

Query No. 19

Subject: *Accounting for surcharge on delayed payments from customers (beneficiaries).*¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the company’) is a central public sector enterprise mainly engaged in construction and operation of hydro-electric power projects. The company’s shares are listed in BSE and NSE. The company has adopted Indian Accounting Standards (Ind ASs) during the 1st Phase, i.e., from April 1, 2016.

2. The company operates in a regulated environment wherein tariff to be charged for electricity generated is fixed by the Central Electricity Regulatory Commission (CERC) under applicable tariff regulations. At present, CERC (Terms and Conditions of Tariff) Regulations, 2014 are applicable for tariff period 2014-19.

3. The aforesaid tariff regulations provide, *inter alia*, regulations for billing of charges for electricity supplied by generating companies and collection thereof. Further, in order to ensure timely collection of dues to generating companies, tariff regulations also provide for levy of interest in the form of late payment surcharge at prescribed rate by the generating company if payment is delayed by customers beyond a period of 60 days from the date of billing.

Regulation 45 of the CERC Tariff Regulations for the tariff period 2014-19, which deals with levy of late payment surcharge, provides as under:

“45. Late payment surcharge: In case the payment of any bill for charges payable under these regulations is delayed by a beneficiary of long term transmission customer/DICs as the case may be, beyond a period of 60 days from the date of billing, a late payment surcharge at the rate of 1.50% per month shall be levied by the generating company or the transmission licensee, as the case may be.”

4. *Billing of late payment surcharge, accounting policy and presentation in the accounts:*

(i) Paragraph 5 of Indian Accounting Standard (Ind AS) 18, ‘Revenue’ provides, *inter alia* that:

“5. The use by others of entity assets gives rise to revenue in the form of:

(a) Interest—charges for the use of cash or cash equivalents or amounts due to the entity;

...”

The querist is of view that the late payment surcharge on outstanding dues is thus in the nature of interest and should, therefore, be accounted for in accordance with the principles laid down in Ind AS 18 for recognition of revenue.

(ii) Paragraph 29 of Ind AS 18 provides as under:

“29 Revenue arising from the use by others of entity assets yielding interest and royalties shall be recognised on the bases set out in paragraph 30 when:

(a) **it is probable that the economic benefits associated with the transaction will flow to the entity; and**

¹ Opinion finalised by the Committee on 23.7.2018.

(b) the amount of the revenue can be measured reliably.”

As per querist, revenue on account of interest should be recognised when no significant uncertainty as to measurability or collectability exists.

- (iii) In line with Regulation 45 of the CERC Tariff Regulations 2014-19, the company has been raising bills for late payment surcharge also. The outstanding balances due and recoverable from beneficiaries are reconciled at regular interval. One of the major beneficiaries in default has signed such reconciliation statement including late payment surcharge, however, payments are overdue including those for supply of electricity. Further, release of payments towards surcharge in respect of a significant number of beneficiaries are outstanding and even when the same are released, the timing of such payments are uncertain. In view of significant uncertainties attached to realisability of surcharge, the same is being recognised in the books of account in accordance with the accounting policy on the subject which is reproduced as under:

“Policy No. 10.4: Interest/Surcharge recoverable from customers/Liquidated damages /interest on advances to contractors are recognised when no significant uncertainty as to measurability and collectability exists.”

- (iv) The above accounting policy is uniformly followed by all major public sector entities in the power sector.
- (v) Further, amount due on account of surcharge but not recognised in the books as on 31.03.2017 was disclosed as contingent assets in terms of Indian Accounting Standard (Ind AS) 37, ‘Provisions, Contingent Liabilities and Contingent Assets’ as under:

“Late Payment Surcharge:

CERC (Terms and Conditions of Tariff) Regulations 2014-19 provide for levy of Late Payment Surcharge by generating company in case of delay in payment by beneficiaries beyond 60 days from the date of presentation of bill. However, in view of significant uncertainties in the ultimate collection from the beneficiaries as resolved by the management an amount of Rs. 435.20 crore as on 31.03.2017 (previous year Rs. 762.39 crore and as at 01.04.2015 Rs. 389.16 crore) has not been recognised.”

5. The rationale for not accounting of such claims on accrual basis, as per the querist is as under:

- (i) As is well known, the financial condition of most of the distribution companies (discoms) in the country is not healthy and they generally lag behind in timely payment of outstanding dues of electricity generators.
- (ii) Past experience of dealing with such beneficiaries is that they are generally reluctant in paying late payment surcharge citing poor financial condition. During 1998, the Central Government had decided to recover the outstanding surcharge from state governments through appropriation of central plan assistance in various instalments during the next four years. Earlier, only principal was stipulated to be recovered, but subsequently, the Central Government decided to recover the interest accrued and billed upto 31.12.96/31.3.97 after allowing waiver of 60% of the total surcharge billed till that date. Based on government’s decision (2000-01), the

company had to waive off substantial amount of surcharge (to the extent of 60% of the total amount due).

(iii) The signing of reconciliation statement is a routine procedure which serves the purpose of measurability of amounts thus helping in dispute resolution rather than providing certainty of realisation.

(iv) Even when payment is realised towards surcharge, timing of such payments is irregular. There is significant lag between raising of bills and receipt of payment.

6. From the company's perspective, these significant uncertainties involved in the collection of surcharge get resolved only when:

a) Beneficiary gives indication directly or indirectly that it is ready to pay the amount such as issuance of letter of acceptance of claim.

b) Actual payment towards surcharge is received by the company.

c) Such surcharge is included in the appropriation of central plan assistance as was done in the past.

d) To the extent of TDS certificate on surcharge liability issued by one of the beneficiaries in the private sector.

Accordingly, bills raised for surcharge are accounted for only when any one of the above events occurs. Otherwise, the same are disclosed as contingent assets.

7. *Earlier opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on the issue:*

(i) Opinion of the EAC on the subject was obtained earlier by the company during the financial year (F.Y.) 1998-99 (opinion finalised by the EAC on 23.06.1998 and published as Query No. 2 of Volume XVIII of the Compendium of Opinions) on the following issues:

a) (i) Whether the company will be complying with the requirements of section 209(3)(b) of the Companies Act, 1956 read with Accounting Standard (AS) 9, 'Revenue Recognition' if it recognises actual receipt on account of surcharge during the year as revenue, while continuing to disclose the accounting policy, "*Revenues and expenses are generally accounted for on accrual basis except in the case of surcharge recoverable from debtors, sale of scrap, income from consultancy charges and the expenditure on account of LTC encashment.*" with the additional words "*which are accounted for on actual receipt basis*".

(ii) Whether the amount to be recognised would be shown as a 'prior period item' or would it be recognised as an ordinary activity for the year.

b) If answer to (a)(i) is in the negative, which of the amounts, i.e., actual surcharge recovered during the year, the amount of surcharge included for recovery in central appropriation or the total amount accrued as surcharge at the year-end is to be considered as revenue for the year.

(ii) Opinion of the EAC has been summarised by the querist as under:

(a) (i) According to the facts of the query, there does not seem to be any significant uncertainty regarding the recovery of the amount of surcharge included for recovery in central appropriation. Accordingly, recognition of surcharge on actual receipt basis will not be in accordance with the requirements of the Accounting Standard (AS) 9 on 'Revenue Recognition'

and section 209(3)(b) of the Companies Act, 1956, even with the extended note as suggested by the querist.

(ii) The amount of surcharge recognised should not be shown as a prior period item. It should be recognised as an item of income from ordinary activities of the company. However, disclosure in accordance with paragraph 12 of AS 5 reproduced above, would be required to be made.

(b) In view of (a)(i) above, the amount of surcharge included for recovery in central appropriation should be recognised in the year 1997-98. As regards the remaining amount of surcharge accrued as at the end of the year, an assessment needs to be made as to whether there is any significant uncertainty as to its collectability. If there is no such significant uncertainty, it should be recognised. In case of significant uncertainty, the revenue recognition should be postponed and disclosures should be made in accordance with paragraph 14 of AS 9.

8. *Opinion of independent expert as obtained by the querist:*

(i) The accounting policy regarding recognition of surcharge only after resolution of uncertainty as per the opinion of the EAC (quoted above) and industry practice is being followed by the company consistently. However, during F.Y. 2015-16, the joint statutory auditors had differed with the above accounting practice. As per their opinion, the company should account for revenue on account of late payment surcharge on accrual basis due to the fact that beneficiaries had not denied the claim on account of surcharge and had in fact signed the reconciliation statement. The matter was referred to an independent expert on accounting matters.

(ii) Relevant portions of the opinion of the expert have been summarised by the querist as under:

a) The fact that a customer confirms the outstanding amount of the surcharge also acts as an acceptance of validity of the amount claimed by the company and may also be a factor to be considered in assessing reasonable certainty of its collection, but this fact does not in itself provide evidence that the ultimate collection is reasonably certain. Nor does the absence of explicit refusal of a customer to pay the outstanding surcharge provide evidence of such reasonable certainty i.e., it is not an essential requirement that the customer must refuse in writing to pay the surcharge before the company evaluates that on an overall consideration of different factors, the realisability of the surcharge is not reasonably certain.

b) As regards the point made by the joint statutory audit firm that there are no cases of waiver of surcharge in the past, the expert has noted the point made by the company regarding a waiver of 60% of the amount of surcharge in the year 2000-01 based on a decision to this effect then taken by the Central Government.

c) The expert has also noted that other major players in the industry also follow the same policy of accounting for surcharge as being followed by the company. This indicates that there is a consensus on there being a significant uncertainty about ultimate collection of the surcharge.

d) On a consideration of the various relevant factors, the company has concluded that reasonable certainty of ultimate collection is lacking at the time of raising

a bill to a customer for late payment surcharge and accordingly, it postpones the recognition of the surcharge as revenue until the time that ultimate collection becomes reasonably certain. In the view of the expert, on the basis of the factors stated above (and in the absence of any other contradicting facts other than those stated above), the view of the management seems reasonable. The expert has, however, stated that as soon as the uncertainty is resolved (e.g., suppose the Government decides that the surcharge will be recovered through appropriation of central plan assistance or there is sufficient evidence that the particular Discom is going to make the payment), the credit should be recognised without waiting for the actual receipt of the amount.

- e) The independent expert has also opined that the company should disclose the circumstances in which revenue recognition has been postponed pending resolution of significant uncertainties in terms of paragraph 14 of AS 9 and also report the matter separately to the Audit Committee/ Board of Directors. Further, the company should maintain a document containing reasons in support of its conclusion that the late payment surcharge billed to a customer is not reasonably certain of ultimate collection.

(Opinion of the independent expert has been supplied by the querist for the perusal of the Committee.)

- (iii) On the basis of the above opinion of the independent expert, the matter was dropped by the joint statutory auditor during F.Y. 2015-16.

9. *Recent developments:*

- (i) During F.Y. 2016-17 and during the 3rd quarter of F.Y. 2017-18, one of the major beneficiaries, namely M/s ABC, Jammu & Kashmir, has released substantial payment towards surcharge in lump sum. Consequently, outstanding dues on account of surcharge in respect of that beneficiary is now Rs. 31.86 crore as against surcharge of Rs. 48.43 crore billed during F.Y. 2017-18.
- (ii) The joint statutory auditors have again raised the issue that surcharge billed should be recognised on accrual basis. They have submitted the following reasons in support of their stand:
 - a) There is no significant uncertainty in realisation of surcharge considering the release of payment by the beneficiary (refer paragraph 9(i)).
 - b) Surcharge is billed as per CERC Tariff Regulations.
 - c) Reconciliation statements are regularly being signed by the beneficiaries.
 - d) There have been no further instances of waiver of interest since F.Y. 2000-01.
 - e) The management of the company is not empowered to waive/write off the unrecovered surcharge amount without taking approval from appropriate authority/Ministry of Power (MoP)/Central Government.
 - f) In case of one of beneficiary, the company has filed an application in National Company Law Tribunal (NCLT) to recover the principal and surcharge. As discussed in audit committee meeting, the Chairman, audit committee has shown clear cut intentions to recover the surcharge from the beneficiary.
 - g) The beneficiary is providing the liability for such payments in its books of account and submitting TDS certificates showing its intention to pay the liability.

10. *Contention of management on concerns of statutory auditor:*

(i) Paragraph 34 of Ind AS 18 ‘Revenue’ provides as under:

“34 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. ...”

Accordingly, postponing revenue recognition in view of significant uncertainties regarding inflow of economic benefits is not a contravention of Ind AS 18.

(ii) Accounting treatment of late payment surcharge being followed by the company is as per the opinion of the Expert Advisory Committee dated 23.06.1998 (referred to at paragraph 7 above).

(iii) The independent expert has also concurred with the accounting treatment of late payment surcharge vide opinion dated 19.01.2016 (as referred to at paragraph 8 above).

(iv) Similar accounting policy for accounting of surcharge is being followed by major central public sector undertakings (CPSUs) in power sector.

(v) Trend of payment of surcharge in respect of M/s ABC, Jammu & Kashmir referred to at paragraph 9 above during the last 5 years is as under:

	2013-14	2014-15	2015-16	2016-17	(Rs. in crore) 2017-18 (upto 31.12.17)
Opening balance of surcharge	35.93	147.39	345.38	558.64	214.04
Add: Surcharge billed during the year	115.29	197.99	213.26	95.72	48.43
Less: Received during the year	3.83	0	0	440.32	230.62
Closing balance of surcharge	147.39	345.38	558.64	214.04	31.85

It may be seen from the above that the payment released by the beneficiary is irregular. Further, as a matter of fact, payments released during the last two years is due to funds released by the Central Government to the concerned State Government under the Ujjwal Discom Assurance Yojana (UDAY) by the MoP for financial turnaround of Discoms. Accordingly, surcharge released during F.Y. 2016-17 and 2017-18 cannot be considered as a basis for release of further payments.

(vi) As per the statement of surcharge outstanding as on 31st December 2017, out of a total of Rs. 319.74 crore, Rs. 285.66 crore is outstanding for a significant period of time as per details below:

Name of Beneficiary	Outstanding as on 31/12/2017 (Rs. in Crore)	Outstanding since Financial Year	Last payment received during F.Y.	Surcharge statement signed upto
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West Bengal - State Discom (Rangit & TS-V)	1.89	2012-13 to 2016-17	Received Rs. 0.03 crore during F.Y. 2013-14	Dec-2017
West Bengal - State Discom (TLDP-III)	28.03	2015-16 to 2016-17	-	
Manipur- State Discom	14.99	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 0.14 crore during F.Y. 2016-17	Sept-2017
Meghalaya- State Discom	13.39	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 0.05 crore during F.Y. 2014-15	Sept-2017
Punjab State Electricity Board	18.70	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 1.46 crore during F.Y. 2014-15	May-2017
Uttar Pradesh - State Discom	62.90	2002-03 to 2017-18 (upto Dec 17)	Received Rs. 28.14 crore during F.Y. 2016-17	Dec-2017
XYZ Ltd. - Private Discom	145.75	2009-10 to 2017-18 (upto Dec 17)	Received Rs. 2.23 crore during F.Y. 2017-18	Sept-2017
Total	285.66			

- (vii) From the above table, it may be seen that payments, even when received recently, are not commensurate with the total amount of surcharge outstanding.
- (viii) It may also be seen from the above table that upto date reconciliation statements have been signed by all the above beneficiaries. Signing of reconciliation statement is a routine procedure which serves the purpose of dispute resolution at later stage rather than providing certainty of realisation as also pointed out by the independent expert in his opinion (quoted above).
- (ix) Contingent assets are being disclosed in the accounts on account of unrecognised surcharge as per requirement of paragraph 36 of Ind AS 18 since collectability may not be considered remote; however, management is of the view that probability of realisation of surcharge is of a lower threshold than that required for revenue recognition.
- (x) Accounting treatment of surcharge is consistent with that followed by other power sector PSUs. This highlights that there is a consensus in the industry regarding uncertainty of realisation (as also pointed out by the independent expert).

- (xi) With respect to point (e) & (f) of paragraph 9(ii) above, it is submitted that power to waive off surcharge or intention to recover the same from beneficiaries does not provide any additional assurance regarding inflow of economic benefits.
- (xii) As regards point (g) of paragraph 9(ii) above, TDS certificates on outstanding surcharge is provided only by the private discoms. The same provides certainty only to the extent of TDS certificate provided by the beneficiary and not on the unpaid amounts, as may be seen in the case of XYZ Ltd. at paragraph 10(vi) above where Rs. 145.75 crore is outstanding for the period 2009-10 to 2017-18 on account of surcharge and only Rs. 2.23 crore has been received during F.Y. 2017-18.

B. Query

11. The querist has sought the opinion of the Expert Advisory Committee on the following issues:
- (i) Whether accounting treatment of the company relating to late payment surcharge as detailed at paragraph 6 above is proper.
- (ii) If not, the alternative accounting treatment may be suggested.

C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to timing of recognition of revenue with respect to late payment surcharge, as per Indian Accounting Standard (Ind AS) 18, 'Revenue'. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, revenue recognition with respect to principal amount of electricity supplied, discounting and impairment of receivables in respect of principal amount of electricity supplied, measurement of late payment surcharge, accounting for liquidated damages/interest on advances to contractors, disclosure of contingent asset in respect of surcharge receivables, appropriateness of billing of surcharge as per the CERC Regulations, legal interpretation of the CERC Tariff Regulations, etc. The Committee presumes from the Facts of the Case that late payment surcharge in the extant case is of the nature of interest payment and accordingly, the requirements of Ind AS 18 are applicable in the extant case. Further, the Committee further wishes to mention that as the query pertains to financial years 2016-17 and 2017-18, the Committee has expressed its opinion in the context of Ind AS 18 only and not in the context of Ind AS 115, 'Revenue from Contracts with Customers'.

13. The Committee notes the following paragraphs of Ind AS 18, 'Revenue' notified under the Companies (Indian Accounting Standards) (Amendment) Rules, 2016

“5 The use by others of entity assets gives rise to revenue in the form of:

- (a) interest—charges for the use of cash or cash equivalents or amounts due to the entity;

...”

“7 **The following terms are used in this Standard with the meanings specified:**

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in

increases in equity, other than increases relating to contributions from equity participants.

...”

“29 Revenue arising from the use by others of entity assets yielding interest and royalties shall be recognised on the bases set out in paragraph 30 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.”

“34 Revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectibility of an amount already included in revenue, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of revenue originally recognised.”

From the above, the Committee notes that revenue arising from the use by others of enterprise resources yielding interest should only be recognised when *it is probable that the economic benefits associated with the transaction will flow to the entity* and the amount of revenue can be measured reliably. In other words, revenue can be recognized only when no significant uncertainty as to measurability or collectability exists. In this regard, the Committee notes that since late payment surcharge is charged at a fixed percentage of the bill amount, it is reasonably determinable and measurable.

14. Further, with regard to the uncertainty of collection of economic benefits associated with the late payment surcharge, the Committee is of the view that to assess the certainty or uncertainty of ultimate collection is a matter of judgement, which should be exercised by the company considering various factors in its own facts and circumstances of the case, such as, on the basis of past experience (for example, extent of recovery and write off of receivables in the past, etc.), TDS certificates, experience of similar companies in the similar situations, related developments, for example, relating to appropriation of central plan assistance to the customers for this purpose, etc. The Committee is also of the view that mere overdue of payment or untimely/irregular payment of dues do not necessarily represent that there is uncertainty of collection. In this regard, the Committee also wishes to point out that mere reconciliation statements received from the customers confirming the amounts due from them or mere recognition of amount payable (liability) by the customers on account of surcharge cannot be treated as conclusive evidence of certainty of collection. Accordingly, the Committee is of the view that to the extent and till the time such uncertainty of collection exists, revenue recognition should be postponed. The revenue needs to be recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity. For this purpose, events occurring after the end of the reporting period date but before the approval of financial statements by the Board of Directors may also be considered.

D. Opinion

15. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 11 above:

- (i) and (ii) Assessment of certainty or uncertainty of ultimate collection is a matter of judgement, which should be exercised by the company considering various factors in its own facts and circumstances, as discussed in paragraph 14 above. Accordingly, on the basis of this evaluation, if the company considers that there are significant uncertainties in the collection of revenue, then the postponement of recognition of late payment surcharge is considered appropriate.
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