

Query No. 12

Subject: Accounting treatment of delayed payment charges.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is a wholly owned subsidiary of G Ltd. The State Government restructured the erstwhile State Electricity Board under the provisions of the State Electricity Industry (Reorganisation and Regulation) Act, 2003 and Electricity Act, 2003. The following restructured corporate entities came into operation w.e.f. 1st April 2005:

- a) State Electricity Corporation Ltd., the Generation Company
- b) State Energy Transmission Corporation Ltd., the Transmission Company
- c) Dakshin State Vij Company Ltd., the Distribution Company (viz., ‘the Company’)
- d) Madhya State Vij Company Ltd., the Distribution Company
- e) Paschim State Vij Company Ltd., the Distribution Company
- f) Uttar State Vij Company Ltd., the Distribution Company and
- g) State Urja Vikas Nigam Ltd., the residual entity and the holding company of above-mentioned 6 companies (‘G Ltd.’)

Entities listed at (c), (d), (e) and (f) are collectively referred as Distribution Companies (DISCOMs).

2. Financial Framework Applicable:

The Company prepares the financial statements in accordance with Indian Accounting Standards (Ind ASs), under section 133 of the Companies Act, 2013 read together with the Companies (Indian Accounting Standards) Rules, 2015 as amended except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003.

3. Audit related requirements:

The Company and its sister concern companies and holding company (G Ltd.) being government entities, are subject to Comptroller and Auditor General (C&AG) audit including appointment of the independent auditors under the Companies Act for all the entities involved. C&AG conducts a supplementary audit over and above the audit as required under the Companies Act, 2013 (earlier Companies Act, 1956) and issues a supplementary audit report/note on the financial statements prior to its issuance to the shareholders, i.e., the State Government in the extant case.

4. The Company is engaged in the business of distribution of power to the consumers of Southern region of the State. As per accounting policy No. 1.3 (x) of the Company, “Income in respect of delayed payment charges (except for cases where suits are filed in the court) is accounted on the basis of actual realisation of late payment against outstanding energy bills.”

¹ Opinion finalised by the Committee on 20.6.2022.

During the year, the Company has accounted ₹ 6,280.66 lakh as delayed payment charges (DPC) as per the above stated policy and disclosed under Note No. 26, i.e., Revenue from Operations under the heading of 'Income from other Operating Activity' and same has been shown in the Statement of Cash Flows for the year ended 31st March, 2021 as 'Cash Flows from Operating Activities'.

However, C&AG office has contended that the delayed payment charges disclosed by the Company under Revenue from Operations under the heading of 'Income from other Operating Activity' should be presented as 'Other Income'. The basis of the contention is an earlier opinion of the Expert Advisory Committee (EAC) on the subject 'Accounting for surcharge on delayed payment' (published as Query No. 19 of Volume XXXIX of the Compendium of Opinions). It is contended that as the amount of consideration of late payment surcharge varies due to difference in timing of payments and it is to compensate the entity for time value of money, the nature of late payment surcharge is that of finance income and therefore, the same should be presented as 'Other Income'.

5. Similarly, as far as disclosure of delayed payment charges in the Statement of Cash Flows is concerned, it is contended by the C&AG that as per the earlier EAC opinion on the subject 'Disclosure/classification of late payment interest charges collected from consumers in the statement of cash flows' (published as Query No. 18 of Volume XXXIX of the Compendium of Opinions), to the extent surcharge represents time value of money, it should be presented as 'cash flows from investing activities'.

In the case of the above issue of delayed payment charges for the Company, the C&AG has insisted for disclosure as per the opinion of the Expert Advisory Committee on the matter and hence, the querist seeks the opinion on the matter.

6. Following observations have been raised by the C&AG:

Part A:

Cash Flow Statement

Cash Flow from Operating Activity- ₹ 48701.38 lakh

The above includes delay payment charges of ₹ 6280.66 lakh collected from different categories of consumers.

Delayed payment charges will be levied at the rate of 15% per annum in case of all consumers except agricultural category for the period from the due date till the date of payment if the bill is paid after due date. Delayed payment charges will be levied at the rate of 12% per annum for the consumer governed under rate 'Agriculture' from the due date till the date of payment if the bill is paid after due date. As per the EAC opinion on disclosure/classification of late payment interest charges collected from consumers in the statement of cash flows, to the extent surcharge represents time value of money, it should be represented as 'cash flows from investing activities'. Further as per paragraphs 31 and 33 of Ind AS 7, 'Statement of Cash flows', 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. However, the same has not been done by the Company which has resulted in overstatement of 'Cash Flows from Operating Activity'

amounting to ₹ 6280.66 lakh and understatement of 'Cash Flows from Investing Activity' to the same extent.

7. *Summary of the Company's management response:*

The observation of C&AG is primarily based on the opinion given by the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) on the subject, 'Accounting for surcharge on delayed payment'. While the opinion holds true in the case of company for which it is given, the Company wishes to submit that opinion will not be squarely applicable in case of the Company as there are aspects pertinent to the extant case which need to be considered.

While going through the earlier Opinion of EAC on the subject, 'Disclosure/classification of late payment interest charges collected from customers in the statement of cash flows', it has been observed that certain pertinent aspects/arguments were put forth by the concerned company to EAC, which are narrated herein below, on which the Company has a difference of opinion on the facts and merits of the case:

- That company was collecting delayed payment charges as well as interest also on the said delayed charges from its consumers on overdue days, whereas the Company is collecting only delayed payment charges as per the regulations of State Electricity Regulatory Commission (SERC) on overdue days and it has hitherto not levied interest on delayed payment charges.
- Both the delayed payment charges and interest thereto have been shown as non-operating income consistently by that company and accordingly were disclosed under the head 'Other Income' by it; and hence as a consequence, the same was classified under the head 'Cash Flow from Investing Activities', which is not the case in the extant case. The Company construes it in the nature of operating activities as it has a direct nexus with the State Electricity Regulatory Commission (SERC) Tariff order Regulations; and hence, it is being shown as 'Other Operating Revenues' and classified under the head 'Cash Flow from Operating Activities' while preparing the Statement of Cash Flows.
- In the earlier opinion, the company had contemplated that "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." The Company is of a concerted view that the levy of income in the nature of delayed payment charges collected by it from errant consumers is arising out of tariff regulations and hence there is a direct nexus with the operating revenue-producing activities of the Company and is not in the nature of interest at all.
- In the earlier opinion, the company had not mentioned anything with respect to the nomenclature of delayed payment charges and interest collected by it on delayed payment charges as per regulatory framework while seeking for opinion from EAC. The Company is reverent to submit that the delayed payment charges to it are in accordance with the State Electricity Regulatory Commission Regulations on its errant consumers, which act as a deterrent and prompt them to make timely payments of electricity bills.

8. Further, the querist has also submitted that the delay payment charges being levied as per tariff order of the State Electricity Regulatory Commission Regulations are in the nature of penalty. For adjudicating this question, it will be appropriate to make a reference to Section 74 of the Indian Contract Act, which reads as under:

“74. Compensation for breach of contract where penalty stipulated for: When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains, any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.”

Explanation: -- A stipulation for increased interest from the date of default may be a stipulation by way of penalty.”

Thus, one has to first consider as to whether the additional charge, as has been contemplated by the State Electricity Regulatory Commission rate schedule could be treated a part of the primary contract between the parties. The relevant clause on delayed payment charges (DPC) is as follows:

“Delayed payment charges will be levied at the rate of 15% per annum in case of all consumers except Agricultural category for the period from the due date till the date of payment if the bill is paid after due date. Delayed payment charges will be levied at the rate of 12% per annum for the consumer governed under Rate AG from the due date till the date of payment if the bill is paid after due date.”

Section 49(a) of the Indian Electricity (Supply) Act specifically provides that the Board (i.e., DISCOM) may supply electricity to any person not being the licensee upon such terms and conditions as the Board thinks fit and may for the purpose of such supply, frame uniform tariffs. The language of Section 49, in the view of the querist, is wide enough to cover the charge in question.

Section 49 authorises the Board not only to charge the price of the electricity supplied but also authorises the State Electricity Board to supply electricity on “such terms and conditions as the Board thinks fit”. Under this clause, the Board could impose a term which would ensure timely payment of its bills. Additional charge for delayed payment is, therefore, nothing but a device for ensuring timely payment of the Board’s bills. Timely payment of the Board’s bills is necessary for its efficient working. The additional charge for delayed payment, therefore, is squarely covered by Section 49 of the Act.

Also, the querist has emphasised upon few of the points on which EAC, ICAI in the case of earlier opinion has opined on the subject matter:

- As the opinion mentions that the Committee (EAC) has not considered any other issues like the measurement of late payment charges or other aspects of revenue recognition/measurement under Ind AS 115 and also the legal interpretation of Tariff Regulations, etc., the opinion is based prima-facie on the information and narrative provided by the company.
- EAC, while opining, was 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 flow from investing activities' otherwise, it should be considered and presented as 'cash flows from operating activities'*. The above clearly suggests that EAC has also given precedence to the nomenclature of charges under question and if based on the facts of the case, the same are penalty in nature, which is the case as per the considered views of the Company, then it invariably has to be presented in cash flow statement as 'cash flow from operating activities', which is the position adopted by the Company. In view of this, time value of money concept itself becomes redundant in the given case.

(Emphasis supplied by the querist.)

During the year, the Company has accounted ₹ 6280.66 lakh as delayed payment charges as per the above stated policy. There is no investment made by the Company to generate income like Delay Payment Charges (DPC). It is fully dependable on consumers and there is no control of the Company on DPC income.

9. The querist has further stated that as per paragraph 14 of Ind AS 7, 'Statement of Cash Flows', examples of operating activities include cash receipts from the sale of goods and the rendering of services. In view of the querist, as per this clause, the Company's income comprises of receipts from consumers towards receivables from sale of power which includes delay payment charges. The Company's trade receivables are inclusive of DPC because it is ultimately generated from dues regarding sale of power. The Company has not made any investment to generate income of DPC.

The querist has also referred to 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.”

“Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.”

“14 Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

...”

“Investing activities

- 16 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities. ...”

(Emphasis supplied by the querist.)

The above implies that there is no straight forward answer to the query under question and it is at the behest of the Company to classify the interest income on a case-to-case basis as falling under cash flows from operating, financing or investing activities

Further, the querist is of the view that the delay payment charges are levied by DISCOMs owing to the State Electricity Regulatory Commission Regulations, which are penal in nature and are arising out of normal business activities of the Company. Further, the substance of delay payment charges represents a compensation levied by the Company, which is in the form of penalty. Hence, the said charges should be disclosed under cash flows from operating activities.

10. The querist has mentioned that the following observation has been also raised by C&AG:

Part B:

Other Comments

Statement of Profit and Loss

Revenue from Operations - ₹ 12,21,715.93 lakh

The above includes ₹ 6,280.66 lakh towards delayed payment charges received from consumers. The Company has classified the same under the sub-head ‘Other operating revenue’ under ‘Revenue from Operations’.

As per paragraphs 31 and 33 of Ind AS 7, ‘Statement of Cash Flows’, 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.

As per the above provision and EAC opinion on ‘Accounting for surcharge on delayed payment’, as the amount of consideration of late payment surcharge varies due to difference in timing of payments and it is to compensate the entity for time value of money, the nature of late payment surcharge is that of finance income and therefore, the same should be presented as ‘Other Income’.

In view of the above, ‘Revenue from Operations’ is overstated and the ‘Other Income’ is understated by ₹ 6280.66 lakh.

11. *Summary of the Company Management response:*

The Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 (hereinafter referred to as ‘Guidance Note’) states as follows:

“**9.1.7.** Revenue from operations needs to be disclosed separately as revenue from

(a) sale of products,

(b) sale of services and

(c) other operating revenues.

It is important to understand what is meant by the term “other operating revenues” and which items should be classified under this head vis-à-vis under the head “Other Income”.

9.1.8. 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 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.

9.1.9. *The classification of income would also depend on the purpose for which the particular asset is acquired or held. For instance, a group engaged in manufacture and sale of industrial and consumer products also has one real estate arm. If the real estate arm is continuously engaged in leasing of real estate properties, the rent arising from leasing of real estate is likely to be “other operating revenue”.* On the other hand, consider a consumer products company which owns a 10 storied building. The company currently does not need one floor for its own use and has given the same temporarily on rent. In that case, lease rent is not an “other operating revenue”; rather, it should be treated as “other income”.

9.1.10. To take other examples, sale of Property, Plant and Equipment is not an operating activity of a company, and hence, profit on sale of Property, Plant and Equipment should be classified as other income and not other operating revenue. *On the other hand, sale of manufacturing scrap arising from operations for a manufacturing company should be treated as other operating revenue since the same arises on account of the company’s main operating activity.”*

(Emphasis supplied by the querist.)

The above Guidance Note makes it very clear that delayed payment charges are owing to the State Electricity Regulatory Commission Regulations and are arising from operations for a distribution company; and are consistent in nature in case of breach of the regulations as such and hence, these are squarely covered by the guidance as narrated hereinabove in the paragraphs 9.1.7 to 9.1.10 of the Guidance Note in this regard.

The Company is of concerted view that the levy of income in the nature of delayed payment charges collected by it from errant consumers is arising out of tariff regulations and hence there is a direct nexus with the operating revenue-producing activities of the Company; and therefore, delayed payment charges are not in the nature of interest at all.

12. It is seen from the EAC Opinion that the company (to which earlier opinion was issued) has not stated anything while seeking for opinion from EAC, as to the nomenclature of delayed payment charges and interest collected by it on delayed payment charges as per the Regulations framework. The Company submits that the delayed payment charges are nothing but penalty imposed by DISCOMs as per State Electricity Regulatory Commission Regulations on its errant consumers which acts as a deterrent and prompt them to make timely payments of electricity bills.

Also, the querist has emphasised upon few of the points on which EAC, in the case of earlier opinion has opined on the subject matter:

- As the opinion mentions that the Committee (EAC) has not considered, apart from other things, the measurement of late payment charges or other aspects of revenue recognition/measurement under Ind AS 115 and also the legal interpretation of Tariff Regulations, etc., the opinion is based prima-facie on the information and narrative provided by the Company.
- As mentioned in the opinion that the delayed payment charges in substance, represent a compensation for time value of money. The above clearly suggests that EAC has not dwelled upon at all on the correct nomenclature of charges under question and according to State Electricity Regulatory Commission Regulations as well as the crux of the matter and based on the facts of the case, the same are actually penalty in nature, which is the case as per the considered views of the Company and hence it invariably has to be disclosed as 'Other operating revenue', which is the position adopted by the Company. In accordance with this, time value of money concept itself becomes redundant in the given case and accordingly construing the cited charges as interest income in nature.

Auditors' response to C&AG Office:

The statutory auditors of the Company have also replied to C&AG in agreement with the stand taken by Company.

B. Query

13. In view of the above, the opinion of the EAC has been sought on the following issues:
- (i) Whether delayed payment charges being included by the Company as 'Other Operating Income' under the head 'Revenue from Operations' in the Statement of Profit and Loss is correct.
 - (ii) If answer of above question is in the negative, then whether delayed payment charges should be shown by the Company as 'Other Income'.
 - (iii) In the Statement of Cash Flows, whether delayed payment charges being included by the Company as 'Cash Flows from Operating Activities' is correct.
 - (iv) If answer of above question is in the negative, then whether delayed payment charges should be included as 'Cash Flows from Investing Activities' or 'Cash Flows from Financing Activities'.

C. Points considered by the Committee

14. The Committee notes that the basic issue raised in the query relates to the presentation and disclosure of delayed payment charges in the Statement of Profit and Loss and in the Statement of Cash Flows of the Company. 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, measurement of delayed payment charges, timing of recognition, separation of financing component or other aspects, like determination of transaction price for revenue recognition/measurement under Ind AS 115, initial and subsequent recognition and measurement of receivables, accounting in the books of other restructured entities, applicability of Ind AS 114, 'Regulatory Deferral Accounts', etc. The Committee wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified under 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 State Electricity Industry (Reorganisation and Regulation) Act, 2003, Electricity Act, 2003, Indian Electricity (Supply) Act, Indian Contract Act, etc.

At the outset, the Committee wishes to point out that reference to earlier opinions issued on similar subjects have been made by the querist. In this regard, it may be mentioned that the Committee's opinions are based on the specific facts provided to it and may not necessarily apply in scenarios/situations with different facts. Therefore, the Committee has independently examined the issues referred by the querist in the facts and circumstances given in the extant case and the extent to which the earlier opinions are applicable or are relevant has not been examined by the Committee.

15. With regard to presentation of delayed payment charges in the Statement of Profit and Loss, the Committee is of the view that accounting treatment including presentation and disclosure of an item of income/expense depend on its nature and not the nomenclature used for the same. Therefore, in order to examine the nature of DPC, which is arising in the course of supply of electricity to its customers, the Committee notes the following paragraphs from Ind AS 115, 'Revenue from Contracts with Customers':

“47 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

48 The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

- (a) variable consideration (see paragraphs 50–55 and 59);
- (b) constraining estimates of variable consideration (see paragraphs 56–58);
- (c) the existence of a significant financing component in the contract (see paragraphs 60–65);
- (d) non-cash consideration (see paragraphs 66–69); and
- (e) consideration payable to a customer (see paragraphs 70–72).

49 For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in

accordance with the existing contract and that the contract will not be cancelled, renewed or modified.

Variable consideration

- 50 If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.
- 51 An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.
- 51AA In some contracts, penalties are specified. In such cases, penalties shall be accounted for as per the substance of the contract. Where the penalty is inherent in determination of transaction price, it shall form part of variable consideration. For example, where an entity agrees to transfer control of a good or service in a contract with customer at the end of 30 days for Rs. 1,00,000 and if it exceeds 30 days, the entity is entitled to receive only Rs. 95,000, the reduction of Rs. 5,000 shall be regarded as variable consideration. In other cases, the transaction price shall be considered as fixed.”

The Committee notes from the above that the transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. Further, Ind AS 115 provides that while determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of, inter alia, variable consideration, such as, penalty. The Committee also notes that as per paragraph 51 of Ind AS 115, promised consideration can vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. In the extant case also, one may argue that the promised consideration is contingent on the occurrence of the customer making the payment and accordingly, it may be considered as a variable consideration. However, the Committee notes that even if one were to assume that the DPC is of the nature of penalty, the transaction price in the extant case is fixed at the rate or price specified by the SERC for the electricity supplied, whereas DPC is a charge to be paid by the customers towards delay in payment and is not towards exchange of promised goods and services to the customer. Further, in this context, the Committee also notes that the penalty specified in paragraph 51AA is a penalty paid by an entity to its customers and is linked with its performance, whereas DPC is a levy on customers for default on their part and therefore, it cannot be considered of the nature of penalty covered under variable consideration as per the requirements of Ind AS 115.

16. With regard to the nature of DPC from accounting perspective, the Committee further notes the following requirements of Ind AS 115 and the 'Basis for Conclusions' of International Financial Reporting Standard (IFRS) 15 (which is corresponding international standard of Ind AS 115), issued by the International Accounting Standards Board (IASB):

“The existence of a significant financing component in the contract

- 60 In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. In those circumstances, the contract contains a significant financing component. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.
- 61 The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price). An entity shall consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including both of the following:
- (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services; and
 - (b) the combined effect of both of the following:
 - (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and
 - (ii) the prevailing interest rates in the relevant market.
- 62 Notwithstanding the assessment in paragraph 61, a contract with a customer would not have a significant financing component if any of the following factors exist:
- (a) the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer.
 - (b) a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).
 - (c) the difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 61) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract.

63 As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.”

“65 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.”

“BC232 The boards also decided to remove the term ‘time value of money’ from the discussion about adjustments for financing components, to reflect their decision that the focus is on whether the payment terms provide the customer or the entity with a significant benefit of financing. This is because the term ‘time value of money’ is a broader economic term that may suggest that it is necessary to adjust the promised amount of consideration in circumstances other than when the cash sales price may differ from the contractual payments. In addition, the boards decided to refine the factors in paragraph 61 of IFRS 15 that an entity should consider when deciding whether a contract includes a significant financing component. Those factors require evaluation of:

- (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services. If the entity (or another entity) sells the same good or service for a different amount of consideration depending on the timing of the payment terms, this generally provides observable data that the parties are aware that there is a financing component in the contract. This factor is presented as an indicator because in some cases the difference between cash selling price and the consideration promised by the customer is due to factors other than financing (...).
- (b) the combined effect of (1) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services and (2) the prevailing interest rates in the relevant market. Although the boards decided that the difference in timing between the transfer of goods and services and payment for those goods and services is not determinative, the combined effect of timing and the prevailing interest rates may provide a strong indication that a significant benefit of financing is being provided.”

“BC234 The boards also observed that for many contracts, an entity will not need to adjust the promised amount of customer consideration because the effects of the financing component will not materially change the amount of revenue that should be recognised in relation to a contract with a customer. In other words, for those contracts, the financing component will not be significant. During their redeliberations, the boards clarified that an entity should consider only the *significance* of a financing component at a contract level rather than consider whether the financing is *material* at a portfolio level. The boards decided that it would have been unduly burdensome to require an entity to account for a financing component if the effects of the financing component were not material

to the individual contract, but the combined effects for a portfolio of similar contracts were material to the entity as a whole.”

“Presentation of the effect of a significant financing component

BC244 As a result of the boards’ decision on the existence of a significant financing component (...), a contract with a customer that has a significant financing component would be separated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred or advance payment terms). Consequently, the accounting for a trade receivable arising from a contract that has a significant financing component should be comparable to the accounting for a loan with the same features. Consider the following example: Customer A purchases a good on credit and promises to pay CU1,000 in three years. The present value of this trade receivable is CU751. Now consider Customer B who borrows CU751 from a bank with a promise to pay CU1,000 in three years. Customer B uses the loan to purchase the same good as Customer A. Economically, those transactions are the same, but, in the absence of the requirements in IFRS 15 to account for a significant financing component, the form of the transaction would determine whether an entity would recognise revenue of CU751 or CU1,000 (ie on a discounted or an undiscounted basis). For this reason, paragraphs 60–65 of IFRS 15 require a contract with a financing component that is significant to the contract to be separated, which results in the same revenue recognition for both transactions.”

“BC246 The boards decided that an entity should present the effect of the financing (ie the unwinding of the discount) separately from revenue from contracts with customers, as interest revenue or interest expense, rather than as a change to the measurement of revenue. This is because contracts with financing components that are significant have distinct economic characteristics—one relating to the transfer of goods or services to the customer and one relating to a financing arrangement—and those characteristics should be accounted for and presented separately.

BC247 The boards noted that some entities (for example, banks and other entities with similar types of operations) regularly enter into financing transactions and, therefore, interest represents income arising from ordinary activities for those entities. The boards noted that the requirements in paragraph 65 of IFRS 15 do not preclude an entity from presenting interest as a type of revenue in circumstances in which the interest represents income from the entity’s ordinary activities.”

From the above, the Committee notes that Ind AS 115 provides that while determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer. The objective of such adjustment is to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price). The Committee also notes that the Standard requires an entity to consider all relevant facts and circumstances in assessing whether a contract contains a financing component and whether that financing component is significant to the contract, including: (a) the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or

services; and (b) the combined effect of: (i) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and (ii) the prevailing interest rates in the relevant market.

Moreover, as per the 'Basis for Conclusions' of IFRS 15, if the entity sells the same good or service for a different amount of consideration depending on the timing of the payment terms, this generally provides observable data that the parties are aware that there is a financing component in the contract and this factor is considered as an indicator of financing component. However, the entity should also evaluate other factors considering the requirements of Ind AS 115 while determining whether the contract contains a significant financing component.

17. In this context, the Committee notes clause 15 from the Company's Tariff Schedule, 'Tariff for Supply of Electricity at Low Tension, High Tension, and Extra High Tension', which, inter alia, states as follows:

"Delayed payment charges will be levied at the rate of 15% per annum in case of all consumers except Agricultural category for the period from the due date till the date of payment if the bill is paid after due date. Delayed payment charges will be levied at the rate of 12% per annum for the consumer governed under Rate AG from the due date till the date of payment if the bill is paid after due date."

From the above, the Committee notes that the terms for late payment from the due date of payment are expressly provided in the Tariff Schedule, which is binding on both the buyer as well as the Company. The Committee further notes that delayed payment charges are charges to the customers who have not paid the bill within due date as per Tariff Schedule; and that such charges are defined in terms of percentage *per annum*, which indicates that the same is directly linked with the passage of time and the quantum of the same depends on timing of payment by the customers. Thus, the amount of consideration varies due to difference in timing of payments (as the consideration will increase with increase in timing of payment). Therefore, considering the requirements of Ind AS 115 reproduced above, the Committee is of the view that the DPC is of the nature of financing component and if such component is significant at the contract level, considering the facts and circumstances of the Company and the above-reproduced requirements of Ind AS 115, the Company should not consider the same as part of its transaction price and revenue. Further, considering the requirements of paragraph 63 of Ind AS 115 reproduced above, the Committee is of the view that as a practical expedient, in the extant case, if the Company expects, at contract inception, that the period between when it transfers the promised good or service to a customer and when the customer pays for that good or service will be one year or less, it need not make adjustments for the effects of significant financing component while recognising revenue.

18. Accordingly, the Committee is of the view that in the extant case, if the financing component in a contract is significant and the practical expedient is either not applied or the Company expects the period between the transfer of promised good or service to the customers is more than one year, the same shall not be considered as a part of the 'Revenue' of the Company. Further, the Company should present the effect of the financing separately from revenue from contracts with customers, as interest income.

19. With regard to presentation of interest income, the Committee also notes the following paragraphs from the Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013, issued by the ICAI (hereinafter referred to as 'Guidance Note'):

“**9.1.7.** Revenue from operations needs to be disclosed separately as revenue from

(a) sale of products,

(b) sale of services and

(c) other operating revenues.

It is important to understand what is meant by the term “other operating revenues” and which items should be classified under this head vis-à-vis under the head “Other Income”.

9.1.8. 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 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.

9.1.9. *The classification of income would also depend on the purpose for which the particular asset is acquired or held. For instance, a group engaged in manufacture and sale of industrial and consumer products also has one real estate arm. If the real estate arm is continuously engaged in leasing of real estate properties, the rent arising from leasing of real estate is likely to be “other operating revenue”. ...”*

“**9.2 Other income**

The aggregate of ‘Other income’ is to be disclosed on face of the Statement of Profit and Loss. As per Note 5 of General Instructions for the Preparation of Statement of Profit and Loss ‘Other Income’ shall be classified as:

(a) Interest Income;

(b) Dividend Income;

(c) Other non-operating income (net of expenses directly attributable to such income).

Ind AS 107, para 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’.

...”

(Emphasis supplied by the Committee.)

From the above, the Committee notes that revenue from operations essentially arise from *a company’s operating activities, viz., from sale of products or rendering of services* or from *its other principal or ancillary revenue-generating activities*. In this regard, the Committee wishes to mention that the business of the Company is distribution of power; levy and collection of DPC is not the intended or ancillary activity of the Company. Thus, although income from DPC arise during the course of normal operating activities of the Company of

sale of goods and services, the same cannot be considered to arise from or on account of such goods or services or from other operating activities as these are essentially due to delay in payment for such goods or services (viz., receivables) and therefore DPC is over and above the receivables for goods or services or the output of other operating activities. Further, the Committee notes that paragraph 9.2 of the Guidance Note reproduced above explicitly requires interest income to be classified as ‘other income’. Therefore, the Committee is of the view that DPC being a financing component, as discussed above, if it is significant and the practical expedient is either not applied or not applicable as per the requirements of Ind AS 115, the same cannot be considered as ‘Other Operating Revenue’ under the head ‘Revenue from Operations’ in the Statement of Profit and Loss; rather the same should be presented as ‘other income’ in the Statement of Profit and Loss.

20. With regard to the querist’s contentions regarding levy of delayed payment charges in accordance with the SERC Tariff Regulations to act as a deterrent for the errant consumers and which prompts them to make timely payments, the Committee wishes to point out that the DPC being a deterrent for delay payment itself indicates that time is the essence and these are being levied to ensure timely payments so as to avoid loss of time value of money to the Company. Further, the Committee wishes to state that the fact that DPC is arising out of tariff orders/Regulations does not change its accounting nature, as discussed above.

21. With regard to presentation of cash flows from DPC in the Statement of Cash Flows, the Committee notes the following requirements of Ind AS 7, ‘Statement of Cash Flows’:

“Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.”

“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.

12 A single transaction may include cash flows that are classified differently. For example, when the instalment paid in respect of an item of Property, Plant and Equipment acquired on deferred payment basis includes interest, the interest element is classified under financing activities and the loan element is classified under investing activities.”

“14 Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

...”

“Investing activities

- 16 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities. Examples of cash flows arising from investing activities are:
- (a) ...
 - ...
 - (e) cash advances and loans made to other parties ...
 - (f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
 - ...”
- “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.”

From the above, the Committee notes that paragraph 33 of Ind AS 7 explicitly states that in case of an entity which is not a financial institution (as is the situation in the extant case considering the business of the Company of distribution of power), it is more appropriate that interest received is classified as investing cash flows because it is return on investments. Further, as per paragraph 12 of Ind AS 7, a single transaction may include cash flows that are classified differently. Similarly, in the extant case, the cash flows arising from the customers on account of sale of goods and services shall form part of cash flows from operating activities, whereas cash flows on account of DPC need not necessarily be cash flows from operating activities. Therefore, as explained above, since DPC represents financing component, its treatment in the Statement of Cash Flows should be in line with the classification and presentation in the Statement of Profit and Loss, as discussed above.

22. Furthermore, the Committee wishes to mention that the Standard does not differentiate between investments made by the entity out of its own will or intent and those which are circumstantial, i.e., arising out of circumstances, as in the extant case. Since in the extant case, although there is no intentional investment made by the Company, the Company’s resources, as invested in receivables result into income of the nature of interest, the contention of the querist that the Company has not made any investment to generate income does not hold good.

D. Opinion

23. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 13 above:

- (i) and (ii) DPC, being a financing component, if it is significant and the practical expedient is either not applied or not applicable as per the requirements of Ind AS 115, the same cannot be considered as 'Other Operating Revenue' under the head 'Revenue from Operations'; rather the same should be presented as 'other income' in the Statement of Profit and Loss, as discussed in paragraphs 15 to 20 above.
- (iii) and (iv) Since DPC represents financing component, its treatment in the Statement of Cash Flows should be in line with the classification and presentation in the Statement of Profit and Loss, as discussed in paragraph 21 above.
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