

NOTE

Depreciation rates for Infrastructure concession agreements: Amendments to Schedule XIV

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Depreciation rates for infrastructure sector under Schedule XIV- MCA's newest notification

Note

A notification of the Ministry of Company Affairs, dated 17th April 2012¹ sets out a new depreciation rate for concession agreements. As is being observed as a consistent trend with recent MCA notifications, the notification is badly worded, *pro tem* in nature, and would leave lots of confusions.

The following note analyses the impact of the new notification on infrastructure companies in India.

Existing position of Infrastructure assets:

A common form of infrastructure asset creation, particularly in social utility assets such as roads, is public-private partnership (PPP) model. A common mode of PPP projects is build-operate-transfer (BOT). Under the BOT model, the private partner operates the infrastructure asset in accordance with the concession agreement with a public authority, and at the end of a specified period, transfers the asset to the public authority.

Technically, whether the infrastructure asset leads to an “asset” owned by the private partner, or merely a right to collect revenue and therefore, an “intangible asset”, depends on the construction of the agreement. A typical concession agreement may not give ownership over any property to the concessionaire at all – it may simply allow the concessionaire a right to operate and collect proceeds from use of the facility. See, for instance, the model concession agreement that National Highway Authority of India uses².

International Accounting Standards Board (IASB) issued an accounting standards interpretation IFRIC 12 pertaining to concession contracts.

IFRIC 12 is applicable when both the following conditions are satisfied: (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and (b) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement. That is to say, if the provision or pricing of the infrastructure services is under the control of the grantee, that is, the concessionaire, it will be not regarded as a concession agreement, but would possible partake the character of a lease agreement. Similarly, if the economic benefits of residual ownership over the asset are with the grantee, it may be a lease.

IFRIC 12 decomposes the components of the receivables for the concessionaire into (a) a financial asset; and (b) an intangible asset. To the extent a concessionaire gets an unconditional right to receive cash, the concessionaire shall recognise a financial asset. To the extent the receivables of the concessionaire depend on actual usage of the asset by the users, an intangible asset shall be deemed to be have come into existence. Contracts may include both unconditional receivables as well as contingent receivables – in such cases, it would be necessary to split the two and account for the two separately.

In case of recognition of a financial asset, accounting standard IAS 39 (Indian version AS 30) on accounting for financial instruments will apply. The asset will either be amortised based on an effective interest rate or IRR of the project, or accounted for based on fair value.

¹ [http://www.mca.gov.in/Ministry/notification/pdf/GSR_\(E\)_17apr2012.pdf](http://www.mca.gov.in/Ministry/notification/pdf/GSR_(E)_17apr2012.pdf)

² <http://www.nhai.org/concessionagreement.htm>

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To the extent the concessionaire recognises an intangible asset, IAS 38 (AS 26) applies. The standard permits an entity to choose either the cost model or the revaluation model for on-going measurement of intangible assets. In case of cost model, the entity amortises the intangible asset over its useful life. In case of revaluation model, the same effect is achieved, though by periodically restating the asset at its revalued value.

In other words, it should be clear that whether using financial asset model, or intangible asset model, the question of charging off depreciation does not arise. There is no depreciable asset in case of concession rights at all.

Schedule XIV:

Schedule XIV is to be read with sec 205 (2) of the Act. The section provides for "depreciation" before declaration of dividends by the company and lays down the minimum depreciation for divisible profits.

None of the assets listed in the existing Schedule XIV include any intangible asset. Intangible assets, by their very nature, are not subject to wear and tear, and therefore, the question of any natural depreciation of intangible assets does not arise at all.

There is a huge difference between amortisation and depreciation. Amortisation is the allocation of a capitalised expense over a certain period – equivalent of a write off spread over accounting periods. For example, even financial assets like loans or bonds are amortised, but it would be ridiculous to say that such assets are depreciated.

Amendment to Schedule XIV by 17th April Notification:

The 17th April Notification introduces a new category V in Schedule XIV – Intangible Assets, under which Toll Road created under Build Operate and Transfer, or Build Own Operate and Transfer or any other form public private partnership route has been added.

In such case, an amortisation scheme has been notified, under which the amortisation amount is proposed to be split in the ratio of actual cashflows during the period over the projected cashflows from the project.

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Critical analysis of the Notification:

First of all, the Notification introduces "intangible assets" for the first time in Schedule XIV – as we have discussed earlier, this detaches Schedule XIV from sec. 205. Section 205 cannot be stretched to cover amortisation at all, and the word "depreciation" can be taken to relate to amortisations.

Secondly, the Notification is also completely detached from applicable accounting standards. It presumes that a concession agreement will lead to intangible assets –whereas, as we have discussed at length earlier, a concession agreement may lead to both financial assets and intangible assets. In case of intangible assets too, accounting standards refer to amortisation; the amortisation methods stated in the accounting standard do not match with the method introduced in Schedule XIV.

Thirdly, the scope of the Notification has been, for no reason, limited to PPP agreements for roads. IFRIC 12 or accounting standards are not limited to a particular type of concession agreements.

In fact, an amendment in law should not be *pro tem* in nature – it is limited to a particular need. Legislations should be forward looking and broad-based, rather than based on the source of the particular need.