Query No. 26

Subject: Accounting treatment of restoration obligation on the project under the Service Concession Arrangement, under Ind AS framework.[1]

A. Facts of the Case

Background of Company

1. A company (hereinafter referred to as 'the Company') is a public limited company incorporated in India on November 15, 2006, as a special purpose vehicle (SPV) with the objective of executing the BSD Gauge conversion project (hereinafter referred to as 'project railway') for Western Railway. The Company represents a unique collaboration between several public and private stakeholders, functioning as a joint venture (JV) among R Limited, G Board, A Private Limited, G Limited, D SEZ Limited, T Ltd., H Limited, and G Corporation. On June 25, 2008, the Company entered into a concession agreement with the President of India, represented through the Executive Director (Traffic-PPP), Ministry of Railways (MoR), Government of India. Under this Agreement, the Company was granted the authority to develop, finance, construct, operate, and maintain the project railway and to exercise and/or enjoy the rights, powers, benefits, privileges, authorisations and entitlements as set out in this agreement during the concession period. Commercial Operation date of project is 08th March 2012.

2. The concession period is set for 30 years from the date of commencement of commercial operations or until the Company achieves a Net Present Value (NPV) payback of 14% on its equity investment, whichever occurs first or such extended period as provided for in this agreement, unless terminated earlier. At the end of concession period, the Company shall be entitled to receive and MoR shall pay to the Company an amount equal to book value. In case of material breach in terms of the Agreement, the MoR and the Company both have the right to terminate the agreement if they are not able to cure the event of default in accordance with such Agreement. Allocation of freight is also carried out by Western Railway in accordance with the terms of concession arrangement.

3. The Operation and Maintenance of the project railway is being conducted by MoR through Western Railway (WR) and by its own resources under its right, vide agreement dated 29th August 2025, which is co-terminus with the Concession Agreement, entered into between the MoR and the Company.

4. As per clause 4.3 (d) of Concession Agreement, obligation of the Company included:

> "to keep the Project Assets in a proper working condition, including making replacement in accordance with the standards laid down by MoR, of all Project Assets whose lives have expired. Such replacement shall be carried out by the Company either by itself or through MoR, and the costs of such replacements shall be borne by the Company".

5. The Company is currently following Indian Accounting Standards (Ind ASs) as specified in section 133 of the Companies Act, 2013 for the purpose of preparation of financial

[1] Opinion finalised by the Committee on 27.3.2026.

statements. In accordance with requirement of Appendix D to Ind AS 115, 'Revenue from Contracts with Customers', the Company has classified the assets arising out of concession arrangement as intangible assets and amortisation has been charged to the statement of profit and loss over the period of concession.

6. Statutory audit is carried out by statutory auditors appointed by the Comptroller and Auditor General of India (C&AG) under section 139 of the Companies Act, 2013 and supplementary audit is carried out by C&AG under section 143(6) (a) of the Companies Act, 2013.

Observations made by C&AG:

(i) *Observation during audit of the financial year (F.Y.) 2023-24*

During the audit of F.Y. 2023-24, office of the C&AG issued management letter stating as follows:

A. Comments on Profitability

(i) Statement of Profit and Loss for the year ended 31 March 2024
Provisions-Note 18- Rs. 48.24 lakhs

As per Concession Agreement, there is an obligation on the Company to keep the project assets in working condition, including replacement, as per laid down standards of MoR, for project assets, whose codal lives expire during the concession period. Accordingly, the Company is required to provide for in respect of replacement obligations arising during the remaining concession period as per the requirements of Ind AS 115 for best estimate of expenditure required to settle obligation.

In this regard, the Company in the Note No. 47 of the financial statements, has disclosed that at present, reliable estimate for restoration obligation is not available; therefore provision for same not provided in financial statements, the same will be provided in the year in which reliable estimate becomes available.

The above note of the Company is not correct as it is not impossible to estimate the restoration obligation. Therefore, the Company should estimate the restoration obligation and necessary provisions should be made in the books of account.

This has resulted in understatement of 'Short-term provision' and overstatement of Profit for the period. However, the amount could not be ascertained due to non-availability of information pertaining to estimation of restoration obligation by the Company.

It may be ensured that as assured by the Company in its reply, the estimated cost of the restoration obligation and necessary provisions should be made while preparing the financial statements for the financial year 2024-25.

As stated above, office of C&AG advised to identify the estimated cost of the restoration obligation and providing of necessary provision in financial statements.

(ii) Accounting treatment made in the financial statements of F.Y. 2024-25 based on assurance given to the office of C&AG

In compliance with the observation of C&AG of India on the financials for the year ending 31st March 2024, the Company estimated obligation for resurfacing over the remaining concession period at an amount of Rs. 14,200 lakhs to be incurred from F.Y. 2024-25 to the end of concession period. This amount shall be incurred in different years as and when there will be obligation to repair/replace the infrastructure. Since expenditure shall be incurred based on condition of assets, this obligation had been considered as maintenance obligation for the purpose of requirements of Ind AS 115.

Accordingly, the amount of obligation has been apportioned over the period, i.e. each year, certain amount is charged to profit and loss considering time value of money and appropriation of expenses to each year in profit and loss. In financial year 2024-25, the Company has charged an amount of Rs. 1,045.25 lakh in statement of profit and loss and balance amount shall be charged over the period as finance cost and resurfacing cost. Accordingly, the Company complied with observation made by C&AG in F.Y. 2023-24 by estimating the liability and recognising the provision in financial statements during F.Y. 2024-25.

(iii) C&AG's Observation during audit of F.Y. 2024-25

The C&AG of India has made the following observations on the accounting treatment of above items as follows:

A. Comments on Profitability
Statement of Profit and Loss for the year ended 31st March 2025
II Equity and Liabilities - 2 Liabilities
Current Liabilities- (C) Provisions - Note 18 - Rs. 307.33 lakhs
Statement of Profit and Loss
Profit/(loss) for the period - Rs. 4,018.17 lakhs

The above amount of Provisions includes Rs. 261.50 lakhs 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 estimated a liability of Rs. 14,200 lakhs 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. However, against this, the Company has made a provision of Rs. 1045.25 lakhs as on 31st March 2025. Thus, there was a short provision of Rs. 13,154.75 lakhs.

This has resulted in understatement of 'Long term provisions' by Rs. 13,154.75 lakhs and overstatement of 'Profit for the period' to the same extent.

The observation was also raised on the financial statements of the Company for the financial year 2023-24. In response, the Company vide its reply dated 21.11.2024 gave an assurance that the Company shall make efforts to get the estimated cost of the restoration obligation. After the same is received, the necessary changes shall be made in the books of account of the Company. Though the Company has

estimated a liability of Rs. 14,200 lakhs, it made a provision of Rs. 1045.25 lakhs only resulting in short provision of Rs. 13,154.75 lakhs.

(iv) *Management Reply to observations of C&AG*

"A. Background and treatment in financial statements

The Company entered into a Concession Agreement with the Ministry of Railways and commenced operations in 2012 in accordance with its terms. The concession has been granted for a period of 30 years or until the achievement of 14% NPV, whichever is earlier. Under the Agreement, the Company is contractually required to maintain the project assets in proper working condition.

In compliance with the assurance given to the C&AG during the audit of F.Y. 2023-24, the Company has estimated a total restoration liability of Rs. 14,200 lakhs over the remaining concession period. Of this, 1,045.25 lakhs has been recognised in the current year, with the balance to be systematically provided in the financial statements over the remaining concession period, towards replacement obligations in respect of major railway assets.

This liability represents a *maintenance obligation*, accruing over the concession period from inception until the expected replacement of assets as their service potential is consumed. Since the consumption of assets occurs gradually, the obligation for restoration also accrues over time. Accordingly, up to 31st March 2025, the Company has recognised a provision of Rs.1,045.25 lakhs. Further remaining resurfacing provision is expected to be recognised as follows:

1. Upto 2026: Rs. 1,720.65 lakhs
2. At the end of 2031: Rs. 3,051.72 lakhs
3. At the end of 2037: Rs. 9,432.70 lakhs

Accordingly, the Company proposes to allocate the estimated liability of Rs. 14,200 lakhs progressively over the concession period, thereby ensuring alignment between asset consumption and liability accrual.

This approach ensures:

1. Recognition of obligations in accordance with *the matching principle;*
2. Avoidance of undue volatility in reported profits;
3. Compliance with *Ind AS requirements*, by recognising provisions on a best-estimate basis over time; and
4. Presentation of a *true and fair view* of profitability across the concession period, avoiding distortion in a single year's results.

With respect to the audit observation, it is respectfully submitted by the querist that the Company has duly recognised its contractual obligation for 'Provision for Restoration Obligation' in compliance with *Ind AS* and in line with the assurance given to C&AG in the previous year. Recognising the entire liability of Rs.14,200 lakhs in a single year would be inconsistent with the *matching concept* under Ind AS, as the liability accrues

over the next 17 years and becomes payable only in the long term. A one-time recognition would misrepresent the Company's operating results for the year under review."

B. Technical Guidance:

a. Relevant Ind AS Guidance:

- Ind AS 115, Paragraph D21 states that the operator may have contractual obligations it must fulfil in constructing or upgrading the infrastructure (e.g., obligations to restore the infrastructure to a specified level of serviceability, or to maintain it to a specified level of serviceability for a given period). The operator shall recognise and measure these contractual obligations in accordance with Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets'.

- Ind AS 37, Paragraph 14: **"A *provision* shall be recognised when: (a) an entity has a present obligation (legal or constructive) as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. …"**.

- Ind AS 37, Paragraph 45: **"Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation."**

Accordingly:

1. The operator shall recognise and measure its contractual obligation to restore infrastructure to a specified level of serviceability in accordance with Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets'.

2. Provisions are required only for present obligations resulting from past events.

C. Industry Practice and guidance available in IFRIC Interpretation

As Ind AS guidance on recognition of such long-term obligations is limited, reference may be drawn to *Ind AS 8*, 'Accounting Policies, Changes in Accounting Estimates and Errors' (hierarchy for developing accounting policies), which provides that in case guidance is not available in Ind AS, guidance may be taken from pronouncements of International Accounting Standards Board (IASB), industry practice, etc. IFRIC 12, 'Service Concession Arrangements', issued by IASB clarifies that restoration obligations under concession arrangements should be provided systematically over the period, not upfront.

Further, *accepted industry practice* also supports this treatment. For instance, financial statements of 'ABC Metro Rail Limited' and 'XYZ Metro Private Limited' disclose similar recognition of such obligations spread over the concession period.

D. Conclusion

On the observation of C&AG, it has provided for provision for resurfacing cost in its financial statements. The process of recognition of provision is always continuous period, wherein amount of obligation is recognised on the best estimate of expenditure. Thus, the Company's approach is fully consistent with *Ind AS requirements, IFRIC 12 guidance and industry practice*, and the recognition of provision over the concession period is the most appropriate and faithful representation of its contractual obligations.

(v) Assurance given to office of C&AG

In addition to the replies on provisional comments for F.Y. 2024-25 related to 'Provisions for Resurfacing Cost', it has been submitted to C&AG that the Company has already complied with the observation for estimation of resurfacing cost obligation and provided the necessary provision in financial statements. It has been additionally assured that the Company shall refer the matter to Expert Advisory Committee (EAC) of ICAI for their opinion on accounting treatment of provision for resurfacing obligation. On the basis of assurance, office of C&AG has not given comment in its report and issued management letter to the Company."

(Emphasis supplied by the querist.)

7. *Points for consideration by EAC*

In this whole issue along with reply submitted to C&AG, the Company also submits the following for the consideration of EAC:

(i) As stated in the above paragraphs, as the Company is required to keep assets in working condition, the Company has made a cost estimate of resurfacing work amounting to Rs. 14200 lakhs for 67.12 kms of railway line.

(ii) There is difference of opinion between the Company and C&AG over charging of this expense over the period or one time in the statement of profit and loss.

(iii) The Company also wishes to refer illustration as given in one of the renowned Ind AS publication. Illustration as provided in book is as follows:

*"*Illustration:

An operator has entered into 20 years water supply SCA. The operator will need to replace these pumps as soon as their performance drops below certain quality levels. The operator expects this to be the case after 15 years of service. The expected cost of replacing the pumps is INR 1 million.

In this case, replacement of pumps is not a separate revenue-generating activity. Rather, it is a maintenance obligation and provision for the same is accrued over the period from inception of SCA until the date of expected replacement of pumps as their service potential is consumed.

The measurement of provision is at net present value of amounts expected to be paid. Based on Ind AS 37 principles, discount rate used by the operator is 12%. So for the first year, assuming that pumps wear out evenly over time, a provision is recognised at (INR 1 million/15 years/ (1.12^14) = INR 13,641. Unwinding of discount will be treated as finance cost. At the end of 15 years, operator will have a provision amount of INR 1 million which will be used in replacing the pumps.

A similar example can be found in the toll roads. The obligation that the road is maintained at a specified condition such as the one determined by a bounce test is not a separate performance obligation. In such cases, a provision for maintenance would be required, similar to the one described above. The determination of the provision will require more estimates and judgement about the condition of the road over the next maintenance schedule.

When estimates of provision are revised, they are adjusted on a cumulative catch-up basis, such that the provision at the balance sheet date is reflected at the corrected amount.

Detailed working based on above example is as follows:

Balance sheet						
Year	**Opening Provision**	**Finance Cost**	**Expenditure for the year**	**Finance Cost**	**Expenditure**	**Total Debit to P&L**
1	-	-	13,641.32	-	13,641.32	13,641.32
2	13,641.32	1,636.96	15,278.28	1,636.96	15,278.28	16,915.24
3	30,556.56	3,666.79	17,111.67	3,666.79	17,111.67	20,778.46
4	51,335.02	6,160.20	19,165.07	6,160.20	19,165.07	25,325.28
5	76,660.29	9,199.24	21,464.88	9,199.24	21,464.88	30,664.12
6	1,07,324.41	12,878.93	24,040.67	12,878.93	24,040.67	36,919.60
7	1,44,244.01	17,309.28	26,925.55	17,309.28	26,925.55	44,234.83
8	1,88,478.84	22,617.46	30,156.61	22,617.46	30,156.61	52,774.08
9	2,41,252.91	28,950.35	33,775.41	28,950.35	33,775.41	62,725.76
10	3,03,978.67	36,477.44	37,828.46	36,477.44	37,828.46	74,305.90
11	3,78,284.57	45,394.15	42,367.87	45,394.15	42,367.87	87,762.02
12	4,66,046.59	55,925.59	47,452.02	55,925.59	47,452.02	1,03,377.61
13	5,69,424.20	68,330.90	53,146.26	68,330.90	53,146.26	1,21,477.16

14	6,90,901.36	82,908.16	59,523.81	82,908.16	59,523.81	1,42,431.97
15	8,33,333.33	1,00,000.00	66,666.67	1,00,000.00	66,666.67	1,66,666.67
	Total	**4,91,455.45**	**5,08,544.**	**4,91,455.45**	**5,08,544.5**	**10,00,000.0**

(iv) Therefore, in compliance with assurance given to office of C&AG, opinion of EAC of ICAI is required on this transaction.

B. Query

8. In view of the above, opinion of the Expert Advisory Committee is required on the following issues:

(i) Whether the accounting treatment adopted by the Company — recognition of restoration obligation progressively over the period i.e. upto the date restoration obligation arises — is appropriate and in accordance with Ind AS, i.e., yearly allocation of expenses and finance cost in statement of profit and loss on a systematic basis.

(ii) Whether the treatment suggested by the C&AG—recognising the entire obligation upfront in statement of profit and loss —is appropriate.

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to accounting treatment of restoration obligation on the project railway under the Service Concession Arrangement. 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, classification of the arrangement between the Company and MoR as service concession arrangement, recognition of assets under the arrangement as intangible asset and amortisation thereof, accounting for construction or upgrade elements under the arrangement, accounting for operating and maintenance (routine) obligations under the arrangement, determination of amount and presentation of provision/liability for resurfacing cost, accounting for the Company's entitlement to receive book value of the assets at the end of concession period, determination of concession period, etc. Further, the Committee has not examined the relationship or arrangement between the Company and Western Railways/MoR; 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 within the scope of Appendix D 'Service Concession Arrangements' to Ind AS 115.

10. With regard to the accounting for restoration obligation of the Company under the concession agreement, 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. …"

"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 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 and are accounted for accordingly. The Committee notes that as per the terms of concession agreement with Railways, the Company is responsible for keeping the project assets in good working condition. This includes replacing any project assets whose codal life (useful life) has expired, in accordance with the standards prescribed by the Ministry of Railways (MoR). Such replacement/restoration may be carried out either directly by the Company or through MoR, and in all cases, the related replacement/restoration costs are to be borne by the Company. Thus, the Company has been incurring costs on carrying out the replacement of various items of the Project Railway on expiry of their codal lives within the concession period (viz., restoration activities). However, it is noted from the facts supplied that the Company will not be reimbursed separately by the grantor (viz., MoR) for these restoration activities. Also, based on the facts stated by the querist, it is noted that such restoration activities have been considered as maintenance obligation, which do not include any upgrade element and are incurred to maintain the project assets in proper working condition.

11. The Committee further 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 restoration activity will be accounted for as per Ind AS 37. In this regard, the Committee notes the following requirements of Ind AS 37 and extracts from Example 2 of Illustrative Examples (IE) to IFRIC 12, issued by IASB:

Ind AS 37

"14 A *provision* shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised."

"Best estimate

36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period."

"Present value

45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation."

"60 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost."

Illustrative Example (IE) to IFRIC 12

"**Resurfacing obligations**

IE19 The operator's resurfacing obligation arises as a consequence of use of the road during the operating phase. It is recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, ie at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.
[Refer: paragraph 21]

IE20 For the purpose of this illustration, it is assumed that the terms of the operator's contractual obligation are such that the best estimate of the expenditure required to settle the obligation at any date is proportional to the number of vehicles that have used the road by that date and increases by CU17 (discounted to a current value) each year. The operator discounts the provision to its present value in accordance with IAS 37.

…"

12. The Committee notes from the above that the Company's restoration 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 restoration 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 their expected date of replacement /restoration.

Also, the provision should be discounted to its present value in accordance with Ind AS 37 and the carrying amount of provision in each reporting period is increased to reflect the passage of time, which is to be recognised as borrowing or finance cost in the Statement of Profit and Loss.

Therefore, the Committee notes that the in-principle approach followed by the Company to build and recognise the provision over the concession period (considering the expected replacement of assets); rather than recognising the entire amount at the end of the reporting 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).

D. Opinion

13. On the basis of the above and subject to presumptions made in paragraphs 9 to 12 above, the Committee is of the following opinion on the issues raised in paragraph 8 above:

(i) and (ii) Since the Company's restoration 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, 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 their expected date of replacement/restoration.

Also, the provision should be discounted to its present value in accordance with Ind AS 37 and the carrying amount of provision in each reporting period is increased to reflect the passage of time, which is to be recognised as borrowing or finance cost in the Statement of Profit and Loss.

Therefore, the in-principle approach followed by the Company to build and recognise the provision over the period (considering the expected replacement of assets); rather than recognising the entire amount at the end of the reporting period, is as per the requirements of Ind AS 37, as discussed in paragraph 12 above.

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