Query No. 6

Subject: 'Principal vs. Agent' classification under Ind AS 115.[1]

A. Facts of the Case

1. XYZ Electricity Trading Ltd. ('the Company') is primarily engaged in the business of trading of electricity. The Company sources power from various utilities and generating companies across India/neighbouring countries and supplies to its customers. Electricity trading is a licenced activity under Electricity Act (EA), 2003. Section 2(26) of the EA defines 'electricity trader' as "a person who has been granted a licence to undertake trading in electricity...". Section 12 of EA specifies that "No person shall, (a) transmit electricity; or (b) distribute electricity; or (c) undertake trading in electricity, unless he is authorised to do so by a licence issued under section 14…". Central Electricity Regulatory Commission (CERC) has granted electricity trading license to the Company under section 14 of EA.

'Trading' has been defined in section 2(71) of EA as "purchase of electricity for resale thereof…". CERC has prescribed regulations regarding eligibility criteria, performance obligation, maintenance of accounts, reporting of data by an electricity trader. CERC (Fixation of trading margin) Regulations specifies the trading margin that an electricity trader can charge from its customers.

2. In the normal course of trading business, a trader enters into the following types of trading arrangement:

- Over the Counter Trade (OTC) – Trade between buyers and sellers of electricity through the trader, where the price and terms of the contract are determined through negotiations, competitive bidding and regulatory approval process. Depending on the duration of power supply, the contracts are further classified into long-term (upto 25 years), medium-term (upto 5 years) and short-term contracts (upto 1 year). Depending on the nature of arrangement, these contracts can either be:
  - Back to back -Trade where the trader buys a specific quantity of power for a particular duration from one party and simultaneously sells it to another party on same terms and conditions.
  - Deals with Open position – Trade where the trader takes a position in a power purchase or sale contract based on price/other factors.
- Power Exchange Trade (PX) – Trade between buyers and sellers through a trader, being a member of Power Exchange, on standardised contracts. The trade is carried out through the power exchange, who is always a counter party to the contract.

3. As per CERC trading licence condition regulation, the Company enters into Power Purchase Agreement (PPA) and Power Sale Agreement (PSA) for purchase and sale of power for the trading business. Key terms and conditions of the different contracts have been separately provided by the querist for the perusal of the Committee.

4. As per CERC trading licence condition regulation (clause 7(h)), the trader is required to "take such safeguards as he may consider necessary with regard to payment security mechanism from the buyers, but shall always ensure timely payment of dues to

[1] Opinion finalised by the Committee on 6.5.2020 and 7.5.2020.

the seller for purchase of the agreed quantum of electricity either through a letter of credit or any other appropriate instrument or as may be mutually agreed between the seller and the licensee."

5. For the purpose of GST, the trading transaction is considered as that of Buy/Sell of electricity and accordingly GST is not applicable on the trading margin/commission.

6. Ind AS 115 'Revenue from Contract with Customers' supersedes Ind AS 18 'Revenue' and related interpretations and it applies, with limited exceptions, to all revenue arising from contracts with its customers. Ind AS 115 establishes a five-step model to account for revenue arising from contracts with customers and requires that revenue be recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

Accounting for sale of electricity:

7. The Company recognises revenue from sale of electricity, net of estimated rebates and other similar allowances when the units of electricity are delivered. Revenue from such contracts is recognised over time for each unit of electricity delivered at the pre-determined rate. As the customer simultaneously receives and consumes the benefits of the Company's performance obligation, it best depicts the value to the customer and completes satisfaction of performance obligation.

8. The Company determines its revenue on below contracts, net of power purchase cost based on the following factors:

a. Another party is primarily responsible for fulfilling the contract as the Company does not have the ability to direct the use of power supplied or obtain benefits from supply of power.

b. The Company does not have inventory risk before or after the power has been delivered to customers as the power is directly supplied to customer.

c. The Company has no discretion in establishing the price for supply of power. The Company's consideration in these contracts is only based on the difference between sales price charged to procurer and purchase price given to supplier.

Type of Arrangement
Trade deal on back-to-back basis as well as trade through power exchanges

9. For other contracts, which do not qualify the conditions mentioned above, revenue is determined on gross basis.

Type of Arrangement
Trade Deals on Open Position

10. The criteria considered for determination of principal-agent relationship specified under paragraphs 34-38 of Appendix B of Ind AS 115[2] have been provided by the querist as follows:

"B34 When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a

[2] The paragraphs reproduced by the querist are from Ind AS 115, which was initially notified vide Notification G.S.R. 310(E) dated 28th March, 2018; however Ind AS 115 was subsequently amended vide Notification G.S.R. 273(E) dated 30th March, 2019.

performance obligation to provide the specified goods or services itself (i.e. the entity is a principal) or to arrange for the other party to provide those goods or services (i.e. the entity is an agent).

B35 An entity is a principal if the entity controls a promised good or service before the entity transfers the good or service to a customer. However, an entity is not necessarily acting as a principal if the entity obtains legal title of a product only momentarily before legal title is transferred to a customer. An entity that is a principal in a contract may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf. When an entity that is a principal satisfies a performance obligation, the entity recognises revenue in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred."

B36 An entity is an agent if the entity's performance obligation is to arrange for the provision of goods or services by another party. When an entity that is an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the other party to provide its goods or services. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

B37 Indicators that an entity is an agent (and therefore does not control the good or service before it is provided to a customer) include the following:

(a) another party is primarily responsible for fulfilling the contract;

(b) the entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping or on return;

(c) the entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit that the entity can receive from those goods or services is limited;

(d) the entity's consideration is in the form of a commission; and

(e) the entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services."

The querist has further stated that in the Exposure Draft issued by the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) in respect of revised Ind AS 115, paragraph B37 provides for indicators pertaining to an entity to be a 'principal'. In the Exposure Draft of revised Ind AS 115, the criteria of the entity possessing credit risk was not considered as an indicator for assessing the entity to be a principal. Thus, even though the entity possesses any credit risk, that does not make the entity a principal. In other words, the credit risk cannot be an indicator of assessing principal-agent relationship.

11. Before the adoption of Ind AS 115, the Company concluded that based on the existence of credit risk and the nature of the consideration in the contract, it has an exposure to the significant risks and rewards associated with the sale of power to its customers, and accounted for the contracts as if it is a principal. Upon the adoption of Ind

AS 115, the Company has determined that in back-to-back OTC and power exchange contract, it does not control the goods before they are transferred to customers, hence, recognises revenue as an agent.

12. Summary analysis of the accounting implications of contracts:

Indicators	Trade deal on back-to-back basis and trade through power exchanges	Trade Deals on Open Position
Primary Obligation [Para B37(a)]	**Agent -** since the ultimate responsibility of generation lies with the generator.	**Principal** - the Company is primary obligor of selling the power since deal is not on back to back basis.
Inventory Risk [Para B37(b)]	**Agent** - Electricity as a commodity can't be stored. Deviation risk, if any passed on back-to-back basis to the buyer/seller.	**Principal** - the Company has guaranteed off take obligation from the generator/seller.
Price Determination and Fixed Fee [ParaB37(c & d)]	**Agent** - Price is determined on back-to-back basis. Trading margin of the Company is regulated by CERC.	**Principal** – The price is determined by the Company since the deal is not back to back.
Credit Risk [ParaB37(d)]	**Principal** - Credit Risk is with the Company.	**Principal** - Credit Risk is with the Company.
Overall	**Agent**	**Principal**

13. The querist has also separately supplied copies of PPAs/PSAs with power generating entity/buyers for different arrangements and has provided the following clarifications for the perusal of the Committee:

(i) In respect of trade deals on back to back basis, the quantum of power purchased from the power generating Company (viz., M Ltd.) is 300 MW, which, is utilized for onward sale to one of the buyer entity, viz., W Ltd., as per the Power Sale Agreement. This cannot be sold to any other party than the W Ltd. However, Third Party sale is allowed under the specific conditions as per the PSA (clause No. 7.5 of PSA). The Company has no role to play with regard to conversion/ stabilisation of the power supplied by M Ltd.

(ii) In respect of trade deals on back to back basis, the PPA with power generating entity (M Ltd.) is entered into and signed prior to the PSA with the buyer entity (W Ltd.).

(iii) In respect of trade deals on back to back basis, with regard to the question that whether the buyer entity (W Ltd.) can directly contact the power generating entity (M Ltd.) for any issues with regard to power supply or whether it essentially has to go through the Company in the extant case, it has been submitted by the querist that except power scheduling, requisition of power & other operational activities in relation to scheduling & requisition of power, everything is essentially required to be gone through the Company.

(iv) In respect of trade deals on back to back basis, trading margin is being charged by the Company from the buyer entity (W Ltd.) for scheduled power. As per Clause No. 4.3.1 of PSA, trading margin is a part of variable charges and is payable only for scheduled power. In case power is not scheduled, the Company will not earn any trading margin. Further, this margin has been commercially negotiated. CERC regulates margin only when both power purchase and power sale agreement are for a period of up to one year. As the PPA and PSA in the present case are for a period of more than 1 year, the margin has been commercially negotiated.

(v) In respect of trade deals on open position, the Company considers itself as the primary obligor as the amount to be paid to another power generating entity (D Corporation) is fixed/ per unit or as per schedule given irrespective of sale of power to the ultimate buyer entity (W Ltd.). Moreover, the contract with the power generating Company (D Corporation) is of 25 years; however, the contract with the ultimate buyer entity (W Ltd.) is of 4 years only. The terms and conditions are altogether different in both the PPAs under trade deals on back to back basis and open position and accordingly, the arrangement may not be classified as back to back contract. As per the market practice and current regulations, the generator has to be identified in advance when contract of sale is executed.

(vi) The CERC power tariff regulations prescribed rules for determination of tariff on the basis of cost plus method between generator and Discom; however, the tariff can be mutually decided by both the parties on the basis of competitive bidding/ mutual agreement. The justification for the same is required to be given and regulator adopts the same. However, in the extant case, in the case of open arrangement, the arrangement is between generator and trader and accordingly the regulations prescribed above are not applicable.

(vii) In respect of trade through power exchange, with regard to the issue whether there are some limit/ cap on the quantum of power to be purchased by the ultimate buyer, the querist has informed that as per current regulations, the ultimate buyer (N Ltd.) has to intimate about the quantum it wishes to purchase on 15 minutes basis during the day i.e. quantum should be uniform for each 15 minute time block. Before trading in Power Exchange, N Ltd. has to take a No Objection Certificate (NOC) from its State Load Despatch Centre (SLDC). The quantum in each 15 minute time block cannot exceed the quantum for which NOC has been taken.

(viii) Further in respect of trade through power exchange, with regard to the issue that whether the selling price charged by the Company to N Ltd. is regulated by CERC or it is negotiated commercially and whether trading margin of the Company paid by N Ltd. also regulated by CERC, the querist has clarified that the selling price is not regulated by CERC. The price as discovered in Power Exchange is the sale price charged from N Ltd. CERC has given a ceiling for the Trading Margin which can be charged for such transactions. The Company commercially negotiates a trading margin ensuring that it remains within this ceiling.

B. Query

14. Considering the nature of electricity trading business, whether the Company's

revenue recognition policy from electricity trading business is in conformity to the principles of principal-agent relationship specified under paragraphs 34-38 of Appendix B of Ind AS 115.

C. Points considered by the Committee

15. The Committee notes that the basic issue raised by the querist relates to the assessment of principal or agent as per the requirements of Ind AS 115, 'Revenue from Contracts with Customers', with respect to various types of arrangements in relation to its power trading activities. The Committee has, therefore, restricted its opinion only to this issue and has not looked into other issues that may arise from the Facts of the Case, such as, applicability of Ind AS 114, 'Regulatory Deferral Accounts'; the assessment, whether the Company's activities and contracts to buy or sell power are within the scope of Ind AS 109, 'Financial Instruments'; whether the Company's contracts contain embedded derivatives under Ind AS 109 or whether the arrangements entered into by the Company are within the scope of Appendix D to Ind AS 115, 'Service Concessions Arrangements' or within the scope of Ind AS 116, 'Leases'; and the point at which revenue from sale of electricity shall be recognised under Ind AS 115. Further, the Committee wishes to point out that its assessment of the issue under Ind AS 115 of principal and agent is purely from an accounting perspective. This opinion would neither affect the legal status of the Company vis-à-vis other parties or assessment under tax regulations and, as such, the Committee has not assessed any legal and tax implications or issues related to the matter.

16. The Committee notes that Ind AS 115, 'Revenue from Contracts with Customers' states as follows with regard to principal versus agent assessment:

> "B34 When another party is involved in providing goods or services to a customer, the entity shall determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by the other party (ie the entity is an agent). An entity determines whether it is a principal or an agent for each specified good or service promised to the customer. A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer (see paragraphs 27–30). If a contract with a customer includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others.
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> B34A To determine the nature of its promise (as described in paragraph B34), the entity shall:
>
> (a) identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party (see paragraph 26)); and
>
> (b) assess whether it controls (as described in paragraph 33) each specified good or service before that good or service is transferred to the customer.
>
> B35 An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. However, an entity does not necessarily control a specified good if the entity obtains legal title to that good only momentarily before legal title is transferred to a customer. An entity that is a principal may satisfy its performance obligation to provide the specified good or service itself or it may engage another party (for example, a

subcontractor) to satisfy some or all of the performance obligation on its behalf.

B35A When another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

(a) a good or another asset from the other party that it then transfers to the customer.

(b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf.

(c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. For example, if an entity provides a significant service of integrating goods or services (see paragraph 29(a)) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which includes goods or services from other parties) and directs their use to create the combined output that is the specified good or service.

B35B When (or as) an entity that is a principal satisfies a performance obligation, the entity recognises revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred.

B36 An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

B37 Indicators that an entity controls the specified good or service before it is transferred to the customer (and is therefore a principal (see paragraph B35)) include, but are not limited to, the following:

(a) the entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications). If the entity is primarily responsible for fulfilling the promise to provide the specified good or service, this may indicate that the other party involved in providing the specified good or service is acting on the entity's behalf.

(b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). For example, if the entity

obtains, or commits itself to obtain, the specified good or service before obtaining a contract with a customer, that may indicate that the entity has the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service before it is transferred to the customer.

(c) the entity has discretion in establishing the price for the specified good or service. Establishing the price that the customer pays for the specified good or service may indicate that the entity has the ability to direct the use of that good or service and obtain substantially all of the remaining benefits. However, an agent can have discretion in establishing prices in some cases. For example, an agent may have some flexibility in setting prices in order to generate additional revenue from its service of arranging for goods or services to be provided by other parties to customers.

B37A The indicators in paragraph B37 may be more or less relevant to the assessment of control depending on the nature of the specified good or service and the terms and conditions of the contract. In addition, different indicators may provide more persuasive evidence in different contracts.

B38 If another entity assumes the entity's performance obligations and contractual rights in the contract so that the entity is no longer obliged to satisfy the performance obligation to transfer the specified good or service to the customer (ie the entity is no longer acting as the principal), the entity shall not recognise revenue for that performance obligation. Instead, the entity shall evaluate whether to recognise revenue for satisfying a performance obligation to obtain a contract for the other party (ie whether the entity is acting as an agent)."

"26 Depending on the contract, promised goods or services may include, but are not limited to, the following:

(a) sale of goods produced by an entity (for example, inventory of a manufacturer);

(b) resale of goods purchased by an entity (for example, merchandise of a retailer);

(c) resale of rights to goods or services purchased by an entity (for example, a ticket resold by an entity acting as a principal, as described in paragraphs B34–B38);

(d) performing a contractually agreed-upon task (or tasks) for a customer;

(e) providing a service of standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or of making goods or services available for a customer to use as and when the customer decides;

(f) providing a service of arranging for another party to transfer goods or services to a customer (for example, acting as an agent of another party, as described in paragraphs B34–B38);

(g) granting rights to goods or services to be provided in the future that a

customer can resell or provide to its customer (for example, an entity selling a product to a retailer promises to transfer an additional good or service to an individual who purchases the product from the retailer);

(h) constructing, manufacturing or developing an asset on behalf of a customer;

(i) granting licences (see paragraphs B52–B63B); and

(j) granting options to purchase additional goods or services (when those options provide a customer with a material right, as described in paragraphs B39–B43)."

"33 Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

(a) using the asset to produce goods or provide services (including public services);

(b) using the asset to enhance the value of other assets;

(c) using the asset to settle liabilities or reduce expenses;

(d) selling or exchanging the asset;

(e) pledging the asset to secure a loan; and

(f) holding the asset."

The Committee notes that as per the requirements of Ind AS 115, where another party is involved in providing goods or services to the customer, the entity should first determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (ie the entity is a principal) or to arrange for those goods or services to be provided by the other party (ie the entity is an agent). Further to determine the nature of its promise, the entity should identify the specified goods or services to be provided to the customer (which, for example, could be a right to a good or service to be provided by another party). Thus, the Committee notes from the above that, in accordance with paragraph B34A(a) of Ind AS 115, the specified good may be the underlying good a customer ultimately wants to obtain (power supply in the extant case) or a right to obtain that good or service (right to supply of power). When the specified good or service is a right to a good that will be provided by another party, the entity would determine whether its performance obligation is a promise to provide that right (and it is, therefore, a principal) or whether it is arranging for the other party to provide that right (and it is, therefore, an agent). The fact that the entity will not provide the underlying goods or services itself is not determinative under Ind AS 115.

Further, as per the requirements of Ind AS 115, the entity should assess whether it *controls* each specified good or service before that good or service is transferred to the customer.

The Committee is of the view that the condition described in paragraph B35A(a) of Ind AS 115 would include contracts in which an entity transfers to the customer a right to

future goods to be provided by another party. If the specified good or service is a right to a good to be provided by another party, the entity evaluates whether it controls the right to the goods before that right is transferred to the customer (rather than whether it controls the underlying goods). The Committee further notes from the above-reproduced requirements of Ind AS 115 that in assessing such rights, one of the criterion that may be relevant in assessing 'control' is to assess whether the right is created only when it is obtained by the customer or whether the right exists before the customer obtains it. If the right does not exist before the customer obtains it, an entity would not be able to control right before it is transferred to the customer.

Further, the Standard provides three indicators of when an entity controls the specified good or service (and is, therefore, a principal) in paragraph B37. The Committee notes that these indicators are meant to support an entity's assessment of control, not to replace it. These indicators do not override the assessment of control; and should not be viewed in isolation. Furthermore, they should not be considered as a checklist of criteria to be met or factors to be considered in all scenarios. As per paragraph B37A of Ind AS 115, these indicators, depending on the facts and circumstances, may be more or less relevant or persuasive to the assessment of control.

17. Considering the aforesaid requirements of Ind AS 115, in case of back-to-back arrangements, based on the sample power sale agreement shared, the Committee notes that there are mainly three parties, viz., the Company i.e. a trader, a buyer (who is the ultimate buyer) and an identified seller, who is generator of power. The company is not itself power generator, but there is a separate power generator, which is identified in the power sale agreement between the Company and the buyer. There is either a separate power purchase agreement (PPA) between the Company and the power generator or sometimes a tripartite agreement between the above parties is entered into. The Company is not licensed to generate power itself and sources power from power generating Company and sells it to other entities. The Committee further observes the following from the sample power sale agreement (PSA) with the ultimate buyer (W Ltd.), as shared for back-to-back arrangements by the querist for the perusal of the Committee:

- In Article 1 of the PSA, the terms such as 'Declared Capacity', 'Delivery Point' and 'Power Station' have been defined with reference to the power generator's capacity/delivery point/power station.
- The power generator has been identified in the agreement. The power sale agreement states that the delivery point for the agreement shall be the power generator's outgoing terminal of power station i.e. at the power generator's periphery. Furthermore, Clause 3.2 of the agreement mentions conditions precedent including, the power generator's financial closure, valid leasehold rights and existence of the PPA between the Company and the power generator. Clause 3.3 of PSA requires each party be informed about the continuing confirmation about these conditions precedent to the contract.
- Clause 2.3 (a) of PSA provides that the agreement stands extended by the period for which the power generator is not able to supply electricity due to any Force Majeure event which indicates that the arrangement between the Company and its customers is entirely dependent on the supply from the generating entity and is not primary responsible for the power supply.
- As per Clause 4.3.1, the buyer has an obligation to pay to the Company, the capacity charges for un-availed/ unscheduled power in case the buyer does not

avail/ schedule power upto the net declared capacity. This means that the buyer is assuring the seller (vz., power generating entity) and the trader (the Company), at a minimum, the capacity charges in case of any un-availed/ unscheduled power units from the power station. Therefore, the Company is exposed to minimal demand risk.

- As per Clause 7.8.1, the buyer is required to pay a trading margin on the entire energy delivered, to the seller, in addition to the CERC tariff for the project. Further, Clause 7.2.2 states that the monthly bills shall include, amongst others, the seller's computation of various components of the monthly tariff payable in accordance with Tariff as approved/ determined by the CERC and the sellers trading margin as per the Tariff.
- Clause 7.5.1 permits third-party sale by the Company only in case of payment default by the buyer beyond certain number of days.

Further, as per separate clarifications provided by the querist;

- The trader (the Company) has no role to play with regard to conversion/ transmission/stabilisation of the power supplied by the power generator.
- Trading Margin being charged by the trader (the Company) from the buyer is for scheduled power. As per Clause 4.3.1 of PSA, the trading margin is a part of variable charges and is payable only for scheduled power. In case power is not scheduled, the Company will not earn any trading margin.

Further, if the arrangement is examined for the indicators stated in paragraph B37 of Ind AS 115, the Committee notes the following:

- Primary responsibility: the power generator (the seller) has been identified in the agreement and aspects such as, delivery point, declared capacity and capacity charges are identified with respect to the power generator. This suggests that the primary responsibility for fulfilment of the contract is not with the Company.
- Inventory risk: Declared capacity is defined as specifically in relation to the capability of the power generator's power station. The buyer is obliged to offtake the energy output i.e. the metered output delivered by the power generator. Further, as per Clause 4.3.1 of the sample power sale agreement, the buyer has an obligation to pay for the Capacity charges for unavailed/ unscheduled power in case the buyer does not avail/ schedule power up to the Declared capacity, in case the sale realisation to third parties is less than the capacity charges. This indicates that there is no inventory risk with the trader (the Company) on account of lack of demand.
- Pricing discretion: The Company does not have pricing discretion since the power tariff is regulated.

The Committee also notes that in the tripartite agreement for purchase and sale of power between M Ltd. (seller), the Company (trader) and N Ltd. (Buyer), Clause 4.4.2 states that if the seller (power generating entity) is generating and is making the net declared capacity available to the trader, and trader fails to supply such net declared capacity to the buyer, then the seller and buyer shall have the right to suspend sale and purchase from the trader, and may undertake direct sale and purchase of such energy. During such sale and purchase, the trader shall not be entitled to receive any trading margin.

The Committee also notes from the PPA between the power generating entity (M Ltd.) and the Company in the extant case that the Company has entered into a Memorandum of Understanding with the power generating entity *to tie up sale* of power generated by the generating entity to *potential customers.* Further, the PPA states that pursuant to the aforesaid MoU, the Company would *facilitate* the power purchase agreements of power generated as well as the open access and evacuation arrangements and other related activities *for a consideration/trading margin* of 4 paise per unit payable by the ultimate buyers for the duration of this Agreement. Thus, from the language of the PPA itself, it is apparent that the Company in the extant case is merely acting as a facilitator for the power generating entity in making sale arrangements with the ultimate buyers for an agreed consideration or trading margin.

The Committee further notes from the PPA with the M Ltd. (a power generating entity) that transmission losses for sale of the contracted capacity of power beyond the Delivery Point shall be on account of buyer and shall be borne by the buyer (viz., the Company). Similarly, it is noted from the copies of PSA with the ultimate buyer that the transmission losses beyond the delivery point shall be borne by the ultimate buyer and the delivery point in both the PPA and PSA is the power generating entity's switchyard outgoing terminal. From this, it implies that in substance, any transmission loss beyond the delivery point shall be borne by the ultimate buyer and not the trader, viz., the Company in the extant case.

The Committee notes that as per Ind AS 115, 'control' refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. In this context, in case of back-to-back type of arrangements, the Committee notes from the PPA between M Ltd. (a power generating entity) and the Company that even the ultimate buyer entity to whom the Company intends to sell has been identified, which indicates the Company's restrictions on its ability to direct the use of power supply to another entity. Further, based on the above clauses in the PPA/PSA and the aforesaid discussion, it can be said that the Company does not have the ability to direct the right to use the power that it obtains under the power purchase agreement with the power generator to fulfil another customer contract and that the Company doesn't control the right to the power to be supplied before that right is transferred to the buyer. Therefore, it can be inferred that the Company is acting as an agent for the purpose of accounting under Ind AS 115 and its performance obligation is to arrange for the right to power supply rather than supplying power itself.

18. In case of arrangements under open position i.e. not on back-to-back basis, the Committee observes that:

- The Company enters into the power purchase agreement with power generators (D Corporation) to purchase power before entering into power sale agreement with the buyer of power.
- As per Clause 4.2.1 and Clause 4.3.1 of the sample power purchase agreement shared, the Company is obliged to offtake and purchase all the power generated and delivered by the power generator at the identified delivery point and pay the agreed tariff.
- The sample power sale agreement for open contracts does not contain any minimum offtake obligation clause requiring the buyer to purchase minimum quantity of power from the Company.
- The tariff for the power to be supplied as mentioned in Clause 1 of Annexure I

of the sample power sale agreement, is not regulated by CERC, but negotiated by the Company with the buyer of power. The CERC power tariff regulations prescribe rules for determination of tariff on the basis of cost plus method between generator and customer. However, the tariff can be mutually decided by both the parties on the basis of competitive bidding/ mutual agreement. The justification for the same is required to be given and regulator adopts the same.

As per the separate clarifications provided by the Company, the amount to be paid to the power generator is fixed per unit or as per schedule given irrespective of sale of power to the customer. Generally, the contract with the power generator is of 25 years, however the contract with customer is of 4 years only.

Further, in contrast to the back-to-back arrangements, in case of open trade deals, in the PPA between the Company and power generating entity (D Corporation), ultimate buyer entity has not been identified. Further, the PPA also specifically states that the Company "shall have the right to sell the delivered power to any person at its cost and responsibility", which indicates that the Company is the buyer for the power generating entity and has an autonomy and independence to decide the terms of subsequent sale. In other words, the Company has the ability to direct the use of the right to supply of power received from the power generating entity.

Furthermore, the Committee observes in case of such an arrangement, that the Company is assuming the obligation to offtake the minimum quantity of power from the power generator. However, the customer of the Company, i.e. the ultimate buyer of the power is not assuming such an obligation in the power sale agreement since there is no minimum offtake clause in the power sale agreement. It is to be noted that the right is not created only when it is obtained by the customer and the right exists with the Company, by virtue of the power purchase agreement, before the customer obtains it. Therefore, it can be said that the Company's right to get power supply from the power generator exists before the customer obtains it, and, resultantly, the company is able to control right to the power to be supplied before it is transferred to the customer. Accordingly, the Committee is of the view that in such arrangements, the Company is 'principal' under Ind AS 115 and therefore, should recognise revenue from sale of power and corresponding costs on gross basis.

19. In case of power trading through power exchange, the Committee observes the following:

- The Company is bidding on behalf of the customer on the power exchange. The Company is not selling or purchasing power on its own as a principal.
- The power price is discovered in power exchange. The Company earns a trading margin in such an arrangement. CERC, the regulator provides a ceiling for the trading margin which can be charged by the Company for such transactions. The Company commercially negotiates the trading margin with the customer.

Further, if the arrangement is examined for the indicators stated in paragraph B37 of Ind AS 115, the Committee notes the following:

- Primary responsibility: The primary responsibility for fulfilment of the contract i.e. power supply is not with the Company.
- Inventory risk: There is no inventory risk that the Company is exposed to.
- Pricing discretion: The Company does not have pricing discretion since the

price for power is discovered through power exchange.

Based on the above, it seems that the Company doesn't control the right to the power traded through power exchange before that right is transferred to the customer. The Company is merely bidding for power on behalf of the customer. Therefore, it can be inferred that the Company is acting as an agent for the purpose of accounting under Ind AS 115 and its performance obligation is to arrange for the right to power supply rather than supplying power itself.

D. Opinion

20. The Company should account for revenue in case of back to back arrangements and where power is traded through power exchange as an agent under Ind AS 115 for the reasons discussed in paragraphs 17 and 19 above. The Company should account for revenue arising in case of open contracts as a principal under Ind AS 115 for reasons stated in paragraphs 18 above.

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