

Query No. 18

Subject: *Disclosure/classification of late payment interest charges collected from customers in the statement of cash flows.*¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the company’) is a public limited company domiciled in India and incorporated under the provisions of the Companies Act. The company is a government company under section 2(45) of Companies Act, 2013. Its shares are listed on Bombay Stock Exchange and National Stock Exchange in India. The company is engaged in the business of distribution of natural gas in various cities/districts in India. Natural gas business involves distribution of gas from sources of supply to centres of demand and to the end-user customer, i.e., industrial, commercial, domestic customers and CNG to transporter as fuel.

2. The querist has stated that the company prepares its annual financial statements as per the provisions of the Companies Act, 2013 and follows financial year as its accounting year. Sales are billed bi-monthly for domestic customers, monthly/fortnightly for commercial and non-commercial customers and fortnightly for industrial customers and billed on the spot / daily / weekly / fortnightly cycle in case of CNG customers.

3. Further, the company charges late payment charges/delayed interest charge on overdue balances to the customers who have not paid the bill within due date as per published tariff or as per Gas sales agreement signed with respective customers. The late payment charges are fixed amount in case of domestic customers (irrespective of the days of delay) and variable percentage in case of other categories of customers on overdue amount for delayed days.

4. As informed by the querist, during the financial year 2018-19, the company has collected Rs. 19.70 crores as late payment charges broken up into Rs. 8.24 crores from domestic customers and Rs. 11.46 crores from industrial and commercial customers. This has been accounted and disclosed as ‘Interest Income’ under the head ‘Other Income’ in the annual accounts. An extract of the financial statements has been provided as below:

“Note 31

OTHER INCOME

(Rs. in Crores)

Particulars	For the year ended 31st March, 2019	For the year ended 31st March, 2018
Interest Income (including interest on tax refunds Rs. 55.29 Crores, Previous year Rs. 0.53 Crores)*	98.61	27.77
Provisions no longer required written back	2.91	0.55
Profit/(Loss) on sale as scrap and diminution in Capital Inventory	-	0.53
Other Non-Operating Income	9.76	6.83
Total	111.28	35.68

*Includes interest income on deposits, staff advances, employee loans and delayed payments from customers.

¹ Opinion finalised by the Committee on 21.11.2019.

Detailed break-up of interest income of the company is as below:

(Rs. in Crores)

Sr. No.	Other Interest (including interest on income tax refunds)	for the year ended 31st March - 2019	for the year ended 31st March - 2018
1	Late payment charges – Customer	8.24	8.22
2	Interest on delayed payment - Customer	11.46	6.75
	Interest income from customers for delayed payment	19.70	14.97
3	Interest On Income Tax Refund	55.29	0.53
4	Interest on Fixed Deposits / Bank Balances	23.27	11.76
5	Interest income - others (on loan & advances & deposits)	0.34	0.50
	Total	98.61	27.77

5. The querist has stated that the treatment in the statement of cash flows is as follows:

A. Late payment charges and interest on late payment charges

In the statement of cash flows, the late payment charges and interest on late payment charges Rs. 19.70 crores have been adjusted as non-cash item from net profit before tax for determining Cash flow from Operating Activities. Further, since the income has been shown as a non-operating income, for the purposes of statement of cash flows, it has been classified under the head ‘Cash flow from Investing Activities’.

B. Other interest income including interest on income tax refunds

In the statement of cash flows, other interest income including interest on income tax refunds of Rs. 55.29 crores has been adjusted as non-cash item from net profit before tax for determining ‘Cash flow from Operating Activities’. Further, since the income has been shown as a non-operating income, for the purposes of statement of cash flows, it has been classified under the head ‘Cash flow from Investing Activities’.

6. The querist has informed that the Office of Comptroller and Auditor General of India (C&AG) had conducted the supplementary audit of annual accounts of the company under section 145(6)(b) of the Companies Act, 2013 and issued the following comment on the annual accounts for the financial year 2018-19 vide letter dated 09.07.2019 (Copy of comments received from C&AG Office has been supplied by the querist for the perusal of the Committee):

Statement of Cash Flows

Net Cash Flows from Investing Activities – (Rs. 604.19 crores)

Interest Received – Rs. 95.83 crores

The above includes interest income of Rs. 19.70 crores comprising of late payment charges of Rs. 8.24 crores and interest on late payment charges Rs. 11.46 crores collected from domestic, industrial and commercial customers. The same has been adjusted as non-cash item from net profit before tax for determining ‘Cash flow from

Operating Activities’ and has been classified under the head of Cash flow from Investing Activities.

As late payment charges and interest on late payment charges of Rs. 19.70 crores pertain to the operational activities of the company, the same should have been classified under the head of Cash flow from Operating Activities instead of Cash flow from Investing Activities.

This has resulted in understatement of Cash flow from Operating Activities and overstatement of Cash flow from Investing Activities by Rs. 19.70 crores.

7. *Company’s views:* In the statement of cash flows, the late payment charges and interest on late payment charges have been adjusted /deducted as Other items for which the cash effects are investing or financing cash flows from ‘Net profit before tax’ for determining ‘Cash flow from Operating Activities’ and has been classified under the head of ‘Cash flow from Investing Activities’ based on the following grounds:

- (i) Paragraphs 31 and 33 of Indian Accounting Standard (Ind AS) 7, ‘Statement of Cash Flows’, provide as follows:

“Interest and dividends

31 Cash flows from interest and dividends received and paid shall each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial institution should be classified as cash flows arising from operating activities. *In the case of other entities, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities.*”

“33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Some argue that interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. *However, it is more appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.*”

In reference to the above definition and provisions of Ind AS, *it is more appropriate that interest received is classified as investing cash flows, because they are costs of obtaining financial resources or returns on investments.*

- (ii) Paragraph 9.2 of the Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 (revised July, 2019 Edition), issued by the Institute of Chartered Accountants of India (ICAI), *inter alia*, states that “...‘Other Income’ shall be classified as: (a) Interest Income ...

Ind AS 107, paragraph 20(b) requires total interest revenue calculated using the effective interest method for financial assets that are measured at amortized cost and that are measured at FVOCI, to be shown separately.

Accordingly, 'Interest Income' for financial assets measured at amortized cost and for financial assets measured at FVOCI, calculated using effective interest method, should be presented in separate line items under 'Other Income'."

Based on the above guidance, the company has consistently followed the practice to present interest income as part of 'Other Income'.

Further, with respect to 'other income', the Guidance Note on Division I – Non Ind AS Schedule III to the Companies Act, 2013 (paragraph 9.2.2) provides that all *kinds of interest income for a company other than a finance company should be disclosed under 'Other Income'. Examples of other income are interest on fixed deposits, interest from customers on amount overdue, etc.*

- (iii) Paragraph 9.1.8 of the Guidance Note on Division II - Ind AS Schedule III to the Companies Act 2013 provides that, "The term "other operating revenue" is not defined. This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from the sale of products or rendering of services. *Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities.*"

Further, paragraph 14 of Ind AS 7, 'Statement of Cash Flows', states that "Cash flows from operating activities are *primarily derived from the principal revenue-producing activities of the entity. ...*". Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. Hence the interest received of ₹ 19.70 crores collected from customers towards interest on late payment charges is not the principal operating revenue-producing activities of the company.

- (iv) Further, Trade receivable is treated as financial assets in financial statements prepared under Ind AS and overdue amount after due date is an indirect way of financing the customer. The late payment interest charges would presumably be based on calculations using effective Interest method (EIR) which is under Ind AS 109 and accordingly, 'Interest Income' for financial assets should be presented in separate line items under 'Other Income'.

Further, paragraph 65 of Ind AS 115, 'Revenue from Contracts with Customers' states that, "an entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognised only to the extent that a *contract asset* (or receivable) or a contract liability is recognised in accounting for a contract with a customer". It does not define operating or non-operating. Hence, based on the Guidance Note on Schedule III and Ind AS, the company opted to show this as non-operating since these were infrequent. This policy has been consistently followed, as management is of the view that this presents the true and fair picture.

- (v) Further, the same treatment has been given by other entities for interest and late payment charges collected from customers towards overdue outstanding; and same are treated as 'other income' and disclosed under 'Cash Flow from Investing Activities' in the Statement of Cash Flows.

Accordingly, the company has classified the interest received of ₹ 19.70 crores collected from customers towards interest on late payment charges as ‘Cash Flow from Investing Activities’. Further, the company has been following the same practice consistently.

(Emphasis supplied by the querist.)

B. Query

8. On the basis of above, the company has sought the opinion of the Expert Advisory Committee of the ICAI as to whether the disclosure already given by the company relating to interest income collected from customers towards late payment charges as interest received in the statement of cash flows (adjusted as non-cash item from net profit before tax for determining Cash Flow from Operating Activities and has been classified under the head of Cash Flow from Investing Activities) is in order or not. If not, then what is the correct disclosure/classification of the same?

C. Points considered by the Committee

9. The Committee notes that the basic issue raised in the query relates to the disclosure of interest income collected from customers towards late payment charges/delayed interest charges (hereinafter referred to as ‘the late payment charges’) in the statement of cash flows. The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, presentation and disclosure in the statement of profit and loss, measurement of late payment charges, timing of recognition, accounting for interest on income tax refunds, determination of transaction price, separation of financing component or other aspects for revenue recognition/ measurement under Ind AS 115, initial recognition/measurement of the receivables, detailed aspects related to calculation of interest income, timing of recognition, applicability of Ind AS 114, ‘Regulatory Deferral Accounts’ and Ind AS 116, ‘Leases’ (as the same have not been specifically referred to by the querist in the extant case), etc. At the outset, the Committee wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified by the Companies (Indian Accounting Standards) Rules, 2015 as amended from time to time. Further, the opinion issued is purely from accounting perspective and not from the perspective of legal interpretation of Tariff Regulations or gas sales agreement, etc.

10. The Committee notes that in order to determine the appropriateness of presentation of this income, it is necessary to evaluate the nature of late payment charges. In this context, the Committee notes from the Facts of the Case that the company charges late payment charges/delayed interest charge on overdue balances to the customers who have not paid the bill within due date as per published tariff or as per Gas sales agreement signed with respective customers; and that the late payment charges are fixed amount in case of domestic customers (irrespective of the days of delay) and variable percentage in case of other categories of customers. Thus, in case of customers other than domestic customers, the amount of consideration varies due to difference in timing of payments (as the consideration will increase with increase in timing of payment) and therefore, it appears that the late payment interest/charge in such a case is directly linked to the timing of payment by the customers. Therefore, the Committee is of the view that the late payment interest/charge is of the nature of finance income in the case of customers other than domestic customers and should be accounted for and presented accordingly in the financial statements.

11. Having determined that the late payment charges are in the nature of finance income, with regard to presentation in the statement of cash flows, the Committee notes the following requirements of Ind AS 7:

- “33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Some argue that interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. However, it is more appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.”
- “11 An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.”

From the above, the Committee is of the view that considering the business of the company of distribution of natural gas and that the company is not a financial institution/NBFC, the late payment interest/charge in case of customers other than domestic customers in the extant case, should be presented as ‘cash flows from investing activities’.

12. As far as the domestic customers are concerned, the Committee notes that the late payment charges are fixed amount, irrespective of the days of delay and therefore, the Committee is of the view that the company should consider its facts and circumstances to determine as to whether the same, in substance, represents a compensation for time value of money or whether it is compensation for some other element, such as penalty. The Committee is further of the view that to the extent, it represents time value of money, it should be presented as ‘cash flows from investing activities’, otherwise, it should be considered and presented as ‘cash flows from operating activities’.

D. Opinion

13. On the basis of the above, the Committee is of the view that considering the business of the company of distribution of natural gas and that the company is not a financial institution/NBFC, the late payment interest/charge in case of customers other than domestic customers in the extant case should be presented as ‘cash flows from investing activities’, as discussed in paragraphs 10 and 11 above. As far as domestic customers are concerned, the late payment interest/charge, to the extent, it represents time value of money, should be presented as ‘cash flows from investing activities’, otherwise, it should be considered and presented as ‘cash flows from operating activities’, as discussed in paragraph 12 above.