

Query No. 8

Subject: Applicability of Ind AS 114 and Presentation of Deferred Tax Liabilities on 'Regulatory Deferral Accounts'.¹

A. Facts of the Case

1. A Company (hereinafter referred to as 'the Company' or 'the Corporation') was incorporated on 20th March 2009 as a wholly owned subsidiary of P Ltd., a Government of India enterprise, to take over the business of system operations and market operations, which was earlier carried out by P Ltd., the erstwhile Holding Company. National Load Despatch Centre (NLDC), New Delhi and five Regional Load Despatch Centers (RLDCs) located at New Delhi, Mumbai, Kolkata, Bangalore and Shillong are being operated by the Company w.e.f. 1.10.2010 in accordance with the Gazette Notification dated 27.9.2010. The Company is a public limited company and a Government of India undertaking, incorporated and domiciled in India. The Ministry of Power has notified vide S.O.4089(E) [F.No.18/2/2015-PG] in the Gazette of India on 19th December, 2016 stating that the Company, a wholly owned government company shall operate the NLDC and all RLDCs with effect from 3rd January, 2017.

2. The Company is responsible for the following operations:

- i. To supervise and control all aspects concerning operations and manpower requirement of NLDC and RLDCs
- ii. To act as the apex organisation for human resources requirement of NLDC and RLDCs.
- iii. To ensure planning and implementation of infrastructure required for smooth operation and development of NLDC and RLDCs.
- iv. To coordinate the functioning of NLDC and all RLDCs.
- v. To advise and assist State Level Load Dispatch Centres, including specialised trainings etc.
- vi. To perform any other function entrusted to it by the Ministry of Power.

3. The Corporation is engaged in the business of scheduling and despatch of electricity over inter-regional links in accordance with Grid standards specified by the Authority and Grid Code specified by the Central Commission. These functions are being exercised through National Load Despatch Centre (NLDC), New Delhi and five Regional Load Despatch Centers (RLDCs). It is responsible to ensure the integrated operation of the Grid in a reliable, efficient and secured manner.

4. The Company is governed by the Electricity Act, 2003 and regulated by the Central Electricity Regulatory Commission (CERC) under the Act. The CERC issued Central Electricity Regulatory Commission (Fees and Charges of Regional Load Despatch Centre and other related matters) Regulations, 2019 (hereinafter referred to as the 'CERC Regulations') dated 05.04.2019, for the control period 2019-24, for determination of fees and charges to be collected by RLDCs from the generating companies, distribution licensees, inter-state

¹ Opinion finalised by the Committee on 12.5.2022.

transmission licensees, buyers, sellers and inter-State trading licensees and any other users. Prior to the aforementioned Regulation, CERC Regulation notified on 18th May 2015 was applicable for the control period 2014-19.

5. As per Regulation 17, under Chapter 'Fees and Charges Structure', RLDC Fees and Charges shall comprise Regional Load Despatch Centre Fees to be recoverable by the Corporation towards registration for commencement of grid access and scheduling and annual charges to be collected in the form of Annual Load Despatch Center (LDC) Charges from users.

6. As per Regulation 18, the annual LDC charges shall correspond to the expenditure proposed to be incurred by the RLDCs or NLDC and as approved by Commission. The annual LDC charges (ALDC) as approved by the Commission shall be recovered on monthly basis. The annual charges shall consist of the following components, namely:

- (a) Return on equity (ROE);
- (b) Interest on loan capital;
- (c) Depreciation;
- (d) Operation and maintenance (excluding human resource) expenses including:
 - Administrative and general expenses (excluding HRD expenses);
 - Repair and maintenance expenses;
- (e) Operational Expenditure (OPEX)
- (f) Human resource (HR) expenses including Human Resource Development (HRD) expenses;
- (g) NLDC and Corporate office expenses
- (h) Interest on working capital

7. Regulation 19 under Chapter 6 'Computation of Annual LDC Charges (ALDC)' prescribes method and rates for calculation of 'Return on Equity' as one of the components of ALC.

As per Regulation 19 (3), The rate of return on equity shall be computed by grossing up the base rate with the effective tax rate of the respective financial year based on relevant Finance Act.

As per Regulation 19 (4), Return on equity with respect to the actual tax rate applicable to the Corporation in line with the provisions of the relevant Finance Acts of the respective year during control period shall be trued up at the end of the control period.

8. Regulation 3(15) defines Effective tax rate for tax on return on equity as the rate (in %) calculated on the basis of actual tax paid by the concerned Load Despatch Centre in respect of the financial year *in line with the provisions of the relevant Finance Acts* and in line with the norms defined in CERC (Terms and Conditions of Tariff) Regulations for the relevant control period notified by the Commission. (Emphasis supplied by the querist.)

9. *Government Audit Query:*

Audit observed that:

Paragraph B10 of Ind AS 114 (Regulatory Deferral Accounts) states that in some rate-regulatory schemes, the rate regulator permits or requires an entity to increase its future rates in order to recover some or all of the entity's income tax expense. In such circumstances, this might result in the entity recognising a regulatory deferral account balances in the balance sheet related to income tax. The recognition of this regulatory deferral account balance that relates to income tax might itself create an additional temporary difference for which a further deferred tax amount would be recognised.

Further, Paragraph B11 of Ind AS 114 states that when an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances, the entity shall not include that deferral tax amount within the total deferred tax assets (liability) balances. Instead, the entity shall present the deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balance either: (a) with the line items that are presented for the regulatory deferral account debit balances and credit balances; or (b) as a separate line item alongside the related regulatory deferral account debit balances and credit balances.

Paragraph 17 of CERC (Fees and Charges of Regional Load Despatch Centre and other matters) Regulations, 2019 states that RLDC Fees and charges shall comprise RLDC Fees to be recoverable by the Company towards registration for commencement of grid access and scheduling and annual charges to be collected in the form of Annual LDC charges from users. Paragraph 18 of the above Regulations states that the annual LDC charges shall correspond to the expenditure proposed to be incurred by RLDCs or NLDC and as approved by Commission. The annual LDC charges (ALC) as approved by the Commission shall be recovered on monthly basis. The annual charges among other items shall consist of the return on equity.

Paragraph 19 of the above Regulations states that the rate of return on equity shall be computed by grossing up the base rate with the effective tax rate of the respective financial year based on relevant Finance Act. Return on equity with respect to the actual tax rate applicable to the Corporation in line with the provisions of the relevant Finance Acts of the respective year during control period shall be trued up at the end of the control period.

Audit observed that the Company had recognised Rs. 218.53 lakh as Deferred Tax Assets (Net) under Non-current Assets (Note No. 2.7) which includes an amount of Rs. 109.65 lakh (Rs. 63.39 lakh for F.Y. 2020-21 and Rs. 46.26 lakh for F.Y. 2019-20) towards deferred tax liability on account of grossing up the base rate with the effective tax rate which would be recovered from customers in due course through future tariff as per CERC Regulations 2019.

The Company acts under rate regulated activities regime and deferred tax liability of Rs. 109.65 lakh will be recovered by the entity in future from the customers through tariff. Thus, Ind AS 114 should apply for presentation of deferral account balances.

Ind AS 114 (paragraph 20) requires that 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. Ind AS 114 (paragraph 22)

also requires that 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.

Thus, the Company has not complied with the requirements of Ind AS 114 in respect of 'Deferred Tax Assets (Note 2.7)' and accordingly has not created regulated deferral account balance. This has resulted in understatement of deferred tax assets (net) to the extent of Rs. 109.65 lakh which should have been shown as Regulatory Deferral Account Balances in the Statement of Profit and Loss. Consequently, profit for the year is also understated by Rs. 63.39 lakh (F.Y. 2020-21). Net Movement under the regulatory deferral account for the year 2020-21 has also not been recognised in the Statement of Profit and Loss.

It is pertinent to mention here that as per paragraphs 26 and 73 of Ind AS 33 and paragraph 26 of Ind AS 114, Earnings Per Share (Basic and Diluted) shall also be shown by including and excluding movement in Regulatory Deferral Account balances in the Statement of Profit and Loss. Furthermore, as per paragraph 18 of Ind AS 7, 'Statement of Cash Flows', the impact of 'Net movement in Regulatory Deferral Account Balance' of Rs. 63.39 lakh of F.Y. 2020-21 shall also be taken while calculating Cash flow from operating activities for the year 2020-21.

Moreover, significant accounting policies pertaining to earnings per share and Cash Flow Statement shall be revised to the above extent.

Management stated that Ind AS 114 is not applicable to the Company.

Reply of the management is not tenable because the annual charges as approved by the CERC (regulator) shall be recovered on monthly basis and return on equity is one of the components of annual charges, and shall be computed by grossing up the base rate with the effective tax rate of the respective financial year based on relevant finance act.

Temporary differences have arisen in the carrying values and tax bases of property, plant and equipment (PPE) (tangible assets) and intangible assets (these assets are being utilised for generating revenue over the period of the life of assets) due to difference in depreciation rates of income tax and CERC Regulation, resulting in creation of Deferred Tax Liabilities (DTL) to be recovered through future tariff (as and when this temporary difference would reverse). As such, as per paragraphs B10 and B11 of Ind AS 114 (Rate Regulated Activities), the same should have been recognised through 'Regulatory deferral account balance' instead of deferred tax liabilities.

Company's Point of View:

10. The Company relied on the Guidance Note on Accounting for Rate Regulated Activities, issued by the Institute of Chartered Accountants of India (ICAI) read with Ind AS 114, as follows:

The scope of Ind AS 114 provides as under:

“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 statements, it recognised regulatory deferral account balances by electing to apply the requirements of this Standard. (Emphasis supplied by the querist.)**
- 7 This Standard does not address other aspects of accounting by entities that are engaged in rate-regulated activities. By applying the requirements in this Standard, any amounts that are permitted or required to be recognised as assets or liabilities in accordance with other Standards shall not be included within the amounts classified as regulatory deferral account balances.”

In this regard, it is to mention that since no item is in the nature of deferral account balance existed as per the Guidance Note of the previous GAAP, regulatory deferral account was not applicable in the previous GAAP and accordingly, Ind AS 114 was not applied in the first Ind AS financial statements.

11. Therefore, according to the querist, as per paragraph 6 of the Ind AS 114, as mentioned above, the requirements of Ind AS 114 shall not apply for the subsequent periods for the reasons mentioned as under:

1. **Recovery/Refund through former Users:** In the case of the Company, the recovery/refund of actual cost incurred by the entity in excess/short of the estimate considered for the tariff fixation purpose is not to be adjusted for determining the future tariff; rather it is to be recovered/refunded by the entity from/to its users (the then existing users) without impacting the future tariff to be charged (Refer to Regulation 13(4) of the CERC Regulations 2019-24; similar provisions also existed in the previous regulations). Accordingly, this type of Regulations does not fall within the scope of this Guidance Note. Therefore, paragraph B10 of the Ind AS 114, as stated in the query is not applicable.

Hence, revenue in such case is to be recognised in accordance with Ind AS 115, ‘Revenue from Contracts with Customers’.

2. **Accounting of Taxes as per Ind AS 12, Income Taxes:** With regard to temporary differences in carrying value and tax bases of PPE (tangible assets) and intangible assets due to difference in depreciation rates of income tax and CERC Regulation resulting in creation of Deferred Tax Liabilities (DTL) to be recovered through future tariff, it is to mention that recovery of depreciation under Fee and Charges is worked out as per the specific provision of CERC Regulations, 2019 for this purpose. Further, there is no provision in ‘Fees and Charges’ Regulation allowing the recovery through future tariff for the difference in depreciation under Income-tax Act and CERC Regulations. Hence, deferral account balance does not arise in the instant case.

However, the temporary difference is accounted for and presented in the financial statements as per the applicable provisions of Ind AS 12, ‘Income Taxes’ and presented in financial statements as deferred tax asset/liability. Further, it does not include any amount towards deferred tax liability on account of grossing up the

base rate with the effective tax rate which would be recovered from customers in due course through future tariff as per CERC Regulations 2019 as stated in CAG para.

From the above, it may be derived that paragraph B10 of Ind AS 114 is not applicable; and since paragraph B10 is not applicable, as per the Government audit query, presentation as per paragraph B11 is also not applicable.

12. Furthermore, as per the querist, as per paragraph 7 of Ind AS 114, any amounts that are permitted or required to be recognised as assets or liabilities in accordance with other Standards shall not be included within the amounts classified as regulatory deferral account balances. Therefore, since Ind AS 115 and Ind AS 12 are applicable, no other amounts will be classified as regulatory deferral accounts balance with respect to it.

Essentially, it is hereby to submit that in the case of the Company, the return on equity is grossed up with the effective tax rate as defined in the CERC Regulations and since the same corresponds to the tax rates of respective Finance Act, which is settled in that particular year itself, no deferred balance arises on this account. However, in case of difference between the amount claimed and amount allowed by the CERC, such differential amount is to be refunded/recovered as per truing-up order to/from the same billed users (on monthly basis) as was done in the normal billing for the relevant control period and does not pass on to the future customers; therefore, does not give rise to any deferral balance (Refer to Regulation 13(4) of the CERC Regulation 2019-24; similar provisions also existed in the previous regulations.)

Accordingly, accounting is done in that manner by referring to the tax rates of the applicable Finance Act, and the same is supported by the CERC Order on Truing-up Petition wherein the effective tax rate considered for grossing up of the return of equity is the applicable tax rate of that particular financial year of the Finance Act applicable to domestic companies.

13. The querist has also stated that that in the Truing up Order, the CERC has considered the following tax rates for computing the grossing up of ROE. The extracts of Truing up Order for Petition No. 431/MP/2019 of Northern Regional Load Despatch Centre (NRLDC) for the control period 2014-19 provide as follows:

Petitioner's submission... and analysis para of Order

On the basis of submissions of the Petitioner, following effective tax rates are considered for the purpose of grossing up of rate of return on equity:

Year	Effective tax (in %)	Grossed up ROE (Base Rate/1-t) (in %)	Computation of Grossed up Rate based on tax rates of respective year's Finance Act (%)
2014-15	33.990	23.481	15.5%/ (1-33.99%)
2015-16	34.610	23.704	15.5%/ (1-34.61%)
2016-17	34.610	23.704	15.5%/ (1-34.61%)
2017-18	34.610	23.704	15.5%/ (1-34.61%)
2018-19	29.120	21.868	15.5%/ (1-29.12%)

The Tax rates notified in the Finance Act of the respective Financial Year

Description	Tax Rate (%) / Financial Year				
	2014-15	2015-16	2016-17	2017-18	2018-19
Tax rate (A)	30	30	30	30	25
Add Surcharge (B)	10	12	12	12	12
Add- S&HE Cess/ H&E Cess (C)	3	3	3	3	4
Applicable Tax Rate : {A*(1+B)*(1+C)}	33.99	34.61	34.61	34.61	29.12

It may be seen from the above that the effective tax rate as per the order of CERC for each year of the control period 2014-19 is the same as notified in the Finance Act of the respective financial year and on that basis, billing and accounting for grossing up of ROE were done and as a result, no deferral balance arose.

As stated in the query of the auditor, that an amount of Rs. 109.65 lakh (Rs. 63.39 lakh for 2020-21 and Rs. 46.26 lakh for 2019-20) is towards deferred tax liability on account of grossing up the base rate with the effective tax rate. It may be mentioned that there is no amount which is in the nature of deferral balance as explained above and recovery from customers in due course through future tariff does not arise. Hence, there is no understatement of profit as observed by the Govt. auditor.

It may be worthwhile to mention that, at the time of introduction of the Guidance Note on Accounting for Rate Regulated Activities, issued by the ICAI, the Company was functioning as a wholly owned subsidiary of P Ltd. Since, the Company's fee and charges were not covered under the ambit of the Guidance Note, the same was not adopted.

(Emphasis supplied by the querist.)

B. Query

14. In view of the above, opinion of the Expert Advisory Committee has been sought by the querist on the following issues:
- (i) Applicability of Ind AS 114 on the financial statements of the Company.
 - (ii) Whether the presentation of deferred tax assets/liability in financial statements made by the Company is in compliance with the Indian Accounting Standards.

C. Points considered by the Committee

15. The Committee notes that the basic issues raised by the querist relate to the applicability of Ind AS 114 to the Company and presentation of deferred tax assets/liabilities in its financial statements. The Committee has, therefore, considered only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, revenue recognition under Ind AS 115, accounting for deferred tax asset/liability as per the requirements of Ind AS 12, recognition and measurement of regulatory assets or liabilities (if any), applicability of the Guidance Note on Accounting for the Rate Regulated Activities, etc. Further, the Committee has examined the issue only from Ind AS perspective and has not

examined any regulatory or legal aspects, such as, interpretation of CERC Regulations, Tariff Order, Electricity Act, etc.

16. With regard to the issue of applicability of Ind AS 114 to the Company, the Committee notes that Ind AS 114 provides as follows:

“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.”

“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.”

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”.

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 *previous financial statements as per the Previous GAAP, i.e., those prepared in accordance with the Guidance Note on Accounting for 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. Even if an entity is within the scope of this Standard, it may elect not 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, the Committee notes from the Facts of the Case that the querist has stated that no regulatory assets and liabilities were recognised in its financial statements prepared under previous GAAP because, in the view of the querist, no item in the nature of deferral account balances existed as per the Guidance Note specified in the definition of ‘Previous GAAP’, and accordingly, Ind AS 114 was not applied in the first Ind AS financial statements. Thus, the Company has neither recognised

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 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.

regulatory deferral account balances under previous GAAP financial statements, nor elected to apply Ind AS 114 in its Ind AS financial statements.

Therefore, the Committee is of the view that Ind AS 114 is not applicable in the extant case. Also, since Ind AS 114 is not applicable, the question of recognition of any regulatory deferral account balances in respect of deferred taxes does not arise. Accordingly, the issue of applicability of paragraphs B10 and B11 of Ind AS 114 would not arise in the context of given facts and circumstances of the case.

17. The Committee is, however, of the view that with regard to the contention of CAG in paragraph 9 above in respect of temporary differences arising with regard to the carrying values and tax bases of property, plant and equipment (PPE) (tangible assets) and intangible assets due to difference in depreciation rates for income tax purposes and CERC Regulations, (which in the extant case are presumed to be the depreciation rates acceptable for accounting purposes), the Company shall apply the relevant requirements of Ind AS 12, 'Income Taxes' for the purpose of recognition, measurement, presentation and disclosure of deferred tax assets/liability in normal course in its financial statements.

D. Opinion

18. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 14 above:

- (i) Since the Company has not recognised regulatory deferral accounts under previous GAAP financial statements and has also not elected to apply Ind AS 114 in its Ind AS financial statements, the said Ind AS is not applicable in the extant case, as discussed in paragraph 16 above.
- (ii) Since Ind AS 114 is not applicable, the question of recognition of any regulatory deferral account balances in respect of deferred taxes does not arise. Therefore, as discussed in paragraph 16 above, the issue of applicability of paragraphs B10 and B11 of Ind AS 114 would not arise in the given facts and circumstances. The Company should, however, follow the relevant requirements of Ind AS 12 for the purpose of recognition, measurement, presentation and disclosure of deferred tax assets/liability with regard to temporary differences in carrying values and tax bases of PPE (tangible assets) and intangible assets due to difference in depreciation rates for income tax purposes and CERC Regulations, (which in the extant case are presumed to be the depreciation rates acceptable for accounting purposes) in its financial statements, as discussed in paragraph 17 above.
