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Implication of NFRS (IFRIC 12) on Hydro-Power Entity

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NFRS Implementation

Type	Entities Requiring adoption of NFRS	NFRS Complied Financial Statements
A	<ol style="list-style-type: none">1. Listed Multinational Manufacturing Companies2. Listed State Owned Enterprises (SOEs) with minimum paid up capital of Rs. 5 billions (except Banks and Financial Institutions under BAFIA Act, 2006)	2014-15
B	<ol style="list-style-type: none">1. Commercial Banks, including State Owned Commercial Banks;2. All other Listed State Owned Enterprises (SOEs)	2015-16
C	<ol style="list-style-type: none">1. All other Financial Institutions not covered under A & B above2. All other SOEs3. Insurance Companies4. All other Listed Companies5. All other Corporate Bodies/Entities not defined as SMEs.	2016-17
D	NFRS for SMEs (SMEs as defined and classified by ASB)	2019-20

IFRIC Interpretation 12

- IFRIC Interpretations are developed by the IFRS Interpretations Committee (previously the International Financial Reporting Interpretations Committee, IFRIC) and are issued after approval by the International Accounting Standards Board (IASB).
- IFRIC Interpretation 12; It is interpretation by IASB for BOT, ROT or Public to Private service concession arrangement. This interpretation gives guidance on the accounting by operators for public to private service concession arrangement.

Service Concession Arrangement

- A service concession arrangement is an arrangement whereby a government or other public sector body contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons or hospitals. The grantor controls or regulates what services the operator must provide using the assets, to whom, and at what price, and also controls any significant residual interest in the assets at the end of the term of the arrangement.

Service Concession Arrangement contd.

NFRS

- In many countries, infrastructures for public service- such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks- has traditionally been constructed, operated and maintained by public sector and financed through public budget appropriation.
- In some countries, governments have introduced contractual service arrangements to attract private sector participation in development, financing, operation and maintenance of such infrastructure. The infrastructure may already exist or may be constructed during the period of the service arrangement.

Service Concession Arrangement contd.

- An arrangement within the scope of this interpretation typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it and operating and maintaining that infrastructure for a specified period of time.
- The arrangement is often described as a "Build-Operate-Transfer, a "Rehabilitate-Operate-Transfer" or a "Public to Private" service concession arrangement. (BOOT Model in Nepal).

Service Concession Arrangement contd.

- Common features are;
 - The service arrangement contractually obliges the operator to provide the service to the public on the behalf of the public sector entity.
 - The grantor is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved.
 - The operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor.
 - The contract sets the initial prices to be levied by the operator and regulates price revisions over then period of the service arrangement.
 - The operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

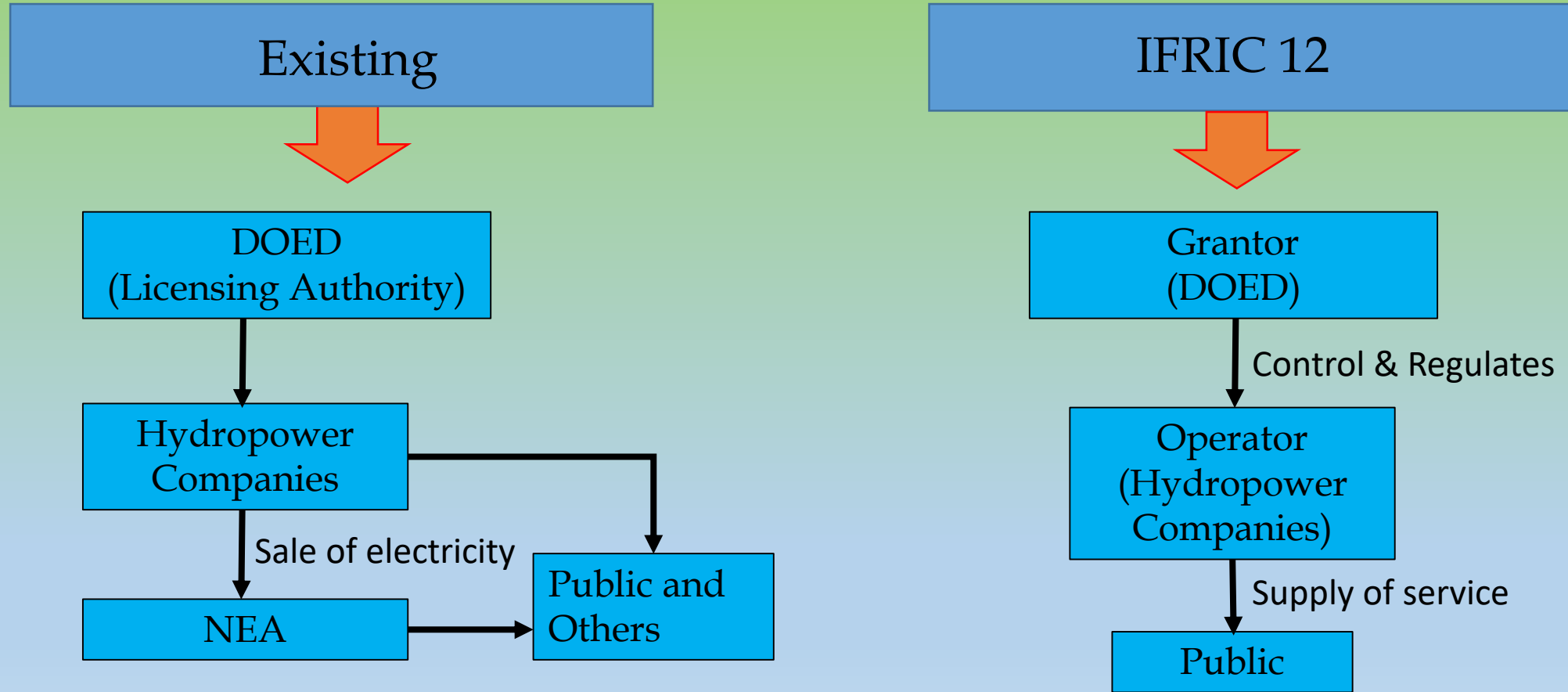
Scope of IFRIC 12

- The grantor controls or regulates what **services** the operator must provide with the infrastructure, **to whom** it must provide them, and at **what price**; and
- The **grantor controls** through ownership, beneficial entitlement or otherwise-any significant residual interest in the infrastructure at the end of the term of arrangement.

Test of Relevancy in Hydro Sector in Nepal

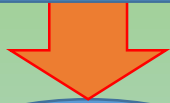
- What is the current Business model?
- Is “Power sales” service or goods?
- Who controls whom to sell?
- Who controls the sales price?
- Does the grantor have any control on the entity/business?
- Is the operator contractually obliged to provide the service to the public on the behalf of the public sector entity?
- Does the operator have practical ability to sell or pledge the infrastructure?
- BOT or BOOT ?

Business Model



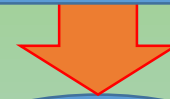
Is “Power sales” service or goods?

Revenue from sale of goods
under NAS 18 (14)



- Measurable
- Transfer of risk and reward
- Control of goods
- Flow of economic benefit
- Cost of product

Revenue from sale of service
under NAS 18 (20)



- Flow of economic benefit
- Stage of completion can be measured reliably

Test of Relevancy.....contd.

- Is “Power sales” service or goods?

अनुसूची-३

(दफा १५ को उपदफा (२) को खण्ड (क) सँग सम्बन्धित)

ऊर्जा मूलक उद्योग

१. जलस्रोत, वायु, सौर्यशक्ति, कोइला, प्राकृतिक तेल र इन्धन वा ग्यास, वायोमास वा अन्य स्रोतहरूबाट ऊर्जा उत्पादन गर्ने उद्योग, त्यस्तो ऊर्जा उत्पादन गर्न प्रयोग गरिने मेसिन/उपकरण निर्माण गर्ने उद्योग,
२. विद्युत प्रसारण लाइन,
३. विद्युत वितरण प्रणाली ।

अनुसूची-८

(दफा १५ को उपदफा (२) को खण्ड (ज) सँग सम्बन्धित)

सेवामूलक उद्योग

१. यान्त्रिक कार्यशाला (वर्कशप),
२. छापाखाना तथा छपाई सम्बन्धी सेवा,
३. पेशागत अनुसन्धान तथा विकास, व्यवस्थापन, ईन्जिनियरिङ तथा डिजाइन, कानूनी, लेखा, लेखापरीक्षण, शिक्षण प्रशिक्षण, शैक्षिक तथा प्राविधिक परामर्श सेवाहरू,
४. जिनिङ तथा बेलिङ व्यवसाय,
५. चलचित्र निर्माण व्यवसाय,
२६. निर्माण भइसकेका पूर्वाधारहरूको सञ्चालन गर्ने (जस्तै: सभा सम्मेलन भवन, खानेपानी आपूर्ति, इन्धन तथा इन्धनजन्य ग्यास आपूर्ति सम्बन्धी पाइप लाइन, गोदामघर तथा भण्डारण, विमानस्थल, बसपार्क, रङ्गशाला, स्पोर्ट्स कम्प्लेक्स, रोपवे, सडक, सिँचाई, विद्युत प्रसारण, विद्युत गृह, रेलवे सेवा, कार्गो कम्प्लेक्स, इनल्याण्ड क्लियरेन्स डिपो (आई.सि.डि.) आदि सेवा सञ्चालन गर्ने) व्यवसायहरू,

**Industrial Enterprises
Act, 2073**

Who controls whom to sell?

1. Is the hydropower company free to sell its generated power to anyone?
2. Does the grantor (DOED) controls or regulates to whom it must provide the product to?

**Electricity Act,
2049**

२१. उत्पादित विद्युतको विक्री : (१) कसैले यस ऐन बमोजिम उत्पादन गरेको विद्युत एकमुष्ट विक्री गर्न चाहेमा राष्ट्रिय ग्रिडमा समावेश हुने गरी नेपाल सरकारले खरिद गर्न गराउन सक्नेछ ।

Who controls the sales price?

1. Is the hydropower company free to sell its generated power at their prices?
2. Does the grantor (DOED) controls or regulates at what price the product is to be sold?

Who controls the sales price?

**Electricity Act,
2049**

१७. विद्युत महशूल र अन्य दस्तुरको निर्धारण : (१) विद्युत महशूल र अन्य दस्तुरहरू निर्धारण गर्नका लागि नेपाल सरकारले एउटा महशूल निर्धारण आयोग गठन गर्नेछ ।

(२) उपदफा (१) बमोजिमको आयोगमा नेपाल सरकारको प्रतिनिधि, अर्थविज्ञ, विद्युतको उत्पादन, प्रसारण र वितरणकर्ता तथा ग्राहकहरू मध्येबाट कम्तीमा पाँचजना व्यक्तिहरू रहनेछन् ।

(३) उपदफा (१) बमोजिमको आयोगले विद्युत महशूल र अन्य दस्तुर निर्धारण गर्दा ह्रास कट्टी दर, उपयुक्त लाभ, संरचनाको सञ्चालन तरिका, उपभोक्ता मूल्य सूचीको परिवर्तन, रोयल्टी इत्यादीको आधारमा निर्धारण गर्नेछ ।

१८. छुट्टै महशूल र दस्तुर निर्धारण गर्न सकिने : (१) दफा १७ मा जुनसुकै कुरा लेखिएको भए तापनि राष्ट्रिय ग्रिडबाट असंलग्न रही विद्युतको वितरण गर्ने भएमा त्यसरी वितरण हुने विद्युतको महशूल र अन्य दस्तुर विद्युत वितरण गर्ने आफैले निर्धारण गर्न सक्नेछ ।

(२) उपदफा (१) बमोजिम विद्युत महशूल र अन्य दस्तुर निर्धारण गर्दा विद्युत उत्पादन, प्रसारण वा वितरणमा लगाएको सम्पूर्ण लगानी औसत पच्चीस वर्षमा फिर्ता हुने गरी ह्रास कट्टी हुने र शेयर पूँजीमा पच्चीस प्रतिशत लाभान्स प्राप्त हुने गरी निर्धारण गर्न सक्नेछ ।

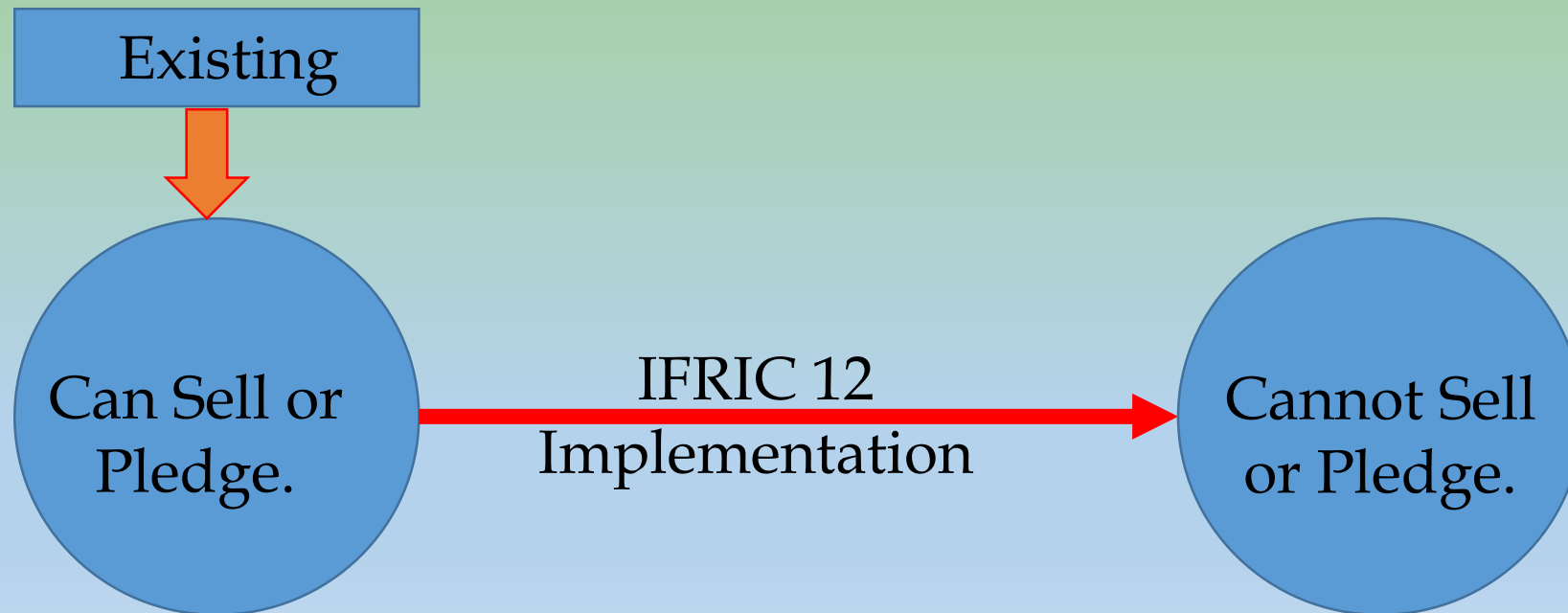
Does the grantor have any control on the entity/business?

- Does the grantor (DOED) control the company in any manner?

Is the operator contractually obliged to provide the service to the public on the behalf of the public sector entity?

Test of Relevancy.....contd.

Does the operator have practical ability to sell or pledge the infrastructure?



Does the operator have practical ability to sell or pledge the infrastructure?

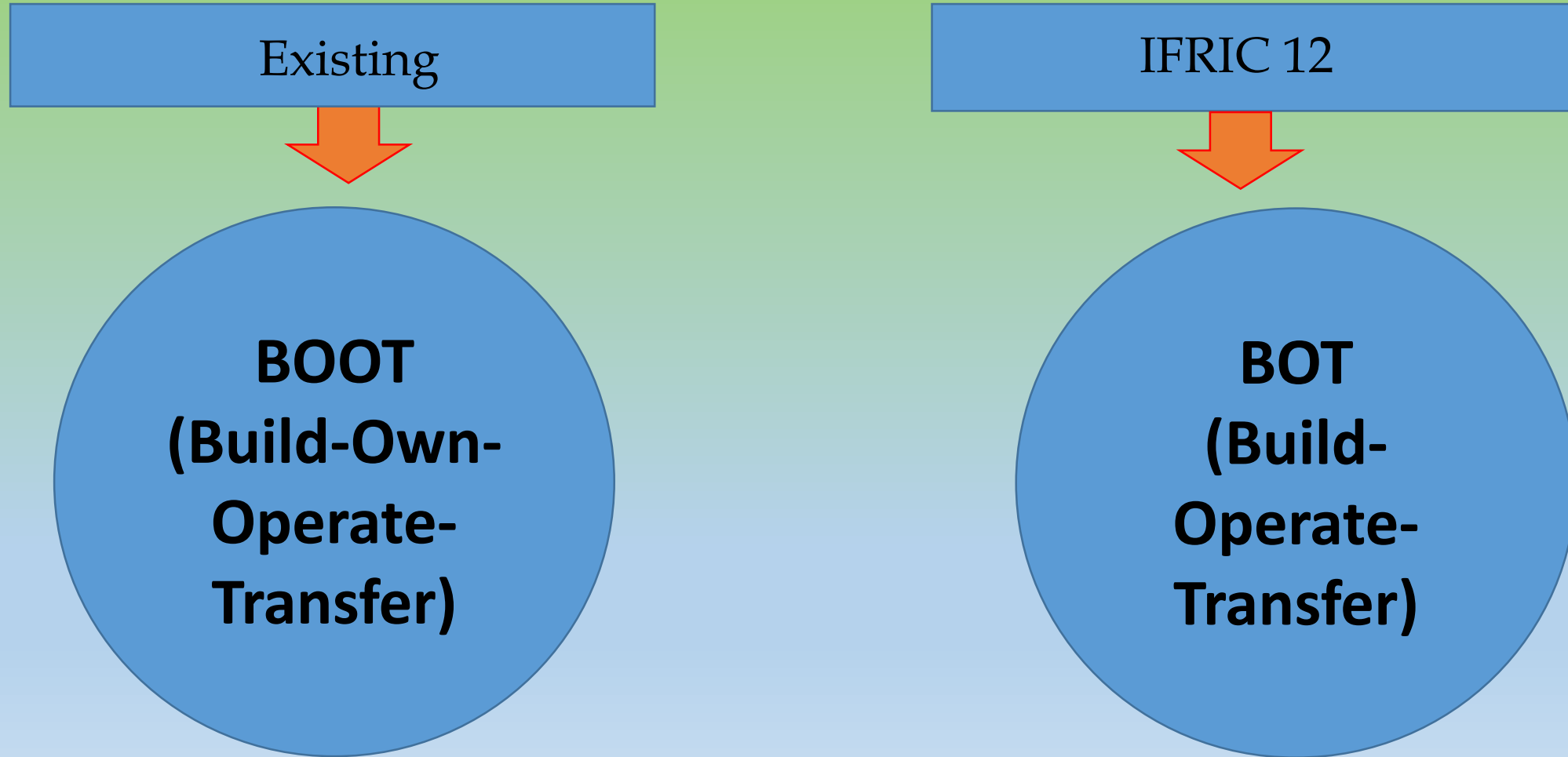
Existing Practice

Security

The Credit Facilities shall be secured against the following (collectively called "Security"):

- a. First legal charge by way of registered mortgage over the entire present and future fixed assets (land, buildings and other constructions, plant & equipment of hydro-mechanical, electro-mechanical, transmission line & office equipment, etc.) created with or without financing owned by the Borrower company in favor of Consortium of the Participating Banks/Financial Institutions on pari-passu basis.

BOT or BOOT?



Financial reporting in the power and utilities industry

1.5.1 Service concession arrangements

Public/private partnerships are one method whereby governments attract private sector participation in the provision of infrastructure services. These services might include, toll roads, prisons, hospitals, public transportation facilities and water and power distribution. These types of arrangements are often described as concessions and many fall within the scope of IFRIC 12, *Service Concession Arrangements*. Arrangements within the scope of the standard are those where a private sector entity may construct the infrastructure, maintain and provide the service to the public. The provider may be paid for its services in different ways. Many concessions require that the related infrastructure assets are returned or transferred to the government at the end of the concession.

Water distribution facilities and energy supply networks are examples of infrastructure that might be the subject of service concession arrangements. For example, the government may have authorised the building of a new town. It may grant a concession to a power distribution entity to construct the distribution network, maintain it and operate it for a period of 25 years. The distribution network is transferred to the government at the end of the concession period, with a specified level of functionality for no consideration. The national regulator sets prices on a cost plus basis. The concession arrangement has base-line service commitments that trigger substantial penalties if service is interrupted. The government requires the power to entity provide universal access to the electricity network for all residents of the town.

Implication

- Business Concept
 - Change in business concept
- Accounting Concept
 - Change in revenue concept
 - Change in Classification of Assets
- Tax Implications
- Financing Implications

Business Concept

Existing Business
Concept

Expected Business
Concept

Hydropower
Developer

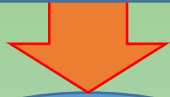
IFRIC 12
Implementation

Construction
Contractor

Operator
(Operation
and
Maintenance
Service)

Revenue Concept

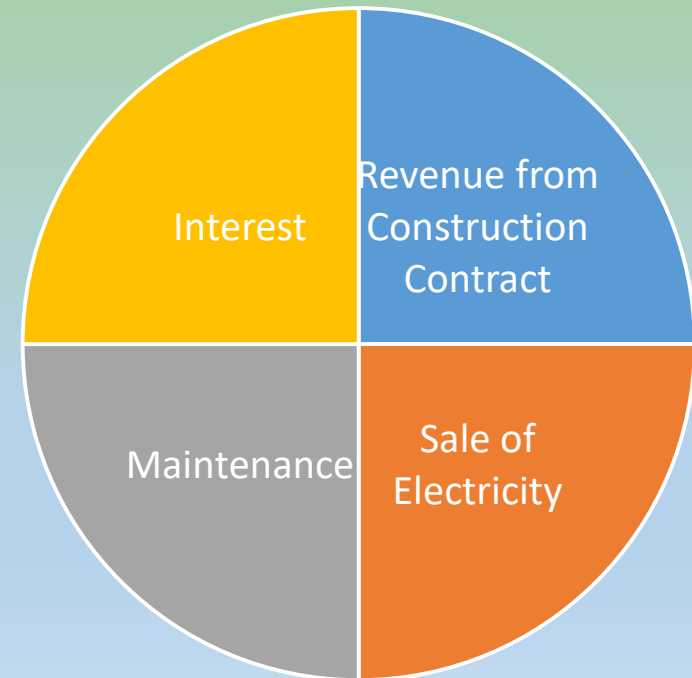
Existing Source of Revenue



Sale of Electricity

IFRIC 12
Implementation

Expected Source of Revenue



Revenue Concept..... contd

Revenue to be booked as per construction contract; NAS 11.

Revenue to be booked as per operator; NAS 18.



■ Construction

■ Operation and Maintenance

Assets Concept

Existing

Expected
(Any one Model)

Property,
Plant &
Equipment

IFRIC 12
Implementation

Financial Asset
Model

Intangible Asset
Model

Bifurcated
Model

Tax Implication

- Income Tax
 - Revenue to be accounted as per long term contract under section 26 of Income Tax Act, 2058.
 - Expected profit to be charged as per market trend.
 - Income tax to be levied on such expected profit as the profit is derived from construction contract, not by sale of electricity which is exempted u/s 11.

Tax Implication contd

- Value Added Tax (VAT)
 - Since the entity is deemed as “Construction Contractor” instead of “Hydropower Developer”, for the purpose of accounting during the construction period, same may be applicable for income tax/VAT purpose. If so, VAT shall be charged on construction revenue.

Tax Implication contd

- Withholding Tax (TDS)
 - Withholding tax @ 1.5% is applicable on construction contract income.
 - If the assets are treated as financial assets, there shall be interest income too. As per section 88 of Income Tax Act, 2058, interest shall be chargeable to withholding tax @ 15%.
 - Again as per section 90(4), TDS on such incomes is to be paid by the receiver i.e. the company.

Financing Implication

- IFRIC 12: AG4 states, “the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the infrastructure and give the grantor a continuing right of use throughout the period of the arrangement.

--Thank You --