

Amortisation of Land Right of Way

The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A company (hereinafter referred to as ‘the company’) is a Government company within the meaning of Section 617 of the Companies Act, 1956. The shares of the company are listed with recognised stock exchanges. The company is engaged in the business of refining of crude oil and marketing of petroleum products. It has two refineries and lube blending/filling plants. The company also has depots, installation and LPG plants across India, besides having administrative offices at Delhi, Chennai, Kolkata, Mumbai and other major cities.
2. The company owns pipelines for movement of petroleum products from one location to another for the purpose of stock transfer/sale. These pipelines are underground pipelines having sectionalising valve stations/intermediate pigging stations/booster pumping stations in between. Products are pumped through these pipelines as and when movement of product is required and at any point of time, the pipeline is filled with the product. For the purpose of laying the pipelines, the company acquires ‘right of way’, i.e., right of use in land (ROU) under which such pipeline is to be laid. The right is acquired under the Petroleum and Minerals Pipelines (Acquisition of Right of User in Land) Act, 1962, and vests absolutely with the company free from all encumbrances.
3. Though the ownership of the land under which the pipeline is laid continues with the land owner, the pipeline remains the property of the company. The company also has perpetual and absolute right to enter the land under which pipeline has been laid for the purpose of maintaining, examining, repairing, altering or removing any such pipeline or for doing any other acts necessary for any of the aforesaid purposes or for the utilisation of such pipeline. This right enables the company to lay one or more pipelines. The land owner cannot construct any permanent structure or plant any tree having deep roots on this piece of land, though he can raise crops. According to the querist, the ROU is an independent fixed asset as this right is absolute and perpetual as per the Petroleum and Minerals Pipelines (Acquisition of Right of User in Land) Act, 1962. The Act provides provision for repair and replacement of the pipeline as and when necessary.
4. *Accounting treatment:*
 - (i) *Current accounting treatment:* In view of the above facts, the cost of ROU is capitalised as intangible asset, disclosed separately and not amortised. The accounting policy of the company on intangible assets also states that “cost of right of way that is perennial in nature is not amortised as no finite useful life can be identified for the same”. Paragraph 68 of Accounting Standard (AS) 26, ‘Intangible Assets’, which became effective from the accounting periods commencing on or after 1-04-2004, *inter alia*, states that “the useful life of an intangible asset may be very long but it is always finite.” Further, paragraph 63 of AS 26 states that “there is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use.” However, in the opinion of the company, AS 26 does not deal with an intangible asset perennial in nature and hence, the company does not provide for amortisation on Land Right of Way.
 - (ii) *Expert Advisory Committee (EAC) Opinion:* The above accounting treatment of not amortising the land right of way is in line with EAC Opinion dated 23.10.1999 (Query No. 31 of Volume XIX of the Compendium of Opinions). The opinion states that since right of way is perpetual in nature, it does not meet the definition of depreciable asset in terms of paragraph 3.2 of Accounting Standard (AS) 6, ‘Depreciation Accounting’ as it does not have a finite useful life. It may, however, be

noted that the EAC Opinion was issued prior to introduction of AS 26.

(iii) *International Financial Reporting Standards (IFRS):*

It may be noted that International Accounting Standard (IAS) 38, 'Intangible Assets' (paragraph 107) permits an intangible asset with an indefinite useful life not to be amortised. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity (paragraph 88 of IAS 38).

(iv) *Indian Accounting Standards (Ind AS):*

Ind AS 38, 'Intangible Assets' (notified, but yet to be implemented) is also in line with IAS 38 (paragraph 105 of Ind AS 38).

It has also been observed that other companies having major pipelines do not amortise the right of way.

5. *The Issue:*

The statutory and government auditors have been raising the issue that the company should amortise the cost of right of way on the grounds that as per AS 26, the life of intangible assets is always finite and cost needs to be amortised over the same (paragraph 69 of AS 26).

B. Query

6. In view of the above, the querist has sought the opinion of the EAC on the following issues:

- (i) Whether the current practice of the company not to amortise the land right of way as it is perennial in nature is correct.
- (ii) In case it is not correct, what should be the useful life to be considered for computing the amortisation in view of the fact that the right of way is perennial in nature?

C. Points considered by the Committee

7. The Committee notes that the basic issue raised in the query relates to whether the land right of way, which, as per the querist, is perennial in nature, is eligible for amortisation as per AS 26. The Committee has, therefore, considered only this issue and has not touched upon any other issue arising from the Facts of the Case, such as, determination of depreciable amount for amortisation, if any, required, as per the

discussion in the following paragraphs, etc. Further, the Committee wishes to point out that the issue has been examined in the context of the notified Accounting Standards only and not from the International Financial Reporting Standards (IFRS) and Indian Accounting Standards (Ind AS) perspective as referred to by the querist.

8. The Committee notes from the Facts of the Case and the Petroleum and Minerals Pipelines (Acquisition of Right of User in Land) Act, 1962 (paragraph 4) that the user's right is restrictive for laying down and maintaining the pipelines and not unlimited for any purpose. The Committee further notes the definition of the term 'useful life' as given in paragraph 6 of AS 26 and the following paragraphs of AS 26:

“6.9 Useful life is either:

(a) the period of time over which an asset is expected to be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the asset by the enterprise.”

“63. The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

64. As the future economic benefits embodied in an intangible asset are consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors need to be considered in determining the useful life of an intangible asset including:

- (a) the expected usage of the asset by the enterprise and whether the asset could be efficiently managed by another management team;
- (b) typical product life cycles for the asset and public information on estimates of

useful lives of similar types of assets that are used in a similar way;

- (c) technical, technological or other types of obsolescence;
- (d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
- (e) expected actions by competitors or potential competitors;
- (f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the company's ability and intent to reach such a level;
- (g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
- (h) whether the useful life of the asset is dependent on the useful life of other assets of the enterprise."

"66. Estimates of the useful life of an intangible asset generally become less reliable as the length of the useful life increases. This Standard adopts a presumption that the useful life of intangible assets is unlikely to exceed ten years.

67. In some cases, there may be persuasive evidence that the useful life of an intangible asset will be a specific period longer than ten years. In these cases, the presumption that the useful life generally does not exceed ten years is rebutted and the enterprise:

- (a) amortises the intangible asset over the best estimate of its useful life;
- (b) estimates the recoverable amount of the intangible asset at least annually in order to identify any impairment loss (see paragraph 83); and
- (c) discloses the reasons why the presumption is rebutted and the factor(s) that played a significant role in determining the useful life of the asset (see paragraph 94(a)).

...

68. The useful life of an intangible asset may be very long but it is always finite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short."

"70. There may be both economic and legal factors influencing the useful life of an intangible asset: economic factors determine the period over which future economic benefits will be generated; legal factors may restrict the period over which the enterprise controls access to these benefits. The useful life is the shorter of the periods determined by these factors."

"94. The financial statements should also disclose:

(a) if an intangible asset is amortised over more than ten years, the reasons why it is presumed that the useful life of an intangible asset will exceed ten years from the date when the asset is available for use. In giving these reasons, the enterprise should describe the factor(s) that played a significant role in determining the useful life of the asset;

..."

9. On the basis of the above, the Committee is of the view that paragraphs 68 of AS 26 specifically envisages that the useful life of an intangible asset is always finite, howsoever long and indefinite it may be. AS 26 does not justify non-amortisation; it only requires disclosures where the useful life is considered more than 10 years. It stipulates that the life has to be determined on a prudent and rational basis. The Committee also does not agree with the view of the querist that the useful life of land right of way is infinite. In the view of the Committee, the useful life of the land right of way may be determined considering various technical, legal and economic factors, such as, useful life of petroleum reserves from which the petroleum products are being produced and then transported, technological changes in the transportation modes, alternative resources of energy, etc. The Committee is further of the view that, as per the Standard, the useful life of the land right of way may be indefinite but it is not infinite and, accordingly, the depreciable amount should be allocated on a systematic basis over the best estimate of its useful life. Therefore, the Committee is of the view that the current practice of the company not to amortise the land right of way is not correct. The Committee also wishes to point out that in case useful life of the

intangible assets is determined to exceed more than 10 years, the company should provide reasons for such presumption as per the requirements of paragraph 94 of AS 26 reproduced above.

10. With regard to applicability of earlier opinion of the Committee dated 23.10.1999, as referred to by the querist in paragraph 4 above, the Committee wishes to point out that the earlier opinion was based on AS 10 as at that time, AS 26 was not applicable. The Committee is of the view that after AS 26 coming into force, the requirements of AS 26 should be applied in the context of intangible assets dealt with by it as discussed above and AS 10 shall no longer be applicable to it.

D. Opinion

11. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 6 above:

- (i) No, the current practice of the company not to amortise the land right of way is not correct as discussed in paragraphs 8 and 9 above.
- (iii) The useful life should be determined keeping in view the principles of AS 26, as discussed in paragraph 9 above.

1	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on April 5-6, 2013. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty volumes. A CD of Compendium of Opinions containing thirty volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.in

ICAI NEWS

Request for Suggestions on Revision of the Guidance Note on Audit of Banks

The Auditing and Assurance Standards Board of ICAI is revising the *Guidance Note on Audit of Banks* to bring out its Revised 2014 edition. The Board requests suggestions from interested readers for the revision of Guidance Note. Suggestions can be sent at email

aasbsecretariat@icai.in by **September 15, 2013**. The complete text of announcement issued in this regard is available on ICAI Website at the link: http://www.icai.org/post.html?post_id=9834

Online Articles Placement Portal: CA Firms and students

Online Articles Placement Portal for selection of Articled Assistants by CA Firms

The Board of Studies of the ICAI has been providing optional Online Articles Placement facility for selection of Articled Assistants by CA Firms through its Articles Placement Portal on pan India basis. It provides a platform to the firms of Chartered Accountants having vacancies for Articled Assistants to shortlist eligible students for selection of articled assistants, and call them for Interview at their offices, as per date and time convenient to them. The eligible candidates who have passed Group-I or both Groups of the Intermediate (Integrated Professional Competence) Course or have been admitted under the Direct Entry Scheme and are willing to join articled training can register themselves on the portal. **The services to the Online Placement Portal are available free of charge for both CA Firms and students and**

they can register themselves online through the Portal at <http://bosapp.icai.org>.

The services on the Portal would be available for two months, twice a year from the date of registration by the firms. Similarly the bio data of a student will also be available on the portal for a maximum period of 2 months from student's registration. The candidates shortlisted by CA Firms would be informed by e-mails through the Portal, to appear for interview at their respective Offices, at the designated date and time.

Detailed guidelines are available at the institutes' website www.icai.org and on the Portal. In case of any further clarification, please contact the Board of Studies, ICAI Bhawan, A-29, Sector-62, Noida-201309, Tel. No. 0120-3045930/931; eMail: bosapp@icai.org.

Chairman, Board of Studies