

Query No. 13

Subject: *Presentation of ‘Deferred assets for deferred tax liability’ in balance sheet and statement of profit and loss.*¹

A. Facts of the Case

1. A Government of India enterprise (hereinafter referred to as the ‘company’) incorporated under the Companies Act, is engaged in the business of transmission of power from the generating units to different State Electricity Boards (SEBs) through its transmission network. The company is mandatorily required to comply with Indian Accounting Standards (Ind ASs) in preparation of financial statements for the accounting periods beginning on or after 1st April, 2016 with the comparatives for the periods ending on 31st March, 2016 as per the Notification dated 16th February, 2015, issued by the Ministry of Corporate Affairs (MCA). The equity shares of the company are listed in NSE and BSE.

2. The company is governed by the Electricity Act, 2003 and regulated by Central Electricity Regulatory Commission (CERC) under the Act. CERC issued Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2014 (‘CERC Regulations’) for determination of tariff for the block period 2014-19.

3. The querist has mentioned that as per Regulation 20 of Chapter 5 of the CERC Regulations, the tariff for transmission of electricity on inter-state transmission system shall comprise transmission charge for recovery of annual fixed cost consisting of the components specified in Regulation 21.

4. Further, as per Regulation 21 of Chapter 5, the annual fixed cost (AFC), i.e., tariff of a transmission system including communication system shall consist of the following components:

- (a) Return on equity;
- (b) Interest on loan capital;
- (c) Depreciation;
- (d) Interest on working capital; and
- (e) Operation and maintenance expenses

5. Also, Regulation 24 of Chapter 6 of CERC Regulations prescribes method and rates for calculation of ‘Return on Equity’ as one of the component of tariff.

6. The querist further states that as per Regulation 25 of Chapter 6, tax on return on equity is allowed by grossing up the base rate of return on equity with the effective tax rate of the respective financial year. Deferred tax liability is as per Indian Accounting Standard (Ind AS) 12, ‘Income Taxes’ to recognise tax effect of timing difference. Such deferred tax liability would reverse in future years. The company has also recognised deferred assets for deferred tax liability which would also reverse in future years along with the deferred tax liability and netted with the deferred tax liability for presentation in the financial statements of financial year 2016-17 as below:

Line item of Statement of Profit and Loss

¹ Opinion finalised by the Committee on 5.6.2018 and 6.6.2018.

Rupees in Crore	
Particulars	For the Year ended 31 st March 2017
Tax expense	
Current Tax	1988.45
Deferred Tax	2680.23
Less : Deferred Assets for deferred Tax liability	2619.07
	2049.61

Note of Balance Sheet

Deferred Tax liabilities (Net)	Rupees in Crore
Particulars	As at 31st March,2017
<u>A. Deferred Tax Liability</u>	
Depreciation difference on Property, Plant and equipment	11214.62
Finance Lease assets	90.83
Others	66.30
Sub-total (A)	11371.75
<u>B. Deferred Tax Assets</u>	
Income during Construction Period	18.69
Self Insurance Reserve	11.26
Provisions allowable on payment basis	236.77
Advance Against Depreciation	562.31
Others	123.98
Sub-total (B)	953.01
Deferred Tax Liability (Net) (A-B)	10418.74
Less: Deferred assets for deferred tax liability	7868.20
Net Deferred tax liability	2550.54

7. Government auditor has raised a query in the financial year 2016-17 that the presentation of deferred assets for deferred tax liability is not appropriate and it should be considered as regulatory assets and the presentation in the statement of profit and loss and balance sheet should be done accordingly.

Company's point of view for presentation:

8. The querist has referred to paragraph 21 of the Guidance Note on Accounting for Rate Regulated Activities, issued by Institute of Chartered Accountants of India, which states that a regulatory asset is an entity's right to recover fixed or determinable amounts of money towards incurred costs as a result of the actual or expected actions of its regulator under the applicable regulatory framework.

9. The company has recognised deferred tax liability as per Ind AS 12, 'Income Taxes' to recognise tax effect of timing differences. Such deferred tax liability would reverse in future years. The company has recognised a deferred asset for deferred tax liability which would also reverse in future years along with the deferred tax liability. The company is not expecting any action in this reference from the regulator, i.e., CERC.

10. As per the querist, the deferred asset against deferred tax liability is thus not a regulatory asset as per the definition of the 'regulatory asset' given in the Guidance Note.

11. The querist further states that paragraph B10 of Appendix B to Indian Accounting Standard (Ind AS) 114, 'Regulatory Deferral Accounts' provides a background explaining the circumstances when an additional temporary difference might arise on recognising a regulatory deferral account balance that relates to income tax. If a regulatory deferral account balance that relates to income tax gives rise to a temporary difference, then paragraph B11 of Appendix B to Ind AS 114 provides the disclosure guidance. B11 is applicable when "an entity recognises a deferred tax asset and recognising deferred asset on deferred tax liability or a deferred tax liability as a result of recognising regulatory deferral account balances".

12. The querist mentions that in the present case, DTL is recorded in accordance with requirements of Ind AS 12, 'Income Taxes'. This DTL is not a regulatory deferral account balance. Also, the DTL is not recognized as a result of recognising regulatory deferral account balance. Further, as DTL is not a regulatory deferral account balance, the 'Deferred Asset for DTL' also does not meet the requirement of paragraph B11 which, inter alia, states "...when an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances". Hence, the disclosure requirements of paragraph B11 will not apply to 'deferred asset for deferred tax liability' line item.

13. The querist further refers to provisions of paragraph 33 of Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements' which permits offsetting of income and expenses, and assets and liabilities when it reflects the substance of the transaction or other event or when separate disclosure detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. In the present case, the deferred tax liability and deferred assets for deferred tax liability are closely related and separate disclosure thereof would not reflect the substance of the transaction. Accordingly, the deferred assets for deferred tax liability has been deducted from the deferred tax expense with adequate disclosure on the face of the statement of profit and loss as well as in the notes to the balance sheet. It may also be seen that similar provisions for netting are available in Ind AS 18, 'Revenue', which provides that the entity may net any income with the related expenses when it reflects the substance of the transaction.

14. According to the querist, as per Ind AS 12 also, the netting of deferred tax assets and deferred tax liability is permitted to reflect the substance of the underlying asset/liability. Otherwise assets as well as liabilities will increase by an equal amount in the balance sheet without any substance. Further, the practice of offsetting/deduction related to deferred asset against deferred tax liability from the deferred tax liability is being followed consistently by the company from the financial year 2014-15.

B. Query

15. In view of the above facts and the circumstances, the querist has sought the opinion of the Expert Advisory Committee as to whether the presentation of deferred assets for deferred tax liability in the statement of profit and loss and in the balance sheet, being made by the company is in compliance with the Indian Accounting Standards or it should be presented as net movement in regulatory deferral account balance in the statement of profit and loss and regulatory deferral account balances as assets in the balance sheet.

C. Points considered by the Committee

16. The Committee notes that the basic issue raised by the querist relates to whether the presentation of ‘Deferred assets for deferred tax liability’ in the statement of profit and loss and in the balance sheet being made by the company is in compliance with the Indian Accounting Standards. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, recognition of deferred tax liability, etc. Further, this opinion is restricted to the financial reporting requirements under Ind AS and does not deal with the regulatory aspects of the CERC tariff regulation or any other related regulations or Electricity Act, 2003. The Committee also presumes that the ‘Deferred Asset for Deferred Tax Liability’ has been appropriately recognised as per the requirements of Ind AS 114/Guidance Note on Accounting for Rate Regulated Activities.

17. The Committee notes from the above, that the CERC tariff norms for the period 2014-19 provides for grossing up of the return on equity with the effective tax rate for the financial year based on the actual tax paid during the year and considering these norms, the company has recognised an asset balance referred to as ‘Deferred asset for deferred tax liability’.

18. With regard to the nature of the ‘Deferred asset for deferred tax liability’, the Committee notes that Appendix A to Ind AS 114 defines ‘regulatory deferral account balance’ as a ‘Regulatory Asset’ or a ‘Regulatory Liability’ as defined in the Guidance Note on Accounting for Rate Regulated Activities. Paragraph 21 of the Guidance Note states that a regulatory asset is an entity’s right to recover fixed or determinable amounts of money towards incurred costs as a result of the actual or expected actions of its regulator under the applicable regulatory framework. The Committee further notes that paragraph 5 of Ind AS 12 ‘Income Taxes’ defines deferred tax assets and liabilities as follows:

“Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:

- (a) deductible temporary differences;**
- (b) the carryforward of unused tax losses; and**
- (c) the carryforward of unused tax credits.**

Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

- (a) taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or**
- (b) deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.”**

19. The Committee notes that ‘Deferred asset for deferred tax liability’ that the company has recognised in the extant case would reverse in future by way of tariff adjustment. The Committee further notes that future reversals of ‘Deferred asset for deferred tax liability’

balance would affect the tariff recoverable from the beneficiaries in future periods and therefore fulfills the definition of regulatory deferral account balance under Ind AS 114. The Committee further notes that such deferral account balance would not be recoverable through adjustment in future income tax liabilities arising on the company as assessed under Income Tax Act and is, therefore, not a deductible temporary difference resulting into deferred tax asset under Ind AS 12. Rather, it is a regulatory deferral account balance, as mentioned in paragraph B10 of Ind AS 114.

20. Ind AS 12 does not allow deferred tax liabilities to be offset with assets other than deferred tax assets under Ind AS 12 and as discussed in paragraph 19 above, ‘Deferred asset for deferred tax liability’ balance is not a deferred tax asset under Ind AS 12. Accordingly, the Committee is of the view that ‘Deferred asset for deferred tax liability’ cannot be offset with deferred tax expense or liability in the financial statements.

21. Further, with regard to presentation of ‘Deferred asset for deferred tax liability’, the Committee further notes that paragraphs 20, 22 and 23 of Ind AS 114, which requires as follows:

“20 An entity shall present separate line items in the balance sheet for:

- (a) the total of all regulatory deferral account debit balances; and**
- (b) the total of all regulatory deferral account credit balances.”**

“22 An entity shall present, in the other comprehensive income section of the statement of profit and loss, the net movement in all regulatory deferral account balances for the reporting period that relate to items recognised in other comprehensive income. Separate line items shall be used for the net movement related to items that, in accordance with other Standards:

- (a) will not be reclassified subsequently to profit or loss; and**
- (b) will be reclassified subsequently to profit or loss when specific conditions are met.**

23 An entity shall present a separate line item in the profit or loss section of the statement of profit and loss , for the remaining net movement in all regulatory deferral account balances for the reporting period, excluding movements that are not reflected in profit or loss, such as amounts acquired. This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total, which is drawn before the net movement in regulatory deferral account balances.”

Accordingly, the Committee is of the view that the company should follow the above-reproduced requirements of Ind AS 114 in respect of ‘Deferred asset for deferred tax liability’ in its financial statements.

22. Incidentally, the Committee wishes to point out that in view of paragraph B10 of Ind AS 114, the company should also examine as to whether or not the recognition of regulatory deferral account balance in the extant case, viz., ‘Deferred tax asset for deferred tax liability’ is creating an additional temporary difference for which a further deferred tax amount needs to be recognized. Further, if a deferred tax/deferred liability (as the case may be) is created considering the requirements of B10, the same should also be presented as per the requirements of Ind AS 114 and not Ind AS 12.

D. Opinion

23. On the basis of the above, the Committee is of the opinion that the nature of the 'Deferred asset for deferred tax liability' is in the nature of regulatory deferral account balance under Ind AS 114 and not in the nature of deferred tax asset for reasons mentioned in paragraphs 18 and 19 above. The presentation by the entity of deferred tax liabilities balance in balance sheet and deferred tax expense in statement of profit and loss, each net of 'Deferred asset for deferred tax liability' are not in compliance with the requirements of Ind AS 114 and Ind AS 12. The same should be in accordance with paragraphs 20, 22 and 23 of Ind AS 114, as discussed in paragraphs 20 and 21 above.
