

## *Query No. 29*

**Subject:** *Recognition of interest income on delayed payment by customers.*<sup>1</sup>

### **A. Facts of the Case**

1. A company is a public-sector undertaking engaged in mining of coal and having a production of raw coal of about 567 million tonne during the 2017-18 fiscal year. The company is the holding company of eight Indian subsidiaries out of which seven are coal producing and one being mine planning and designing service oriented subsidiary. The company is the largest pureplay coal producer in the world and is having share of more than 80% of total coal production in India. The company operates through both underground mines as well as open cast mines. The share of production from underground mines is about 30 million tonnes whereas the production from open cast mines is 537 million tonnes. The company is also having one overseas subsidiary in Mozambique where commercial production is yet to commence. Further, it is also having a few joint ventures. The company, having a share capital of Rs. 6207.41 crore, is a listed company (in Bombay Stock Exchange and National Stock Exchange). At present, the Government of India holds 78.55% of the company's shares. All the subsidiaries are wholly owned by the company.

2. The company or its subsidiary enters into Fuel Supply Agreements (FSAs) with certain customers. (Copy of model FSA with private power utilities and copy of model Coal Supply Agreement (CSA) with State Electricity Boards have been furnished by the querist for the perusal of the Committee). Supply of coal to such customers is regulated through the FSAs. One of the clauses of FSA provides the following:

#### **“13.0 INTEREST ON DELAYED PAYMENT**

In the event of delay in payment/ adjustment of any amount payable/ recoverable pursuant to the provisions of this Agreement, the Seller/the Purchaser shall be entitled to charge interest on such sum remaining outstanding for the period after the due date till such time the payment is made. The interest charged by the Seller/ Purchaser pursuant to this Clause shall be at the Interest Rate, as per Clause 1.1(dd).”

As per Clause 1.1 (dd), “**Interest Rate**” shall mean the repo rate of Reserve Bank of India (RBI) as applicable on the due date of payment by the Purchaser plus 3% (three).

3. In some cases, payments of dues are delayed for more than the allowed period, and in some cases delays are substantial too. The company claims interest on delayed payments regularly from customers. However, recognition of claim towards interest is postponed till reasonable certainty is ascertained by way of admission of claim of interest on delayed payment by the customer. Further, in some cases, where direct information of admission of claim is not received, the company recognises interest income only when the customer deducts tax at source on interest income due to the company/subsidiaries, as it clearly indicates that claim has been accepted and accounted for by the customer. To sum up, unless certainty of realisation is assured, the company does not recognise the claim towards interest on delayed dues from debtors.

---

<sup>1</sup> Opinion finalised by the Committee on 8.1.2019.

4. As per the querist, management's understanding of aforesaid accounting treatment was based earlier on paragraph 9.2 of Accounting Standard (AS) 9, 'Revenue Recognition', and subsequently on paragraph 34 of Indian Accounting Standard (Ind AS) 18, 'Revenue', which are reproduced below:

AS 9

"9.2 Where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, e.g., for escalation of price, export incentives, interest etc., revenue recognition is postponed to the extent of uncertainty involved. In such cases, it may be appropriate to recognise revenue only when it is reasonably certain that the ultimate collection will be made. Where there is no uncertainty as to ultimate collection, revenue is recognised at the time of sale or rendering of service even though payments are made by instalments."

Ind AS 18

"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."

The querist has pointed out that Ind AS 18 has been replaced by Ind AS 115, 'Revenue from Contracts with Customers'.

5. Recently, in order to speed up the recovery of past dues from customer, the company has decided the following:

(i) The company took exception about the delay in realisation of dues from the debtors and recommended the following steps for realisation of debts.

(ii) All debtors are to be analysed bill-wise and notice is to be sent to customers advising them to make payment by 30<sup>th</sup> April 2018.

(iii) A statement of up-to-date accounts indicating the interest due thereon be sent to all the parties as on 28<sup>th</sup> February 2018 and thereafter every month. The company should try and recover even previous interest.

(iv) The recovery of interest for despatches effected after 1st April 2018 will mandatorily be insisted upon and will not be waived. It shall be made clear to all the customers.

(v) FSA mandates to collect payment in advance and delivery order is to be given after that. The management should decide on 'Cash & Carry' on all despatches.

(vi) Till such time 'Cash & Carry' system is implemented, Audit Committee recommends charging interest for the delay beyond 15 days as per FSA provisions i.e., Repo rate plus 3% on monthly rest basis.

(vii) The management should take a policy decision to charge interest for the delayed payment beyond 15 days. In future, for any delay in payment, interest is to be charged mandatorily and will not be relaxed.

(viii) Due to delayed payment by the customers, the company is incurring loss and interest charged from the customers is towards compensation for the loss.

(ix) Recommended that in respect of dues which are even less than 6 months but more than 15 days, interest should be charged for all sales with effect from 1<sup>st</sup> April 2018, and recovered from the customers.

6. The querist has separately clarified that in case of advance payment by the customers, the advance is lying with coal companies till the supply is made and bills are raised. Hence, it would not be prudent to charge interest on the advance amount due but not paid for the period from the due date of each instalment till the bill date. Hence, interest may be charged to customers only to the extent of unpaid amount towards bill raised as per FSA.

7. As per the querist, a view has emerged that based on FSA between the parties, interest on delayed payment may be recognised as accrued income on each reporting date.

## **B. Query**

8. The querist has sought the opinion of the Expert Advisory Committee on the following issues:

(i) Whether the recognition of interest on delayed payment from customer shall be postponed till certainty of realisation of income is reliably ensured under Ind AS 115 and whether there is any disclosure requirement in such a case. Further, how certainty of collection may be assessed where there is no past experience with the customer.

or

(ii) Whether, taking cognizance of the FSA, the company should recognise the claim towards interest on delayed payment as soon as it is raised and later test such financial asset (accrued interest) for impairment, if any.

## **C. Points considered by the Committee**

9. The Committee notes that the basic issue raised by the querist relates to recognition of interest income on delayed payment from customers after the revenue and related receivable from the customer has been recognised in accordance with Ind AS 115 and other applicable Indian Accounting Standards (Ind AS) notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as the 'Rules') as amended till date. The Committee has, therefore, considered only this issue and has not examined any other issue that may be contained in the Facts of the Case. For example, the Committee has not examined the issues, such as, separation of financing component or other aspects, like determination of transaction price for revenue recognition/ measurement under Ind AS 115, initial recognition/ measurement of the receivables, detailed aspects related to calculation of interest income and/ or recognition or measurement of impairment loss using the expected credit loss. Further, the Committee notes that

with effect from 1<sup>st</sup> April 2018, Ind AS 18, 'Revenue' and Ind AS 11, 'Construction Contracts', notified under the Rules, have been replaced by Ind AS 115, 'Revenue from Contracts with Customers'. Though the querist has referred to both Ind AS 18 and Ind AS 115, since the querist has raised the issue in the context of Ind AS 115, while formulating its views, the Committee has considered the provisions of Ind AS 115 only and not Ind AS 18.

10. At the outset, the Committee notes the following requirements of Ind AS 32, Ind AS 109 and Ind AS 115:

*Ind AS 32*

**"A financial asset is any asset that is:**

- (a) ...
- (c) **a contractual right:**
  - (i) **to receive cash or another financial asset from another entity; or**
  - (ii) **to exchange financial assets or financial liabilities with another entity under conditions that are potential favourable to the entity; or**
- (d) ..."

"AG4 Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:

- (a) trade accounts receivable and payable;
- (b) ..."

*Ind AS 109*

**"2.1 This Standard shall be applied by all entities to all types of financial instruments except:**

- (a) ...
- (j) **rights and obligations within the scope of Ind AS 115, *Revenue from Contracts with Customers*, that are financial instruments, except for those that Ind AS 115 specifies are accounted for in accordance with this Standard.**

**2.2 The impairment requirements of this Standard shall be applied to those rights that Ind AS 115 specifies are accounted for in accordance with this Standard for the purposes of recognising impairment gains or losses."**

*Ind AS 115*

“5 An entity shall apply this Standard to all contracts with customers, except the following:

...

- (c) financial instruments and other contractual rights or obligations within the scope of Ind AS 109, *Financial Instruments*, ...”

“108 A receivable is an entity’s right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. *An entity shall account for a receivable in accordance with Ind AS 109.* Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Ind AS 109 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss).” (Emphasis supplied by the Committee.)

From the above, the Committee notes that receivables for the coal supplied and amount billed to the customers represent a contractual right to receive cash from another entity, viz., customer. Hence, these are financial assets as defined in paragraph 11 of Ind AS 32 and their accounting post initial recognition is governed by Ind AS 109.

11. The Committee notes the following paragraphs of Ind AS 109 with regard to subsequent measurement of trade receivables:

**“5.2.1 After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1.1–4.1.5 at:**

- (a) **amortised cost;**
- (b) **fair value through other comprehensive income; or**
- (c) **fair value through profit or loss.”**

**“4.1.2 A financial asset shall be measured at amortised cost if both of the following conditions are met:**

- (a) **the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and**
- (b) **the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

**Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions.”**

**“4.1.3 For the purpose of applying paragraphs 4.1.2(b) and 4.1.2A(b):**

- (a) principal is the fair value of the financial asset at initial recognition. Paragraph B4.1.7B provides additional guidance on the meaning of principal.**
- (b) interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin. Paragraphs B4.1.7A and B4.1.9A–B4.1.9E provide additional guidance on the meaning of interest, including the meaning of the time value of money.”**

12. The Committee notes that paragraphs 4.1.2A and paragraph 4.1.4 of Ind AS 109 lay down criteria for measurement of financial assets as at fair value through other comprehensive income (FVTOCI) or as at fair value through other profit or loss (FVTPL). The Committee also notes that these criteria will be relevant if the amortised cost measurement criteria is not met. Hence, the Committee examines the amortised cost measurement criteria first and observes the following:

- (a) From the Facts of the Case, it appears that the company holds trade receivables only for collecting the contractual cash flows on maturity and not for either selling the trade receivables or both collecting the contractual cash flows and selling the trade receivables. The Committee assumes that based on past practices, business plans and related aspects, the company will be able to demonstrate this fact. Hence, in the extant case, business model requirement for amortised cost classification as prescribed in paragraph 4.1.2(a) of Ind AS 109 is met.
- (b) As far as the second criterion related to principal and interest is concerned, the Committee notes the fact that the company charges interest @ RBI Repo rate (which is generally meant for overnight borrowings by banks from RBI as benchmark rate) plus 3%. The Committee presumes that it covers the factors, such as, time value of money, credit risk associated with the principal amount outstanding and other basic lending risks and costs as well as a profit margin, as mentioned in paragraph 4.1.3 of Ind AS 109 reproduced above. Accordingly, the Committee is of the view that the requirement of paragraph 4.1.2(b) is also met.

13. Considering the above, the Committee believes that after initial recognition, trade receivable should be measured at amortised cost and interest income thereon should be recognised using the effective interest method and in accordance with the requirements of Ind AS 109. Ind AS 109 defines effective interest method as below:

**“effective interest** The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the

**method**      **gross carrying amount of a financial asset** or to the **amortised cost of a financial liability**. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the **expected credit losses**. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1 – B5.4.3), **transaction costs**, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).”

The Committee is of the view that while applying effective interest rate method, the company should determine the expected cash flows including those related to interest on delays based on the facts and circumstances of the case. Here, the expected life should be considered as expected timing of payment by the customer.

14. The Committee also notes that section 5.5 of Ind AS 109 deals with impairment recognition based on expected credit losses on certain categories of financial instruments which include trade receivables arising from Ind AS 115 (refer paragraph 2.2 of Ind AS 109, as reproduced in paragraph 10 above) measured at amortised cost. Accordingly, the Committee is of the view that recognition of expected credit loss on the trade receivable *including* interest element should be made in accordance with section 5.5 (specifically considering paragraphs 5.5.1, 5.5.3, 5.5.5 and 5.5.15) of Ind AS 109.

#### **D. Opinion**

15. Based on the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 8 above:

- (i) & (ii) The trade receivables should be measured at amortised cost and interest income should be recognised in accordance with the provisions of Ind AS 109, as discussed in paragraph 13 above. Recognition of expected credit loss on the trade receivables *including* interest element should be made in accordance with the section 5.5 of Ind AS 109, as stated in paragraph 14 above.