

## Query No. 20

**Subject:** *Classification of business activity as operating activity or investing activity.*<sup>1</sup>

### A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) is a wholly-owned Government of India company, engaged in providing long-term finance to viable infrastructure projects through the Scheme for Financing Viable Infrastructure Projects through a Special Purpose Vehicle called ‘the Company’, referred to as SIFTI. The Company enjoys the status of public financial institution and is also registered as a Non-Banking Financial Company - Infrastructure Finance Company (NBFC-IFC) with the Reserve Bank of India. The Company is categorised as Systemically Important Non-Deposit taking company. The Company complies with various elements of RBI Regulations applicable to NBFC-IFC. As per SIFTI (a copy of which has been provided by the querist for the perusal of the Committee), “The Company would raise funds as and when required. The funds so raised may be utilised for on-lending and *surplus funds may be invested in marketable government securities* (G-Sec and T-Bills) and/or Certificates of Deposit, Fixed Deposits and, for Treasury Management purposes, in AAA rated PSU Corporate Bonds.” (Emphasis supplied by the querist.)

2. The querist has stated that the Comptroller and Auditor General of India (C&AG) conducts supplementary audit of accounts of the Company under section 143(6)(b) of the Companies Act, 2013. The office of C&AG after completing the supplementary audit of the Company for financial year (F.Y.) ended 31<sup>st</sup> March 2020 has issued a letter dated 5<sup>th</sup> January 2021 and informed, inter-alia, the following:

“Cash Flow Statement is deficient as detailed below:

- Investment of Rs. 5297.60 crore in Government Securities has been shown under Operating Activities instead of Investing Activities which is in contravention to Ind AS 7.
- Similarly, receipt of Rs. 97.87 crore on account of sale of Government Securities has been shown under Operating Activities instead of Investing Activities.
- Equity Infusion of Rs. 188.45 crore in ABC (UK) Ltd., (a wholly owned subsidiary of the Company) has been shown under operating activities instead of Investing Activities.”

3. In this regard, the querist has submitted as follows:

#### A. **Investment of Rs. 5297.60 crore in Government Securities:**

- a) The Company is operated under the Scheme for Financing Viable Infrastructure Projects (SIFTI) and as per this scheme; *the Company doesn't undertake any investment activities*. Interest/ income on surplus funds is considered as income from operations.

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<sup>1</sup> Opinion finalised by the Committee on 27.10.2021.

- b) The surplus funds are invested in marketable government securities (G-Sec and T-Bills) and/or certificates of deposit, fixed deposits and, for treasury management purposes, in AAA rated PSU corporate bonds.
- c) Government of India, on 30<sup>th</sup> March 2020 infused equity share capital, by way of Right Issue (Recapitalisation bonds) of Rs. 5,297.60 crore.
- d) Consequently, the Government of India issued, vide Notification dated 26<sup>th</sup> March 2020, Special GoI securities (non-transferable) aggregating Rs. 5,297.60 crore. The special securities shall not be transferable and conversion in any other form of security is not permitted.

*As per point 8 of the aforesaid Notification, "The investment in the special securities by the Company would not be considered as an eligible investment which the Company is required to make in Government securities in pursuance of any statutory provisions or directions applicable to the investing bank/company, i.e., the Company."*

Considering the fact that the Company cannot undertake the investing activities and parked the surplus funds in Government Securities, which is the part of primary operations of the Company, the *subscription of Special GoI Securities is considered as operating activity* by the Company.

**B. Receipt of Rs. 97.87 crore on account of sale of Government Securities:**

- a) *The Company doesn't undertake any investment activities.* The surplus funds are invested in marketable government securities (G-Sec and T-Bills) and/or Certificates of Deposit, Fixed Deposits and, for Treasury Management purposes, in AAA rated PSU Corporate Bonds.
- b) The investment in government securities by the Company is considered as an operating activity. *Accordingly, the proceeds from maturity of any government security are treated as operating activity of the Company.*

Further, the querist has clarified that the receipt of Rs. 97.87 crore was on account of redemption of marketable Government Securities, other than special Government Securities.

**C. Equity Infusion of Rs. 188.45 crore in ABC (UK) Ltd.:**

- a) ABC (UK) Limited, a 100% owned subsidiary of the Company, was incorporated in February 2008 to lend to Indian companies implementing infrastructure projects in India, or to co-finance their external commercial borrowings for such projects, solely for the capital expenditure outside India. The Company infused capital of Rs. 188.45 crore (USD 25 million) during the financial year 2019-20.
- b) In accordance with the Company's plan for business continuance to further supplement financial resources for infrastructure development in India, ABC (UK) Ltd. was set up with the objective of lending in foreign currency to Indian companies implementing infrastructure projects in the Country specifically for import of capital

equipment. The Reserve Bank of India (RBI) has extended line of credit of USD 5 billion from foreign exchange reserves for the same.

- c) *The Company's equity investment is a part of operating activity in the Cash Flow Statement considering it as an integral part of its operation to fund infrastructure loan.*

It is also submitted by the querist that the Company had received a similar comment on classification of interest on fixed deposits as operating activity from the office of C&AG during the supplementary audit for the financial year ended 31<sup>st</sup> March 2010 and 31<sup>st</sup> March 2011. The matter was referred to the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI). The *EAC opined* (published as Query No. 16 of Volume XL (Part-II) of Compendium of Opinions) that *"it is appropriate for the company to treat interest on bank deposits as income from operations in its books of account and, accordingly, to consider and disclose interest on bank deposits as income from operations in preparation of financial statements including cash flow statement"*.

(Emphasis supplied by the querist.)

## **B. Query**

4. On the basis of the above, the querist has sought the opinion of the EAC regarding classification of investment/redemption of government securities and equity investment in the cash flow statement.

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

5. The Committee notes that the basic issue raised in the query relates to classification of investment/redemption of government securities and equity investment in the statement of cash flows, presented in accordance with Indian Accounting Standard (Ind AS) 7, 'Statement of Cash Flows'. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment of investment in foreign subsidiary in the financial statements of the Company, accounting for equity contribution received from the Government, classification of cash flows arising from investments other than the above-mentioned investments, if any, valuation of investments, etc. Further, the Committee presumes from the Facts of the Case that investments in marketable government securities do not meet the definition of 'cash equivalent' as per Ind AS 7.

6. The Committee notes that the Company in the extant case is a Non-Banking Financial Company - Infrastructure Finance Company and therefore, can be considered as a financial institution under Ind AS 7.

The Committee notes that the following three types of transactions/investments have been referred to in the extant case:

- (i) Investment in Special government securities: These special securities shall not be transferable and conversion in any other form of security is not permitted.
- (ii) Sale of marketable government securities other than special government securities as referred above.

(iii) Equity infusion in the wholly-owned subsidiary, ABC (UK) Ltd.

7. In the context of the issue raised, the Committee notes the following paragraphs of Ind AS 7, 'Statement of Cash Flows':

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

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

***Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.”***

“11 An entity 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 entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.”

“14 Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of 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 entity 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 from contracts held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities. However, cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as described in paragraph 68A of Ind AS 16, *Property, Plant and Equipment*, are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

15 An entity 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 institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

### **Investing Activities**

- 16 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. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities. Examples of cash flows arising from investing activities are:
- (a) *cash payments to acquire* property, plant and equipment, intangibles and other *long-term assets*. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;
  - (b) cash receipts from sale of property, plant and equipment, intangibles and other long-term assets;
  - (c) *cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes)*;
  - (d) *cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes)*;
  - (e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);
  - (f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
  - (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.

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.”

- “33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Some argue that

interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of 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.”

**“39 The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.”**

(Emphasis supplied by the Committee.)

8. The Committee notes that in the definition of ‘operating activity’, reproduced in paragraph 7 above, the term ‘principal’ qualifies the term ‘revenue-producing activity’ and not just ‘revenue’. Revenue may flow from activities undertaken by an entity or from a resource created or acquired by an entity. 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 7 above) are investing activities even for a financial institution (unless held for trading or dealing purposes or which are considered to be cash equivalents), while earning of income, such as interest and dividend, may be the principal revenue-producing activity. Receipts of interest and dividend (for a financial institution) are, therefore, cash flows from operating activities.

Further, the examples cited in Ind AS 7 indicate that irrespective of the nature of an entity, 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 15, 16(c) and 16(d) of Ind AS 7, reproduced in paragraph 7 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 entity, 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 long-term assets; rather considered similar to inventories. 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 for a financial institution. 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 institution, acquisition and disposal of some investments may qualify as investing activities.

This is evident from Illustrative Example B, titled ‘Statement of cash flows for a financial institution’, contained in International Accounting Standard (IAS) 7, ‘Statement of Cash Flows’, issued by the International Accounting Standards Board, wherein 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 Committee notes that investments in non-transferrable and non-convertible special government securities are apparently long-term in nature, having a tenure of 10-15 years and therefore, cannot be considered as held for trading or dealing purposes. Accordingly, considering the above discussion, the Committee is of the view that acquisition and disposal of the special government securities are investing activities and therefore cash flows from acquisition and disposal/maturity of such investments are cash flows from investing activities.

With reference to the above discussion, the Committee also notes from the annual report of the Company for F.Y. 2019-20 that in the extant case, the special government securities are carried at amortised cost and not fair value. 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.

9. With regard to cash flows from redemption of government securities other than special government securities, the Committee is of the view that as discussed above, 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 entity is a financial institution or not. Rather cash flows from investments are classified as operating activities when these are held for trading or dealing purposes or are considered to be cash equivalents. Accordingly, in the extant case, the proceeds from redemption of government securities other than special government securities would depend upon whether these can be considered as held for trading or dealing purposes or are long-term resources. If investments in marketable government securities can be considered as held for trading or dealing purposes, cash flows from redemption of these securities should be considered as operating activities, otherwise these should be considered as investing activities.

10. With regard to cash flows from equity infusion in wholly-owned subsidiary, the Committee notes that the requirements of Ind AS 7 relating to investments in subsidiaries do not make distinction in classification due to an entity being a financial institution. Accordingly, considering the requirements of paragraph 39 of Ind AS 7 and the above discussion on investing activities, the Committee is of the view that the cash flows from obtaining control of a subsidiary cannot be considered as cash flows from operating activity and should be classified as cash flows from investing activity.

#### **D. Opinion**

11. On the basis of the above, the Committee is of the opinion that in the Cash Flow Statement of the Company, presented in accordance with Ind AS 7, cash flows from purchase of special government securities should be classified as cash flows from investing activities, as explained in paragraph 8 above. With regard to cash flows from redemption of government securities other than special government securities, these can be considered as operating activities only if investments in marketable government securities can be considered as held for trading or dealing purposes; otherwise these should be considered as investing activities,

as explained in paragraph 9 above. The cash flows to acquire investment in subsidiary cannot be considered as cash flows from operating activity and should be classified as cash flows from investing activity, as explained in paragraph 10 above.

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