

Query No. 41

Subject: Accounting treatment for late payment interest expenses in case of a new Company formed for setting up of new Urea Plant and is under operation phase under Ind AS framework.¹

A. Facts of the Case

1. A company (hereinafter referred to as ‘the Company’) is a joint venture company promoted by N Ltd., E Ltd. and F Ltd. The Company was incorporated on 17th February, 2015 in terms of Government of India’s (GoI) mandate of setting up of new gas based Ammonia-Urea Complex at the closed R unit of F Ltd. in terms of nomination by the Cabinet Committee of Economic Affairs (CCEA), Government of India’s decision dated 4th August, 2011 for revival of closed fertilizers units of F Ltd., which includes R unit.

2. As per the process of revival of closed R unit of F Ltd., the old plant was dismantled and sold off by F Ltd. and the Company set up a new State of Art gas based Ammonia-Urea Complex with production capacity of 2200 MTPD of Ammonia and 3850 MTPD of Urea (1.27 Million MT Urea Per Annum).

3. For setting up Urea Plant, the Company opened its project office at New Delhi for execution of the project on 1st October, 2015 and subsequently with the commencement of construction activities, site office at R place was made operational.

a) Current shareholding of the Company is as under:

S.No.	Particulars	% of Shareholding
1.	N Ltd.	26
2.	E Ltd.	26
3.	F Ltd. (in lieu of Land to the Company on leasehold basis and other usable assets)	11
4.	State Government	11
5.	G Ltd.	14.30
6.	Y Consortium (Foreign Equity)	11.70

b) Abridged statement of affairs as on 31st March, 2023:

Particulars	Amount INR in crores
Equity Share Capital	1890.25
Outstanding Term Loan from Consortium of Bank	4302.01
Trade Payables	1500.57
Reserve & Surplus	(865.86)

c) The Project is being executed on Engineering Procurement & Construction Management (EPCM) route and the project is commissioned in March, 2021.

¹ Opinion finalised by the Committee on 6.12.2023.

d) With initial bottlenecks, plant took some time in stabilisation and due to which losses were incurred in the first whole year of operation and it has caused scarcity of funds for the newly established company.

e) The basic raw material for ammonia and urea production is natural gas. Accordingly, the Company signed a long term gas sales agreement with G Ltd. All the terms related to supply, quantity, quality, payment terms etc. are derived by this agreement.

f) This gas agreement also provides for late payment charges at Marginal Cost of Funds based Lending Rate (MCLR) + 6.25% for delayed payment. During financial year (F.Y.) 2022-23, the Company delayed its payment to G Ltd. for nearly 6-9 months due to non-availability of funds. The Company duly provided for and paid late payment charges amounting to Rs. 79.88 crores during F.Y. 2022-23. These charges being in nature of finance cost have been duly disclosed as 'Finance Cost'.

g) Since the date of incorporation of the Company, i.e., 17th February 2015, its first annual accounts were prepared for the period of 17th February 2015 to 31st March 2016 as per Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI). All annual accounts for all the financial years from F.Y. 2016-17 onwards were prepared as per Indian Accounting Standards (Ind AS) in terms of requirements of Companies Act, 2013.

h) Annual accounts for the financial year 2022-23 (duly audited by statutory auditor appointed by the Comptroller and Auditor General of India (CAG)) have also been prepared in terms of Ind AS, which have been adopted and approved by the Board in their meeting held on 17th May 2023.

4. Audited accounts of the Company for the financial year 2022-23 were selected by government auditor for audit under section 143(6)(a) of the Companies Act, 2013 for supplementary audit. Government auditor has raised comment – II which is given below:

Government Audit Provisional Comment–II

“II. Statement of Profit and Loss

Expenses

Finance cost- Note-35

Other Interest-Rs.7998.08 lakh (Rs.7987.83 lakhs (Previous Year (P.Y.) 239.59 lakh))

As per the terms and conditions of Gas Sale Agreement between G Ltd. (Seller) and the Company (Buyer), for the period commencing from 01.10.2020 and ending on 31.03.2023 (Interim Interest Period), the applicable interest rate for the delayed payments was to be SBI MCLR plus 2%. And the applicable interest rate from 01.04.2023 was to be SBI MCLR plus 6.25%, unless the Interim Period is extended pursuant to a written confirmation from Seller.

The Company included an amount of Rs. 7987.83 lakhs (P.Y. 239.59 lakh) under Finance Cost towards interest payable to G Ltd. at SBI MCLR +2% for late payment. This amount should not be included under finance cost as per the Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013, issued by the ICAI.

Further, it also can be seen that a sudden huge rise of Rs. 7748.24 (Rs. 7987.83 – Rs. 239.59) lakh had occurred in interest for delayed payment in comparison to the previous year 2021-22 which qualifies as exceptional item as per Ind AS 1 (paragraphs 85, 86, 97 and 98) and should be disclosed on the face of the statement of profit and loss.

Thus, it has resulted in overstatement of 'Finance Cost' and understatement of 'Other Expenses' by Rs. 7987.83 lakh."

5. *The Company's Management Reply to Provisional comment:*

"In connection with Provisional Comment-II, it is to submit that:

We agree with the auditor observations that as per Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013, issued by the ICAI, "as per Note 4 of the General Instructions for the Preparation of the Statement of Profit and Loss, disclosure of Finance costs is to be bifurcated under the following:

- (A) Interest;
- (B) Dividend on redeemable preference shares
- (C) Exchange differences regarded as an adjustment to borrowing costs;
- (D) Other borrowing costs (specify nature)."

Further as per Guidance Note, interest expenses are interest cost on financial liabilities measured at amortised cost such as borrowings from banks and others, on debentures, bonds or similar instruments etc. calculated as per the effective interest method.

It implies that Guidance Note permits interest cost booking for borrowings from other than banks also in this head. The Company has total finance cost of Rs. 453.20 crores in F.Y. 2022-23 in comparison to finance cost of Rs. 363.51 crores in F.Y. 2021-22. It implies an increase of Rs. 90 crores. It gives a real picture of increase in interest expenses, with the increase in multiple rise of revenue.

During F.Y. 2022-23, trade payables of the Company has risen by more than Rs. 1000 crores, due to outstanding G Ltd. payment. It implies that the Company has taken working capital financing from G Ltd. to meet its operational expenditure and repayment of its due term loan instalment amounting to Rs. 360 crores during F.Y. 2022-23.

As per principle of substance over form, G Ltd's interest is a finance cost to meet the Company's expenditure which would otherwise have been financed by loans to be raised by the Company. Since the Company's financial position was not sound to raise the sufficient funds during F.Y. 2022-23, payments of G Ltd. were withheld and received subsidy was utilised to meet other operational cost for plant running.

Further as per opinion issued by ICAI, on similar matter of disclosure of late payment interest income as cash flow from investing activities in the cash flows, it simply implies that late payment interest cost will also qualify as borrowing cost for the payer.

The disclosure of same as other expenses will prejudice the decision making of users of financial statements as an extraordinary item, which is general business practice of industry.

In addition to our above submissions, following paragraphs of Ind AS 1 may also be considered:

“7 Material:

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.”

“29 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.”

“85 An entity shall present additional line items, (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity’s financial performance.”

“87 An entity shall not present any items of income or expense as extraordinary items, in the statement of profit and loss or in the notes.”

“97 When items of income or expense are material, an entity shall disclose their nature and amount separately.

98 Circumstances that would give rise to the separate disclosure of items of income and expense include:

- (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
- (c) disposals of items of property, plant and equipment;
- (d) disposals of investments;
- (e) discontinued operations;
- (f) litigation settlements; and
- (g) other reversals of provisions.”

As per paragraph 87 of Ind AS 1, it prohibits for disclosure of any item as extraordinary item in the statement of profit and loss or in notes. Hence showing this late payment interest to G

Ltd. as exceptional items on the face of the statement of profit and loss will be non-compliance of Ind AS provisions.

As per paragraphs 97 and 98, circumstances for separate disclosures are provided in Ind AS and late payment interest to supplier does not fall in any of the category to qualify for separate disclosure.

As per paragraphs 7, 29 and 85, any material item shall be disclosed as separate line item with similar nature items and accordingly, the Company has shown the same as separate line item under finance cost with specific disclosure of its nature and calculation in Note 35.

As per paragraph 9.5 of Guidance Note on Division II-Ind AS Schedule III to the Companies Act, 2013, issued by ICAI, the aggregate of the following expenses is to be disclosed on the face of the Statement of Profit and Loss:

- Cost of materials consumed
- Purchases of Stock-in-Trade
- Changes in inventories of finished goods, work in progress and stock in trade
- Employee benefits expense
- Finance costs
- Depreciation and amortization expense
- Other expenses

So, there is no reporting of exceptional expenses on the face of statement of profit and loss and this late payment expense is covered under finance cost.

Further, as per paragraph 9.5.5 of Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013, issued by ICAI, the interest expenses would include, interest cost on financial liabilities measured at amortised cost such as borrowings from banks and others. Here others may also include the amount of loan received from the suppliers in terms of material provided by them and covered that interest cost also as part of Finance cost as per Ind AS provisions.

Accordingly, based on the relevant nature of expense, the same is clubbed under Finance cost.

Further, as per an earlier *opinion of Expert Advisory Committee of ICAI* (Query No. 19 of Volume 39 of Compendium of Opinions), *enquiring for accounting for surcharge on delayed payment, it has been opined that the nature of late payment surcharge received by a power sector company is that of finance income*. Similar to that, late payment surcharge payable by a customer will be a finance cost and accordingly clubbed in finance cost.

Audit is requested to drop this provisional comment please.”

(Emphasis supplied by the querist.)

6. *Government Auditor's Final Comment*

Government Auditor has taken an assurance from the Company to take ICAI opinion on the accounting for interest on delayed payments.

7. *Nature of transaction related to Government Audit Comment*

The Company signed a gas sales agreement with G Ltd. dated 17th November, 2017 for 10 years for purchase of requisite gas at prescribed rate with specified payment terms. The wordings of clause 12.3(c) of this agreement are as follows: "Should either the buyer or the seller fail to make payment to the other of any sum, due hereunder, the defaulting party shall be liable to pay from the date such payment is due until the actual date of payment, interest compounded annually at the then applicable SBI's MCLR rate as on seller's due date or buyer's due date, as the case may be plus 6.25%."

Later on contract was amended with the enhancement of credit period up to 30 days and reduction in late payment interest rate to SBI MCLR plus 2%. The Company has accounted for this late payment interest expenses paid/payable to G Ltd. under the head finance cost as 'Other Interest' in Note No. 35 in annual accounts for F.Y. 2022-23. It has also been disclosed in the notes, that this interest is payable to G Ltd. for late payment at SBI MCLR plus 2%.

B. Query

8. In view of the above, the opinion of Expert Advisory Committee has been sought as to whether presentation of expenses on account of late payment interest accounted for under finance cost as done by the Company is correct. If no, what is the relevant head for its disclosure?

C. Points considered by the Committee

9. The Committee notes that the basic issue raised by the querist relates to the appropriateness of presentation of late payment interest expenses under finance cost in the Statement of Profit and Loss. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for the expenditure incurred on revival of the closed unit/plant, accounting for any other expense incurred during execution of project, accounting for debt and the loan taken from consortium of banks, trade payables, accounting under the previous GAAP, determination of applicable rate of late payment interest including implications of change in rate of late payment interest, materiality of the late payment interest as per the requirements of Ind AS, presentation in the Statement of Cash Flows, etc. Further, the opinion, expressed hereinafter is purely from accounting perspective and not from the legal perspective or from the perspective of interpretation of the gas sale agreement, etc. The Committee wishes to point out that the Standards referred to in the opinion are the Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time.

10. At the outset, the Committee notes that in the extant case, the Company owes to G Ltd. towards purchase of raw materials and the same remains unpaid from 1.10.2020 due to which the Company is required to pay late payment interest at specified rates as per the terms and conditions of gas sale agreement. The Company has accounted for late payment interest expenses paid/payable to G Ltd. under the head 'finance cost' as 'Other Interest'.

11. The Committee notes that in order to determine the appropriateness of presentation of late payment interest, it is necessary to evaluate the nature of late payment interest. In this context, the Committee notes from the Facts of the Case that one of the clauses of the agreement with G Ltd., states that “Should either the buyer or the seller fail to make payment to the other of any sum, due hereunder, the defaulting party shall be liable to pay from the date such payment is due until the actual date of payment, interest compounded annually at the then applicable SBI’s MCLR rate as on seller’s due date or buyer’s due date, as the case may be plus 6.25%.” Later on contract was amended with the enhancement of credit period up to 30 days and reduction in late payment interest rate to SBI MCLR plus 2%. From this, it appears that late payment interest is essentially towards compensating for time value of money.

12. With regard to the issue raised relating to presentation of late payment interest incurred by the Company in the financial statements, the Committee notes the following requirements of Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 (Revised January, 2022 Edition):

“9.5.5. Finance Costs

As per Note 4 of the General Instructions for the Preparation of the Statement of Profit and Loss, disclosure of Finance costs is to be bifurcated under the following:

- (A) Interest;
- (B) Dividend on redeemable preference shares;
- (C) Exchange differences regarded as an adjustment to borrowing costs;
- (D) Other borrowing costs (specify nature).

(A) Interest expense

This would present the following types of finance charges incurred by the Company:

- (a) Interest cost on financial liabilities measured at amortized cost such as borrowings from banks and others, on debentures, bonds or similar instruments etc. calculated as per the effective interest method;

...”

From the above, the Committee notes that the interest cost/expense on financial liabilities measured at amortised cost, calculated as per the effective interest method is to be presented as interest expense under finance costs. In this context, the Committee notes that in the extant case, the amount owed by the Company to G Ltd. is an interest bearing liability which represents a contractual obligation to deliver cash to G Ltd. and therefore, meets the definition of financial liability as per Ind AS 32, ‘Financial Instruments: Presentation’. Hence, it should be accounted for as per the requirements of Ind AS 109, ‘Financial Instruments’, which requires it to be initially measured at fair value less transaction costs and subsequently measured at amortised cost, including interest on delayed payments after the due date. Thus, such an interest is essentially of the nature of finance cost and accordingly, the same should be presented as interest expense under finance costs.

13. With regard to the issue raised relating to presentation of interest payable to G Ltd. under the head ‘exceptional items’, the Committee notes that Part II of Division II of Schedule III to the Companies Act, 2013 (hereinafter referred to as the ‘Ind AS Schedule III’),

prescribes the format of Statement of Profit and Loss applicable for companies adopting Ind ASs, which requires presentation of 'Exceptional Items' as a separate line item in the Statement of Profit and Loss. Further, Note 7 of the 'General Instructions for Preparation of Statement of Profit and Loss' applicable for companies adopting Ind ASs requires that a Company should disclose by way of notes, additional information regarding aggregate expenditure and income on some items. One of the items to be disclosed in this regard is 'details of items of exceptional nature'. However, the term 'exceptional item' is neither defined in 'Ind AS Schedule III', nor it is used in Ind ASs. Further, as noted above, the Format of the Statement of Profit and Loss prescribed in Schedule III to the Companies Act also requires presentation of 'Finance costs' as separate line items under 'Expenses'. Furthermore, Note 7 of the 'General Instructions for Preparation of Statement of Profit and Loss' requires inter alia, to disclose by way of notes, additional information regarding details of aggregate expenditure in respect of this item. Thus, considering the nature of item, viz., finance costs, Schedule III specifies a specific presentation and disclosure requirements.

14. In this regard, the Committee also notes the following paragraphs of Indian Accounting Standard (Ind AS) 1, 'Presentation of Financial Statements':

“31 Some Ind ASs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an Ind AS if the information resulting from that disclosure is not material except when required by law. This is the case even if the Ind AS contains a list of specific requirements or describes them as minimum requirements. An entity shall also consider whether to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.”

“82 In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:

(a) revenue, presenting separately interest revenue calculated using the effective interest method;

(aa) gains and losses arising from the derecognition of financial assets measured at amortised cost;

(b) finance costs;

...”

“85 An entity shall present additional line items (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.”

“86 Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial

performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement of profit and loss, and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance. An entity considers factors including materiality and the nature and function of the items of income and expense. For example, a financial institution may amend the descriptions to provide information that is relevant to the operations of a financial institution. An entity does not offset income and expense items unless the criteria in paragraph 32 are met.”

“Information to be presented in the statement of profit and loss or in the notes

- 97 When items of income or expense are material, an entity shall disclose their nature and amount separately.**
- 98 Circumstances that would give rise to the separate disclosure of items of income and expense include:
- (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
 - (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
 - (c) disposals of items of property, plant and equipment;
 - (d) disposals of investments;
 - (e) discontinued operations;
 - (f) litigation settlements; and
 - (g) other reversals of provisions.
- 99 An entity shall present an analysis of expenses recognised in profit or loss using a classification based on the nature of expense method.**
- 100 Entities are encouraged to present the analysis in paragraph 99 in the statement of profit and loss.
- 101 Expenses are subclassified to highlight components of financial performance that may differ in terms of frequency, potential for gain or loss and predictability. This analysis is provided in the form as described in paragraph 102.
- 102 In the analysis based on the ‘nature of expense’ method, an entity aggregates expenses within profit or loss according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs), and does not reallocate them among functions within the entity. ...”

Further, the Committee notes that the concept of ‘materiality’ has been discussed in paragraph 7 of Ind AS 1 as below:

“Material:

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Materiality depends on the nature or magnitude of information, or both. An entity assesses whether information, either individually or in combination with other information, is material in the context of its financial statements taken as a whole.

...”

15. From the above, the Committee notes that material items need to be presented as line items and/or disclosed in financial statements, which includes the notes. As per Ind AS 1, materiality depends on the magnitude and/or nature of information and an information is material if omitting or misstating or obscuring it could be expected to influence the decisions of primary users of financial statements. Further, as per the requirements of paragraphs 86 and 101 of Ind AS 1, since effects of events and transactions differ in frequency, the components of financial performance should be disclosed and additional line items/headings should be presented when such presentation is relevant to understanding of the entity’s financial performance having regard to factors including materiality and the nature of the items of income and expense.

Therefore, drawing an analogy from the above-reproduced requirements of Ind AS 1, the Committee is of the view that exceptional items are those items which meet the test of ‘materiality’ as well as the test of ‘frequency of occurrence or incidence’; and the meaning of the term ‘material’ should be construed as per paragraph 7 of Ind AS 1, as reproduced above. The Committee is of the view that ‘exceptional items’ could be of the nature of items listed in paragraph 98 of Ind AS 1 reproduced above, if such items are material and are infrequent in occurrence. Further, the Committee notes from the requirements of Schedule III and above-reproduced paragraphs of Ind AS that they require items to be presented and classified as per their nature and also require specific items, such as, ‘finance costs’ to be disclosed in a specific manner.

In the above context, the Committee notes that the ‘interest payable’ arising on non-payment of dues to G Ltd. in the extant case is of the nature of a ‘finance cost’, which is a common business expense and therefore, it cannot be considered as ‘exceptional’. Thus, considering the requirements of Schedule III and Ind AS, the Committee is of the view that interest payable in the extant case should be presented as a part of ‘Finance costs’ and not as an exceptional item in the Statement of Profit and Loss. However, considering the nature and size/magnitude of ‘interest payable’ in the extant case, these expenses should be presented separately under the head, ‘finance cost’ in the Statement of Profit and Loss for better understanding of the entity’s financial performance, along with appropriate disclosure in the notes to financial statements, as per the requirements of Ind AS 1.

D. Opinion

16. On the basis of the above, considering the requirements of Schedule III and Ind AS, the Committee is of the opinion that interest payable in the extant case should be presented separately under the head ‘Finance costs’ along with appropriate disclosure in the notes to

financial statements and not as an exceptional item in the Statement of Profit and Loss, as discussed in paragraph 15 above.
