the Company, having exercised right as a Concessionaire under the Concession Agreement, has created additional facility/ assets in form of Overhead Equipment (OHE) assets / Traction Distribution (TRD) assets on the Project Railway. With this, initially constructed Broad Gauge line (being diesel line) has been upgraded into electrified Broad Gauge rail line by making investment on the above rail line by the Company.
- (i) As per clause 4.2(e) of the Concession Agreement, the Company has right "*to develop, design, engineer, finance, market, procure, construct, **own** and operate the Project Railway and market freight services ...*" In view of this clause, the Company is owning the infrastructure created by it (during the Concession Period) and the cost of infrastructure is capitalised.
- (j) Further, *there is recurring benefit of electrification to the Company* in form of significant saving in cost of fuel to the Company since train operation performed in electric mode is much cheaper as compared with that of diesel mode. The above

expenditures have been benefiting the Company in form of economical, more efficient and time effective goods train operations on the above line. This benefit is not limited to a particular year but is bound to accrue during the entire Concession Period.

- (k) It is to mention that, there has been net saving of cost of Rs. 71.78 crores to the Company upto November 2024 (since start of electric operation on the Company's line) due to running of goods train on electrified rail line, as under:

| Period | Diesel Train Operations | | Electric Train Operations | | % of Electric goods train operations | Net saving in cost due to electric train operations (in Rs. Crores) |
|-----------------------|---|---------------------------|--------------------------------|-----------------------------|--------------------------------------|---|
| | Fuel cost (in Rs. Crores) | GTKM (Diesel) (in Crores) | Cost of Energy (in Rs. Crores) | GTKM (Traction) (in Crores) | | |
| 2022-23 | 60.81 | 267.81 | 5.32 | 132.15 | 33% | 20.91 |
| 2023-24 | 48.25 | 271.60 | 7.71 | 235.52 | 46% | 27.71 |
| 2024-25 (till Nov-24) | 25.36 | 151.58 | 4.42 | 154.85 | 51% | 17.78 |
| | Add: Initial benefit of net cost saving (upto Mar-22) | | | | | 5.38 |
| | Net benefit of reduction of cost due to Rail Electrification (up-to Nov-24) | | | | | 71.78 |

Note: GTKM refers to Gross Tonne Kilometre carried out by freight train on the Company line

Saving in the cost is also accruing to the Company during the subsequent period and will continue to accrue to the Company upto the end of Concession Period.

- (l) From the above table, it is evident that the Company has been getting significant benefit of reduction in cost year over year due to electrification of the Company's line. This saving in cost due to electric trains operation on the Company's line upto F.Y. 2024-25 is 51% only. In the coming years, this percentage is bound to increase in view of shifting of train operations more on electric mode of train operations. Therefore, more saving in cost would accrue to the Company.
- (m) It is to mention that the Government of India has mandated 100% electrification of Indian Railways' networks in a target mode. Therefore, it has become inescapable for the Company to electrify the rail line as non-electrification of the Company's line would render loss of business to the Company and make train operations with enhanced cost. Therefore, the Company has electrified its rail line which has not only sustained its business but is also accruing recurring benefits in form of saving of cost and smooth rail operations on its rail line.

- (n) As a result of expenditure incurred by the Company on the rail electrification work, new TRD assets have been created on the Company's line, which have been reaping economic benefits to the Company in form of *improved rail operations* and *saving in the operating costs*.
- (o) Paragraph 15(b) of Appendix D to Ind AS 115 (Service Concession Arrangements) provides to recognise intangible assets in respect of *construction/ upgrading activities* by Concessionaire. Rail electrification work is the activity to upgrade the Broad-Gauge line into Electrified Broad-Gauge line. Therefore, expenditure incurred by the Company on rail electrification work (and also to create TRD/OHE assets) on the Project Railway has been recognised as 'Intangible Asset' in compliance with Appendix D to Ind AS 115.
- (p) TRD/OHE assets are the permanent structure/ assets. These assets are having life which shall be going beyond the Concession Period.
- (q) Also, the Company owns the project assets on BOOT basis including the TRD/OHE assets created on execution of the rail electrification works. Further, clause 8.1 of the Concession Agreement provides that, "Upon expiry of the agreement all the assets created by the Company within the Project Area shall revert back to MOR for a consideration equivalent to Depreciated Replacement Value (DRV) of these assets.....". Hence, the Company would also be entitled to receive DRV in respect of TRD/OHE assets as well, in the terms of the Concession Agreement. Since the new assets created on electrification of rail line will have residual value to be received on expiry of the agreement, these cannot be written off as 'Revenue Expense' as of now in a single year. Therefore, the Company has not treated the above expenditure as revenue, but the same is the investment made by the Company in the Project Railway for improved operations and cost saving.
- (r) The benefits of reduced costs and improved rail operations accruing to the Company from rail electrification work are not limited to a particular year; rather the same would be accruing to the Company throughout the concession period. Hence, it would not be appropriate to charge the expenditure incurred on electrification to the profits in a single year whereas the benefit of the same is accruing over the concession period. Charging the cost of rail electrification work as revenue expenditure in a single year would hence result in deviation from basic accounting fundamental of 'Matching Concept'.
- (s) The Company has been consistently following the same accounting methodology since inception of the rail electrification work; and the cost of work is also capitalised in previous financial years i.e. 2020-21, 2021-22 and 2022-23 and also accepted by the Audit as well.

(Emphasis supplied by the querist.)

6. *Accounting treatment of Resurfacing Cost*

During the supplementary audit of the financial statements of the Company for the F.Y. 2023-24, the CAG office has also given the following Provisional Comment:

Comment No. 2

Comments on profitability

Equity and Liabilities - 2 Liabilities

(i) Non-current Liabilities- (b) Long Term Provision - Note 17 - Rs. 8338.05 lakh

Statement on Profit and Loss

Profit/ (loss) for the period - Rs. 2332.09 lakh

The above amount of Long-Term Provisions includes Rs. 8079.93 lakh towards 'Provision for Resurfacing Cost'. Provision for Resurfacing Cost represents accumulated balance of provision made by the Company for obligations in respect of major replacement works on Project Railway. The Company had an equivalent estimated liability of Rs. 14,141.05 lakh for replacement obligations in respect of major items of Project Railway which are likely to become due for replacement during the remaining concession period as per their codal lives. Though, the Company has estimated a liability of Rs. 14,141.05 lakh for replacement obligations in respect of major items of Project Railway, but the provision is made for an annual equalised amount of Rs. 734.52 lakh every year in violation of Appendix D to Ind AS 115.

The Company has made a provision of Rs. 8079.93 lakh against the required provision of Rs. 14,141.05 lakh as on 31st March 2024. Thus, there was a short provision of Rs. 6061.12 lakh.

This has resulted in understatement of 'Long term provisions' by Rs. 6061.12 lakh and overstatement of 'Profit for the period' to the same extent.

The Company has submitted detailed reply on the above Provisional Comment to the CAG office. In context of the above Comment, it is to mention that:

- (a) As per the Operation and Maintenance Agreement, the replacement of Project Assets after the lives of the assets have expired, shall be carried out by the Company either through itself or Western Railway. The life cycle of assets as stipulated in the codal guidelines/standards of Ministry of Railways shall generally be used for replacement of the Project Assets.
- (b) Appendix A to Ind AS 11 (now merged with Ind AS 115) deals with the manner of recognition of these contractual obligations. Paragraph 21 of Appendix A to Ind AS 11 provides that, "*the operator may have contractual obligations it must fulfil as a condition of its licence (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement. These contractual obligations to maintain or restore infrastructure, except for any upgrade element (see paragraph 14 of this Appendix), shall be recognised and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period.*"
- (c) In Appendix to Ind AS 11, such contractual obligations are referred as 'Resurfacing Obligations' and the manner of recognition of the cost of these obligations is

explained with the help of example that cost of resurfacing obligations is to be provided on a yearly basis over the period of concession during which an entity is under obligation to incur these obligations.

- (d) In terms of the Agreement, the Company is under obligation to make replacement of various items of the Project Assets, which become due for replacement after expiry of their codal lives, in order to keep the Project Railway to its serviceable level.
- (e) At the time of adoption of Ind AS for preparation of financial statements for the F.Y. 2016-17, the Company had made an estimation of total liability amounting to Rs. 14,141.05 lakh in respect of its contractual obligation of making replacement of various items of Project Assets on their expiry of useful lives during the Concession Period, so that same could be recognised in book as per requirement of Appendix A to Ind AS 11.
- (f) Based on the total estimated liability of Rs. 14,141.05 lakh, the Company has started to recognise the cost of replacement obligation (Resurfacing Cost) on an annual basis w.e.f. 1/4/2015 for an amount of Rs. 734.52 lakh every year in the books which is the annual equalised amount of the total estimated liability of Rs. 14,141.05 lakh towards the cost of replacement works in accordance with the requirements of Appendix D to Ind AS 115 (earlier Appendix B to Ind AS 11). The equalised amount of Rs. 734.52 lakh is charged to Statement of Profit and Loss every year [Refer Note 23(ii) of the financial statements].
- (g) Further, the Company has also been recognising inflation component to present the 'Provision for Resurfacing Cost' to its present value every year, by applying implicit rate of interest. This inflation component is charged to the Statement of Profit and Loss as 'Unwinding of discount on resurfacing obligations' under 'Finance Cost' [Refer Note 25 of the financial statements] every year.
- (h) The cost of replacement works as and when incurred is charged to 'Provision for Resurfacing Cost' in the year of incurrence of expenditure on replacement work by the Company. Till 31st March 2024, the Company has incurred Rs. 702.28 lakh on major replacement works and accordingly debited the same to 'Provision for Resurfacing Cost'.
- (i) In this regard, paragraph 21 of Appendix D to Ind AS 115 also provides the same provision that, "The operator may have contractual obligations it must fulfil as a condition of its licence (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement. These contractual obligations to maintain or restore infrastructure, except for any upgrade element (see paragraph 14 of this Appendix), shall be recognised and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period."

In view of paragraph 21 of Appendix D to Ind AS 115, out of the total estimated liability of Rs. 14,141.05 lakh which the Company had initially estimated to incur during the entire Concession Period, the liability to the extent of Rs. 8079.93 lakh,

reflects the present obligations of the Company upto the reporting date (31st March 2024) on an equally proportionate basis. Balance of Rs. 6061.12 lakh represents the proportionate obligation for the future remaining concession period and does not reflect the present obligation of the Company as on reporting date i.e. 31st March 2024, hence the same is not qualified to be recognised as liability/ expenditure as on 31st March 2024; as per the Appendix D to Ind AS 115.

Therefore, the Company has made provision for resurfacing obligation to the extent of Rs. 8079.93 lakh upto end of reporting period ended on 31st March 2024 to reflect the present obligation at the end of reporting period (i.e. 31st March 2024). After the end of F.Y. 2023-24, balance amount of Rs. 6061.12 lakh will be recognised as provision for resurfacing obligation on an equally proportionate basis during the remaining Concession Period to reflect the obligation (on equally proportionate basis) on each reporting date in line with paragraph 21 of Appendix D to Ind AS 115.

- (j) Resurfacing Cost and inflation component (being recognised every year) are getting accumulated (net after adjustment of the cost of actual expenditure) as 'Provision for Resurfacing Cost' in the books which is shown under the head 'Long Term Provision' [Refer Note No. 17 of the financial statements].
- (k) Year-wise position of Provision of Resurfacing Cost provided in the books is as under:

| Amount (in Rs. Lakh) | | | | | |
|----------------------|---|--------------------------------------|--|------------------------------|---|
| Year | Opening Balance of provision for Resurfacing Cost | Yearly expense provided in the books | Yearly Interest cost recognised in the books | Actual Cost of work adjusted | Closing Balance of Provision for Resurfacing Cost |
| 2015-16 | - | 734.52 | - | - | 734.52 |
| 2016-17 | 734.52 | 734.52 | 51.42 | - | 1,520.46 |
| 2017-18 | 1,520.46 | 734.52 | 106.43 | - | 2,361.41 |
| 2018-19 | 2,361.41 | 734.52 | 165.30 | - | 3,261.23 |
| 2019-20 | 3,261.23 | 734.52 | 228.29 | - | 4,224.04 |
| 2020-21 | 4,224.04 | 734.52 | 295.68 | - | 5,254.25 |
| 2021-22 | 5,254.25 | 734.52 | 367.80 | - | 6,356.56 |
| 2022-23 | 6,356.56 | 734.52 | 444.96 | 85.36 | 7,450.68 |
| 2023-24 | 7,450.68 | 734.52 | 511.65 | 616.92 | 8,079.93 |
| | Total (A) | 6610.69 | | | |

Out of total cost of resurfacing obligations of Rs. 14,141.05 Lakh estimated to be incurred during the Concession Period, Rs. 6610.69 Lakh has been provided upto 31st March 2024 as mentioned in the above table. Balance of estimated cost is to be provided during the remaining Concession Period as under:

| Year | Yearly expense (in Rs. Lakh) |
|------------------------|------------------------------|
| 2024-25 | 734.52 |
| 2025-26 | 734.52 |
| 2026-27 | 734.52 |
| 2027-28 | 734.52 |
| 2028-29 | 734.52 |
| 2029-30 | 734.52 |
| 2030-31 | 734.52 |
| 2031-32 | 734.52 |
| 2032-33 | 734.52 |
| 2033-34 | 734.52 |
| 2034-35 (June) | 185.15 |
| Total (B) | 7530.36 |
| Gr. Total (A+B) | 14,141.05 |

- (l) As on 31st March 2024, the book balance of 'Provision for Resurfacing Cost' stands at Rs. 8079.93 lakh which represents the liability provided upto the period ended on 31st March 2024, out of the total liability of Rs. 14,141.05 lakh estimated for the entire Concession Period towards the obligation to make replacement of items of Project Railway during the Concession Period.
- (m) As per the Provisional Comment given by the office of CAG, balance estimated liability for resurfacing cost of Rs. 6061.12 lakh (Rs. 14141.05 lakh less Rs. 8079.93 lakh) should be recognised in the current F.Y. 2023-24. However, this balance amount does not relate to the current financial year rather the same is to be recognised in an equalised manner over the remaining Concession Period.
- (n) Also, Ind AS requires that contractual obligations to maintain or restore infrastructure shall be recognised and measured in accordance with Ind AS 37, i.e., at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period which denotes that expenditure to the extent of present obligation as on the reporting date (as per the best estimates) is only to be provided in the books. In view of this, in the context of a reporting period, only those expenditures which represent obligation upto that reporting period meet recognition criteria and to that extent, the liability is required to be provided in the books. Therefore, provision for resurfacing obligations being made by the Company is in accordance with manner as laid down in the Ind AS.
- (o) The above method of accounting is being followed by the Company to comply with the Indian Accounting Standards (Ind AS), which the Company has consistently been applying in the accounting of resurfacing obligation since adoption of Ind AS in the preparation of financial statements of the Company for the financial year 2016-17 and onward and also accepted by the Audit as well.

(Emphasis supplied by the querist.)

7. Further, with regard to obligation of the Company with regard to upgrade and whether electrification of rail line can be considered as an obligation under the arrangement, the querist has supplied the following additional information/ clarification:

- (i) Concession agreement does not specifically provide for obligation of the Company towards upgrading facilities. However, clause 4.2(f) of the Concession Agreement entitles the Company, “right to develop additional facilities in the Project Area, which are in the interest of Project, whether in terms of additional stations and freight handling facilities, crossing stations, or any other facility for the purpose”. At the time of entering into the Concession Agreement, no planned upgrades were considered. It is to mention that, in keeping with IR’s mission of 100% electrification, the Company electrified the Project Railway considering the same in the interest of the Company as electrification results into saving of fuel cost and facilitates uninterrupted freight train operations on Project Railway.
- (ii) Practically speaking, the proposal could not be denied being initiated in the larger interest of overall train operations. Further, non-electrification would have adversely affected train operations by way of lower speed and detentions due to traction change. It would have also led to depriving the Company from the recurring benefit of saving of fuel cost. Saving of fuel cost has already accrued to the Company to the extent of Rs. 80 crores (approx.) upto March 2025.
- (iii) In view of the above, compliance with the Government’ mandate of 100% electrification on Indian Railways can be seen as obligation as well as opportunity (right) of the Company.

B. Query

8. In view of the foregoing, opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) is sought by the querist as under:

- (i) What is the category under which expenditure incurred by the Company on the electrification of Broad-Gauge Rail Line falls - capital expenditure or revenue expenditure?
- (ii) Whether accounting treatment by the Company to recognise resurfacing cost and to charge the same to the Statement of Profit and Loss every year for an annual equalised amount of Rs. 734.52 Lakh (worked out based on total estimated liability of Rs. 14,141.05 lakh likely to be incurred during the Concession Period towards fulfilling contractual obligation of making replacement of various items of Project Railway) has been done in compliance with the extant applicable Indian Accounting Standards.

C. Points considered by the Committee

9. The Committee notes that the issues raised by the querist relate to the accounting for subsequent expenditure incurred by the Company with regard to the service concession arrangement, viz., on the electrification of Broad-Gauge Rail Line and the resurfacing cost. The Committee has, therefore, considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as classification of the arrangement as service concession arrangement, recognition of intangible asset including amortisation of intangible asset recognised, accounting for the Lease Agreement between the Company and the Ministry of Railways, accounting impact of first-time adoption of Ind AS, transition from Ind AS 18, ‘Revenue’ and Ind AS 11, ‘Construction Contracts’ to Ind AS 115, ‘Revenue from Contracts with Customers’, recognition, measurement and presentation of unwinding of discount on provision and impact of inflation on measurement thereof, determination of amount and

presentation of provision/liability for resurfacing cost, accounting for operating and maintenance (routine) obligations under the arrangement and costs incurred in relation thereto, accounting for the Company's entitlement to receive depreciated replacement value of all the assets upon expiry of the arrangement, etc. Further, the Committee has not examined the relationship or arrangement between the Company and Western Railways/Indian Railways; the discussion below is on the basis that the Company is acting as a principal while providing concessionaire services to the Ministry of Railways. The Standards hereinafter referred to are Indian Accounting Standards (Ind AS), notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time. At the outset, the Committee presumes from the Facts of the Case that the concession arrangement in the extant case falls in the scope of Appendix D 'Service Concession Arrangements' to Ind AS 115.

10. The Committee notes that Appendix D to Ind AS 115 ('Appendix D') provides as follows:

“12 Under the terms of contractual arrangements within the scope of this Appendix, the operator acts as a service provider. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

13 The operator shall recognise and measure revenue in accordance with Ind AS 115 for the services it performs. The nature of the consideration determines its subsequent accounting treatment. ...”

In the given case, the service concession arrangement involves inter-alia the following promises to the grantor:

- (a) Construction of the Broad-Gauge rail line – After construction, the above rail line was successfully commissioned in the year 2003;
- (b) Operation of the rail line;
- (c) Routine maintenance; and
- (d) Major replacement works.

In addition, the Company has created enhanced or additional facilities such as electrification of lines.

11. The Committee notes that Appendix D requires that the separate services within a service concession arrangement, i.e., 'construction services', 'upgrade services' or 'operation services', must be disaggregated because each separate phase or element has its own distinct skills, requirements and risks. The allocation of revenue for the provision of these separate services is determined in accordance with Ind AS 115. This involves identifying the performance obligations under the contract with the customer, determining the transaction price under the contract(s), and allocating that transaction price to the performance obligations in the contract. Accordingly, the Company, being the operator under service concession arrangement, needs to evaluate whether the above promises should be accounted for separately under Ind AS 115. In this regard, the Committee notes the following requirements of Ind AS 115:

“22 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).”**

“27 A good or service that is promised to a customer is distinct if both of the following criteria are met:

- (a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and*
- (b) the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).”*

(Emphasis supplied by the Committee.)

Thus, the promises stated above should be accounted for separately as performance obligations if they are both (1) capable of being distinct, and (2) distinct in the context of the contract.

12. In the above context, the Committee notes that in the extant case, the construction activity is clearly a separate performance obligation. It is capable of being distinct and also being distinct in the context of the contract since:

- grantor (MoR/IR) can benefit from the rail line on its own.
- other entities could provide the construction services.

Construction of the rail line is separately identifiable from other promises and does not significantly affect the other services.

On account of construction of Broad-Gauge rail line (from Surendranager to Pipavav), the Company has received a right to get share of freight earning from the use of the above rail line by the general public. Therefore, as per the requirements of Appendix D (paragraphs 15 to 18), an intangible asset measured at the fair value of the construction services (and not the cost of construction) would be recognised.

13. *Accounting for resurfacing costs*

The Committee notes that under the arrangement with Railways, there is an obligation on the Company to keep the project assets in working condition, including making replacement, as per standards laid down by MOR, of all project assets whose codal lives (i.e. useful lives) expire during the Concession Period. Therefore, the Company has been carrying out the replacement of various items of the Project Railway on expiry of their codal lives within the concession period (viz., resurfacing activities). The Company will not be reimbursed separately by the grantor for these resurfacing activities. Accordingly, the Company carries out resurfacing activities based on predetermined useful life of project assets. Based on the facts stated by the

querist, it is noted that such resurfacing activities do not include any upgrade element and are incurred to keep the project assets in their serviceable level/condition.

14. With regard to accounting for such resurfacing obligation, the Committee notes paragraph 21 of Appendix D of Ind AS 115 as follows:

“Contractual obligations to restore the infrastructure to a specified level of serviceability

- 21 The operator may have contractual obligations it must fulfil as a condition of its licence (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement. These contractual obligations to maintain or restore infrastructure, except for any upgrade element (see paragraph 14 of this Appendix), shall be recognised and measured in accordance with Ind AS 37, ie at the best estimate of the expenditure that would be required to settle the present obligation at the end of the reporting period.”

The Committee notes that paragraph 21 of Appendix D requires an entity to recognise and measure its contractual obligations to maintain or restore infrastructure in accordance with Ind AS 37. Therefore, in the given case, the resurfacing activity will not be accounted for as a separate performance obligation and instead be accounted for as per Ind AS 37.

15. The Committee notes that the Company’s resurfacing obligation arises as a consequence of use of the project assets during the operating phase and in this regard, assumes that the service potential of these assets is consumed evenly in proportion to their useful life. Accordingly, since as per the requirements of Ind AS 37, the resurfacing obligation is to be measured at the best estimate of the expenditure required to settle the present obligation at each reporting date and since such best estimate of expenditure required to settle the obligation at any date is proportional to the use of the project assets by that date and which will increase proportionately by each passing year (considering the assumption), the provision to be recognised should be increased in annual increments by charge to profit or loss over the useful life of the respective project assets till the expected date of resurfacing (and not during the entire Concession Period, as seem to be done by the Company). Also, the provision should be discounted to its present value in accordance with Ind AS 37. Therefore, the Committee notes that the in-principle approach followed by the Company to build and recognise the provision over the period (and not providing for the entire amount in the beginning of concession period) is as per the requirements of Ind AS 37. (The Committee has not considered the computation of provision made by the Company in this regard).

16. *Accounting for electrification of the rail line:*

As discussed above, upgrade or construction services are separate performance obligations specified in the contract. The Committee notes that in the given case, the rail line operated on the diesel mode and the Company undertook the electrification of the rail line in F.Y. 2020-21, which required creation of additional facility/ assets in form of Overhead Equipment (OHE) assets / Traction Distribution (TRD) assets on the commissioned rail line. Thus, it would represent upgrade activities (and not the requirement to maintain or restore the infrastructure to a specified level of serviceability or a specified condition; and therefore, cannot be considered as maintenance activities).

The Committee further notes that as per the concession agreement, in addition to the **right** to “develop, design, engineer, finance, market, procure, construct, own and operate” the rail line, the Company has a **right** to “develop additional facilities in the project area, which are in the interest of the Project, whether in terms of additional stations and freight handling facilities, crossing stations, or any other facility for the purpose”. Thus, the upgrade activities are stated as part of the rights of the Company rather than as part of its obligations. Also as clarified by the querist, no upgrades were planned at the time of entering into the agreement. Hence, the Committee is of the view that in the extant case, ‘upgrade’ does not seem to be a contractual obligation under the concession agreement and therefore, it is not a component of the original intangible asset recognised in exchange of construction of Broad Gauge rail line.

In this regard, the Committee notes the following requirements of Appendix D to Ind AS 115:

“Construction or upgrade services

- 14 The operator shall account for construction or upgrade services in accordance with Ind AS 115.

Consideration given by the grantor to the operator

- 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.”

- “19 The nature of the consideration given by the grantor to the operator shall be determined by reference to the contract terms and, when it exists, relevant contract law. The nature of the consideration determines the subsequent accounting as described in paragraphs 23–26 of this Appendix. However, both types of consideration are classified as a contract asset during the construction or upgrade period in accordance with Ind AS 115.”

- “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 notes from the above that revenue and costs relating to construction or upgrade services should be recognised in accordance with Ind AS 115. This implies that construction or upgrade services should be accounted for in accordance with the appropriate model (intangible asset or financial asset), regardless of when they take place. Thus, if an upgrade adds to or extends the existing infrastructure from which an entity can generate additional revenue, then the extension of the infrastructure will create a new intangible asset, giving rise to new construction revenues, which are recognised using the same principles as for the initial construction revenue.

However, from the limited facts supplied, it appears that the electrification will not result in the extension of the existing rail line; instead it will modify the existing rail line. Thus, there is no new intangible asset to be recognised; rather it is a subsequent expenditure on existing intangible asset, which as per the requirements of paragraph 26 of Appendix D should be recognised as per the requirements of Ind AS 38, ‘Intangible Assets’. With regard to subsequent expenditure on an existing intangible asset, paragraph 20 of Ind AS 38 states as follows:

“The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the business as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognised in the carrying amount of an asset. ... ”

The Committee notes that the querist has mentioned that the electrification provides future economic benefits in the form of saving in fuel cost (compared to diesel mode) and increased revenue (due to increasing train speed and frequency, and enhancing overall network capacity, ultimately leading to higher volumes and increased revenue). Without electrification, it would have lost the traffic and cost of operations would be more expensive. Basis this, the Committee notes that the electrification of rail line will provide additional/ incremental benefits from the rail line through (a) cost savings (b) retaining the existing traffic and (c) also increase in revenue compared to original projections due to higher speed, frequency and efficiency. Accordingly, the Committee is of the view that the expenditure incurred on electrification of rail line in the extant case can be recognised in the carrying amount of the existing intangible asset as per the requirements of Ind AS 38.

D. Opinion

17. On the basis of the above and subject to paragraph 8 above, the Committee is of the following opinion on the issues raised in paragraph 8 above:

- (i) Since the electrification of rail line will provide additional/incremental benefits from the rail line through (a) cost savings (b) retaining the existing traffic and (c) also increase in revenue compared to original projections due to higher speed, frequency and efficiency, the expenditure incurred on electrification in the extant case can be recognised in the carrying amount of the existing intangible asset as per the requirements of Ind AS 38, as discussed in paragraph 16 above.
- (ii) Since the Company’s resurfacing obligation arises as a consequence of use of the project assets during the operating phase, it should be recognised and measured in accordance with Ind AS 37, i.e. at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Further, since such best estimate of expenditure required to settle the obligation at any date is proportional to the use of the project assets by that date and which will increase proportionately by each passing year (considering the assumption made in paragraph 15 above), the provision to be recognised should be increased in annual

increments by charge to profit or loss over the useful life of the respective project assets till the expected date of resurfacing (and not during the entire Concession period, as seem to be done by the Company).

Also, the provision should be discounted to its present value in accordance with Ind AS 37.

Therefore, the in-principle approach followed by the Company to build and recognise the provision over the period (and not providing for the entire amount in the beginning of concession period) is as per the requirements of Ind AS 37, as discussed in paragraph 15 above.
