F.No. AERA/20010/Policy Matter/Dep./2015-16

Consultation Paper No. 09/ 2017-18

सत्यमेव जयते

Airports Economic Regulatory Authority of India

In the matter of Determination of Useful life of Airport Assets

19th June, 2017

AERA Building
Administrative Complex
Safdarjung Airport
New Delhi – 110 003

1. Background

1.1 Normative Approach - Background

1.1.1 The Authority had issued its philosophy and framework for economic regulation of major airports vide its Order No. 13 of 2011 dated 12th January, 2011 (hereinafter called "Airport Order"). As indicated in Para 17.5.13 of the Airport Order, it had also indicated that it proposes to operationalize the regulatory philosophy and approach as decided in the Airport Order through detailed guidelines. The Authority had also stated that draft of the "Airports Economic Regulatory Authority of India (Terms and Conditions for determination of tariff for Airport Operators) Guidelines 2011" is being issued separately for stakeholders' consultation before its finalized. Accordingly, the Authority issued a Consultation Paper on 2nd February, 2011, for the purpose of finalizing the Airport Guidelines. After stakeholders' meeting thereon (held on 14th February, 2011), it finally issued the Airport Guidelines vide its Order No. 14 of 2010-11 dated 28th February, 2011.

1.1.2 MoCA had indicated to the Authority to give its consideration to developing norms with respect to the following items. The Govt. has indicated that by so doing all the stakeholders' would be aware of the boundaries within which they have to operate:

1.1.2.1 Debt-Equity Ratio

1.1.2.2 Rate of return

1.1.2.3 Rate of Depreciation

1.1.2.4 Operating Expenditure

1.1.2.5 Procedure and norms for incurring additional capital expenditure.

1.1.3 In addition to the items mentioned above and based on the experience of the Authority in determining aeronautical tariffs of airports, the Authority has felt the need to also consider norms with respect to the following items.

1.1.3.1 Capital costs in Airport Projects

1.1.3.2 Asset allocation norm between aeronautical and non-aeronautical services.

1.1.3.3 Allocation of Operation and Maintenance expenditure between aeronautical and non-aeronautical services.

1.1.3.4 Estimation of Operations and Maintenance costs based on certain normative features like O&M costs per passenger.

1.1.3.5 Incentivisation of airport operator for increasing non-aeronautical revenues purely commensurable with the "efforts" of the Airport Operator.

1.2 Normative Consultation Paper and Normative Order issued so far

1.2.1 The Authority had, accordingly issued Consultation Paper CP.No. 05/2014-15 "Normative approach to Building blocks in Economic Regulation of Major Airports" on 12th June 2014 (Normative CP).

1.2.2 In the Normative CP, the Authority had stated the following on 'Depreciation and useful lives of assets.

"5.1. Different airport operators have adopted different rates of depreciation over different elements that go into the Regulatory Asset Base (RAB). There has been an opinion indicating that the rate of depreciation adopted by AAI are on the higher side. The Authority had an occasion to go into these questions while analyzing the tariff determination in respect of Chennai as well as Kolkata airports. For example, it noticed that the rate of depreciation that AAI has adopted for runway is 13% (broadly equating it to the depreciation rate of 11% applicable to plant and machinery). AAI takes the life of a road at 7.5 years and depreciation rate at around 13%. On the other hand, airport operator like BIAL has provided depreciation at 3.3% (corresponding to useful life of 33 years) for Apron etc. (equating it to RCC road). Though the Authority, by and large, has been of the considered view that it would be preferable to leave depreciation rates for different items to the Board of the airport companies, the Authority feels that such wide variation needs to be adequately addressed. The Planning Commission had also felt that some reasonable uniformity in this regard could be considered.

5.2. The Authority has noted the latest depreciation rate mentioned in the Companies Act, 2013 effective from 1st April 2014, according to which, only to take an example, of roads, the depreciation rate for the concrete road is given as 10 years. By and large, the private operators have been taking runway equivalent to concrete carpeted road RCC. Bringing into force of the new Companies' Act and the Schedule indicating depreciation rates thereon, the individual discretion of the airport operator to apply its rates of depreciation, in Authority's opinion, can be said to have been considerably reduced. The Authority notes for e.g., that the category of runway, taxiway, apron is not mentioned specifically in the Companies Act, 2013. It was also not so in the previous Companies Act, 1956.

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5.3. The Authority has noted that the Schedule II (and particularly Part C thereof) of the Companies Act, 2013 indicates the useful life or residual value of any specified asset. Part B of Schedule II states that "The useful life or residual value of any specific asset, as notified for accounting purposes by a Regulatory Authority constituted under an Act of Parliament or by the Central Government shall be applied in calculating the depreciation to be provided for such asset irrespective of the requirements of *this Schedule". After considerable deliberation, the Authority has separately initiated the process to issue such notification as appropriate on the useful life or residual value of an asset specific to the requirements of an airport. Such assets may either not have been clearly mentioned in the Schedule II of the Companies Act or may justifiably have useful life different from that mentioned in the Companies Act. For example, the Authority has noted that AC No: 150/5320-6E, dated 30th September 2009 issued by FAA of USA, gives certain design standards in respect of Airport pavements as follows: "The FAA design standards for airport pavements use the 20 year structural design life criteria as a policy."*

5.4. The Authority has been of the considered view that it would be preferable to have, as far as practicable, a broad year to year consistency in what depreciation is charged by the companies as certified by the relevant statutory auditors and what the Authority would take into account in its process of tariff determination. Issue of a notification will ensure this objective.

1.2.3 The Authority had in its Order No. 8/2014-14 dated 10.06.2014, inter-alia, decided to lay down, to the extent required, the depreciation rates for airports, taking into account the provisions of the useful life of assets given in Schedule II of the Companies Act 2013 (Act 18 of 20130, assets that have not been clearly mentioned in the Schedule II of the Companies Act or that may have a useful life justifiably different than what is indicated in the Companies Act 2013 in the specific context of the airport sector.

1.2.4 The Authority had in its Consultation Paper no. 5/2014-15 dated 12.06.2014 in the matter of Normative Approach to Building Blocks in Economic Regulation of Major Airports, indicated the same view. Subsequently, in Consultation Paper no. 16/2014-15 dated 28.01.2015 the Authority had proposed to commission a study to determine appropriate rates of depreciation to be adopted for the regulatory purpose in line with the provision of the Companies Act 2013.

1.2.5 The Authority, for the purpose of tariff determination in the interim, had gone by the useful life of airport specific assets, particularly Runway, Taxiway and Apron as per the past practice, where airports had adopted different depreciation rates for these assets varying from 8 years to 30 years, as depreciation rates for these assets were not mentioned in the Companies Act, 1956. The Authority therefore decided to institute a study to identify the airport specific assets, which have not been covered in Part – C of Schedule-II of the Companies Act, 2013, and prescribe a useful life for these assets in line with the industry practice and accounting principles.

2. Study by ICAI

2.1 Terms of Reference

2.1.1 The Authority awarded the study to the Institute of Chartered Accountants of India on 7th September, 2015. The Institute submitted its Report on 10.04.2017 and made a presentation to the Authority on 18.05.2017.

2.1.2 Terms of Reference of the study was:

" 2.1 To identify class of assets which can be considered as exclusively Airport Asset such as Runway, Taxiway, Apron etc., which would be covered primarily within the scope of this study and other class of assets which are used in Airport as well as several other industries like Escalators, Walkalators for which a differential treatment in case of Airport may be required.

2.2 To survey technical useful life assessment for these assets considering OEM life prescriptions, technical studies on life expectations considering their respective operating environment in India, technical studies on the subject by AAI if any, life prescription of similar assets by other sector specific regulators and other technical literature available on this subject.

2.3 To consider generally accepted accounting practices in India with regard to depreciation rates.

2.4 To study practices of Airports in different continents specifically Asian Airports and also consider prescription in this regard by ICAO. To address India specific issues while considering such international practices.

2.5 To consider current practices by Airports in India both the Airports under AAI as well as private Airports.

2.6 Analyzing and drawing reference from the aspects as above, recommend useful life for the specific Airport assets under the scope of study and the differential rates for other common assets in case of an Airport."

2.2 Report submitted by ICAI

2.2.1 The Authority had interactions with the study group constituted by ICAI in this regard.

2.2.2 ICAI has submitted the study report which is enclosed in **Annexure 1.**

2.2.3 ICAI also had made a presentation to the Authority on the methodology, study carried out and its results which is enclosed as **Annexure 2**.

2.2.4 ICAI has suggested the broad grouping of asset category and sub-categories of asset that can be mentioned as **Annexure 3**.

2.2.5 Salient observations / recommendations of the study by ICAI are briefly mentioned below:

The following assets / asset categories need a specific review:

- Land development activities
- Airfield works – Runway, Taxiway and Apron
- Buildings and Roads
- Specific Equipments – Aerobridges, Baggage Handling and Security equipments

A. Land Development Activities

Observations:

(i) Land development activities in relation to Airports comprise of preparing and leveling the land to be fit for further development activities relating to Airside works, Buildings, Roads etc.

(ii) In India, Airports have been constructed on lands owned by the Airport Operators (Ex. AAI Airports, Cochin Airports etc.) or lands which have been given on lease by Government (acquired by Government / Government agencies) wherein the land lease term generally runs co-terminus with the Concession Agreement which gives the right of Airport Development to the Airport Operator.

(iii) Land development activities carried out before further construction works are done, are permanent in nature and do not need to be altered / changed in any time in future and do not have a determinate useful life.

(iv) Where Land is owned by the company, these are generally to be treated as part of the Land value and is not to be depreciated.

(v) In cases where the development activities are carried out on land which is leased to the Airport Operator, the development charges are generally to be charged off over the period of the lease rentals.

Recommendations:

(i) Land Development related costs should be identified and accounted as a separate line item under a sub-head of "Land Development" cost.

(ii) If the land is owned by the Airport Operator, Land development costs cannot be depreciated.

(iii) If the land is leased to the Airport Operator, Land development cost shall be depreciated over the balance period of lease term (total lease term to be considered shall be a minimum of 60 years). If a different total lease term is to be considered, the same should be justified based on applicable underlying agreements.

B. Airfield works - Runway, Taxiway and Apron

Observations:

Runway, Taxiway and Apron are key Airfield assets which are specific to Airport Operations. It is also common for airports to take up upgradations / repair works on the pavement structures. There are also upgradation activities / improvement activities to bring the Runway in line with the changing business scenario (Code D to Code E etc.). There are no specific rates prescribed for these under Companies Act, 2013. Useful life of Runway / Taxiway / Apron mentioned in agreements with DIAL, MIAL, BIAL, HIAL, AAI have been examined. Also the useful life / depreciation rates mentioned in (a) ICAO Airports Economic Manual (2013 edition); (b) UK Government – CAA prescription in "A guide to Airfield Pavement design and evaluation – Design and Maintenance Guide (February 2011); (c) US Department of Federation Aviation Administration Advisory circular AC No. 150/5320-6E; (d) FAA Airport Compliance Manual – Order 5190 B – 2009; and (e) Aerodrome Design Manual Part 3 (2003 edition) have been considered.

Recommendations:

(i) The useful life should be based on the design life parameters considered for the Pavement construction. In view of the international prescriptions on standards of design life, the practices followed by certain airports in Asia and other parts of the world, useful life of 10 – 15 years for Runways and Taxiways surfaces and 30 years for Runways and Taxiways bases can be prescribed considering that Runways and Taxiways surfaces requires higher frequency of relaying that Runways and Taxiways basis. Further, useful life of 30 years for Rigid Pavements (Apron) can be prescribed.

(ii) Wherever the Pavement structure is expanded in size (length / width etc.) or upgraded for a different Pavement Classification Number (PCN) / different Code prescriptions of ICAO, these can be capitalized as part of the Fixed Assets. Regular repair works undertaken for upkeep / maintenance which do not improve the life or the functional quality of the pavement shall be accounted as revenue expenditure.

C. Buildings & Roads

Observations:

Buildings **have been defined in Schedule II** to Companies Act, 2013.

Prescription of Companies Act, 2013 for Buildings is as follows:

(a) Buildings [NESD]

(i)	Buildings (other than factory buildings) RCC Frame Structure	60 Years
(ii)	Buildings (other than factory buildings) other than RCC Frame Structure	30 Years
(iii)	Factory buildings	-do-
(iv)	Fence, wells, tube wells	5 Years
(v)	Others (including temporary structure, etc.)	3 Years

For buildings, Airport operators can continue to use the rates in Schedule II to Companies Act, 2013.

(b) Roads

Since there **are defined** useful lives in Companies Act, 2013, for roads, the Airport Operators could use the useful life specified in Schedule II; where there is a change in the useful life based on Schedule II prescriptions, from the existing/ earlier useful life used by the Airport Operator, a technical justification on the reason for the change and the evaluation carried out may be submitted to the Authority.

Recommendations:

(i) For buildings, Airport operators can continue to use the rates in Schedule II to Companies Act 2013.

(ii) Since there are defined useful lives in Companies Act, 2013, for roads, the Airport Operators could use the useful life specified in Schedule II; where there is a change in the useful life based on Schedule II prescriptions, from the existing / earlier useful life used by the Airport Operator, a technical justification on the reason for the change and the evaluation carried out may be submitted to the Authority.

D. Specific Equipments (Aero Bridges, Baggage handling and Security)

Observations:

Trend of existing useful lives of these equipments, across different Airport Operators in India ranges between 7 and 15 years.

Useful life of the Plant and Machinery / Equipments vary based on individual asset specifications, quality, design intent and the Original Equipment Manufacturer (OEM specifications). Considering the nature of some of the special equipments, it is possible that the useful lives could differ from the specific rates prescribed in the Companies Act, 2013.

Guidance to determine useful life for these assets should be based on

- Design intent
- OEM prescriptions
- Replacement plans

Recommendations:

(i) Equipments used in Airports could include machinery / equipments that are largely used only in Airports such as Aerobridges, Baggage Handling Systems etc and also those which could have other common uses viz. Escalators, elevators etc.

(ii) Useful life of Plant and Machinery / Equipments vary based on individual asset specifications, quality, design intent and the Original Equipment Manufacturer (OEM specifications). Considering the nature of some of the special equipments, useful lives could differ from the specific rates prescribed in the Companies Act, 2013.

(iii) Useful life for specific equipments should be defined considering the Design intent, OEM prescription and Replacement plans and where these are different from the useful life specified for general Plant & Machinery under Companies Act 2013, these should be supported by detailed technical justification, documentation and evidences.

(E) Treatment for existing assets

In line with prescriptions under Schedule II to Companies Act, 2013, rates when applicable from the effective date, would be applicable to all assets existing and new. For existing assets, based on the rates prescribed, carrying value should be written off over the balance useful life. For new assets, the prescribed rates could be adopted.

(F) Salvage Value

Schedule II of Companies Act's prescription on Residual value states as follows:

Ordinarily, the residual value of as assed is often insignificant but it should generally be not more than 5% of the original cost of the asset.

As rates are proposed to be prescribed only for a class of assets (and not entirely) and residual value estimation would vary on a case to case basis for each asset category, these could be left to the decision of the Airport Operators.

3. Authority's analysis

3.1.1 The Authority has reviewed the report and presentation submitted by ICAI.

3.1.2 Based on the above, and as explained in the Normative CP, the Authority considers it fit to define useful lives for key Airport Assets, as per the mandate given under Part B of Schedule II to the Companies Act 2013 for the general asset mentioned in the Company Act.

3.1.3 In case of specific asset like Runway/ Taxiway/Apron which are not specified in the Company Act, Authority found that different Airport operators are adopting different life span and depreciation rate. It is proposed to adopt the rates/life span adopted by majority of the Airport operators.

3.1.4 The Authority notes that different useful lives could have been considered by different Airport Operators thus far. In line with Para 7 of Part C of Schedule II to Companies Act 2013, the Authority notes that from the date of this schedule coming into effect (Authority proposes to make this effective 1st April 2016), the carrying amount of the asset as on that date shall be depreciated over the remaining useful life of the asset as per the aforementioned schedule.

3.1.5 The Authority also notes that Para 7.3.2 of ICAI report details certain asset sub-groups for recording different asset categories. The Authority has studied the recommendation and has proposed various sub-groups to be maintained in the Fixed Asset Register of the Airports for ease of review and analysis. **(Annexure-4)**

3.1.6 **Proposal No. 1 - Regarding useful lives**

1.a. To determine useful lives for key Airport Assets under Part B of Schedule II to Companies Act, 2013 as stated in Part-I of Annexure-5.

1.b. To determine useful lives of key Airport specific Assets (not stated under Part-B of Schedule-II of Companies Act) as prescribed in Part-II of Annexure-5.

1.c. To propose that the written down value of the asset as on the date of effect shall be depreciated over the remaining useful life of asset.

1.d. To recommend minimum asset group and sub-group information to be maintained as detailed in Annexure-4.

1.e. In case the Airport operator decide to specify useful life of any Asset other than that has been stated at Annexure-5, the authority will consider it base on manufacturer's specifications & technical justifications.

1.f. As the residual value of most of the Airport Specific Asset is often insignificant, it is proposed to allow 100 % depreciation on the Asset over the useful life of the Asset.

4. Stakeholder Consultation Timeline

4.1.1 In accordance with the provisions of Section 13(4) of the AERA Act 2008, the proposal contained Section 3 read with the Authority's analysis, is hereby put forth for Stakeholder Consultation. To assist the stakeholders in making their submissions in a meaningful and constructive manner, necessary documents are enclosed (Annexure - 1 to 5). For removal of doubts, it is clarified that the contents of this Consultation Paper may not be construed as any Order or Direction of this Authority. The Authority shall pass an Order, in the matter, only after considering the submissions of the stakeholders in response hereto and by making such decision fully documented and explained in terms of the provisions of the Act.

4.1.2 The Authority welcomes written evidence-based feedback, comments and suggestions from stakeholders on the proposal **latest by 10.07.2017** at the following address:

Secretary
Airports Economic Regulatory Authority of India
AERA Building, Administrative Complex, Safdarjung Airport,
New Delhi- 110003
Email: puja.jindal@nic.in
Tel: 011-24695043; Fax: 011-24695039

Chairperson

5. List of Annexures

Annexure Number	Particulars
Annexure – 1	ICAI study report
Annexure – 2	ICAI Presentation
Annexure – 3	Broad grouping of Asset suggested by ICAI
Annexure – 4	Grouping of Asset suggested by Authority
Annexure – 5	Useful life and depreciation rate suggested by Authority