

Accounting Treatment of Cash Rebates

The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. One of the objectives of a government company incorporated in 1975 under the Companies Act, 1956, is to set up thermal power plants in various geographical locations in the country and to supply bulk power to various State Electricity Boards/successor entities.

2. The company is governed by the provisions of the Electricity (Supply) Act, 1948. As the government has not prescribed any statement of accounts for the central undertakings engaged in generation of electricity, the company is preparing its accounts as per Schedule VI to the Companies Act, 1956, since inception, which have been accepted by various auditors. The terms and conditions and tariff for sale of energy by the company, consequent upon promulgation of the Electricity Regulatory Commission Act, 1998, is regulated by the Central Electricity Regulatory Commission.

3. The bills for sale of energy supplied during a month are raised on the customers in the first week of the following month and depending upon the receipt of the payments from the customers, rebates for prompt payment are allowed. As per the terms for supply of energy, the company allows a rebate of 2.5% on the amount paid through letter of credit (LC) upon presentation of bills to the bank. Thereafter, a rebate of 1.5% is allowed on the amount paid through LC upto 20th day from the date of billing. Where payments are made subsequently through LC or otherwise within a period of one month from the date of issue of bills by the company, a rebate of 1% is allowed. No rebate is allowed to the customers for payments made after one month of the date of the bill. The rebate is limited to the amount of the bill after excluding wheeling charges, if any,

taxes, duties, levies, cess, etc., billed therein.

4. The rebates allowed to customers are accounted for by the company at the time of receipt of payment against the energy bills from the customers. At the end of financial year, no provision is made in the accounts towards cash rebate allowed on the payments received in the subsequent year since in the opinion of the company, cash rebates accrue only on receipt of payment from the customers. To illustrate, bills for sale of energy during the month of March 2002, are raised during the first week of April 2002. The sale of energy is accounted for in the financial year 2001-02 and the rebate allowed as per applicable rate in respect of payments received against the energy bills in April 2002, are accounted for in the financial year 2002-03.

5. The government auditors have commented that the policy of the company in respect of accounting for rebates is on 'cash basis' instead of 'accrual basis'. The term 'accrual' has been explained in Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', issued by the Institute of Chartered Accountants of India, as "Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate". Further, according to the querist, as per the 'Guidance Note on Terms used in Financial Statements', 'accrual basis of accounting' means the method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue.

6. As per the querist, the company allows rebate to customers for prompt payment of energy bills. The bills are raised for full price without considering any rebate for the reason that eligibility for rebate is dependent upon the date of payment. The rebate accrues to the customer on actual payment and in the opinion of the company, the existing practice of accounting for cash rebates on settlement of energy bills is in conformity with the accepted accounting practice of recognising expenses on accrual basis. This practice has been consistently followed by the company for past several years and in any

1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.

2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 21 volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.

financial year, rebate allowed on the payments received during all the twelve months is accounted for. The cash rebate accrues to the customers only on payment within the prescribed time schedule. There is no liability for the cash rebate at the time of sale of energy. The liability arises only on prompt payment by the customers.

B. Query

7. The querist has sought the opinion of the Expert Advisory Committee as to whether the practice of the company to account for cash rebate for prompt payment on settlement of bills by the customers is in compliance with the requirement of accrual basis of accounting.

C. Points considered by the Committee

8. The Committee notes the meaning and the explanation of the term 'accrual' as reproduced in paragraph 5 of the facts of the case.

9. The Committee notes that the query basically relates to the issue about the point of time at which the cash rebate allowed to the customers for prompt payment accrues for the purpose of recognition in financial statements. As per the accrual basis of accounting, expenses

should be recognised when they are incurred by the enterprise. Similarly, the liabilities or provisions therefor should be recognised when they accrue. As per the generally accepted accounting principles, a liability or a provision therefor accrues when an obligation arises. The Committee is of the view that in the case of cash rebates of the nature explained by the querist, the obligation of the company arises as soon as the customer makes the payment within the stipulated period.

10. The Committee is further of the view that as far as 'matching concept' is concerned, which is an inherent aspect of accrual, the expense of cash rebate allowed to the customers for prompt payment is matched with the saving of interest to the enterprise due to early receipt of payment. This is because the purpose of allowing cash rebate is to save interest on the monies held up pending realisation of payment from the customers before the end of the stipulated period.

D. Opinion

11. On the basis of the above, the Committee is of the opinion that the practice of the company to account for cash rebate for prompt payment, on settlement of bills by the customers, is in compliance with the requirement of accrual basis of accounting. ■

INTERNATIONAL CONFERENCE

Theme: Redefining the Accountancy Profession: A Measured Response to Global Challenge

March 10 – 12, 2004, Jaipur

Considering with the meeting of the International Federation of Accountants Board and the South Asian Federation of Accountants, an international conference has been scheduled to be organised from 10th – 12th March, 2004 at, Jaipur. List of the tentative topics for discussion in the Conference are as under:-

TECHNICAL SESSIONS:

Governance Mandate - Professional Mindset
Perspective on Accounting: Yesterday, Today and Tomorrow
Expectation Gaps – Bridging the Unbridgable
Gearing up for New Economy - Emerging Challenges and Robust Solutions
Emerging Concerns for the Accountancy Sector – Country Perspective

SPECIAL ADDRESSES:

Globalised Capital Market – Divergence and Harmonisation
Banking Sector - Maintaining Resilience to Risk and Shock
Creating Shareholders' Value through Corporate Social Responsibility

More details on the programme would be published in the forthcoming issues of the Journal.