

Query No. 13

Subject: Accounting treatment of true-up value arising as per Rate Regulations.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a Joint Venture Company of I Limited, B Limited and D Limited. The Company was incorporated under the laws of India on August 11, 2009 as a private limited company as per the Companies Act, 1956.

2. The Company started its commercial operations with effect from 14th July, 2010 when Indira Gandhi International (IGI) Airport Terminal-III was commissioned for the public. It owns the Aviation Turbine Fuel (ATF) Facility which includes the on-site facility at Aviation Fuelling Station at IGI Airport, New Delhi and the Aviation Fuel Hydrant System (AFHS) at Terminal-III and Terminal-II at IGI Airport.

The Company provides the infrastructure aimed at ensuring an uninterrupted flow of ATF to all type of aircrafts at the IGI Airport as per international benchmarking. The Company also ensures a trustworthy, reliable, safe and secured means of supplying ATF for maintaining a smooth and uninterrupted operational life at the IGI Airport.

3. The Company was assigned the responsibility of Fuel Facility by means of Concession & Operating Agreement (C&OA) executed by and amongst I Ltd., B Ltd., S Ltd. and D Ltd., whereby the Company (the Concessionaire) was granted the right to design, develop, construct, manage, maintain, upgrade and operate the Aviation Fuelling Facility at the Fuel Farm on a Build, Own, Operate & Transfer (BOOT) basis. Further, the Concession & Operating Agreement is for a period of 25 years.

4. The Company earns its revenue through rendering of fuel farm infrastructure services and currently revenue is measured with reference to quantity, operating expenses, and the effective Fuel Infrastructure Charges (FIC) at the rate determined by the Airport Economic Regulatory Authority (AERA). However, tax as collected on behalf of the Government is excluded from the revenue.

Background on Regulated Rate:

5. At the inception of its operation from 14th July, 2010, the Company was charging revenue rate/FIC Rate as per the revenue rate calculation method mentioned in the Concession & Operating Agreement and there was no Regulator for determination of revenue rate till 31.03.2011.

6. The first regulatory control period of the Company was started from April 01, 2011 to March 31, 2016 and the first control period order was issued by AERA on 22nd October 2012. The revenue rate/FIC Rate for first control period was kept same as existing rate (i.e., the rate in force before issue of first control period order) by AERA and was not subject to true-up (adjustment of over/under recovery) as defined below in the next Control period.

7. Subsequently, for Second Control period (i.e., April 01, 2016 to March 31, 2021), AERA has determined the maximum revenue rate/FIC rate for the Company under Price-Cap Regulation vide its Order No. 32/2017-18 dated 18th December 2017 (effective from April 01,

¹ Opinion finalised by the Committee on 20.6.2022.

2016 to March 31, 2021) subject to true-up (adjustment of over/under recovery) in the next Control period.

8. The querist has stated that under the Price-Cap Regulation, AERA determines Aggregate Revenue Requirement (ARR) for the given control period to arrive at FIC rate/revenue rate for the control period based on the projected financials (i.e., revenue, expenses and capital expenditure, ATF volume, FRoR and RAB) of next five years. During the process, AERA allows all the reasonable expenses incurred by the service provider along with Fair Rate of Return (FRoR) on Regulatory Assets Base (RAB) of the Company. Further, the FRoR allowable by AERA is Weighted Average Cost of the Capital (WACC) determined in the case of the service provider. Further, the formula for determining ARR under Price-Cap Regulation is given below:

$$ARR = \sum_{t=1}^5 (ARR_t)$$

$$ARR_t = (FRoR \times RAB_t) + Dt + Ot + Tt - NART$$

Where;

- ‘t’ is the Tariff Year in the Control Period;
- ARR_t is the Aggregate Revenue Requirement for year ‘t’;
- FRoR is the Fair Rate of Return for the control period;
- RAB_t is the Regulatory Asset Base for the year ‘t’;
- D_t is the Depreciation corresponding to the RAB for the year ‘t’;
- O_t is the Operation and Maintenance Expenditure for the year ‘t’, which includes all expenditure incurred by the Airport Operator (s) including expenditure incurred on statutory operating costs and other mandate operating costs;
- T_t is the corporate tax for the year ‘t’ paid by the Airport Operator on the aeronautical profits;
- NART is the revenue from services other than aeronautical services for the year ‘t’;

ARR_t determined above is discounted by applying discounting factor at FRoR and NPV of aggregate revenue requirement is determined in order to arrive at applicable FIC rate for the control period.

9. The FIC rate with effect from second control period (i.e., April 01, 2016 to March 31, 2021) fixed by AERA as per above formula is subject to true up (i.e., cash outflows or inflows for over recovery or under recovery are spread over the control period through adjustment in FIC rate for next control period) based on audited financial statements of respective years (i.e., based on actual financial data of various building blocks considered in the formula for determination of ARR) of the Company. AERA allows adjustment of true up in the next control period under both the scenarios, i.e., under recovery or over recovery of aggregate revenue requirement.

10. Further, the order for second control period under Price Cap Regulation was issued on December 18, 2017, by AERA (i.e., effective from financial year (F.Y.) 2016-17 to F.Y. 2020-21). The Company had challenged and filed appeal against AERA order with Telecom

Dispute Settlement and Appellate Tribunal (TDSAT), and received final judgment of TDSAT in the mid of F.Y. 2019-20 confirming AERA order revenue rate/FIC rate. Thereafter, the Company has been recognising revenue as per the rate determined by the AERA.

11. Third control period tariff (F.Y. 2021-22 to F.Y. 2025-26): In response to AERA's letter dated 10.09.2020, the Company submitted the Multi-year Tariff Proposal (MYTP) for third control period on 10.02.2021 seeking higher tariff and declared a true-up (over recovery) of Rs. 38.87 crores during second control period. The AERA vide its Tariff Order No. 23/2021-22 dated 07.10.2021 has approved maximum revenue rate/FIC rate per KL to be charged by the Company for the services during third control period (F.Y. 2021-22 to F.Y. 2025-26). The AERA has considered audited financial statements of second control period (F.Y. 2016-17 to F.Y. 2020-21) and based on various building blocks (those were subject to true-up), determined a true-up (over recovery) of Rs. 144.54 crores. As per AERA tariff order, the above true-up value was adjusted while fixing FIC rate of third control period (F.Y. 2021-22 to F.Y. 2025-26).

12. The Company has adopted Indian Accounting Standards (Ind AS) from April 01, 2016. The Company has not made any accounting treatment of the above true-up in any of the previous year(s) in the second control period (F.Y. 2016-17 to F.Y. 2020-21).

Current Accounting Practice of the Company related to AERA Order on revenue rate determination:

13. The Company recognises revenue at the revenue rate/FIC rate determined by the AERA for the control period without recognising amount of true-up (over recovery/under recovery) based on actual financial data vis-à-vis projected financial data. Further, with respect to industry practice in airport sector, the Company has not come across any private airport operator who is recognising the true-up value (either over/under recovery) in their financials.

14. The Company's view on the accounting treatment is as follows:

The revenue is recognised as per the provisions of Indian Accounting Standard (Ind AS) 115 'Revenue from Contracts with Customers'. As per Ind AS, there are five steps for revenue recognition which are:

1. Identify contract with the customer.
2. Identify the performance obligation.
3. Satisfaction of performance obligation.
4. Determining transaction price.
5. Recognition of revenue when or as a performance obligation is satisfied.

As per the business operating model of the Company, i.e., 'Concession & Operating Agreement' (commercial arrangement to operate fuel farm), the Company raises monthly invoice on the operator of the fuel farm (S Ltd.) for realising the fuel infrastructure charges and S Ltd. recovers the said charges from the fuel supplier companies (oil companies), basis service/user agreements with the oil companies based on Aviation Turbine Fuel (ATF) supplied to airlines.

As per the above, it can be clearly identified that the Company has a single customer, i.e., S Ltd. Since the Company is providing fuel farm facility to the operator on 24/7 basis, the performance of the contract is getting satisfied on delivering the fuel farm activities to the customer on daily basis.

The transaction rate to be recovered by the Company from its customer is being fixed by AERA FIC tariff determination mechanism. Tariff is determined considering projected financials/cash flows for a control period (usually a period of 5 years) and any difference in projected vs. actual is adjusted as true-up for the tariff determination of next control period. The rate fixed by AERA for a particular period will be recovered from the customer on the date of performance obligation getting satisfied. There is no obligation toward the customer for any rate fixed by AERA for next control period for any 'true up' value adjustment. Accordingly, the transaction price has been concluded as the rate fixed by AERA for a control period.

Accordingly, in line with Ind AS 115, the Company is recognising revenue based on Aviation Turbine Fuel (ATF) quantity supplied to Airlines utilising the fuel farm infrastructure facility by the operator and transaction price as determined by AERA after netting off operating cost charged by the Fuel farm operator (S Ltd.) since all the parameters of revenue recognition have been met.

During third control period also, the Company will be recognising the revenue for ATF supplied to airlines utilising the fuel farm infrastructure facility by the operator and transaction price is as determined by AERA. Though the rate as declared by AERA is after adjusting the 'true up' value (determined as discussed above), 'the Transaction Price' for the supply made in the next control period is based on the rate declared by AERA. As the Company has not made any over recovery from the customer with whom contract/arrangement was entered for supply of service. Therefore, there is no liability on the Company to refund the amount to its customer or to someone else.

The true-up value (under/over recovery) calculated by AERA is based on fuel infrastructure facility rate formula as mentioned in the AERA guidelines, which assures reasonable return to the service provider after considering the entire customer group consisting of airport/airlines and allied services. Since the true-up model factored in the AERA guidelines for the next control period is primarily for protecting interest of the users of airport/airlines, it cannot be considered as a liability which needs separate treatment in the books of the account of the Company and the same is already being disclosed in the notes to accounts forming part of financials.

15. The querist has also supplied the following additional facts to be considered:

1. Section 148 of the Companies Act, 2013, read with rule 3 of the Companies (Cost Records and Audit) Rules, 2014, categorises "Regulated and Non-Regulated sectors" of different Industries, wherein the following services are defined under Non-Regulated sector.

"Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008)"

It is imperative to note that aeronautical services related to supply of fuel (including fuel farm facility services) at airports as governed by Airports Economic Regulatory Authority (AERA) do not fall under regulated sector.

2. As per the Company's revenue recognition policy, the tariff rates are declared by the AERA for the Company and the same are considered as the transaction price as per Ind AS 115. Therefore, the Company is recognising revenue by charging the above transaction price (AERA declared tariff) as final rates from its customer (S Ltd.) and discharging statutory dues (i.e., GST, income-tax etc.) to the Government accordingly.
3. The above revenue recognition practice (accounting convention) is being followed by the other Industry partners (governed by AERA regulations) and as per available information, any true up differential is not being recognised by other industry partners.
4. As per AERA guidelines / agreement with the Company's customer, for true-up liability amount, there is no present obligation for the Company (i.e., to whom and when it should be paid). Further, in case of closure/end of concessionaire period, there is no guidance/evidence of surrender/recovery of true-up amount to/by the customer.

Considering the above, Management of the Company is of the view to follow revenue recognition as per Ind AS 115 as per aviation industry accepted practice and thereby not accounting for AERA true-up in the books of account. To make user(s) aware of the fact, the Company has included a detailed disclosure about true-up value in the notes to accounts forming part of financials.

B. Query

16. On the basis of the above, the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) is sought in respect of the following issues:

- (i) Whether the Company has to recognise the above mentioned true-up value of Rs. 144.54 crores in the books of account.
- (ii) If the answer to (i) is affirmative, then opinion is sought on the following issues:
 - (a) The accounting treatment (including disclosure in accounting policy and notes to accounts) for the above true-up (over recovery) of Rs. 144.54 crores of the second control period in the books of account of the Company.
 - (b) The accounting treatment in case the true-up amount for the second control period would have been under-recovered instead of over-recovery.
 - (c) The accounting treatment in the subsequent year(s) for the above true up, since it is already adjusted in revenue/FIC rate of third control period (i.e., to make it zero by the end of third control period i.e., as of March'2026).
 - (d) Considering the fact of the case that previously, the Company has not elected to adopt any specific Ind-AS and/or Guidance Note for accounting treatment of true-up (over/under recovery), now in case any specific Ind-AS and/or Guidance Note is required to be adopted by the Company in current period, then whether the accounting treatment of the same can be done with prospective effect.

- (e) Accounting treatment of true-up that arises during third control period years from F.Y. 2021-22 to F.Y. 2025-26 (i.e. difference between revenue rate/FIC rate as per AERA order vis-à-vis actual) to nullify the impact of true-up on the results of the Company so that the impact can be accounted on regular basis to minimise it at the end of the control period (which will be subsequently adjusted by AERA while determining revenue/FIC rate for the fourth control period, i.e., F.Y. 2026-27 to F.Y. 2030-31). Also, the disclosure in accounting policy and notes to accounts.

C. Points considered by the Committee

17. The Committee notes that the basic issue raised in the query relates to accounting treatment of true-up value arising as per AERA Rate Regulations. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, method/basis of determination of tariff, detailed aspects of recognition and measurement of revenue earned through rendering of fuel farm infrastructure services, accounting for tax collected, application of requirements of Ind AS 115, applicability of Ind AS 116, applicability of the Guidance Note on Accounting for Rate Regulated Activities etc. Further, the Committee has opined purely from accounting perspective and not from any legal perspective, such as from the perspective of Airport Economic Regulatory Authority (terms and conditions for determination of tariff for services provided for cargo facility, ground handling and supply of fuel to the aircraft) Guidelines 2011. Further, the Accounting Standards referred hereinafter are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended/revised from time to time.

18. At the outset, the Committee notes that with effect from 1st April, 2016 when the Company started preparing Ind AS financial statements, it became subject to Price Cap Regulations, issued by the AERA, wherein FIC/revenue rates to be charged by the Company from its customer (which allows recovery of its costs and reasonable return on investment) shall be decided by the AERA and such rates are also subject to true-up exercise. Since in the Ind AS framework/context, Ind AS 114, 'Regulatory Deferral Accounts' is the applicable Standard for entities that are subject to rate regulation, involving tariffs under true-up mechanism, the Committee notes the following paragraphs from Ind AS 114:

“Scope

- 5 An entity is permitted to apply the requirements of this Standard in its first Ind AS financial statements if and only if it:**
- (a) conducts rate-regulated activities; and**
 - (b) recognised amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its previous GAAP.**
- 6 An entity shall apply the requirements of this Standard in its financial statements for subsequent periods if and only if, in its first Ind AS financial statements², it recognised regulatory deferral account balances by electing to apply the requirements of this Standard.”**

² An entity subject to rate regulation coming into existence after Ind AS coming into force or an entity whose activities become subject to rate regulation as defined in this Ind AS subsequent to preparation and presentation

“8 An entity that is within the scope of, and that elects to apply, this Standard shall apply all of its requirements to all regulatory deferral account balances that arise from all of the entity’s rate-regulated activities.”

“Changes in accounting policies

13 ³An entity shall not change its accounting policies in order to start to recognise regulatory deferral account balances. An entity may only change its accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable*, or more reliable and no less relevant to those needs. An entity shall judge relevance and reliability using the criteria in paragraph 10 of Ind AS 8.

14 This Standard does not exempt entities from applying paragraphs 10 or 14–15 of Ind AS 8 to changes in accounting policy. To justify changing its accounting policies for regulatory deferral account balances, an entity shall demonstrate that the change brings its financial statements closer to meeting the criteria in paragraph 10 of Ind AS 8. However, the change does not need to achieve full compliance with those criteria for the recognition, measurement, impairment and derecognition of regulatory deferral account balances.

15 Paragraphs 13–14 apply both to changes made on initial application of this Standard and to changes made in subsequent reporting periods.”

Further, *Appendix A to Ind AS 114* defines ‘Previous GAAP’ as “the basis of accounting that a **first-time adopter** used immediately before adopting Ind ASs for its reporting requirements in India. ...” and Explanation to this definition states that “*Guidance Note on Accounting for the Rate Regulated Activities, issued by the Institute of Chartered Accountants of India (ICAI) shall be considered to be the previous GAAP*”.

First Ind AS financial statements are also defined as “the first annual financial statements in which an entity adopts Indian Accounting Standards (Ind AS), by an explicit and unreserved statement of compliance with Ind AS”.

The Committee notes that Ind AS 114 allows an entity to apply the Standard in its first Ind AS financial statements only if both the conditions of paragraph 5 of Ind AS 114, i.e. (a) it is carrying on rate regulated activities, and (b) the entity had recognised regulatory deferral account balances in its *financial statements as per previous GAAP, i.e., those prepared in accordance with the Guidance Note on Accounting for the Rate Regulated Activities*. In case any one of the aforesaid conditions is not met, for instance, the entity had not recognised regulatory deferral account balances in its previous GAAP financial statements, Ind AS 114 is not applicable. Further, even if an entity is within the scope of this Standard, it may elect not

of its first Ind AS financial statements shall be entitled to apply the requirements of the previous GAAP in respect of its such rate regulated activities.

³Substituted vide Notification No. G.S.R. 419(E) dated 18th June, 2021.

* The term “faithful representation”, which is used in the *Conceptual Framework for Financial Reporting under Ind AS* issued by the Institute of Chartered Accountants of India, encompasses the main characteristics that the *Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards* called “reliability”. The requirement in paragraph 13 of this Standard is based on the requirements of Ind AS 8, which retains the term “reliable”.

to apply this Standard in its first Ind AS financial statements in view of the requirements of the Standard as reproduced above.

In this context, it is noted from the facts of the case that the Company has not made any accounting treatment of the true-up in its Ind AS financial statements in any of the year(s) from F.Y. 2016-17 to F.Y. 2020-21. Further, paragraph 16 (d) above also states that previously, the Company has not elected to adopt any specific Ind AS and/or Guidance Note for accounting treatment of true-up (over/under recovery). Thus, since the Company has neither recognised regulatory deferral account balances in its financial statements in accordance with previous GAAP nor elected to recognise regulatory deferral accounts in its first Ind AS financial statements, the Committee is of the view that Ind AS 114 is not applicable to the Company for recognition of true-up value adjustments. Also, as per the requirements of paragraphs 13, 14 and 15 of the Standard, the Company should not change its accounting policies in order to start to recognise regulatory deferral account balances and that it may change its accounting policies for the recognition of regulatory deferral account balances, only if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs, as per the requirements of Ind AS 8. In case the Company decides to change its accounting policy in accordance with the aforesaid requirements, it may do so by applying the requirements of the Guidance Note on Accounting for Rate Regulated Activities.

D. Opinion

19. On the basis of the above, the Committee is of the following Opinion on the issues raised in paragraph 16 above:

- (i) Since the Company has neither recognised regulatory deferral account balances in its financial statements in accordance with previous GAAP nor elected to recognise regulatory deferral accounts in its first Ind AS financial statements, Ind AS 114 is not applicable to the Company for recognition of true-up value adjustments. Also, as per the requirements of paragraphs 13, 14 and 15 of the Standard, the Company should not change its accounting policies in order to start to recognise regulatory deferral account balances and that it may change its accounting policies for the recognition of regulatory deferral account balances only if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs, as per the requirements of Ind AS 8, as discussed in paragraph 18 above. In case the Company decides to change its accounting policy in accordance with the aforesaid requirements, it may do so by applying the requirements of the Guidance Note on Accounting for Rate Regulated Activities.
- (ii) In view of (i) above, the answer to these questions does not arise.