

## **Query No. 27**

**Subject:** *Classification of cash flows from long-term investments in the cash flow statement of an Alternative Investment Fund.*<sup>1</sup>

### **A. Facts of the Case**

1. Fund A (hereinafter referred to as 'the Fund'), is established as a Trust and is registered with the Securities and Exchange Board of India (SEBI) as a Category II Alternative Investment Fund. The Fund is regulated by the SEBI (Alternative Investment Funds) Regulations, 2012 (hereinafter referred to as 'AIF Regulations'). These Regulations define an Alternative Investment Fund as:

“any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which-

- (i) is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and
- (ii) is not covered under the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 or any other regulations of the Board to regulate fund management activities”.

2. The properties of the Fund will vest with the Trustee. The Trustee will conduct the affairs of the Trust in accordance with the Trust Deed, the other Fund documents and applicable laws including the AIF Regulations. The Fund raises the capital commitments on a private placement basis, make drawdowns of contributions therefrom and makes investment from contribution amount received. The Trustee has all powers in respect of the properties of the Fund including power to manage, administer, invest and dispose the trust property of the Fund. These powers have been delegated to the Investment Manager pursuant to, and in terms of, the Investment Management Agreement. Accordingly, the Fund has engaged an investment manager (Investment Manager is a separate company registered under the Companies Act) to oversee operational and administrative activities. The management fee paid to the investment manager is recognised as an expense of the Fund.

3. The objects of the Fund as per its Trust Deed are as follows:

The Fund has been established to carry on the activity of an Alternative Investment Fund and for this purpose, subject to applicable laws and the Fund documents, the Fund may inter alia:

- (a) raise Capital Commitments on a private placement basis and make drawdowns of Contributions therefrom;
- (b) make Portfolio Investments in accordance with the Fund documents;
- (c) achieve primarily long term capital appreciation from the divestment of portfolio investments;
- (d) receive returns from portfolio investments;
- (e) do all other acts, deeds and things as may be incidental, necessary or conducive to the attainment of the above objects and/or the objectives as set out in the respective Contribution Agreement and other Fund documents

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<sup>1</sup> Opinion finalised by the Committee on 18.1.2021 to 20.1.2021.

including, but not limited to, conducting due diligence on potential investment opportunities, making and divesting holdings, appointing representatives on the management or board of the Portfolio Vehicles and attending board and shareholder meetings of Portfolio Vehicles for the surveillance or protection of such investments, if the Trustee or the Investment Manager so decides; and/or

- (f) The Fund will carry out only investment activities with the object of earning long-term capital appreciation and returns in the nature of interest, dividend or capital gains through a combination of appropriate instruments on its investments in accordance with the terms of this Deed and the Fund documents, and shall accordingly hold its investments as capital assets.

Provided however, that the Fund will not carry out any activity in the nature of business or trade.

4. The objective of the Fund is to make investments (generally for 3-5 years) in non-convertible debentures, redeemable preference shares, optionally convertible redeemable preference shares and equity shares in investee companies for long-term capital appreciation/interest/dividend income which are engaged in:

- (a) development and sale of residential units (including plotted developments);
- (b) rendering services to entities undertaking real estate projects where such services shall include estate management, project management, facility management, sales, marketing, finance, legal, administration, logistics, branding, operations and allied services; or
- (c) such other activities as may be determined from time to time by the Trustee/Investment Manager with the prior approval of all the Contributors in terms of the respective Contribution Agreements.

5. As at Balance Sheet date and during the year, the Fund has invested in non-convertible debentures, redeemable preference shares, optionally convertible redeemable preference shares and equity shares issued by companies engaged in development of real estate projects.

6. The Fund, follows Accounting Standards issued by the Institute of Chartered Accountants of India for the purpose of preparing statutory financial statements under the AIF Regulations. As per the querist, in the financial statements of the Fund prepared under Indian GAAP, the management proposes to disclose:

- a. Investments- under non-current investments as 'Long term investments' in the Balance Sheet.
- b. Revenue from these investments-
- (i) Interest income (ii) Premium on redemption i.e., on sale (iii) dividend income in the Income and Expenditure Account.
- c. Cash flows from investments (on account of purchase/sale of investment, receipt of interest/ dividend etc.) - Presented under 'investing activities' in the cash flow statement prepared under Accounting Standard (AS) 3, 'Cash Flow Statements'.
- d. Cash flows for expenses relating to investments - Presented under 'operating activities' in the cash flow statement prepared under AS 3.

7. The querist has reproduced the following paragraphs from AS 3:

"2. Users of an enterprise's financial statements are interested in how the enterprise generates and uses cash and cash equivalents. This is the case regardless of the nature of

the enterprise's activities and irrespective of whether cash can be viewed as the product of the enterprise, as may be the case with a financial enterprise..."

***"5.4. Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.***

***5.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents."***

"9. An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities."

"12. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:

- (a) cash receipts from the sale of goods and the rendering of services;
- (b) cash receipts from royalties, fees, commissions and other revenue;
- (c) cash payments to suppliers for goods and services;
- (d) cash payments to and on behalf of employees;
- (e) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;
- (f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
- (g) cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes."

"14. An enterprise may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial enterprises are usually classified as operating activities since they relate to the main revenue-producing activity of that enterprise.

### **Investing Activities**

15. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

- (a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;
- (b) cash receipts from disposal of fixed assets (including intangibles);
- (c) cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered

to be cash equivalents and those held for dealing or trading purposes);

- (d) cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes);
- (e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);
- (f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);
- (g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
- (h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.”

***“30. Cash flows from interest and dividends received and paid should each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities. In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities.”***

*“32. Interest paid and interest and dividends received are usually classified as operating cash flows for a financial enterprise. However, there is no consensus on the classification of these cash flows for other enterprises. Some argue that interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of net profit or loss. However, it is more appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are cost of obtaining financial resources or returns on investments”.* (Emphasis supplied by the querist).

8. As per the querist, one view can be that in the extant case, cash flows from investments are considered as cash flows from/used in, investing activities. As per this view, it seems appropriate that the cash flows from investments i.e., generated from interest, dividends, etc., and proceeds from purchase/sale of investments from non-convertible debentures, redeemable preference shares, optionally convertible redeemable preference shares, equity shares etc., are considered as cash flows from/used in, investing activities by the Fund. The following arguments support this proposition:

- (a) The objects of the Fund as per its Trust Deed referred to in paragraph 3 above support the above proposition. Specific attention is drawn to the following:
  - c. achieve primarily long term capital appreciation from the divestment of Portfolio Investments;
  - d. receive returns from Portfolio Investments”
- (b) As stated in paragraph 9 of AS 3, presentation of cash flows from operating, investing and financing activities should be such that it is most appropriate to the business of the enterprise. It further states, "Classification by activity

provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents". These activities impact the non-current investments. For cash generation, the Fund raises capital commitments on a private placement basis. In addition, the appropriateness of the classification should also be evaluated in relation to the classification of the related item in the financial statements as this reduces divergence in practice and, therefore, results in financial statements that are easier for users to understand.

- (c) The only activity carried on by the Fund is to hold investments in non-convertible debentures, redeemable preference shares, optionally convertible redeemable preference shares, equity shares etc., for a period of 3 to 5 years. During the year and at the balance sheet date, the Fund has invested only in non-convertible debentures, redeemable preference shares, optionally convertible redeemable preference shares and equity shares issued by companies engaged in development of real estate projects. As per the object clause of the Fund in the Trust Deed as stated in paragraph 3 above, the income is "in the nature of interest, dividend or capital gains through a combination of appropriate instruments on its investments." Just because no other activity is carried out, the aforesaid streams of income do not qualify as revenue from principal business activities of the Fund. In fact, as per object clause in the Trust Deed as mentioned in paragraph 3 above, the Fund does not carry out any activity in the nature of business or trade.
- (d) Paragraph 9 of AS 3 states that cash flows should be classified in the manner "which is most appropriate to its business". The activity of the Fund is not that of a financial enterprise whose business activity is to invest in securities in the normal course. In the instant case, the activity of the Fund is not to perform any business activity. Its purpose is only to act as an investment vehicle by pooling the investments of investors to generate benefits from the investment for those investors.
- (e) As per paragraph 15(c) of AS 3, cash payments to acquire shares, warrants and debt instruments of other enterprises (other than payments for those held for dealing or trading purposes) are classified as cash flows from investing activities. Similarly, as per paragraph 15(d) of AS 3, cash receipts from disposal of shares, warrants and debt instruments of other enterprises (other than receipts from those held for dealing or trading purposes) are classified as investing activities. In the instant case, the Fund does not invest for dealing or trading purposes, rather these investments are made for long-term purposes for earning interest/ dividend/ capital appreciation.

9. As per the querist, the other view can be that in the extant case, cash flows from investments are considered as cash flows from/used in, operating activities. As per this view, the relevant cash flows of the Fund i.e., generated from interest, dividends, etc., and proceeds from purchase/sale of investments of non-convertible debentures, redeemable preference shares, optionally convertible redeemable preference shares, equity shares etc., as well as the cash outflows of expenses incurred in carrying out the objectives of the Trust are of the nature of operating cash flows. In this regard, the following arguments can be made:

- (i) Paragraphs 5.4, 5.5, 9, 12, 14, 15, 30 and 32 of AS 3, reproduced in paragraph 7 above merit consideration. In addition, paragraph 11 of AS 3 states, "The amount of cash flows arising from operating activities is a key indicator of the

extent to which the operations of the enterprise have generated sufficient cash flows to maintain the operating capability of the enterprise, pay dividends, repay loans and make new investments without recourse to external sources of financing. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows”.

- (ii) As per the opinion of Expert Advisory Committee published in Compendium of Opinions, Volume 29, Query No. 31, amounts of loans disbursed to, and the repayments received from, the borrowers of a financial institution should be presented as cash flows from operating activities.
- (iii) From the above, the following may be derived:
  - (a) The only, and therefore, the principal activity of the Fund is to make investments and to generate net cash flows from interest and dividends received and receipts from purchase and sale of investments (after meeting the cash outflows for expenses, etc.). Thus, this is the principal revenue producing activity of the Fund, and, therefore, paragraph 12 of AS 3 applies.
  - (b) It cannot be stated that as an entity, the Fund does not carry out any activity of the nature of its business. All entities carry out business activities for the sole benefit of its owners (in the extant case, contributors). This does not imply that the Fund does not have operating activities. The reference in the Trust Deed that the Fund does not carry out any activity in the nature of business or trade only provides that the Fund can earn revenue only from making investments and is restricted from other revenue-generating activities. In other words, in the absence of a revenue-generating activity, an entity cannot be a going concern. In the given case, the financial statements of the Fund have been prepared on a going concern basis. Thus, it would be inconsistent to state that the Fund does not carry out any activity of the nature of its business.
  - (c) The activities of the Fund are of the nature of a financial enterprise. Therefore, paragraph 30 of AS 3 applies. Paragraph 30 of AS 3 only deals with cash flows from interest and dividend and not cash flows from purchase and sale of investments. However, it would not be appropriate to classify the cash flows from purchase and sale of investments differently from classification of cash flows from interest and dividend earned on those investments.
  - (d) Paragraph 14 of AS 3 requires cash flows from securities held for dealing or trading to be classified as operating activities. This implies that where the principal revenue-generating activity of an entity is to make investments, the cash flows from such investments should be classified as operating activities.
  - (e) Cash flows for expenses relating to investments are presented under operating activities in the cash flow statement since these represent normal operating expenses of the Fund. Thus, the related revenue generated should also be presented in operating activities. Otherwise, the cash flows from operating activities would not show a true and fair view.

10. The querist has separately informed the following:

- (i) Long-term investments are made with a long-term horizon and are intended to be held for more than one year. Long-term investments are carried at carrying cost less diminution in value, other than temporary, in nature.
- (ii) Each investment is distinct in nature and is monitored/ tracked separately. Based on project milestones achieved, an independent valuer determines the fair value of the investment which is then used for a periodic update to the unitholders by the investment manager.
- (iii) The unitholders are given a periodic update on the value of long-term investments over and above the carrying cost of the investments.
- (iv) The cash flow statement is prepared under the indirect method.

## **B. Query**

11. The querist has sought the opinion of the Expert Advisory Committee as to whether cash flows from investments (on account of purchase/sale of investments, receipt of interest/dividend and other related expenses, etc.) should be presented as cash flows from investing activities or as cash flows from operating activities in the Cash Flow Statement in accordance with AS 3.

## **C. Points considered by the Committee**

12. The Committee notes that the basic issue raised by the querist relates to classification of cash flows from investments, which, as per the Facts of the Case, are of long-term in nature, in the cash flow statement of the Alternative Investment Fund (hereinafter referred to as 'the Fund' or 'AIF'), presented in accordance with Accounting Standard (AS) 3, 'Cash Flow Statements', issued by the Institute of Chartered Accountants of India (ICAI). The Committee has, therefore, considered only this issue and has not examined any other issue that may be contained in the Facts of the Case, such as, classification of cash flows from contributions received from contributors/investors and distributions to the contributors/investors, classification of cash flows arising from investments other than long-term investments, if any, relevance of non-applicability of AS 13, 'Accounting for Investments' to some enterprises, such as mutual funds (see paragraph 2(d) of AS 13) for the extant case, valuation of long-term investments, method of accounting, etc. The Committee notes that the Fund has been established as a Trust and follows Accounting Standards issued by the ICAI. Hence, the Committee expresses its views in the context of those Standards.

13. The Committee notes that a financial enterprise may be engaged in various activities, such as, providing finance to customers, making investments etc. In the extant case, as per the 'object' clause of Trust Deed, the Fund is permitted only to make long-term investments (generally for 3 to 5 years) in debt and equity instruments of companies engaged in development of real estate projects, the main source for such investments being contributions from contributors/investors on private placement basis. Thus, it is a financial enterprise with restricted activities. The Committee wishes to point out that whether an enterprise is a financial enterprise or not, is mainly relevant for classification of interest paid and interest and dividend received in the cash flow statement (see paragraphs 30 and 32 of AS 3, reproduced in paragraph 14 below) while it is useful for understanding whether some cash flows are principal revenue-producing activities having regard to the nature of the business of an enterprise (see paragraphs 14, 15(e) and 15(f) read with paragraph 9 of AS 3, reproduced in paragraph 14 below).

14. The Committee notes paragraphs 5.4, 5.5, 5.6, 9, 12 to 15, 30, 32 and 33 of AS 3, reproduced below:

**“5.4. Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.**

**5.5 Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.**

**5.6 Financing activities are activities that result in changes in the size and composition of the owners’ capital (including preference share capital in the case of a company) and borrowings of the enterprise.”**

“9. An enterprise presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the enterprise and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.”

“12. Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Examples of cash flows from operating activities are:

- (a) cash receipts from the sale of goods and the rendering of services;
- (b) cash receipts from royalties, fees, commissions and other revenue;
- (c) cash payments to suppliers for goods and services;
- (d) cash payments to and on behalf of employees;
- (e) cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits;
- (f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
- (g) cash receipts and payments relating to futures contracts, forward contracts, option contracts and swap contracts when the contracts are held for dealing or trading purposes.

13. Some transactions, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of net profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

14. An enterprise may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial enterprises are usually classified as operating activities since they relate to the main revenue-producing activity of that enterprise.

### **Investing Activities**

15. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

- (a) cash payments to acquire fixed assets (including intangibles). These payments include those relating to capitalised research and development costs and self-constructed fixed assets;
- (b) cash receipts from disposal of fixed assets (including intangibles);
- (c) cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than payments for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
- (d) cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint ventures (other than receipts from those instruments considered to be cash equivalents and those held for dealing or trading purposes);
- (e) cash advances and loans made to third parties (other than advances and loans made by a financial enterprise);
- (f) cash receipts from the repayment of advances and loans made to third parties (other than advances and loans of a financial enterprise);
- (g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
- (h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.”

***“30. Cash flows from interest and dividends received and paid should each be disclosed separately. Cash flows arising from interest paid and interest and dividends received in the case of a financial enterprise should be classified as cash flows arising from operating activities. In the case of other enterprises, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities.”***

“32. Interest paid and interest and dividends received are usually classified as operating cash flows for a financial enterprise. However, there is no consensus on the classification of these cash flows for other enterprises. Some argue that interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of net profit or loss. However, it is more appropriate that interest paid and interest and dividends received are classified as financing cash flows and investing cash flows respectively, because they are cost of obtaining financial resources or returns on investments.”

15. The Committee notes that in the definition of ‘operating activity’, reproduced in paragraph 14 above, the term ‘principal’ qualifies the term ‘revenue-producing activity’ and not just ‘revenue’. Revenue may flow from activities undertaken by an enterprise or from a resource created or acquired by an enterprise. For example, in the case of manufacturing enterprises, plant and machinery (which are long-term assets) are resources and, hence, construction/acquisition of the same are investing activities, while purchase of raw materials, manufacturing and sale of finished goods are principal revenue-producing activities. Cash flows arising from such revenue-producing activities are, therefore, cash flows from operating activities. Similarly, investments are resources and, hence, *normally*, acquisition and disposal

of investments (whether or not long-term - see the definition of investing activities, reproduced in paragraph 14 above) are investing activities even for a financial enterprise, while earning of income, such as interest and dividend, is the principal revenue-producing activity. Receipts of interest and dividend are, therefore, cash flows from operating activities. However, the examples cited in AS 3 indicate that *irrespective of the nature of an enterprise*, purchase and sale of securities, such as debt and equity instruments, held for trading or dealing purposes or which are considered to be cash equivalents are operating activities, while purchase and sale of securities in other cases are investing activities (see paragraphs 14, 15(c) and 15(d) of AS 3, reproduced in paragraph 14 above). The reason is that in the case of purchase and sale of securities held for trading or dealing purposes, earning of interest and dividend is an incidental activity only, while revenue is principally generated by the trading or dealing activities of the enterprise, and, consequently, purchase and sale of the securities themselves are principal revenue-producing activities. In fact, shares, debentures and other securities held as stock-in-trade (i.e., for sale in the ordinary course of business) are not investments as defined in AS 13. Such securities are also not long-term assets. Hence, purchase and sale of securities held for trading or dealing purposes are not investing activities.

In the case of purchase and sale of securities held not for trading or dealing purposes, earning of interest and dividend is generally considered as the principal revenue-producing activity. In such cases, purchase of the securities is considered as acquisition of a resource for generating future revenue and not as a principal revenue-producing activity. Hence, sale of securities in such cases is also not a principal revenue-producing activity. Thus, it is possible that even for a financial enterprise, acquisition and disposal of some investments may qualify as investing activities. This is evident from Illustration II, titled 'Cash Flow Statement for a Financial Enterprise', contained in AS 3, wherein proceeds from sales of permanent investments and purchase of permanent investments are exhibited as cash flows from investing activities even for a financial enterprise. Similarly, in Illustrative Example B, titled 'Statement of cash flows for a financial institution', contained in International Accounting Standard 7, 'Statement of Cash Flows', issued by the International Accounting Standards Board, proceeds from sales of non-dealing securities and purchase of non-dealing securities are exhibited as cash flows from investing activities.

In the extant case, the long-term investments cannot be described as held for trading or dealing purposes. As per the Facts of the Case, earning of interest, dividend and capital appreciation from long-term investments (and not any activity of the nature of trading or dealing in debt and equity instruments) is the principal revenue-producing activity. The acquisition and disposal of the long-term investments themselves are not principal revenue-producing activities. Consequently, the Committee is of the view that in the extant case, acquisition and disposal of the long-term investments are investing activities and therefore cash flows from acquisition and disposal of such investments are cash flows from investing activities.

With reference to the above discussion, the Committee notes that in the extant case, the long-term investments are carried at cost less diminution in value, other than temporary, in nature. Further, as stated by the querist in paragraph 10 above, each investment is considered distinct in nature and is monitored/ tracked separately. The fair value of the investment is determined by an independent valuer based *on project milestones achieved* and the unitholders are given a periodic update on the value of long-term investments *over and above the carrying cost* of the investments. Therefore, considering the facts of the extant case, the Committee has not examined the situation where investments are managed on a fair value basis and fair value changes are recognised in the Statement of Profit and Loss.

16. With regard to the earlier opinion of the Committee cited by the querist in paragraph 9(ii) above, the Committee notes that as per paragraph 15 of AS 3, cash advances and loans

held for earning interest as well as debt and equity instruments (hereinafter referred to as 'securities') held for earning interest, dividend and capital appreciation - whether long-term or not - are in the nature of investing activities. At the same time, cash flows from both securities and loans held for trading or dealing purposes are cash flows from operating activities as per paragraph 14 of AS 3, reproduced in paragraph 14 above, since these are not held for earning interest, dividend or capital appreciation and also, these are not long-term assets. However, cash advances and loans are different from investments in securities. Paragraphs 14, 15(e) and 15(f) read with paragraph 9 of AS 3, reproduced in paragraph 14 above, indicate that cash advances and loans made to third parties and cash receipts from the repayment of such cash advances and loans are cash flows from operating activities in the case of a financial enterprise and cash flows from investing activities in other cases. In the case of purchase and sale of securities, distinction between operating activities and investing activities is not made on the basis of whether an enterprise is a financial enterprise or not (see paragraph 16 above). The Committee wishes to point out in the case of financial enterprise, cash advances and loans made (and cash receipts from the repayment of such cash advances and loans) represent transactions with customers. The examples cited in paragraph 12 of AS 3, reproduced in paragraph 14 above indicate that operating activities which are of the nature of principal revenue-producing activities *include* transactions with customers and suppliers. Paragraph 14 of AS 3 specifically points out that cash advances and loans made by a financial enterprise relate to the main revenue-producing activity of a financial enterprise. On the other hand, investments in securities held for earning interest, dividend and capital appreciation do not usually represent transactions with customers or suppliers. Hence, the Committee is of the view that the same analogy cannot be drawn from cash advances and loans made by a financial enterprise to investments in securities made by a financial enterprise.

17. As regards cash flows in respect of receipts of interest and dividend from long-term investments, since the Fund is of the nature of a financial enterprise (see paragraph 13 above), the same should be classified as cash flows from operating activities, pursuant to paragraph 30 read with paragraph 32 of AS 3, reproduced in paragraph 14 above. Further, since the gain (loss) on disposal of long-term investments (hereinafter referred to as 'capital gain (loss)') is inbuilt in the disposal proceeds of the investments classified as investing cash flows (see paragraph 16 above), net profit or loss (hereinafter referred to as 'net income') should be adjusted for the capital gain (loss), while arriving at net cash flow from operating activities under the 'indirect method' of presentation. This is in line with paragraph 13 of AS 3, reproduced in paragraph 14 above.

18. Now, the Committee examines the issue of classification of cash flows in respect of 'related expenses' i.e., expenses related to acquisition, and disposal of the investments. The Committee is of the view that in view of paragraph 12 read with paragraph 30 of AS 3, reproduced in paragraph 14 above, cash flows in respect of 'related expenses', other than interest, that enter into the determination of net income of the Fund, should generally be classified as cash flows from operating activities. If an expense is included in the cost of the investment, 'Purchase of investments' reported under cash flows from investing activities will automatically include cash flow in respect of the same. Similarly, expenses related to disposal of investment are inbuilt in the net disposal proceeds while computing capital gain (loss), the treatment of which has been explained in paragraph 18 above. Hence, cash flows relating to such expenses would, in effect, reduce the cash inflow from investing activities.

19. The Committee wishes to point out that in case there is any interest expense, cash flows relating to the same should also be classified as cash flow from operating activities in view of the specific provisions of paragraph 30 read with paragraph 32 of AS 3, reproduced in paragraph 14 above. In this regard, the Committee notes that paragraph 31 of AS 3 requires

that the total amount of interest paid during the period is disclosed in the Cash Flow Statement whether it has been recognised as an expense in the Statement of Profit and Loss or capitalised in accordance with AS 10, 'Accounting for Fixed Assets', since revised and titled as 'Property, Plant and Equipment'. Incidentally, the Committee notes that under Regulation 17(c) of the SEBI (Alternative Investment Funds) Regulations, 2012, the Fund, being Category II 'AIF', it is not permitted to borrow funds directly or indirectly and shall not engage in leverage except for meeting temporary funding requirements, which is subject to some more restrictions.

**D. Opinion**

20. On the basis of the above, the Committee is of the opinion that in the Cash Flow Statement of the Alternative Investment Fund presented in accordance with AS 3, issued by the ICAI, cash flows from long-term investments on account of purchase/sale of such investments should be classified as cash flows from investing activities. Receipts of interest/dividend should be classified as cash flows from operating activities. Cash flows in respect of 'related expenses' i.e., related to purchase and sale of long-term investments should be classified as explained in paragraphs 18 and 19 above.

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