

Query No. 12

Subject: Classification of Advances for Infrastructure Projects to be leased.¹

A. Facts of the Case

1. A Public Sector Undertaking (PSU) (herein after referred to as ‘the Company’) is an infrastructural leasing non-banking financial company, wholly owned by the Government of India (GoI). It leases infrastructural assets to one of the Ministries of Government of India in the transportation sector.

2. The Company was hitherto required to adopt Companies (Accounting Standards) Rules, 2006² (AS). It is now required to adopt Companies (Indian Accounting Standards) Rules, 2015 (Ind AS) with the date of transition to Ind AS being 1st April 2017. All its leases, as a Lessor, in the past have been classified as finance leases in accordance with AS 19, ‘Leases’.

3. The Company has entered into a Memorandum of Understanding (MoU) with the administrative Ministry (hereinafter referred to as ‘the Ministry’) of the Government of India for financing of certain infrastructure projects. It may be noted that the infrastructure projects have a long gestation period of 5 years or more.

4. Prior to entering into the aforesaid MoU, the Ministry had entered into a Memorandum of Understanding in March 2015 with a leading insurance company in the public sector to draw funds for its infrastructure projects. In accordance with the said Memorandum of Understanding, the Ministry authorised the Company to draw funds from the insurance company and invest those funds in the identified projects of the Ministry, to be subsequently leased by the Company to the Ministry.

5. The querist has mentioned that the preamble to MoU states as follows:

“The terms and conditions of the financial assistance agreed between the Ministry and insurance company provide for a tenor of 30 years for each instalment, with capitalization of interest accruing in the first 5 years and repayment of principal in equal semi-annual instalments in 20 years commencing after a moratorium of 10 years. In accordance with the provisions of the above MoU and understanding between the Ministry & insurance company, the Ministry has vide its letter of July 2015, authorized the Company to draw the funds from insurance company against issue of bonds. It has also been agreed upon between the Ministry, insurance company & the Company that the Company will invest the funds in identified Ministry’s project to create infrastructure assets which would be leased by the Company to the Ministry and the terms and conditions of the lease will substantially reflect the terms and conditions of funding by insurance company under the MoU with the Ministry.

This MoU is being entered into by the Parties to incorporate and record the main terms of understanding between the two Parties in relation to the Transaction defined below, pending the execution of formal agreement between the two Parties. As and when formal agreements between the Parties are executed, this Memorandum of Understanding will be deemed to have been subsumed in such formal agreements. Until then, the terms and conditions incorporated herein shall continue to bind the Parties.

¹ Opinion finalised by the Committee on 4.8.2020 and 5.8.2020.

² Subsequently, in respect of accounting periods commencing on or after April, 2021, Companies (Accounting Standards) Rules, 2006 (as amended from time to time) have been superseded by Companies (Accounting Standards) Rules, 2021.

This MoU shall be deemed effective from date of first Pre-lease Disbursement”

6. The querist has further mentioned that as per the said MoU:

- Lessor is the Company;
- Lessee is Ministry.

The methodology that is adopted as per MoU is as under:

- MoU coming into effect;
- Fund mobilisation by Lessor;
- Pre – lease disbursement to Lessee;
- Execution of Lease Agreement, License Agreement and Development Agency Agreement. The effective date of each of these agreements shall be the date of execution of the MoU;
- Lessee, as Development Agent of Lessor under Development Agency Agreement continues to carry out asset installation;
- Production of Utilisation Reports(s) / Completion / Commissioning certificate by Lessee;
- Commencement of lease;
- Payment of periodic lease payments.

The Licensing Agreement grants the Lessor permission to acquire, construct, hold, enjoy and where necessary, transfer to Lessee the infrastructure assets on Lessee’s land.

The Development Agency Agreement provides that all activities pertaining to development of infrastructure assets shall be carried out by Lessee as agent of Lessor.

The Ministry shall appoint the contractors for implementation of projects. The disbursement made by the Company to the Ministry shall be used by the Ministry for making payments to contractors. The Ministry is the agent and the Company is the undisclosed principal.

The Lease Agreement shall contain the terms and conditions of the lease with the Company as Lessor and the Ministry as Lessee.

7. The querist has informed that it is agreed between Lessor and Lessee that the lease payments shall be priced so as to provide an agreed mark-up over the Lessor’s cost of funding. The Lessor’s cost of funding is agreed as under:

“Cost of funding, in respect of any source of Funding, shall include the aggregate cost of borrowing in respect of such source of Funding, including:

- a. Coupons or interest, and in case of funding with any variable rate, inclusive of such variation;
- b. All upfront costs or cost incurred at any time for mobilization of such Funding, including cost of issue, listing, servicing, registration costs, security interest creation;
- c. Cost of hedging Funding, if any either against interest rate risk or foreign exchange risk or both, or whether any such risk is not wholly or partly hedged, the cost or losses incurred due to any variation of interest rates or foreign exchange rates, both on account of principal and interest;
- d. Cost of any equity or equity component inherent in a source of Funding, not being less than the prevailing cost of borrowing for the Lessor in domestic market, disregarding any tax benefits;

- e. All taxes/tax deduction including withholding tax on the servicing of any Funding, to the extent the same is borne by the Lessor.

Cost of funding shall be determined with respect to any source of Funding at the time of raising of the relevant Funding.

In case, in respect of any Infrastructure Asset, different Funding sources are used, or different Funding sources are used at different points of time, then a weighted average Cost of Funding shall be determined with respect to such Infrastructure Assets based on the time when the Pre-lease Disbursement for the same were made.”

8. The querist has also mentioned some other important definitions / terms and conditions of the MoU as follows:

“Acquisition Cost: The total cost to Lessor of acquisition of an Infrastructure Asset more particularly described in agreements to be executed between the Parties, including all development costs, and where the Lessor has made Pre-lease Disbursement, the capitalised value of Pre-lease Payments, to the extent the same are not paid by the Lessee.

Internal Rate of Return (IRR): In respect of any Infrastructure Asset, the rate at which the present value of Lease Payments, discounted on yearly basis, equals, at the Lease Commencement Date, to the aggregate of:

- a. All costs incurred by Lessor towards Development of Infrastructure Asset;
- b. Any Applicable Taxes on acquisition of Infrastructure Asset, unless separately reimbursed by Lessee;
- c. Capitalized interest during the period from Pre-lease Disbursement Date till Lease Commencement Date, unless the Lessee has paid matching Pre-lease Payments.

Lease Commencement Date: The date on which the lease, in respect of an Infrastructure Asset shall have commenced, which shall be the date of completion of the Infrastructure Asset or such further date as notified by the Lessee and shall be specified by the Parties by execution of a Lease schedule.

Lease Payment: The payments in respect of the lease of an Infrastructure Asset, from the Lease Commencement Date, during the Lease Tenure.

Pre-lease Disbursement: Any disbursement of money that Lessor may be called upon by Lessee to make to Lessee, for the purpose of lessee to acquire or bring into existence Infrastructure Assets, to be leased in terms of this Agreement.

Pre-lease Payments: The payment, in respect of any Infrastructure Asset, during the period commencing from the Pre-lease Disbursement date to the Lease Commencement Date, with reference to the Pre-lease Disbursement Amount towards reimbursement of the funding costs of Lessor.

In order to ensure that the Lessor does not have any cash flow shortfall on account of servicing of any Funding source prior to the Lease Commencement Date, Lessee shall pay to the Lessor Pre-lease Payments, based on the amount of Pre-lease Disbursement done, at Cost of Funding.

The Pre-lease Payments shall stop to accrue at Lease Commencement Date.

IRR: It is agreed that Lease Payments shall be priced so as to provide an agreed mark up over the Lessor’s Cost of Funding.

Structuring of Lease Rental- The Lease rental shall be structured in a manner to match with servicing of bonds issued to the insurance company.

Primary Lease Period- 30 years matching the tenor of bonds issued to the insurance company.

Secondary Lease Period- Shall commence on the date immediately following the expiry of the primary lease period as mutually decided between the parties, for a period as mutually decided between the parties.”

9. Due to certain regulatory restrictions, the insurance company is unable to provide the agreed financial assistance in full. Thus, to meet the remaining funding requirements of the Ministry as per MoU, the Company raises funds from alternate sources in addition to the deployment of its own funds. The Company has been making pre-lease disbursements from the financial year 2015 -16 till date. The Company, since financial year 2015-16 has been charging Ministry, the cost of funding, computed as per MoU, that includes the following:

- Interest charged by the insurance company;
- Interest charged by other lenders;
- Interest on own funds deployed;
- Margin;
- Other upfront costs.

The Company, till the accounting period ended 31st March 2018, had adopted Accounting Standards (ASs). With respect to the aforesaid transaction, it had made the following presentation:

- In the Statement of Profit & Loss:
 - o Revenue from Operations:
 - Interest on lease advance (this includes borrowing costs and cost of own funds deployed and margin)
 - o Finance cost includes borrowing cost on funding of the infrastructure assets
- In Balance Sheet:
 - o Long Term Loans and Advances
 - Advance against lease of Ministry infrastructure assets
 - o Other Non-current Assets
 - Interest against construction of Ministry Infrastructure assets accrued but not due

10. The financial statements for the year ended 31st March 2019 have been prepared in accordance with Ind ASs. As per the querist, Ind AS 17, ‘Leases’ applies to the aforesaid transaction, of which the following definitions merit attention:

“The inception of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As on this date:

- (a) A lease is classified as either an operating or a finance lease; and**
- (b) In the case of a finance lease, the amounts to be recognised at the commencement of the lease term are determined.”**

“The commencement of the lease term is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (ie the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate).”

As per the Company, there has already been ‘inception of lease’ on the date the MoU has been executed as it lists in detail the principal provisions of the lease. The lease is classified as a finance lease. The methodology for determination of the amounts to be recognised at the commencement of the lease (i.e. entitlement to exercise its right to use the leased assets) is agreed between the Lessor and the Lessee.

11. In nutshell, Ind AS 17 applies to the transaction. Considering the applicability of Ind AS 17 and other relevant Ind ASs, the Company applied the following judgment relating to presentation of financial statements prepared as per Division III of Schedule III to the Companies Act, 2013 as applicable to a non-banking financial company whose financial statements are drawn up in compliance with Ind ASs:

- In Statement of Profit & Loss:
 - o Finance cost continues to include borrowing cost on funding of the infrastructure assets. However, these borrowing costs are then deducted from the gross finance costs;
 - o Interest accrued on deployment of own funds and Margin are presented under the head ‘Pre-commencement lease – interest income’ under the head ‘Interest Income’;
- In Balance Sheet:
 - o The pre-lease disbursements including borrowing costs are presented under ‘Other financial assets’ as ‘Advance against the Ministry Infrastructure Assets to be leased’.
 - o Interest accrued on deployment of own funds that is presented under the head ‘Pre-commencement lease – interest income’ under the head ‘Interest Income’ in the Statement of Profit & Loss’ is also presented under ‘Other financial assets’ as ‘Interest accrued but not due on advance for the Ministry project to be leased’.

A view has been expressed that ‘the pre-lease disbursements including borrowing costs presented under ‘Other financial assets’ as ‘Advance against the Ministry Infrastructure Assets to be leased’ should be presented, pending completion, under the head ‘Non-financial assets – capital advances’ since the above advances were given to the Ministry for creation of infrastructure assets which are under construction and the lease will commence after the completion of the construction and development of infrastructure assets.

12. The Company has presented the aforesaid item as financial asset since Ind AS 17 already applies to the aforesaid transaction as already concluded above and also based on the following judgements and application of other relevant Ind ASs:

As per paragraph 11 of Ind AS 32, ‘Financial Instruments: Presentation’, “**A financial asset is any asset that is:**

- (a) cash;**
- (b) an equity instrument of another entity;**
- (c) a contractual right:**
 - (i) to receive cash or another financial asset from another entity; or**
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or**
- (d) a contract that will or may be settled in the entity’s own equity instruments and is:**

- (i) **a non-derivative for which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or**
- (ii) **a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity’s own equity instruments.”**

With reference to observation, the attention is drawn to paragraph c(i) of the aforesaid definition that reads as, “a financial asset is any asset that is a contractual right to receive cash or another financial asset from another entity”.

13. The financing of the Ministry Project commenced from the year 2015-16. As per terms of the arrangement with the Ministry, moratorium period of above funding will be 5 years and thereafter the repayment will commence. *The repayment is not linked with the date of completion of construction of projects.* The repayment schedule is in line with the terms and conditions of bonds issued to the insurance company. The right to receive the above amount vests with the Company irrespective of completion of projects and creation of assets by the Ministry. The date of receipt of lease rentals crystallises from the day one when the amount is transferred which confers the contractual right to receive the amount from a specific date. The entire pre-lease disbursement is receivable by the Company from the Ministry as per MoU. There is an underlying confirmed irrevocable contract (MoU) for the Company to receive back from the Ministry, the pre-lease disbursements either in the form of direct fund transfers in cash through normal banking channels (financial asset) from the Ministry or in the form of lease receivables (financial asset). (Emphasis supplied by the querist.)

14. Further, paragraph 35 of ‘Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards’³, issued by the Institute of Chartered Accountants of India, under the heading, ‘Substance over Form’ states that “If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form.”

Furthermore, paragraph 10(b) (ii) of Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’ requires that the financial statements, in order to be reliable should reflect the economic substance of transactions, other events and conditions, and not merely the legal form.

15. The querist has stated that the Company has made the following disclosures in its notes to the financial statements:

³ Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards was replaced by Conceptual Framework for Financial Reporting under Indian Accounting Standards (Ind AS), which is applicable for Standard-setting activity with effect from April 1, 2020 and for Preparers of financial statements for accounting periods beginning on or after April 1, 2021.

“The Ministry vide letter dated dd/mm/2015 had authorized the PSU Company to draw funds from the insurance company in consultation with the Ministry for funding of the Ministry Projects in line with leasing methodology adopted by the PSU Company for funding the Ministry Projects in past. Pending execution of the Lease Documents, the PSU Company has entered into a Memorandum of Understanding with the Ministry on dd/mm/2017 containing principal terms of the lease transactions. The total sum of Rs. x.xx lakhs disbursed to the Ministry till the end of 31st March 2019 (31st March 2018: Rs. x.xx lakhs) has been shown as ‘Advance against the Ministry Infrastructure Assets to be leased’. A sum of Rs. x.xx lakhs (31st March 2018 : Rs. x.xx lakhs) incurred by the PSU Company on account of interest cost on the funds borrowed for the purpose of making aforesaid advances has been capitalised and added to the Advance paid against Infrastructure assets to be leased out to Ministry. Under the erstwhile Indian GAAP, the said amount was accounted for as Interest Income which under the Ind AS has now been reduced from interest expense. The same would be recovered through lease rentals in future over the life of the leases.”

Thus, in the judgement of the Company, the advance has been correctly classified as financial asset. This classification also meets the criteria of ‘substance over form’.

16. The querist has further briefed the issue vide a Supplementary Note which provides as follows:

The Company was incorporated in 1986 as a dedicated borrowing arm of one of the Ministries of GoI, to meet their extra budgetary resource (EBR) requirements. The Company is registered with RBI as Non Deposit Taking- Systemically Important- Non Banking Financial Company. The Company is also notified as a Public Financial Institution under section 4A of Companies Act, 1956, (Now, section 2 (72) of Companies Act, 2013).

Since the beginning, the Company is playing a strategic role in meeting the EBR requirements of the Ministry and has been consistently funding about 25%-30% of the plan outlay of the Ministry on year to year basis.

The Company has adopted the financial leasing model for funding of infrastructure projects. As per allocation of business rules of GoI, no ministry other than Ministry of Finance can make direct borrowings from the market. In terms of these rules, the Ministry can't borrow directly from the market, therefore, in order to meet its EBR requirements, the Company borrows from the market and transfers the borrowed funds to the Ministry which in turn utilises these funds for payment to contractors for construction of its Projects. For construction of Projects, Ministry acts an agent to the Company and the Company is the principal and legal owner of these projects. However, the Company is not involved in the process of selection of contractors, supervision of construction and payment to contractors, etc. Further, the projects are being constructed on the Ministry's land. The projects have a moratorium of 5 years and the Company is also financing the interest during construction period. The projects are being financed by the Company from the borrowed funds and internal accruals. On completion of projects, these projects would be leased out by the Company to the Ministry. The projects will be maintained by the Ministry. Ministry will pay the semi-annual lease rentals to the Company, which will be used by the Company for servicing its debt obligations towards the insurance company / other lenders. The Company prices the leases at cost plus basis, i.e., in addition to actual cost of borrowing, it charges a margin of 25bps-35bps to calculate the IRR of leases. On completion of lease, the assets will be transferred back to

the Ministry at a token amount. To sum up, the entire control of the projects from the beginning till the end rest with the Ministry, the Company is only a financier.

In the instant case, the Ministry entered into a MoU with a public sector life insurance company in March, 2015 for funding of Railway infrastructure projects by the insurance company. Since the Ministry can't directly borrow from the insurance company, it authorised the Company to borrow the funds from the insurance company and transfer the same to them for construction of its projects. Hence, the Company is a channelising agency between the insurance company and the Ministry.

As per agreed terms and conditions with the Ministry, the leases have to be structured on back to back basis with the terms and conditions settled with the insurance company to service its debt. Thus, interest payment / repayment from the Ministry is to commence irrespective of the fact whether projects get completed or not during the moratorium period.

The querist has also separately mentioned that till date, no pre-lease payments have been made by Lessee to Lessor since the date of pre-lease disbursement. Further, no lease income or lease receipts have started. The same would start from October 2020 and would be received during April 2021. Furthermore, lease agreement with the Ministry is yet to be drafted and executed as lease will commence from F.Y. 2020-21. However, principal terms and conditions of lease are mentioned in the MoU with the Ministry. It is also stated by the querist that the query is with reference to accounts relating to F.Y. 2018-19 and at that point of time Ind AS 17 is applicable. However, w.e.f. 1st April, 2019, a new Standard, Ind AS 116, 'Leases' has become applicable; so opinion may be given on the accounting treatment under both the Standards (Ind AS 17 and Ind AS 116).

B. Query

17. Considering the above background, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) The pre-lease disbursements including interest accrued on it, as made by the PSU to the Ministry has been accounted for as a financial asset and classified under 'Other financial assets' as 'Advance against Ministry Infrastructure Assets to be leased'. Is the classification and presentation correct?
- (ii) In case the answer to (i) above is not affirmative, what should be the correct classification and presentation for pre-lease disbursement including interest accrued on it?

C. Points considered by the Committee

18. The Committee notes that the basic issue raised in the query relates to classification and presentation of the pre-lease disbursements including interest accrued, as made by lessor (viz., the Company or PSU) to Lessee (viz., Ministry) for development of Infrastructure assets by Lessee (who is acting as development agent for Lessor). 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, examining whether the Company is acting as an agent or principal under the said arrangement; accounting for leases including determination of classification of lease, recognition and measurement of lease asset/receivable, etc.; recognition and measurement of interest earned on pre-lease disbursements; accounting for borrowing costs on funds borrowed, cost of own funds deployed and margin earned by the Company, etc.; accounting for borrowing cost on funding of the infrastructure assets; accounting treatment under Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006;

adjustments on transition to Ind ASs; nomenclature used for describing the pre-lease disbursements in the financial statements as ‘Advance against the Ministry Infrastructure Assets to be leased’ etc. The Committee further wishes to mention that Indian Accounting Standards cited hereinafter refer to Standards notified under the Companies (Indian Accounting Standards) Rules, 2015.

Further, since the query refers to the presentation in the financial statements for the financial year 2018-19, the Committee has expressed its opinion in the context of position as on 31st March, 2019. However, although in respect of financial year 2018-19, Ind AS 17 is applicable and not Ind AS 116 (which is applicable from financial year 2019-20 onwards), since the querist has sought the opinion in the context of both Ind AS 17 and Ind AS 116, the Committee has examined the issue from the perspective of both the Standards, but in respect of the financial position as on 31st March 2019 (without considering the developments thereafter).

19. *Analysis under Ind AS 116, Leases:*

The Committee notes that as per paragraph 9 of Ind AS 116, **“At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. ...”**

Inception date of the lease has been defined as “the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.”

Further, Ind AS 116 defines the Commencement date of the lease as “The date on which a lessor makes an **underlying asset** available for use by a lessee.”

Underlying asset has been defined under Ind AS 116 as “An asset that is subject of a **lease**, for which the right to use that asset has been provided by a lessor to a lessee.

From the above, the Committee notes that commencement date is the date on which a lessor makes an underlying asset available for use by a Lessee. The timing when the lease payments start does not affect the determination of commencement date of the lease. The Committee is of the view that under Ind AS 116, the term, ‘available for use’ can generally be interpreted as, if a Lessee takes possession of, or is given control of, the use of the underlying asset which may be even before it begins operations or starts making lease payments under the terms of the lease. Thus, the lease term can commence even if the Lessee is not required to pay rent or the lease arrangement states the lease commencement date to be a later date. The timing of when the lease payments begin under the contract does not affect the commencement date of the lease.

Analysis under Ind AS 17:

The Committee notes the following requirements of Ind AS 17:

“The inception of the lease is the earlier of date of a lease agreement and the date of commitment by the parties to the principal provisions of the lease. ...”

“The commencement of the lease term is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (ie the recognition of the assets, liabilities, income or expenses resulting from the lease, as appropriate).”

Thus, the lease commences when the Lessee can exercise its right to use the leased asset, which can generally be construed as the date when the Lessee takes possession of the asset or

when it is available for use and the Lessee can control the use of the asset; and the same may be even before when the entity begins operations or starts making lease payments under the terms of the lease. Thus, under Ind AS 17 also, the timing of when the lease payments begin under the contract does not affect the commencement date of the lease.

From the above analysis, the Committee is of the view that for the purposes of Ind AS 17/116, in the extant case, lease shall commence only when the underlying/leased asset (Infrastructure assets) is available for use to the Lessee. The infrastructure assets shall be available for use to the Ministry (the Lessee) when the Company/PSU (the lessor) gives the possession or right to use the asset, which in this case shall happen only once the asset has been developed and passed by the developer (the Ministry) to the PSU (the Lessor) for further lease to the Ministry (the Lessee).

Ind AS 17/ 116, however, makes a distinction between inception of the lease and the commencement of the lease term. Inception of the lease is defined as the earlier of date of a lease agreement and the date of commitment by the parties to the principal provisions of the lease.

Based on the facts of the case, the Committee observes that there has been inception of lease as on the date the MoU was entered, as the MoU clearly sets the intention of the Ministry taking infrastructure assets on lease from the PSU. However, the Committee notes that as on 31st March 2019, no lease income or lease receipts have started. Further, since the pre-lease disbursements including interest accrued on it, as made by the PSU to the Ministry has been presented as 'Advance against Ministry Infrastructure Assets to be leased', it is apparent that the infrastructure asset, which is to be leased to the Ministry is not yet complete and the leasing thereof has not yet commenced as per the MoU as on March 31, 2019 (which is also stated by the querist to commence from F.Y. 2020-21). In this context, the Committee also notes that as per the requirements of Ind AS 17/116, it is at the commencement of the lease term, the Lessor recognises the finance lease as a lease receivable and not before that. Thus, the Committee is of the view that in the extant case, though there has already been an inception of the lease as on March 31, 2019, since the lease has not commenced, receivable under Ind AS 17/116 cannot be recognised. It is only after the commencement of lease, the pre-lease disbursement shall be considered for valuation of 'Finance Lease Receivable', considering it as advance paid to the developer for construction of the asset. Accordingly, in the extant case, since lease has not commenced as on 31st March, 2019, Ind AS 17/116 are not relevant for determining the presentation of pre-lease disbursement.

20. The Committee now notes the series of transactions in the extant case as follows:

- The Company/PSU ('the Lessor') shall lease infrastructure assets to the Ministry ('the Lessee').
- The PSU has got funding arranged from a leading insurance company and other sources.
- The PSU then advances the funding (pre-lease disbursement) on 'as and when required basis' to the developer of the Infrastructure assets for development, creation and construction of those infrastructure assets. Herein, the developer is the Ministry itself, which is acting as development agent for the PSU.
- Once the infrastructure assets are ready for use as confirmed by the developer, the PSU shall lease the infrastructure assets to the Ministry for lease rentals (which comprise of cost of funding to the Lessor plus margin).

The Committee is of the view that if these transactions are viewed independently, the pre-lease disbursement seems like an advance to vendor for asset development, which is termed as a

‘Capital Advance’. However, the Committee notes that there is a clause of ‘Pre-lease payment’ in the MoU, which requires the Developer (‘the Ministry’) to pay to the PSU payments based on the amount of pre-lease disbursements done, at the cost of funding. The MoU clearly specifies that “*In order to ensure that the Lessor does not have any cash flow shortfall on account of servicing of any Funding source prior to the Lease Commencement Date, Lessee shall pay to the Lessor Pre-lease Payments, based on the amount of Pre-lease Disbursement done, at Cost of Funding. The Pre-lease Payments shall stop to accrue at Lease Commencement Date*”. Further, as per the understanding between the PSU and the Ministry, moratorium period of ‘Pre-Lease Disbursement’ made by the PSU to the Ministry, will be 5 years and thereafter the repayment will commence. *The repayment is not linked with the date of completion of construction of projects.* The repayment schedule is in line with the terms and conditions of the bonds issued to the insurance company by the PSU. The right to receive the above amount (pre-lease disbursements along with cost of funding of the Company) vests with the PSU from the day one when the amount is transferred which confers the contractual right to receive the amount from a specific date irrespective of completion of projects and creation of assets by the Ministry. (Emphasis supplied by the Committee.)

The Committee also notes that the querist has specifically mentioned in the Facts of the Case that there is an underlying confirmed irrevocable contract (MoU) for the Company to receive back from the Ministry, the pre-lease disbursements either in the form of direct fund transfers in cash through normal banking channels (financial asset) from the Ministry or in the form of lease receivables (financial asset). In this context, the Committee notes the following requirements of Ind AS 32, ‘*Financial Instruments: Presentation*’:

“A financial asset is any asset that is:

- (a) cash;**
- (b) an equity instrument of another entity;**
- (c) a contractual right:**
 - (i) to receive cash or another financial asset from another entity; or**
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or**
- (d) a contract that will or may be settled in the entity’s own equity instruments and is:**
 - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or**
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity’s own equity instruments.”**

From the above, the Committee notes that a financial asset is a contractual right to receive cash or another financial asset. The Committee is of the view that pre-lease payment in the

extant case has been defined in a manner to ensure that the Company shall be paid against the pre-lease disbursement made along with interest accrued on it as per the MoU so as to ensure that the Company is never short of cash. Thus, there is a contractual right to receive cash against such disbursement and interest accrued thereon as per MoU. Also, considering the facts of the case, it is apparent that both the PSU and the Ministry have an intent to make repayment against the disbursement made, after the moratorium period of 5 years from the date of disbursement irrespective of the fact whether asset is ready for use or not. Therefore, the Committee is of the view that pre-lease disbursement in the extant case meets the definition of 'financial asset' as per Ind AS 32 and should be presented as 'other financial asset'.

D. Opinion

21. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in paragraph 17 above:

- (i) The classification of pre-lease disbursement along with interest accrued thereon as a 'financial asset' and its presentation in the balance sheet of the PSU under 'other financial assets' is appropriate.
- (ii) See (i) above.
