

Query No. 22

Subject: *Accounting treatment and classification of sales bills discounting, under Ind AS framework.*¹

A. Facts of the Case

1. A company (hereinafter referred as ‘the Company’) is a public sector undertaking owned by the Government of India under the administrative control of the Ministry of Coal. The Company is engaged in the business of mining of lignite and coal and generation of power. The Company is currently operating four open cast integrated lignite mines, one coal mine and five pit head thermal stations. Further, the Company has commissioned various renewable projects. In addition to that, raw lignite and coal are being sold in the open market as well as to other power generating companies through agreements.

2. As the Company is under regulated segment, the tariff is determined by Central Electricity Regulatory Commission (CERC) Regulations. CERC notifies regulations for both thermal and mines for a period of 5 years. Based on the Regulations, the tariff is fixed by the Regulator. Tariff charged has two components, one is capacity charge and another energy charge. Capital cost comprises the fixed cost of thermal stations. Energy cost is the lignite/coal cost, which is transferred to thermal stations at transfer price duly approved by the Regulator for the respective tariff period. The tariff is cost duly compensated with return on equity as given in the Regulations. After the said tariff period, the tariff charged during the control period is tried by the Regulator based on the petition filed.

3. The Company supplies power to state DISCOMs (Distribution Companies). Each of the DISCOMs is bound by power purchase agreement entered into with the Company. Each month, for the energy supplied to the DISCOMs, invoices are raised in the subsequent month. Each of the customer has been given a credit period of 45 days for settling the bills; beyond the credit period, surcharge (interest) is charged as per the Regulations. The customers (DISCOMs) and the Company have the option to settle dues amount by opting the sales bill discounting (SBD) through banker. DISCOMs to meet the scheduled payment of invoices within due dates have opted to bill discounting in order to ensure liquidity and to avoid late payment surcharge (interest).

4. The SBD arrangement basically involves the following activities:

- (i) The rate of bank interest for different tenors upto 360 days is obtained by the Company from different banks through competitive bidding based on the Company’s credentials with recourse to the Company.
- (ii) The lowest rates for the above are provided to all DISCOMs.
- (iii) DISCOMs approach to the bank as per their requirements.
- (iv) The DISCOMs pay the upfront opening charges, interest etc. to the bank.
- (v) The bank remits full invoice amount to the Company.
- (vi) The DISCOMs pay the SBD amount to the bank on due date.

¹ Opinion finalised by the Committee on 6.9.2024.

5. *Treatment in the books of account*

The querist has stated that as per Ind AS 109, 'Financial Instruments', financial asset is derecognised only when:

- (a) the contractual rights to the cash flows from the financial assets expire, or
- (b) if cash flows from the financial assets do not expire, the entity can derecognise the asset when, and only when, it transfers the asset and the transfer has the effect that the entity has either:
 - (i) transferred substantially all the risks and rewards of the asset, or
 - (ii) neither transferred nor retained substantially all the risks and rewards of the asset and not retained control of the asset.

The question whether the entity has transferred the risks and rewards 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.

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.

(Emphasis supplied by the querist.)

The Standard does not provide any specific guidance on bright-lines to be used for comparing the entity's exposure, before and after the transfer, with variability in the amounts and timing of the net cash flows of the transferred asset. Hence, this requires entities to exercise their own judgement based on the facts and circumstances.

6. The Company has been exercising the bill discounting option and based on the past transaction, there were no dishonour of bills by DISCOMs and further, sales bill discounting period is less than one year; hence, according to the Company, in case of default by DISCOMs, 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. Accordingly, as on the reporting period, the Company has transferred substantially all the risks and rewards of ownership of a financial asset i.e., trade receivable by exercise of the sales bill discounting.

The accumulation of dues from the DISCOMs had affected the working capital position of the Company and affected the free flow of funds.

7. Further, as per the querist, all the customers of the Company with whom such bill discounting arrangement is entered into are state owned public sector undertakings (PSUs). Further, the DISCOMs are having sovereign guarantee. Accumulation of debts for the DISCOMs has led to availment of loan and the soaring interest rates has also been a major concern for them. In the event of not meeting the bills at the given due dates, the Company has been charging the surcharge on the bills beyond due date, and any further realisation of the

debts were first appropriated with the surcharge outstanding as per the payment priority clause in the power purchase agreement.

8. To provide a major relief to both the DISCOMs and the Company, the sales bills discounting arrangement has been introduced. The competitive interest rates and period quoted by the banks were more persuasive for the DISCOMs to opt for the scheme, rather than resorting to higher interest bearing working capital; the rate of interest at which the bills were discounted were far more attractive and beneficial.

The Company has entered into such sales bills discounting for the past 4 years. Although, the arrangement is recourse lying with the Company in nature, there has been no default from the DISCOMs on the due dates.

9. Based on the past practices and customer behaviour, the Company is of the opinion that it does not retain any control of the asset and substantially all risks and rewards are transferred. Hence, the financial asset is derecognised.

10. Based on the above paragraph, the Company accounts for the bills discounting arrangement as follows:

Bank A/c dr.
 To Trade Receivable A/c
 (On realisation by execution of Bill of Exchange (BOE))

As per Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability shall be disclosed in case of a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the reporting entity.

Recognition of financial liability for the bills pending for honour by the DISCOMs will not be correct as there are no contractual obligations to pay cash or financial asset presently. However, there is a possible obligation on the Company in case DISCOMs dishonour the bills on the given dates. Accordingly, following the principles of Ind AS 37, 'Provisions, Contingent liabilities and Contingent Assets', the bills pending for honour have been disclosed under 'contingent liabilities'.

However, there are contrary views with respect to the disclosure and accounting among the peer companies in the industries. To clear the ambiguity and for a better presentation of financial statements, opinion of the Expert Advisory Committee is being sought.

11. The Company is of the opinion that all the substantial risks and rewards are transferred on realisation of dues. Further, the DISCOMs are independent to select the banker and also to avail the option of Sales Bill Discounting along with the tenor.

12. The payment default, if any, for which the generating company is responsible under recourse is a future event and triggering of the same is time dependent. Thus, it cannot be ascertained unless the future event occurs. Accordingly, the generating company is treating the SBD as realisation of debtors on receipt of proceeds; however, considering the future events, due to the recourse condition of SBD, contingent liability has been disclosed in notes to accounts under the head 'Contingent Liability'.

13. The querist has also mentioned that the generating company has been following the SBD for last four years where in no such event of default for recourse has been triggered.

Considering all the above facts, and based on the past business practice and payment pattern, it is evident that DISCOMs have honoured their commitments by paying the dues to banks on time and there has not been a single case of any default. Based on the above facts, the Company has been adjusting the proceeds against the trade receivables.

B. Query

14. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee as to whether the accounting treatment of the Company in the given case is correct.

C. Points considered by the Committee

15. The Committee notes that the basic issue raised by the querist relates to whether derecognition of trade receivables, which have been realised by the Company way of discounting of bills in its financial statements and disclosure of the same as a ‘contingent liability’ is appropriate. 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 and impact from the perspective of determination of tariff, accounting for SBD discounting charges, bank charges and any other charges charged by the Bank, accounting for surcharge charged by the Company, accounting in the books of DISCOMs, measurement of receivables, accounting for bill of exchange, disclosure requirements as per Ind AS 107, appropriateness of the Company’s analysis/evaluation of exposure of variability before and after the transfer of financial asset as per the requirements of Ind AS 109, classification of financial liability as per Schedule III to the Companies Act 2013, presentation, classification and disclosure in the books of the Company 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 an accounting perspective and not from the legal perspective.

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

The scope of work and terms and conditions of SBD as per Letter of Award (LOA) by the Company to the Bank:

“f) Type of bill of exchange : With Recourse to the Company.

g) Discounting Charges: DISCOM(s) will pay SBD Discounting charges upfront to the Banker through the Company on the date of discounting. All bank charges will be charged to the DISCOM(s) and total bill value to be credited to the Company by the Banker.

...

i) Standard Documents to be executed on	Request Letter by the Company to Bank for SBD with following documents
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- selection of Bank:
- a) Bill of exchange signed by both the Company and DISCOM(s).
 - b) Demand Promissory Note (DPN)
 - c) Declaration by DISCOM(s)”

Application to be submitted by DISCOM to the Company for Bill discounting:

“Since DISCOM is not in position to pay the monthly power bill on the due date, on request, the Company has arranged the Bills Discounting. ...

...

DISCOM hereby agreed the following conditions for Bills Discounting:

A. CONDITIONS:

...

7. In case, the DISCOM default in making the payment by the due date, the unpaid amount will be debited by the bank from the Company’s Bank account. However, such unpaid amount shall be recovered by the Company, from the DISCOM along with LPSC as if there is no bill discounting.”

The Committee further notes that as a part of bill discounting, the Company also submits a demand promissory note to the bank with whom bill discounting arrangement is made, whereby the Company promises to pay the bank, wherever demanded, notwithstanding non-presentment, the bill discounting amount together with interest thereon, as advised at the time of disbursement for value received by it.

Also as a part of documents for bill discounting and with regard to request for disbursement, the Company, vide its letter, mentions explicitly to the bank that the “the Bill of Exchange is recourse to the Company and the Company undertakes to indemnify the bank in the event of non-payment of amount due on account of bill discounting ”.

17. 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, as follows:

“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."**

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

- (a) a sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;
- (b) a securities lending agreement;
- (c) a sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;
- (d) a sale of a financial asset together with a deep in-the-money put or call option (ie an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and
- (e) a sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur."

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 the asset have expired as per paragraph 3.2.3 (a) of Ind AS 109. If yes, the financial asset is derecognised. The Committee is of the view that paragraph 3.2.3 (a) of Ind AS 109 refers to a notion of expiry to the rights (or cancellation) of the contractual cash flows, which in effect is a legal concept of releasing the borrower from its obligation (for example through repayment of the loan or explicit release as part of a debt forgiveness). The Committee notes from various documents/agreements submitted by the querist that in the extant case, the bills discounting arrangement is with recourse to the Company and in case, DISCOM defaults in making the payment by the due date, the unpaid amount will be debited by the bank from the Company's

bank account. However, such unpaid amount shall be recovered by the Company from the DISCOM along with late payment surcharge (LPSC) as if there is no bill discounting. Thus, the Company still has the right to demand the cash flows from DISCOM against the trade receivables. Therefore, apparently, the arrangement does not result into expiry of contractual cash flows from the receivables.

Accordingly, in the extant case, the financial asset (trade receivables) can be derecognised when, and only when, the Company ‘transfers’ the asset as per the requirements of paragraph 3.2.4 of Ind AS 109 and as per paragraph 3.2.6, the transfer has the effect that the Company has either transferred substantially all the risks and rewards of ownership of the financial asset, or, neither transferred nor retained substantially all the risks and rewards of ownership of the financial asset, and has not retained control of the asset.

18. 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 has guaranteed to indemnify the bank in the event of non-payment of amount due on account of bill discounting. Further, in such a case, the DISCOM has agreed that the Company will have the right to claim/collect the same from DISCOM alongwith appropriate surcharge (LPSC) from the date of bill discounting. Thus, it appears that in case of default by the DISCOM, the only course of action available with the bank is to approach the Company to get the payment and the bank has no other right available, such as, right to sell or pledge the receivables, etc. 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, under an appropriate head as per the requirements of Schedule III to the Companies Act, 2013.

The Committee also wishes to point out that the probability or possibility of default by borrower or occurrence of default in past is not relevant as per the requirements of Ind AS 109 for assessing derecognition of financial assets. Moreover, while evaluating the transfer of risks and rewards of ownership of financial asset, the entity’s exposure to variability is to be compared before and after the transfer of asset and not in case of default.

D. Opinion

19. 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, under an appropriate head as per the requirements of Schedule III to the Companies Act, 2013, as discussed in paragraph 18 above.
