

Query No. 16

Subject: Presentation of Trade Receivables realised by way of discounting of bills in the Financial Statements under Ind AS framework.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a central public sector enterprise incorporated with an objective to plan, promote and organise an integrated and efficient development of hydroelectric power. The Company has extended its objective to include development of power in all aspects through conventional and non-conventional sources in India and abroad. The Company’s shares are listed in BSE and NSE. The Company has adopted Indian Accounting Standards (Ind AS) during the 1st Phase, i.e. from April 1, 2016.

2. The Company constructs Hydropower Projects and operates them on Build, Own, Operate & Maintain (BOOM) basis. Electricity being a regulated product, tariff for each Power Station is determined by the Central Electricity Regulatory Commission (CERC) based on the CERC Tariff Regulations issued for a period of five years at a time. The currently applicable tariff period is 2019-20 to 2024-25, i.e. 2019-24.

3. Tariff is fixed by the CERC based on the capital cost incurred for the Power Station. Tariff Regulations provide for recovery of costs incurred on running and maintenance of the Power Station, depreciation of Property, Plant and Equipment, interest on loans and borrowings for construction of the Plant and interest on working capital, plus a specified rate of return on equity invested in the Plant.

4. *Bill Discounting Agreement*

The Company supplies electricity to the State DISCOMs and other bulk power purchasers who are required to settle their dues as per the agreed payment plan. However, in certain cases, there have been delays in settlement of dues by the DISCOMs. To prevent accumulation of dues and to liquidate its trade receivables, the Company enters into Bill Discounting agreements with scheduled commercial banks. As per these agreements, the bills of a DISCOM upon whom invoices for supply of power have been drawn are presented to the Bank for release of upfront payment (less interest charged) by the Bank to the Company. The amount for which bills have been discounted are repaid to the Bank by the DISCOM in 10-12 monthly instalments as per the quantum of monthly bills discounted. However, this arrangement is with recourse to the Company and in case of non-payment by the DISCOM, the Bank shall be entitled to recover the unpaid amounts along with charges if any, from the Company. It is also pertinent to mention here that the bill discounting charges and any other charges including penal interest for overdue payment charged by the Bank is refunded by the DISCOM to the Company. (Copy of Bill Discounting Agreement with Bank, monthly Bills of Exchange drawn up with the DISCOM and other relevant agreements entered into in this regard have been provided separately by the querist for the perusal of the Committee.)

5. The querist has informed that the following accounting treatment has been made in the books of the Company:

¹ Opinion finalised by the Committee on 8.5.2023.

- (a) The bill discounting arrangement results in transfer of a financial asset (trade receivable) to a Commercial Bank in exchange for cash. Criteria for de-recognition of a financial asset as per Ind AS 109 provide as under:

“3.2.6 When an entity transfers a financial asset (see paragraph 3.2.4), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

...

- (b) if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.”**

“B3.2.5 Examples of when an entity has retained substantially all the risks and rewards of ownership are:

...

- (e) A sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.”

“3.2.15 If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. ...”

“3.2.22 If a transferred asset continues to be recognised, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any income arising from the transferred asset with any expense incurred on the associated liability...”

- (b) Considering the above guidance, the following accounting entries are being passed in the books of the Company:

(a) Sale of Power

Trade Receivables	Dr.	100	
Sale of Power			Cr. 100

(b) Amount received from Bank by way of Bill Discounting

Bank	Dr.	100	
Short Term Borrowings- Bill Discounting			Cr. 100

(c) Repayment of liability by DISCOM (assuming repayment in 10 equal installments):

Short Term Borrowings- Bill Discounting	Dr.	10	
Trade Receivables			Cr. 10

- (c) Trade Receivables which have been liquidated by way of bill discounting are presented in the Balance Sheet as ‘Current Assets-Financial Assets-Trade Receivables’ and the corresponding liability as ‘Current Liabilities-Financial Liabilities-Borrowings’.
6. The querist has proposed the alternative accounting treatments as follows:
- (a) The Company has been following the above accounting treatment consistently. However, considering that the trade receivable has already been realised in cash once the Bill has been discounted, it may be interpreted that the financial asset which has been transferred is no longer in the nature of a trade receivable and should rather be presented as an asset under ‘Current Assets-Other Financial Assets’ instead of ‘Trade Receivables’ and such presentation should be sufficient to fulfill the requirements of Ind AS 109. This is further borne out by the fact that as a part of the bill discounting documentation, the DISCOM undertakes to comply with all the terms and conditions as are agreed upon between the Company and the Banker and such conditions of the Bill Discounting Agreement includes the clause that *“The Borrower (Company) shall ensure that the bills are accepted by the drawee (DISCOM) on presentation and retired on due dates. In the event of the bills remaining unaccepted on presentation or unpaid on due dates, the bank shall be entitled to recover the amounts of such bills along with overdue interest and other incidental charges (in accordance with the sanction letter) by the debit to the account of the borrower.”* Accordingly, trade receivables which have been liquidated by way of bill discounting no longer retains the characteristics of a trade receivable, and should rather be presented in the financial statements as a ‘Receivable’ under ‘Other Financial Assets’.
- (b) Conversely, considering that the beneficiaries whose bills are discounted are State DISCOMs and there is minimal chance of default in payment to Bank, trade receivables of the Company may be presented net of bills discounted and the amount of bills discounted for which the Bank has recourse to the Company in the case of default by the DISCOM (probability of which in any case, is minimal) may be disclosed as ‘Contingent Liabilities’.

B. Query

7. In view of above, the querist wishes to seek the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India as to whether the accounting and presentation of trade receivables which have been liquidated by way of bill discounting as being followed by the Company is proper; or whether these trade receivables should be reclassified to ‘Other Financial Assets’; or whether these trade receivables should be derecognised and the amount for which the Bank has recourse to the Company should be disclosed as a ‘Contingent Liability’.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised by the querist relates to the accounting for trade receivables, which have been realised by the Company way of discounting of bills in its financial statements as per the requirements of Ind AS 109. 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, appropriateness from the perspective of determination of tariff,

accounting treatment for supply of power, accounting for bill discounting charges and any other charges including penal interest for overdue payment charged by the Bank and refund by the DISCOM, measurement of receivables and associated liability, measurement and presentation of financial liability in case of derecognition of receivables, the disclosure requirements as per Ind AS 107, etc. Further, the Indian Accounting Standards referred to in the opinion are the Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time. Further, the opinion expressed hereinafter is purely from accounting perspective and not from the legal perspective.

9. The Committee notes the following relevant clauses from the various agreements/documents furnished by the querist for the perusal of the Committee:

Bill Discounting Agreement between the Company and the Bank:

- “4. That Interest on bill discounting will be recovered upfront by the Bank.
5. That the applied bill discounting facility is with recourse of the Company/borrower only.
10. That the repayment of the bills will be in 12 equal Monthly installments.
12. That the Borrower (the Company) shall ensure that bills are accepted by the drawee on presentation and retired on due dates. In the event of the bills remaining unaccepted on presentation or unpaid on due dates, the bank shall be entitled to recover the amount of such bills along with overdue interest and other incidental charges (in accordance with the sanction letter) by debit to the account of the Borrower;
15. That the borrower hereby declares that the bank shall have exclusive charge over the specific receivables of DISCOM and bills of exchange (under discounting) will be endorsed in favour of Bank. Further that the borrower hereby confirms that DISCOM (drawee) has also given its confirmation regarding the receivables.
16. That the Borrower unconditionally agrees to execute the necessary documents including but not limited to power of attorney wherein if DISCOM fails to pay the dues, the borrower will honour the commitments.
21. That the Borrower shall repay the advances of the bank within such number of days as may be stipulated in the Bank's sanction letter ... by the bank of the utilization of the advances by the Borrower on each occasion whether or not the payment of the said bills/invoices is received by the Borrower or if the bills are returned unpaid for any reason whatsoever the bank shall be entitled to debit the Borrower's account with the said amount advice to the Borrower;
22. That the Borrower shall indemnify the bank and keep the bank harmless and indemnified at all times against all losses, damages, actions, costs (between Attorney and Client), charges or expenses which may be made against or sustained or incurred by the bank (and whether paid by the bank or not) as a result of or in consequence of the bank having agreed to discount the said bills as also as a result of or in consequence of the bank through any of their respective offices or correspondents in India and elsewhere guaranteeing an irregularities or

discrepancies that may be existing in the documents relating to the said bills in connection therewith;

23. That the bank shall have first and paramount lien on the bills and the moneys received thereunder.”

Letter of Undertaking by the Company to the Bank

- “(e) We declare that we have requested the Bank for grant of a Bill Discounting Limit as aforesaid and have further agreed to tender to the Bank from time to time, only instruments drawn as per the terms and conditions of sanction, for discounting. We further authorize you to deduct the discounting and other charges applicable for discounting the instruments and thereafter credit the proceeds (less the discounting and other charges) to our account.
- (f) We agree that in the event of any such bills/instrument becoming unpaid on the due date or remaining unaccepted on presentation, we shall make good the Bank with the amount of all out of pocket expenses incurred/suffered by the Bank and redeem the instrument and we will not insist or request the Bank to exhaust any remedy or course of action against the acceptor of the bill or any other person and hereby waives such course of action specifically.
- (g) We guarantee that the Bills that may be discounted by the Bank as aforesaid shall be promptly paid together with interest, costs, charges and other expenses due thereon by the and in the event of any default on the part of in making payments promptly, we shall make good to the Bank on demand all losses, costs (including reasonable attorney fees), charges and expenses incurred by the Bank by reason of non-payment of amount of such Bills by DISCOM or breach or non-performance or non-observance of the obligations on the part of the DISCOM with respect to said Bills and in the event of non-payment of the amounts of such Bills together with interest, costs, charges and expenses as aforesaid for any reason whatsoever, the same shall be duly paid by us to the Bank on demand but not later than 03 days. We hereby authorise the Bank to debit our account, without any requirement of notice or prior intimation, with the amount of such discounted bills and all interest, commission and all other sums due and payable in connection with the same and all monies as the Bank may become liable to pay or may be called upon to pay hereunder.
- (h) We also understand and agree that the Bank shall be at liberty to novate/assign/transfer the debt and the benefit of these presents to any other Banks/Financial Institutions/Asset Reconstruction Companies. We shall, if and whenever required by the Bank, do so, do and execute and join the doing and executing all such acts, things, deeds, documents or assurance as may be required for perfecting such assignments.”

Letter stating DISCOM's willingness for bill discounting to the Company

- “2. DISCOM shall accept bill discounting proposal against the borrowing limit of beneficiary.

5. The DISCOM shall pay bill discounting amount in twelve monthly from the date of discounting.
6. The DISCOM will reimburse upfront charges (as applicable), stamp duty and other incidental or documentation charges etc. directly to the Company.
8. In case of any default in payment by DISCOM or the facility revoked by the bank, the Company may charge Late Payment Surcharge (LPS) on the defaulted installment for the default period as per CERC regulations.
10. The terms and conditions set forth herein are the indicative terms. The complete terms and conditions as may be mutually agreed between the Company and banker from whom bill discounting shall also be complied by the DISCOM on its acceptance.”

Further, the monthly Bill of exchange states that discounting charges, any penal interest on overdue payment, other charges and expenses in this regard are to be borne by DISCOM.

10. The Committee notes that the Company has entered into an arrangement with the Bank to realise its trade receivables, which are financial assets as per the requirements of Ind AS 32, ‘Financial Instruments: Presentation’. In this context, the Committee notes the derecognition requirements of financial assets as per Ind AS 109, which states the following:

“3.2.3 An entity shall derecognise a financial asset when, and only when:

- (a) the contractual rights to the cash flows from the financial asset expire, or
- (b) it transfers the financial asset as set out in paragraphs 3.2.4 and 3.2.5 and the transfer qualifies for derecognition in accordance with paragraph 3.2.6.

(See paragraph 3.1.2 for regular way sales of financial assets.)

3.2.4 An entity transfers a financial asset if, and only if, it either:

- (a) transfers the contractual rights to receive the cash flows of the financial asset, or
- (b) retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 3.2.5.”

“3.2.6 When an entity transfers a financial asset (see paragraph 3.2.4), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:

- (a) if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognise the

financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.

- (b) if the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognise the financial asset.**
- (c) if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**
 - (i) if the entity has not retained control, it shall derecognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer.**
 - (ii) if the entity has retained control, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 3.2.16).**

3.2.7 The transfer of risks and rewards (see paragraph 3.2.6) is evaluated by comparing the entity's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (eg because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (eg because the entity has sold a financial asset subject only to an option to buy it back at its *fair value* at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 3.2.5).

3.2.8 Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison are made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.

3.2.9 Whether the entity has retained control (see paragraph 3.2.6(c)) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated

third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.”

“Transfers that do not qualify for derecognition

3.2.15 If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.”

The Committee notes that the first step in determining whether derecognition of a financial asset is appropriate is to establish whether the contractual rights to the cash flows from that asset have expired. If yes, the financial asset is derecognised irrespective of whether the entity transfers the financial asset and such transfer qualifies for derecognition as per paragraphs 3.2.3 to 3.2.5 of Ind AS 109. In the extant case, in case of default by the DISCOM, the Bank has full recourse to the Company for principal amount and interest thereon as well as default/delayed payment interest and other incidental costs/charges, and in that case, the Company retains the right to collect the same from the DISCOM. Therefore, apparently, the arrangement does not result into expiry of contractual cash flows from the receivables. Accordingly, the financial asset (Trade Receivables) can be derecognised when, and only when, the entity ‘transfers’ the asset as per the requirements of paragraphs 3.2.3 and 3.2.4 of Ind AS 109 and as per paragraph 3.2.6, the transfer has the effect that the entity has either transferred substantially all the risks and rewards of the asset, or, neither transferred nor retained substantially all the risks and rewards of the asset, and has not retained control of the asset.

11. In this regard, the Committee notes from the Facts of the Case that in case of default by the DISCOM, the Bank has full recourse to the Company and the Company also bears the delayed payment interest and charges. Further, in such a case, the DISCOM has agreed that the Company will have the right to claim/collect the same from DISCOM. These terms, in the view of the Committee, indicate that the Company retains substantially all the risks and rewards of ownership of the receivables despite the transfer and consequently, the derecognition criteria as per Ind AS 109 are not met in respect of the receivables. In view of this, the second criterion for derecognition as prescribed in paragraph 3.2.3 read with paragraphs 3.2.4 – 3.2.8 is also not met. Therefore, pursuant to paragraph 3.2.15 of Ind AS 109, the Company should continue to recognise the trade receivables in entirety and also recognise a financial liability for the consideration received from the Bank on discounting of the receivables. Further, the Committee is of the view that since in the extant case, transfer of trade receivables does not satisfy derecognition requirements as per Ind AS 109, the question of presenting the receivables as ‘Other Financial Assets’ instead of ‘Trade Receivables’ does not arise. Furthermore, in terms of paragraph 3.2.22 of Ind AS 109, financial asset (trade receivables), which continue to be recognised as asset(s) and the associated liability shall not be offset.

D. Opinion

12. On the basis of the above, the Committee is of the opinion that in the extant case, the Company should continue to recognise and present the trade receivables in entirety and also recognise a financial liability for the consideration received from the Bank on discounting of the receivables, as discussed in paragraph 11 above.
