

Query No. 19

Subject: Accounting for embedded derivatives in non-financial host contracts as per Ind AS 109.¹

A. Facts of the Case

1. A Government of India company (hereinafter referred to as ‘the Company’) is engaged in the construction and operation of thermal power plants in the country. The Company has also diversified into hydro power generation, renewable energy, coal mining and oil & gas exploration etc. The Company is registered under the Companies Act, 1956 and being an electricity generating company, is governed by the provisions of the Electricity Act, 2003. The Company prepares its annual financial statements as per the provisions of the Companies Act, 2013. The Company is listed with the Bombay Stock Exchange and the National Stock Exchange. As the Company is a listed entity with a net worth of more than 500 Crore, the Indian Accounting Standards (Ind AS) notified by Ministry of Corporate Affairs (MCA) are applicable to the Company w.e.f. financial year 2016-17.

2. Provisions of Ind AS 109:

2.1 Derivatives and Embedded Derivatives

Ind AS 109, ‘Financial Instruments’ provides accounting guidelines in respect of derivatives and embedded derivatives.

The Standard defines a derivative as a financial instrument or other contract whose value changes in response to an ‘underlying’ like a commodity price or an exchange rate. A derivative requires little or no initial investment and is settled at a future date. Examples of derivatives - commodity futures or forex forward contracts.

Derivatives which are not financial guarantee contracts or not part of an effective hedging arrangement are required to be accounted for at fair value through profit and loss. This condition requires that changes in the fair value of derivatives are booked to the Statement of Profit and Loss.

Paragraph 4.3.1 of Ind AS 109 defines an embedded derivative as follows:

“An embedded derivative is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a *financial instrument* but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.”

An embedded derivative is defined as a combined instrument which includes a non-derivative host contract and a derivative portion whose cash flows have the characteristics of a derivative. The following are few examples of embedded derivatives:

- A convertible bond – The host contract here is a debt instrument and the embedded derivative is the call option on equity securities.

¹ Opinion finalised by the Committee on 29.10.2020 and 30.10.2020.

- A loan paying interest based on an equity index – The host contract is a debt instrument with the interest portion being the embedded derivative which is based on an equity index.
- A loan with an interest rate formula which is leveraged: for example if the interest rate formula is $14.5 - 2.5 \times \text{LIBOR (3 months)}$ – In this case there is a formula determining the interest rate which is the embedded derivative in a debt host contract.

Embedded derivatives can also be found in non-financial host contracts, such as, contracts for purchase of goods and services.

2.2 Accounting for embedded derivatives under Ind AS 109

Provisions related to accounting for embedded derivatives under Ind AS 109 are as follows:

“4.3.3 If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:

- (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs B4.3.5 and B4.3.8);
- (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- (c) the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).

4.3.4 If an embedded derivative is separated, the host contract shall be accounted for in accordance with the appropriate Standards. This Standard does not address whether an embedded derivative shall be presented separately in the balance sheet.

4.3.5 Despite paragraphs 4.3.3 and 4.3.4, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of this Standard, an entity may designate the entire hybrid contract as at fair value through profit or loss unless:

- (a) the embedded derivative(s) do(es) not significantly modify the cash flows that otherwise would be required by the contract; or
- (b) it is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

4.3.6 If an entity is required by this Standard to separate an embedded derivative from its host, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid contract as at fair value through profit or loss.

4.3.7 If an entity is unable to measure reliably the fair value of an embedded derivative on the basis of its terms and conditions, the fair value of the embedded derivative is the difference between the fair value of the hybrid contract and the fair value of the host. If the entity is unable to measure the fair value of the embedded

derivative using this method, paragraph 4.3.6 applies and the hybrid contract is designated as at fair value through profit or loss”.

Embedded foreign currency derivative in a host contract that is not a financial instrument:

- “B4.3.8(d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
- (i) the functional currency of any substantial party to that contract;
 - (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
 - (iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).”

Thus, according to the querist, it is clear from above that the Standard requires an embedded derivative to be separated from the host contract and accounted for as a derivative when all the following three conditions are met:

- a) The economic characteristics and risks of the embedded derivative are not closely related to those of the host contract. For example, a variable interest rate loan wherein the interest rate is indexed to the value of an equity instrument is not closely related to the host loan contract since the characteristics and risks involved are different.
- b) A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.
- c) The entire contract is not measured at fair value through profit and loss account – For example, non-financial contracts like contracts for supply of equipment.

Exemption from accounting for embedded derivatives under Ind AS 109

In case of non-financial host contracts, under the following conditions an entity is exempted from separation of embedded derivatives:

- (a) If the contract is denominated in the functional currency of any substantial party to the contract.
- (b) If the contract is denominated in a currency in which the price of the related good is routinely denominated in commercial transactions around the world.
- (c) If the contract is denominated in a currency which is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place.

3.1 The Company is the largest power producer in the country with an installed capacity of over 49,000 MW. In attainment of its vision to be the world’s leading power producer, the Company is constructing about 17,000 MW capacity. The Company enters into various types of contracts for purchase and installation of power plant equipment, purchases for operation and maintenance and purchases of fuel including through imports. Procurement of power plant equipment is usually done through International Competitive Bidding (ICB) in order to obtain equipment with the latest technology at competitive prices following transparent procurement procedures. Purchases to meet the operation and maintenance requirements of power stations are made from domestic and foreign vendors. This, inter-alia, results in contracts with Indian vendors denominated in foreign currencies.

3.2 The procurements of power plant equipment are generally done through ICB. In such cases, neither the vendor nor the currency in which bids are likely to be received are known when bids are invited. There can therefore be no intention to enter into contracts with specific vendors in specific currencies with a view to achieve desired accounting results or for speculation. Further, the following characteristics of such contracts clearly indicate that there is no intention to enter into any derivative transaction:

- The contracts do not contain a leveraging provision.
- They are for purchase of items for ‘own use’.
- The contracts provide for ‘delivery’ of ordered items and there is no option to ‘net settle’ at any point of time during the tenure of the contract.
- It would make no difference to the Company who the vendor is or what currency is being quoted.

3.3 A contract which the Company has entered into is a contract with domestic vendor, parts of which are denominated in foreign currencies - Agency: M/s ABC Ltd., an Indian PSU for equipment supplies for its project construction:

Sl. No.	Subject	Particulars	Remarks
1.	Nature of the contracts	<p>First Contract: The contract is for design, engineering, manufacturing, shop fabrication, assembly, inspection and testing at suppliers’ work, type testing, packing, forwarding equipment/ material/special tools & tackles and mandatory spares supply on CIF (Indian port of entry) basis.</p> <p>Second Contract: The contract is for design, engineering, manufacturing, shop fabrication, assembly, inspection and testing at suppliers work, type testing, packing, forwarding equipment/material /special tools & tackles and mandatory spares to site of all ex-manufacturing works/place of dispatch (both in India).</p> <p>Third Contract: The contract is for port handling, transportation, transit insurance, installation, supervision, commissioning of all the equipment covered under first and second contract.</p>	<p>First contract involves supply of imported equipment.</p> <p>Second Contract involves supply of equipment manufactured/ assembled in India.</p> <p>Third contract involves erection, commissioning, freight, insurance etc. of the equipment covered</p>

			under first and second contract.
2.	Amount of contract	First Contract. USD 25,000,000 + EURO 47,356,082. Second Contract. USD 90,933,349 + EURO 94,266,958 + INR 37,287,567,022 Third Contract. INR 22,031,905,043	Payments shall be made to M/s ABC Ltd. in the respective currencies.
3.	Terms of contract	The contracts have detailed time schedules having reference to the date of notification of award (NOA). The contract has multiple milestones over the period of 5 years from the date of award.	
4.	Payment terms	The payment terms are in percentage related to the stage of completion of the work.	

As can be seen from the details of the above contracts, the intention of the parties is not to enter into any derivative contract and the purpose is to get the equipment supplies for construction of the power plants.

The querist has separately clarified as follows:

In the First Contract, the material is directly shipped by the foreign party to the Company's plant i.e. bill of lading, Goods Receipt/Invoice Receipt (GR/IR) etc. are in the name of the Company's Plant and the same is on high sea sale basis and the transfer of ownership takes place in sea i.e. in international waters and sale in transit takes place. As per the agreement, the payment is made to the domestic vendor, M/s ABC Ltd.

As per the practice, the Company's team inspects the materials at the manufacturing facilities of the foreign party and Material Dispatch Clearance Certificate (MDCC) is issued by the Company's Quality Assurance (QA) team, after which the material is directly shipped by foreign party (mostly Qualified Steam Generator Manufacturer (QSGM)/ Qualified Steam Turbine Generator Manufacturer (QSTGM)) directly to the Company on high sea sale basis. Custom/ Import clearance is done by the Company itself, as at the time of import, the same is in the name of the Company. All the invoicing to the Company is done by M/s. ABC Ltd.

The main price components of **First contract** are the following:

1. FOB Price of Main Equipment (Prices are in USD and EURO): Under this portion, the items involved are generally that of QSGM / QSTGM and the components are directly shipped by QSGM/ QSTGM to the Company on high sea sale basis and sale in transit takes place.
2. Ocean Freight and Marine Insurance charges for Main Equipment (Prices are in USD and EURO)
3. CIF Price of Mandatory Spares (Prices are in USD and EURO): This portion involves supply of mandatory spares of Steam Generator (SG)/ Steam Turbine Generator (STG) by QSGM/ QSTGM to the Company.
4. Type-Test Charges (Prices are in USD and EURO): This portion involves the testing charges that are paid by the Company for getting the main equipment checked for rating, type etc. by QSGM/QSTGM.

The main price components of **Second Contract** are as follows:

1. Ex-Manufacturing Works for Plant and equipment (Prices are in INR, USD and EURO): As already stated above, the construction of a power plant involves large equipment, so many equipment are supplied by QSGM/ QSTGM in parts to India directly to the domestic vendor, M/s ABC Ltd. for assembly/processing, which after processing are shipped to the Company by the domestic vendor, M/s ABC Ltd. on ex-works basis. Further, as M/s ABC Ltd. is having its own experience in power plants, so some of the equipment are manufactured by M/s ABC Ltd. itself and supplied to the Company.
2. Ex-Works for mandatory spares (Prices are INR only): Supply of Mandatory Spares directly by M/s. ABC Ltd. to the Company.
3. Type Test Charges (Prices are INR only): Type of items manufactured in India.

The main price components of **Third contract** are as follows:

1. Local transportation including port clearance and port charges and Inland insurance charges for plant and equipment (Prices are INR only)
2. Local transportation including port clearance and port charges and Inland insurance charges for mandatory spares (Prices are INR only)
3. Installation services (Prices are INR only)
4. Civil works (Prices are INR only)
5. Structural works (Prices are INR only)

Under the third contract, all the works are generally performed by M/s ABC Ltd. as per drawings, maps, structures provided by QSGM/ QSTGM. This contract also involves installation in which personnel of QSGM and QSTGM are also involved.

For all the three contracts, M/s ABC Ltd. raises the invoices and payments are released to M/s ABC Ltd. as per the provisions of respective contracts.

On the basis of past experience, according to the querist, it can be fairly inferred that foreign currency components of all the above contracts are supplied by QSGM/ QSTGM (hereinafter called as foreign collaborators).

3.4 The Company is of the opinion that in the above referred case, the embedded derivative bears a close economic relationship to the host contract and it has not been embedded to achieve a desired accounting result. Accordingly, foreign currency embedded derivatives are not required to be separated and accounted for in terms of paragraph 4.3.3 of Ind AS 109 as substantiated below.

3.5 The querist has made the following submissions with regard to the provisions of paragraph B4.3.8(d)(i) of Ind AS 109 regarding functional currency of any substantial party to the contract as under:

- (a) The substantial party has not been defined in Ind AS 109. The substantial party generally means a party which is acting as a principal or seller / buyer in the contract.
- (b) While awarding the above referred contract, the following terms and conditions were part of the tender / bid documents for the said contract:
 - (i) Clause 1.2.1: The Bidder should be an Indian Steam Generator and Steam Turbine Generator Manufacturing company who have designed, engineered, manufactured / got manufactured, erected / supervised erection, commissioned /

supervised commissioning (i) at least one (1) number coal fired steam generator for a 500 MW or higher size unit and (ii) at least one (1) number of reheat type of steam turbine and generator set of 500 MW or above capacity, which should have been in successful operation for a period of not less than one (1) year prior to the date of techno-commercial bid opening.

Such Indian Steam Generator and Steam Turbine Generator Manufacturing Company should have valid ongoing collaboration and technology transfer agreements(s) including license to manufacture and supply supercritical steam generator and supercritical steam turbine generator sets covering the type, size and rating specified, in India with a Qualified Steam Generator Manufacturer (QSGM) and a Qualified Steam Turbine Generator Manufacturer (QSTGM) meeting requirements of clause 1.1.1(A) and 1.1.1(B) respectively, valid minimum upto the end of the defect liability period of the contract. The collaboration and technology transfer agreements could be separate for supercritical steam generator and supercritical steam turbine generator with separate QSGM and QSTGM. The bidder shall offer only the type of Steam Generators i.e. single pass (tower type) or two pass type and type of water wall tubing for which its Collaborator is qualified.

- (ii) Clause 1.2.2: The Bidder shall furnish two separate Deed of Joint Undertakings (DJU) (i) executed by it and the QSGM in which the executants of DJU shall be jointly and severally liable to the Employer, viz., the Company for successful performance of supercritical Steam Generator and (ii) other executed by it and the QSTGM, in which the executants of DJU shall be jointly and severally responsible to the Employer for the successful performance of the supercritical Steam Turbine Generator as per the formats enclosed in bidding documents. The DJU shall be submitted along with techno-commercial bid, failing which the Bidder shall be disqualified and its bid shall be rejected.

In case of award, the QSGM and QSTGM will be required to furnish *an on-demand bank guarantee for an amount of 0.6% each of the total contract price of the EPC Package* in addition to the contract performance security to be furnished by the Bidder.

As per the above two conditions of the bidding process under the route considered, the party which is complying with both the conditions can only participate in the bidding process.

As clear from the above pre-qualifying requirements, as per the querist, the role of QSGM and QSTGM are inevitable in the contract and hence, they are also substantial parties to the contract along with domestic vendor considering their continued involvement in contract till final execution and financial and technical guarantee provided by foreign vendor to the Company.

The querist has separately clarified that both QSGM and QSTGM along with the domestic vendor are jointly and severally liable to the Company. Further, QSGM/QSTGM are liable even on breach of Contract commitment by the domestic vendor for their respective portion, i.e., Steam Generator/ Steam Turbine Generator (SG/STG).

The DJU submitted by QSGM provides as under:

“1. That in consideration of the award of the Contract(s) by the Employer to the Contractor, we the Qualified Steam Generator Manufacturer and the Contractor do hereby declare and undertake that we shall be jointly and severally responsible to the Employer for the execution and successful performance including satisfactory thermal performance of Steam Generator and its auxiliaries (Boiler Startup drain recirculation pumps, Air Preheater, Fans, Coal Pulveriser, Control Interlock & Protection, Fuel Oil Pumps) and achievement of all guaranteed parameters of all the units, as specified under the said Contract(s) to the satisfaction of the Employer.

2. In case of *any breach of the Contract(s) committed by the Contractor*, we the Qualified Steam Generator Manufacturer do hereby undertake, declare and confirm that *we shall be fully responsible for the successful performance of complete Steam Generator and its auxiliaries, including its satisfactory thermal performance and achievement of all guaranteed parameters as specified in the Contract*, for all the units and undertake to carry out all obligations and responsibilities under this Deed of Joint Undertaking including the technical guarantees for the complete Steam Generator and auxiliary equipment *in order to discharge the Contractor's obligations* and responsibilities stipulated in the Contract. Further, if the Employer sustains any loss or damage on account of any breach of the Contract(s) related to any or all of the Steam Generators and its auxiliaries, we the Qualified Steam Generator Manufacturer and the Contractor jointly and severally undertake to promptly indemnify and pay such losses/ damages caused to the Employer on its written demand without any demur, reservation, contest or protest in any manner whatsoever. Determination of losses/ damages shall be in line with provisions on Limitation of Liability of the said Contract(s).”

Further, DJU submitted by QSTGM provides as under:

“That in consideration of the award of the Contract by the Employer to the Contractor, we, the Qualified Steam Turbine Generator Manufacturer and the Contractor, do hereby declare and undertake that we shall be jointly and severally responsible to the Employer for the execution and successful performance of all the Steam turbine generator sets and their auxiliaries as well as thermal performance and guaranteed parameters of turbine cycles as specified in the said contract(s) to the satisfaction of the employer.

In case of any breach of the Contracts committed by the Contractor, we the Qualified Steam Turbine Generator Manufacturer do hereby undertake, declare and confirm that we shall be fully responsible for the successful performance of the Steam Turbine and Generator and their auxiliaries, as well as thermal performance and guaranteed parameters of the turbine cycle and undertake to carry out all the obligations and responsibilities under this Deed of Joint Undertaking in order to discharge the Contractor's obligations and responsibilities stipulated under the Contract. Further, if the Employer sustains any loss or damage on account of any breach of the Contracts related to any of the steam turbine generator sets and their auxiliaries, we the Qualified Steam Turbine Generator Manufacturer and the Contractor jointly and severally undertake to promptly indemnify and pay such losses /damages caused to the Employer on its written demand without any demur, reservation, contest or protest in any manner whatsoever.”

As per the above clauses, both QSGM as well as QSTGM along with Contractor are jointly and severally liable to the Employer, i.e., the Company and QSGM/QSTGM are

liable even on breach of Contract commitment by Contractor, i.e., domestic vendor for their respective portion i.e. SG/STG.

(c) It is further submitted that while evaluating the bids submitted by the bidders, the technical and financial qualifying requirements of the foreign collaborators i.e. QSGM and QSTGM are also evaluated along with the bidder. The bid is concluded to be qualified only when all the parties to the bid i.e. bidder as well as collaborators meet the qualifying requirements as specified in the bidding documents. The details of the qualifying requirements applicable to the foreign collaborators are explained below:

(i) The foreign collaborator, i.e., QSGM and QSTGM shall meet the technical qualifying requirements as per the clauses 1.1.1(A) and 1.1.1(B) respectively, which provide as under:

Clause 1.1.1(A): The Bidder should have designed, engineered, manufactured/ got manufactured, erected/supervised erection, commissioned/supervised commissioning of at least one (1) number of coal fired supercritical Steam Generator having rated capacity of 1500 tonnes of steam per hour or above. Further, such Steam Generator should be of the type specified, i.e. single pass (tower type) or two pass type using either spiral wound (inclined) or vertical plain or vertical rifled type water wall tubing, and should have been in successful operation for a period of not less than one year prior to the date of techno-commercial bid opening. In addition, the above Steam Generator should have been provided with evaporator suitable for variable pressure operation (sub-critical and super-critical pressure ranges). The Bidder shall offer only the type of Steam Generator and type of water wall tubing for which he is qualified.

Clause 1.1.1(B): The Bidder should have designed, engineered, manufactured / got manufactured, erected / supervised erection, commissioned / supervised commissioning of (i) at least one (1) number supercritical steam turbine of tandem compound, condensing, reheat type of 500 MW or above capacity with main steam pressure, of 225 Kg/cm² (gauge) or higher and main steam / reheat temperature of 535°C / 535°C or higher and (ii) at least one number of generator of two pole, Thermal class 155(F) winding insulation, hydrogen / water cooled stator and hydrogen / water cooled rotor of 500MW or above capacity. These steam turbine and generator should have been in successful operation for a period of not less than one year prior to the date of techno-commercial bid opening.

(ii) Further, the foreign collaborator i.e. QSGM and QSTGM shall meet the financial qualifying requirements as per the Clause 2.2.0, which provide as follows:

Clause 2.2.1: The average annual turnover of the Collaborator(s) / Associate(s), in the preceding three (3) financial years as on the date of techno-commercial bid opening, should not be less than the following for different Collaborator(s) / associate(s) as applicable.

Collaborator (s)/ Associate(s)	Applicable clauses	Required annual turnover in Million INR or in equivalent foreign currency
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QSGM	1.2.2	INR 1800 Million (Rupees One Thousand Eight Hundred Million only)
QSTGM	1.2.2	INR 1800 Million (Rupees One Thousand Eight Hundred Million only)

Clause 2.2.2: The Net Worth of each Collaborator / Associate as on the last day of the preceding financial year as on the date of techno commercial bid opening should not be less than 25% of the paid-up share capital.

Clause 2.2.5: The unutilized line of credit for fund based and non-fund based limits with cash and bank balances including fixed deposits of the Collaborator / Associate as on a date not earlier than 15 days prior to the date of techno-commercial bid opening, duly certified by the bankers should not be less than the following for different Collaborator(s) / Associate(s) as applicable:

Collaborator(s) /Associate(s)	Applicable clauses	Required unutilized line of credit in Million INR or in equivalent foreign currency
QSTGM	1.2.2	INR 640 Million (Rupees Six Hundred Forty Million only)
QSGM	1.2.2	INR 640 Million (Rupees Six Hundred Forty Million only)

In view of the above, the foreign collaborators, i.e. QSGM and QSTGM are also required to meet the above qualifying requirements for award of the contract.

- (d) As required above, the domestic vendor (ABC Ltd.) submitted the following documents in connection with bid / contract:
- (i) Deed of Joint Undertakings (DJUs) signed by M/s A, USA (QSGM) and M/s S, Germany (QSTGM) (submitted during bidding).
 - (ii) On-demand bank guarantees given to the Company by M/s A, USA (QSGM) and by M/s S, Germany (QSTGM), each for an amount equal to 0.6% of the total contract price (submitted after award of the contract).
- (e) The DJUs with collaborators also provide that, “Any dispute that may arise between the employer and the collaborator in connection with this Deed of Joint Undertaking shall be finally settled by reference to arbitration in accordance with the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules of 1976. The Arbitral Tribunal shall consist of three members and shall be appointed in accordance with the said Rules. The appointing authority for the third arbitrator shall be the President, International Chamber of Commerce, Paris. The language to be used in arbitral proceedings shall be English. The place of arbitration shall be Singapore. The award made in such arbitration shall be final and binding and shall be enforceable in any court of competent jurisdiction”.

It may be appreciated that the foreign collaborators are legally liable to the Company for the successful completion of the contract. The Company has the right to take them to the court of law, in case of any default.

- (f) The DJUs are irrevocable and are valid till ninety days beyond scheduled date of completion of the defect liability period of the all the equipment/ component.

- (g) The bank guarantees provided by collaborators are unconditional, irrevocable and valid till ninety days beyond scheduled date of completion of the defect liability period.
- (h) Further, the foreign party's credential is based on its consolidated position across different countries and they may be having associates in other countries to complete the given contract.
- (i) Domestic vendor did not have the requisite experience, skills, resources and technology to execute the contract individually without including vendor with requisite experience/skill/technology. Thus, the contract has been awarded to a consortium comprising of Indian and foreign vendors. Both the Indian vendor and the foreign vendor compliment each other in skills, experience, technology and resources required for construction of a highly technical and complex power plant.
- (j) Further, as per the provisions of DJUs, all vendors (both Indian and foreign) are jointly and severally liable for successful completion of the project.
- (k) The foreign vendors M/s A, USA (QSGM) and by M/s S, Germany (QSTGM), each have provided financial bank guarantees for an amount equal to 0.6% of the total contract price as stated above.
- (l) If the Indian vendor would have been the sole substantial party, there would not have been a need to sign the DJUs and make the foreign vendors jointly and severally liable.
- (m) From the above facts, it is submitted by the querist that the foreign parties, *M/s A, USA and M/s S, Germany are jointly the substantial parties to the contract* along with the Indian party. As the contract is in the functional currencies of the joint substantial parties to the project, the accounting for embedded derivative may not be required considering the provisions of B4.3.8(d)(i) of Ind AS 109.
- (n) In addition to this contract referred to EAC, there are other tenders / contracts awarded by the Company wherein the prospective vendors qualify under other routes provided in the bidding conditions, having similar provisions of DJUs and bank guarantees. In such cases, the vendors quote in a currency other than INR considering the arrangements with their foreign partner. In such cases, the foreign partner of the vendor is also a substantial party and hence, accounting for embedded derivatives may not be required. It is submitted that in all these cases, the domestic vendor has foreign collaborators and has quoted, inter-alia, in the currencies other than INR i.e. the functional currency of the foreign collaborator.

3.6 The querist has provided the following submissions with regard to the provisions of paragraph B4.3.8(d)(ii) regarding the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world:

- (a) The contract referred above is an EPC contract for execution of 660 MW power plant of one of the project of the company. The subject contract has been awarded by the Company through a process of open tender. In this case, all the participating bidders have quoted in the foreign currencies.
- (b) The prices quoted by the bidders are as under:

S. No.	Name of the Bidder	Quoted price
1	M/s D Ltd.	\$ xxxx

S. No.	Name of the Bidder	Quoted price
		€ xxxx, ¥ xxxx INR xxxx
2	M/s ABC Ltd.	\$ xxxx € xxxx INR xxxx
3	M/s L Ltd.	\$ xxxx, € xxxx ¥ xxxx INR xxxx

(Note: The actual figures have been replaced with xxxx to maintain the confidentiality of the bidding process)

The querist separately clarified that as per the bidding documents, bidder can submit price bids in any freely tradeable currency including INR. On the basis of contracts awarded, it has been observed that the currency of bid is linked to the contractor, its associate, collaborator, QSGM and QSTGM. *In the referred case, where JPY has been quoted, the collaborators are Japanese companies.*

It is further submitted that as there is no restriction on the currency that a bidder can quote, quoting in any currency other than currency of contractor or collaborator is not in the interest of the contractor.

It is also observed that in some of the cases, bids have been submitted in CNY where one of the foreign collaborators was a Chinese company.

- (c) While issuing the tender documents, Company has not specified any currency in which the bid can be submitted as per the requirements of international competitive bidding process. All the bidders are free to quote in any currency. But all the bidders have quoted in the combination of INR and foreign currencies.
- (d) This is an indicator that these goods are quoted, in the normal business transactions, in combination of INR and foreign currencies only and such goods are not available in local currencies alone.
- (e) It is also submitted that the awards for similar works to M/s ABC Ltd. are made in currencies other than INR not only by the Company but also by other power producers in India and outside India e.g. Bangladesh. Further, manufacturers other than M/s ABC Ltd. are also supplying these equipment to other power companies in currencies other than INR.
- (f) Further to the above, it is seen that in number of cases all the participating bidders have quoted in foreign currencies, irrespective of the fact whether the bidders are domestic or foreign and despite no restriction of currency in the tender document. In such cases, these specialized and sophisticated equipment are available in the normal business transactions in those currencies only and such goods are not available in local currencies, just like in case of crude oil.
- (g) From the above, it may be appreciated that the prices of these products in commercial transactions are routinely denominated in currencies other than INR by all vendors to the Company and to various buyers other than the Company, within India as well as outside India.

3.7 Reference is also invited to Report on Meeting of International Forum of Accounting Standard Setters (IFASS), held on 6-7 March 2014, wherein, the following has been recorded regarding discussions on embedded derivatives:

“Issue 4 - Accounting for foreign currency embedded derivatives under international competitive bidding”

7.11 Mr. A, from the Indian standard setter, presented an issue regarding embedded derivatives accounting under IFRS 9.

7.12 Representatives’ comments included the following:

- A representative from the IASB expressed the view that it is hard to define the concept of international competitive bidding. *He and other participants agreed that the U.S. dollar is commonly used in these transactions.*
- Participants agree that this issue should not be sent to IFRIC. A participant from Sierra Leone said that the issue is very clear and *suggested that the Indian standard setter might like to consider issuing clarification guidance.”*

This issue was raised before the international forum by Mr. A on behalf of the Institute of Chartered Accountants of India (ICAI) and under paragraph 7.12, it is mentioned that representative from IASB and other representatives agreed that US dollar is the commonly used currency in the international competitive bidding. The issue was settled with a remark that ICAI may consider issuing clarification in this regard.

3.8 It is also submitted that as per the exchange risk policy of the company, the exchange risk on plant and machinery and capital works contracted in foreign currency *is not hedged*. As such, by entering contracts in currencies other than INR, the Company does not have any intention to obtain any derivative gain. As such, the reason for entering a contract in other currencies is solely due to the facts mentioned above.

3.9 Further to the above, it is submitted that quoting of price in foreign currency by Indian vendors for procurement of critical and sophisticated equipment, for which they are dependent upon foreign vendors technology / collaboration support, is a prevalent practice in India. This is evident from the submissions made above. In the view of the querist, transactions for quoting rates in foreign currency for such items is based on economic environment prevailing in India which also meets the exemption criteria as specified in paragraph B4.3.8(d)(iii) of Ind AS 109.

3.10 Moreover, awarding a contract in a currency other than INR does not place the Company in any preferential position as the Company is working in a regulated / cost plus business environment.

(Emphasis supplied by the querist.)

4. The querist has separately clarified as follows:

(a) Regarding the responsibility for fulfilment of contractual obligations, reference is invited to Clause 1.2.2. of the bidding documents, where the Bidder shall furnish two separate Deed of Joint Undertakings (DJU):

- (i) Executed by it and the QSGM in which the executants of DJU shall be jointly and severally liable to the Employer for successful performance of supercritical Steam Generator. Further, QSGM is liable to the Company even on the breach of the contact obligation by M/s. ABC and work related to SG will need to be completed by QSGM itself.

- (ii) Executed by it and the QSTGM, in which the executants of DJU shall be jointly and severally responsible to the Employer for the successful performance of the supercritical Steam Turbine Generator. Further, QSTGM is liable to the Company even on the breach of the contact obligation by M/s. ABC and work related to STG will need to be completed by QSTGM itself.
- (b) There are various routes through which a bidder can bid and qualify. Various routes defined in the Qualifying Requirements for Bidders are explained as follows:

Route 1: Qualified Steam Generator and/or Qualified Steam Turbine Generator Manufacturer: Under this route, bid is submitted by a party which is either a QSGM, QSTGM or both. Bidder can further collaborate with party meeting remaining technical requirements that bidder itself does not meet. As per the clause 1.1.2 of the Bidding Documents-Qualification requirements for Bidder, as on the date of techno commercial bid opening, bidder should have formed a subsidiary/ JV in India and the restriction like minimum stake and lock in period also apply to the bidder.

Route 2: Indian Steam Generator and Steam Turbine Generator Manufacturer: Under this route, bid is submitted by an Indian bidder who is a SGM/ STGM but not of desired technical requirement. The Indian bidder collaborates with QSGM and QSTGM who are called as collaborator and are also liable for satisfactory performance of their part of the contract.

Route 3: Indian Subsidiary Company of a Qualified Steam Generator Manufacturer and/or Qualified Steam Turbine Generator Manufacturer: Under this route, QSGM/ QSTGM is a foreign party who has subsidiary company in India and bid is submitted by the subsidiary company. Bidder can further collaborate with party meeting remaining technical requirements. Further, as per clause 1.3.1(a) of the Bidding Documents-Qualification requirements for Bidder, subsidiary company shall remain a subsidiary Company of the QSGM and/or QSTGM for a minimum period of 7 years from the date of incorporation of such subsidiary company or up to the end of the defect liability period of the contract whichever is later.

Route 4: Indian Joint Venture (JV) Company for manufacturing of Super Critical Steam Generator and/or Super Critical Steam Turbine Generator in India between an Indian Company and a Qualified Steam Generator and/or Qualified Steam Turbine Generator Manufacturer: Under this route, QSGM/ QSTGM is a foreign party who has JV company in India and bid is submitted by the JV company. Bidder can further collaborate with party meeting remaining technical requirements. Further, as per clause 1.4.1(a) of the Bidding Documents-Qualification requirements for Bidder, the QSGM and/or QSTGM shall maintain a minimum equity participation of 26% in the JV Company for a lock-in period of 7 years from the date of incorporation of JV Company or up to the end of the defect liability period of the contract whichever is later. One of the promoters shall be a majority stakeholder who shall maintain a minimum equity participation of 51% in the JV Company for a lock in period of 7 years from the date of incorporation of JV Company or up to the end of the defect liability period of the contract whichever is later.

Route 5: Indian Company who holds at least 51% equity in a Joint Venture Company for manufacturing Super Critical Steam Generator and/or supercritical Steam Turbine Generator sets in India between an Indian Company and a Qualified Steam Generator and/or Qualified Steam Turbine Generator Manufacturer: Under this route QSGM/ QSTGM is a foreign party who has JV company in India and bid is submitted by the Indian majority stake holder of JV company. Bidder can further collaborate with

party meeting remaining technical requirements. Further, as per clause 1.5.1(a) of the Bidding Documents-Qualification requirements for Bidder, the QSGM and/or QSTGM shall maintain a minimum equity participation of 26% in the JV Company for a lock-in period of 7 years from the date of incorporation of JV Company or up to the end of the defect liability period of the contract whichever is later. The Bidder shall maintain a minimum equity participation of 51% in the JV Company for a lock in period of 7 years from the date of incorporation of JV Company or up to the end of the defect liability period of the contract whichever is later.

Route 6: Company having experience of 500MW Supercritical units on EPC Basis: Under this route, bidder is an EPC Contractor which collaborate/ associate with QSGM/ QSTGM.

The prospective bidder can opt for any of the above routes for participating in the bidding process. In the cases, where bidder is a foreign party/ its subsidiary/ JV, the requirement of minimum stake and lock in period by QSGM/QSTGM has been kept because QSGM and QSTGM are the substantial parties and execution of the contract cannot be done without their active involvement. Where bidder is an Indian bidder, the clauses related to DJU/ submission of BG by QSGM and QSTGM have been kept as they are the substantial parties for the successful fulfilment of the contractual obligation.

In the reference case, M/s ABC submitted the bid under *Route-2* with M/s. A, USA as QSGM and M/s. S, Germany as QSTGM. The said route does not define any requirement related to minimum stake or lock in period as there is no requirement of having a subsidiary/ JV. Further, in the reference case, QSGM/QSTGM are called foreign collaborators.

(c) With regard to pricing of the first and second contract with M/s. ABC in foreign currencies, the querist has informed that Power Plant construction involves large equipment due to which there are many parts which cannot be transported internationally in single piece so they come as parts to India and are assembled in India by M/s ABC at their workshops/ factories. The bidding documents also state the following, which may be noted:

“3.0.0 Phased Manufacturing Program and Transfer of Technology

3.1.0 The Bidder and its associate shall give firm commitment (for their respective equipment) in the form of an undertaking supported by board resolution to set up / augment the existing manufacturing facility for supercritical Steam Generator and Steam Turbine Generator sets in India either by itself or through its subsidiaries or through Joint Venture (JV) in India in a phased manner as per Phased Manufacturing Program elaborated in the bidding documents. The manufacturing may, alternatively, be carried out by another subsidiary registered for manufacturing supercritical Steam Generators / supercritical steam turbine generators in India of the above Indian subsidiary / JV Company. In such an event, the manufacturing company shall remain a subsidiary of the Indian subsidiary / JV company with equity lock in for a minimum lock in period of 7 years from the date of incorporation of the manufacturing company or up to the end of the defect liability period of the contract, whichever is later.

In case of award the Bidder shall submit an on demand bank guarantee of INR 650 Million for Steam Turbine Generators and INR 900 Million for Steam Generators as security for any default against meeting the specified Phased Manufacturing Program.

3.2.0 Valid technology transfer agreements including license to manufacture and supply in India, separately for steam generator sets and steam turbine generator sets, between the Qualified Steam Generator Manufacturer / Qualified Steam Turbine Generator

Manufacturer or their technology provider (if any) and the Indian Manufacturing Company should be in place on the date of techno-commercial bid opening covering the type, size and rating of the Steam Generators / Steam Turbine Generator sets specified, valid minimum up to the end of the defect liability period of the contract. The signatory of the technology transfer agreement with the Indian Manufacturing Company should either own the technology or should have authorization to use and further license the technology. Documentary evidence to this effect shall be furnished along with the techno-commercial bid. The technology transfer agreement shall necessarily cover transfer of technological know-how for super critical Steam Generator / supercritical Steam Turbine Generator in the form of complete transfer of design dossier, design software's, drawings and documentation, quality system manuals and imparting relevant personnel training to the Indian Manufacturing Company. Such technology transfer agreement must have provision that the transfer of technology to the Indian Manufacturing Company shall be completed by the time last 660 MW supercritical unit is supplied by the Bidder under this tender."

So as per the technology transfer agreement, manufacturing of the machinery starts in India in a phased manner under which initially basic materials are imported by M/s. ABC and further processing is done by M/s. ABC at their factory premises due to which second contract also involves currencies like USD and EURO.

Further, bidder is also required to fill the import content included in Schedule-2, i.e., in second contract at the time of submission of bid itself. There was excise/ custom duty exemption provided to the power plant equipment, above a specified capacity and exemption certificates are also issued to the Company by the concerned Ministry regarding the same. Certificate for item list of imported items as per First Contract as well as second contract (import content included in Schedule-2, i.e., in second contract submitted at the time of bid) is to be signed by CMD for exemption of custom/ excise duty on every import of goods.

However, as per the confidentiality agreement between bidder and QSGM/ QSTGM and as per business practices, the break-up between currencies is never disclosed to the Company.

B. Query

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

- (a) Whether the foreign parties (QSGM/QSTGM) involved in the contract as detailed in paragraph 3.5 above are substantial parties to the contract or not, to determine accounting for embedded derivatives as per Ind AS 109.
- (b) Whether it can be construed that these are the currencies in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions where (a) the contract has been awarded by the Company through a process of open tender and participating bidders have quoted in multiple foreign currencies; (b) Companies in the power sector other than the Company also award similar contracts in currencies other than INR; and (c) an Indian company like M/s ABC Ltd., supplies such goods within India and outside India in multiple foreign currencies.
- (c) Where the contracts have been awarded by the Company through a process of open tender and participating bidders have quoted prices in multiple currencies for equipment which are highly specialized and where domestic vendors are dependent upon technology / collaboration support of a foreign vendor, can it be constructed as

normal transactions in the economic environment in which such transactions take place.

C. Points considered by the Committee

6. The Committee notes that the basic issue raised in the query relates to whether the foreign currency embedded derivatives within the contract entered into by the Company in India with an Indian vendor wherein certain components of the contract are denominated in foreign currencies, can be considered as closely related to the host contract as per the requirements of paragraph B4.3.8(d) of Ind AS 109. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, assessment of the functional currency of the Company, domestic vendor, or of the collaborators, accounting for the embedded derivative, accounting for the non-financial items purchased, availability of own-use exemption under Ind AS 109, etc. The Committee notes that the querist has used the terms, ‘foreign party(ies)’ and ‘foreign collaborator(s)’ interchangeably, which basically refer to QSGM and QSTGM. The Committee also wishes to point out that since in the extant case, the route adopted by the local vendor, viz., M/s. ABC while bidding for the contract, is the second route, as explained in paragraph 4 above, the Committee has expressed its opinion only in respect of that route and not in respect of other routes. Accordingly, the Opinion of the Committee can not be applied in case of other bidding routes.

The Committee also notes that the condition in paragraph B4.3.8(d)(iii) of Ind AS 109, has already been dealt with in the past in an earlier Opinion issued by the Committee to the querist (published as Query No. 9, Volume No. XXXIX of the Compendium of Opinions), wherein the Committee had expressed the view that the expression ‘commonly used’ in paragraph B4.3.8(d)(iii) of Ind AS 109 in the extant case should be assessed in the context of the country and not just commonly used by the company or for International Competitive Bidding (ICB) purposes. The Committee also expressed the view that to apply this requirement, the Company should first determine the economic environment in which the transaction takes place, viz., whether the transaction is a local business transaction or is an external trade and then the currencies that are commonly used in contracts to purchase or sell non-financial items in such economic environment. Further, in the context of currency commonly used in local business transactions (internal trade), from an Indian economic environment perspective, the Committee expressed the view that Indian National Rupee (INR) is the currency which is commonly used for local transactions within India. Accordingly, the Committee had opined that for contracts entered into by the Company with Indian vendors in USD or Euro, the foreign currency embedded derivative is not closely related to the host contract. Accordingly, foreign currency embedded derivatives in such contracts are required to be accounted for in terms of paragraph 4.3.3 of Ind AS 109. The Committee notes that the querist in the extant query has not provided any additional facts relating to this condition that may change the opinion of the Committee and therefore, the Committee reiterates its earlier opinion in respect of condition under paragraph B4.3.8(d)(iii) of Ind AS 109 in the extant case.

7. The Committee notes that the functional currency of the Company is INR. The Committee also presumes that,

- (i) the functional currency of the Indian contractor referred above is also INR and;
- (ii) the functional currency of the foreign collaborators is not INR.

8. The Committee further notes the following paragraph of Ind AS 109:

“B4.3.8

...

- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
- (i) the functional currency of any substantial party to that contract;
 - (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
 - (iii) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).”

The Committee believes that the rationale for the above exemption is that when the embedded derivative bears a close economic relationship to the host contract, it is less likely that the derivative was embedded to achieve a desired accounting result.

The Committee further notes that as per the requirements of paragraph B4.3.8(d)(i) of Ind AS 109, an embedded foreign currency derivative in a host contract is considered as closely related to the host contract if the contract is denominated in the functional currency of any substantial party to the contract. The Committee notes that Ind AS 109 does not provide any guidance on identifying which parties are considered as ‘substantial’. The Committee is of the view that generally, in order to be considered as ‘substantial’ party to the contract, factors such as, whether a party is playing a substantial role in executing the contract, whether the party has primary responsibility for contractual obligations, etc. shall be considered. A party merely acting as an agent or a sub-contractor shall not be considered as a substantial party’. In other words, a substantial party should be representing as ‘principal’ to the contract.

The Committee is of the view that in the extant case, the role of the foreign collaborators in the contract needs to be examined. Based on the facts provided, the Committee notes the following:

- (i) The contract is awarded in the bid currency quoted by the bidder and comprises of the following break-up:
 - (a) First Contract: For CIF (Indian port of entry) supply of plant and equipment including type test charges and mandatory spares to be supplied from abroad. (In foreign currency)
 - (b) Second Contract: For Ex-works (India) supply of plant and equipment including type test charges and mandatory spares to be supplied from within India. (Generally awarded partly in INR and partly in foreign currency)
 - (c) Third Contract: For providing all services i.e. port handling, port clearance and port charges for the imported goods, further loading, inland transportation for delivery at site, inland transit insurance, unloading, storage, handling at site, installation services including erection, civil, structural and allied works, insurance covers other than inland transit insurance, testing, commissioning and conducting guarantee tests in respect of all the equipment supplied under the

'First Contract' and the 'Second Contract' and all other services as specified in the contract documents. (Awarded in INR)

The querist has specifically stated that as per the technology transfer agreement, manufacturing of the machinery starts in India in a phased manner under which initially basic materials are imported by the Indian contractor and further processing is done by the Indian contractor at its factory premises. The Second contract also involves currencies like USD and EURO.

Further, the Indian contractor is also required to fill the import content included in the EPC contract i.e. in second contract at the time of submission of bid itself. There is excise/custom duty exemption provided to the power plant equipment, above a specified capacity and exemption certificates are also issued to the Company by the concerned Ministry regarding the same.

As per the confidentiality agreement between the Indian contractor and the foreign collaborators and as per business practices, the break-up between currencies is never disclosed to the Company.

- (ii) In the First Contract, the material is directly shipped by the foreign collaborator to the Company's plant i.e. bill of lading, etc. are in the name of the Company. The FOB Prices of main equipment generally belonging to the foreign collaborators are denominated in USD and EURO. This portion involves supply of mandatory spares of turbine generators by the foreign collaborators to the Company. The transfer of ownership from the foreign collaborators to the Indian contractor takes place in international waters on high sea sale basis in transit. As per the agreement, the payment is made to the Indian contractor.

One of the main price components of Second Contract is the ex-manufacturing works for plant and equipment denominated in INR, USD and EURO. Since the construction of a power plant involves large equipment, many equipments are supplied by the foreign collaborators in parts to India directly to the Indian contractor for assembly/processing which after processing are shipped to the Company on Ex-works basis.

Under the Third contract, all the works are generally performed by the Indian contractor as per drawings, maps, structures provided by the foreign collaborators. This contract also involves installation in which personnel of the foreign collaborators are also involved. Prices are denominated in INR only.

- (iii) Regarding the responsibility for fulfilment of contractual obligations, although as per the bidding documents, the Bidder (the Indian contractor) is required to furnish two separate Deed of Joint Undertakings executed by it and the foreign collaborators, however the foreign collaborators shall be jointly and severally liable only for the successful performance of their part of work, viz., in respect of supercritical Steam Generator/ Steam Turbine Generator and the related auxiliaries. Further, although as per bid documents, in case of award, the foreign collaborators are required to furnish an on-demand bank guarantee (BG), however the amount of BG is only 0.6% of the total contract price which is not significant in relation to the contract price of the EPC Package. Furthermore, the Committee notes from various other clauses of the deed of joint undertaking that the liability of the foreign collaborators is limited, which is evident from the following clauses of the deeds of joint undertaking (DJU):

DJU with QSTGM:

“Determination of losses/damages shall be in line with provisions on Limitation of Liability, i.e. clause 30.1 of GCC of the said contract(s).

The liability of the Qualified Steam Turbine Generator Manufacturer shall be limited to an amount equivalent to US\$ 61 (Sixty One) Million for each Turbine Generator Set to be supplied by the Bidder/Contractor. This is without prejudice to any right of Employer against the Contractor under the Contract and all guarantees.”

“7 ...

- a) We, the Qualified Steam Turbine Generator Manufacturer, shall be fully responsible for engineering, preparation of all design, design calculations and manufacturing drawings for all the Steam Turbine Generator Sets & auxiliaries* (as defined in Annexure-I)* and interfacing & integrating the complete turbine cycle including condenser, Boiler Feed Pump, Condensate Extraction Pump, Heaters, Deaerators, etc. so as to ensure satisfactory, reliable and trouble free performance of Steam Turbine Generator Sets and their auxiliaries (as defined in Annexure-I), Condensers as well as thermal performance of turbine cycle as per guaranteed parameters specified in the Contract.

* However for auxiliaries (as defined at Annexure-I) which are bought out by us, we, the Qualified Steam Turbine Generator Manufacturer, shall only be responsible for engineering, preparation of sizing and selection criteria.”

DJU with QSGM:

- “2.1 The aggregate liability of the Bidder/Contractor to the Employer, whether under the Contract, in tort or otherwise, shall not exceed the total Contract Price of EPC Package for North Karanpura STPP (3x660 MW), provided that this limitation shall not apply to any obligation of the Contractor to indemnify the Employer with respect to patent infringement as per provisions of bidding documents (Clause 30 of GCC and relevant clause of SCC).

The liability of *the Qualified Steam Generator Manufacturer shall be limited to an amount calculated @ US\$61 Million for each Steam Generator set to be supplied by the Bidder/ Contractor. This is without prejudice to any right of Employer against the Contractor under the Contract and all guarantees.”

“3. ...

- a) We, the Qualified Steam Generator Manufacturer shall be fully responsible for complete engineering, preparation of all designs, design calculations, design documents/ drawings and manufacturing drawings for all the Steam Generators; selection of their auxiliaries and interfacing/ integrating all Steam Generators with their auxiliaries so as to ensure satisfactory, reliable, safe and trouble free performance of all Steam Generators and auxiliaries as well as thermal performance meeting all stipulated technical requirements as well as all guaranteed parameters specified in the Contract(s).”

In this regard, the Committee also notes the following relevant clauses of General Conditions of Contract (GCC) and Special Conditions of contract (SCC):

“1.1 ...

“Contractor” means the person(s) whose bid to perform the Contract has been accepted by the Employer and is named as such in the Contract Agreement, and includes the legal successors or permitted assigns of the Contractor.

“Subcontractor”, including vendors, means any person to whom execution of any part of the Facilities, including preparation of any design or supply of any Plant and Equipment, is sub-contracted directly or indirectly by the Contractor, and include its legal successors or permitted assigns.”

“The terms ‘Subcontractor’ and ‘Sub vendor’ are interchangeable and they have the same meaning as defined under “Subcontractor”...” (Added by SCC)

“3.6.1 The Contracts to be entered into between the Employer and the successful bidder shall be as under:

...

For Domestic Bidder

- ‘First Contract’ for CIF (Indian port-of-entry) supply of all Plant and Equipment including mandatory spares to be supplied from abroad.
- ‘Second Contract’ for Ex-works (India) supply of all the Plant and Equipment including mandatory spares of Indian origin.
- ‘Third Contract’ for providing all services i.e. port handling, port clearance and port charges for the imported goods, further loading, inland transportation for delivery at site, inland transit insurance, unloading, storage, handling at site, installation, insurance covers other than inland transit insurance, testing and commissioning including carrying out guarantee tests in respect of all the Plant and Equipment supplied under the ‘First Contract’ and ‘Second Contract’ and all other services specified in the Contract Documents.”

“3.6.2 The award of separate Contract shall not in any way dilute the responsibility of the Contractor for the successful completion of the Facilities as per Contract Documents and a breach in one Contract shall automatically be constructed as a breach of the other Contracts(s) which will confer a right on the Employer to terminate the other Contract(s) also at the risk and the cost of the Contractor.”

“3.9 **Independent Contractor**

...

Subject to the provisions of the Contract, the Contractor shall be solely responsible for the manner in which the Contract is performed. All employees, representatives or Subcontractors engaged by the Contractor in connection with the performance of the Contract shall be under the complete control of the Contractor ... and nothing contained in the Contract or in any sub-contract awarded by the Contractor shall be construed to *create any contractual relationship between any such employees, representatives or Subcontractors and the Employer.*”

“7.1 Unless otherwise expressly limited in the Technical Specifications, the Contractor’s obligations cover the provision of all Plant and Equipment and the performance of all Installation services required for the design, the manufacture

(including procurement, quality assurance, construction, installation, associated civil works, Pre-commissioning and delivery) of the Plant and Equipment and the installation, completion, commissioning and performance testing of the Facilities in accordance with the plans, procedures, specifications, drawings, codes and any other documents as specified in the Technical Specifications. ...”

“7.3.1.7 The Contractor will provide the Employer with all the addresses and particulars of his sub-suppliers while placing the order on vendors for items/components/equipment covered under the Contract and will further ensure with his vendors that the Employer, if so desires, will have the right to place order for spares directly on them on mutually agreed terms based on offers of such vendors.”

“9.1 The Contractor shall design, manufacture (including associated purchases and/or subcontracting), install and complete the Facilities with due care and diligence in accordance with the Contract.”

“13.3.1 The Contractor shall, within twenty-eight (28) days of the Notification of Award, provide securities for the due performance of the Contract for ten percent (10%) of the Contract Price of all the Contracts, with a initial validity upto ninety (90) days beyond the end of scheduled Defect Liability Period of the last equipment covered under the package. If the Employer accepts to enter into ‘Second Contract’ and/or ‘Third Contract’ with the Assignee of a foreign Contractor, pursuant to GCC Sub-Clause 3.6, the said Assignee, in addition to the Contract Performance Securities to be provided by the foreign contractor for ten percent (10%) of the value of all the Contracts i.e. First Contract, Second Contract and Third Contract, shall provide within twenty eight (28) days of the Notification of the Award, separate Contract Performance Security(ies) equivalent to ten percent (10%) of the value of Contract(s) entered into with the Assignee, for due performance of Contract, with a initial validity upto ninety (90) days beyond the end of Scheduled Defect Liability period of the last equipment covered under the package. However, in case of delay in completion of the defect liability period, the validity of all the contract performance securities shall be extended by the period of such delay.”

“19.1 Appendix 5 (List of Approved Subcontractors) to the Contract Agreement specifies major items of supply or services and a list of approved Subcontractors against each item, including vendors. Insofar as no Subcontractors are listed against any such item, the Contractor shall prepare a list of Subcontractors for such item for inclusion in such list. The Contractor may from time to time propose any addition to or deletion from any such list. The Contractor shall submit any such list or any modification thereto to the Employer for its approval in sufficient time so as not to impede the progress of work on the Facilities. Such approval by the Employer for any of the Subcontractors shall not relieve the Contractor from any of its obligations, duties or responsibilities under the Contract.”

“28.1 The Contractor guarantees that during the Guarantee Test, the Facilities and all parts thereof shall attain the Functional Guarantees specified in Appendix 8 (Functional Guarantee) to the Contract Agreement, subject to and upon the conditions therein specified.

28.2 If, for reason attributable to the Contractor, the guaranteed level of the Functional Guarantees specified in Appendix 8 (Functional Guarantees) to the Contract Agreement are not met either in whole or in part, the Contractor shall, within a mutually agreed time, at its cost and expense make such changes, modifications

and/or additions to the Plant or any part thereof as may be necessary to meet such Guarantees. ...”

“30.1 Except in cases of criminal negligence or wilful misconduct,

- (a) the Contractor shall not be liable to the Employer, whether in contract, tort or otherwise, for any indirect or consequential loss or damage, loss of use, loss of production, or loss of profits or interest costs, provided that this exclusion shall not apply to any obligation of the Contractor to pay liquidated damages to the employer and
- (b) the aggregate liability of the Contractor to the Employer, whether under the Contract, in tort or otherwise, shall not exceed the total Contract Price, provided that this limitation shall not apply to any obligation of the Contractor to indemnify the Employer with respect to patent infringement.”

The Committee also notes that there is high-sea sale between the foreign collaborator and the Indian contractor and the same is invoiced to the Company by the Indian contractor. Thus, it can be said that the Indian contractor controls the machine equipments, even though only momentarily before the same are transferred to the Company. Further, the Committee notes that the above clauses of GCC/SCC make the Contractor a primary party for the Contract obligations. All this implies that the Contractor is primarily responsible for the execution and completion of the contract.

Based on the above, the Committee is of the view that in the extant case, the foreign collaborators are merely acting as sub-contractors of the Indian contractor, rather than playing significant role in the contract. Therefore, the foreign collaborators can not be considered as ‘substantial parties’ to the contract. Accordingly, for the components of the contract that are denominated in currencies other than INR, that are functional currencies of the foreign collaborators, the Company shall not apply the exemption under Ind AS 109.B4.3.8(d)(i) and cannot consider the foreign currency components to be ‘closely related’ to the host contract.

9. Further, the Committee is of the view that for the purpose of the exemption under paragraph B4.3.8(d)(ii) of Ind AS 109, the currency must be used for similar transactions of the relevant goods or services all around the world and not just in one local area. For example, if cross-border transactions in natural gas in North America are routinely denominated in USD and such transactions are routinely denominated in Euro in Europe, neither the USD nor Euro is a currency in which the good or service is routinely denominated in international commerce. Therefore, the assessment of routinely denominated criterion is based on evidence of whether or not such commercial transactions of the relevant goods or services are denominated in that currency all around the world and not merely in one local area. This assessment is a question of fact based on an assessment of available evidence.

In the extant case, the Committee notes that the querist has not provided any evidence about whether the similar contracts of those goods or services are routinely denominated in commercial transactions around the world in one single currency. Further, as per the facts provided in paragraph 3.6 above, the querist has stated that often the currencies used in the similar bids and contracts are different depending on the country of domicile of the foreign collaborator in the bid/contract providing goods or services. This itself demonstrates that such contracts are not routinely denominated in commercial transactions around the world in one single currency.

D. Opinion

10. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 5 above:

- (a) As noted in paragraph 8 above, the foreign collaborators in the extant case can not be considered as 'substantial parties' to the contract under the provisions of paragraph B4.3.8(d)(i) of Ind AS 109. Therefore, for contracts entered into by the Company with the Indian contractor, which are partly denominated in the functional currencies of the foreign collaborators, the foreign currency embedded derivative is not closely related to the host contract.
 - (b) As noted in paragraph 9 above, the exemption under paragraph B4.3.8(d)(ii) of Ind AS 109 is not available in the extant case. This is because such contracts for the related goods or services are not routinely denominated in commercial transactions around the world in one single currency.
 - (c) Since the querist in the extant query has not provided any additional facts relating to this condition that may change the opinion of the Committee, the Committee reiterates its earlier opinion issued to the querist in respect of condition under paragraph B4.3.8 (d) (iii) of Ind AS 109.
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