

Query No. 4

Subject: Presentation of change in non-current asset in Cash Flow Statement.¹

A. Facts of the Case

1. A Company (hereinafter referred to as ‘the Company’) has been incorporated as a Special Purpose Vehicle (SPV) by I Ltd., its holding company, on 11th May 2017, for executing the project works of ‘Six-laning of Davangere – Haveri from km 260+000 to km 338+923 of NH-48 (old NH-4) in the State of Karnataka under Hybrid Annuity Model (HAM) under National Highway Development Project (NHDP) Phase – V’ in accordance with the terms of the Concession Agreement (a copy of Concession Agreement has been supplied separately by the querist for the perusal of the Committee), signed with the National Highways Authority of India (hereinafter referred to as ‘the Authority’) on 19th June 2017. Concession period for the project is 15 years excluding the project construction period of 912 days.

2. The querist has stated that the total project execution cost is Rs.1177.00 crores plus escalation wherein 40% project cost is reimbursable by the Authority and 60% is to be funded by SPV, viz., the Company. 40% of the bid project cost (BPC), adjusted for Price Index Multiple, shall be due and payable by the Authority to the Concessionaire in 5 equal instalments of 8% each during the construction period and the remaining bid project cost, adjusted for Price Index Multiple, shall be due and payable in 30 biannual instalments commencing from the 180th day of Commercial Operation Date (COD).

3. Further, interest shall be due and payable by the Authority to Concessionaire on the reducing balance of completion cost at the interest rate equal to the applicable bank rate plus 3%. Such interest shall be due and payable biannually along with each instalment.

4. Presently, the Company is recognising revenue using input method as per Appendix D of Indian Accounting Standard (Ind AS) 115, ‘Revenue from Contracts with Customers’, which states that the consideration received or receivable by the Company is a right to a financial asset. The Company recognises a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor (Authority) for the construction services; the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. Presently, 40% of BPC shall be due and payable by the Authority during construction period in 5 instalments on achievement of milestones and remaining 60% will be payable biannually during 15 years in the form of annuity. Here, financial asset represents the 60% amount payable by the authority. The Company presents amount receivable from the Authority within 12 months on achievement of milestone as current financial asset and remaining as non-current financial asset.

5. Accordingly, the Company presented the movement in non-current financial asset due to billing progress under ‘cash flows from operating activity’ in the cash flow statement for the financial year (F.Y.) 2018-19 as it is a non-cash adjustment and is required to be adjusted from profits only as per the indirect method stated in the relevant standard. However, during supplementary audit, Comptroller and Auditor General of India (CAG) had issued a paragraph

¹ Opinion finalised by the Committee on 13.4.2021.

that “the change in non-current financial asset has been disclosed in adjustment of working capital changes instead of disclosing the same under cash flow from investing activity in cash flow statement”.

6. The Company continued the same treatment in F.Y. 2019-20 in its books of account. However, CAG has again issued the same paragraph, i.e., “The company during the current year has again disclosed the working capital changes in non-current financial assets (amounting to Rs. 12048.40 lakh) under cash flows from operating activities instead of showing under cash flow from investing activities as required under paragraph 16 of Ind AS 7.” Further, change in current financial asset was also disclosed under cash flows from operating activity but CAG does not give any observation on it.

7. The querist has referred to the following provisions of Indian Accounting Standard (Ind AS) 7, ‘Statement of Cash Flows’:

“18 An entity shall report cash flows from operating activities using either:

- (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or**
- (b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.”**

“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 sales 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.”

8. The querist has informed that the Company is of the view that during the F.Y. 2019-20, there was no receipt under the head ‘other non-current financial assets’ (Receivable). Hence, this represented transactions of a non-cash nature as per paragraph 18 of Ind AS 7 and required to be disclosed under operating activities under working capital change. The Company, accordingly, disclosed the same under working capital change.

B. Query

9. In view of above, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) has been sought by the querist on the issue as to whether change in non-current financial asset recognised in accordance with Ind AS 115 should be disclosed as cash flows from operating activity or under investing/financing activity as per Ind AS 7.

C. Points considered by the Committee

10. The Committee notes that the basic issue raised by the querist relates to classification of change in non-current financial asset in the cash flow statement. 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, accounting for the expenditure incurred on the project including classification of cash flows arising from such expenditure, classification of change in current financial asset in the cash flow statement, accounting for interest due/payable by the Authority, accounting for and classification of cash flows from interest and other finance costs incurred by the Company, appropriateness of classification of financial assets as current and non-current, accounting for Concession Agreement and application of Appendix D, ‘Service Concession Arrangements’ to Ind AS 115, ‘Revenue from Contracts with Customers’ in the extant case, recognition of revenue including the appropriateness of method used (input method), accounting for liquidated damages or penalty or bonus element, if any, included/adjusted in the annuity payments, etc. Further, the opinion expressed, hereinafter, is purely from accounting perspective and not from any legal

perspective or interpretation of terms of Concession Agreement. The Committee notes from the Facts of the Case that the Company is recognising revenue as per the requirements of Ind AS 115. Further, it is also noted from the Annual Reports provided by the querist for the perusal of the Committee that the Company is following the requirements of Appendix D, 'Service Concession Agreements' to Ind AS 115, 'Revenue from Contracts with Customers' for the Concession Agreement in the extant case. Although the Committee has not examined the application of the same in the extant case, the Committee presumes that it is a service concession arrangement within the scope of the Appendix D to Ind AS 115.

11. The Committee further notes the following relevant extracts from the Concession Agreement, provided by the querist for the perusal of the Committee as follows:

“2.1 Scope of the Project

The scope of the Project (the **“Scope of the Project”**) shall mean and include, during the Concession period:

- (a) construction of the Project on the Site set forth in Schedule-A and as specified in Schedule-B together with provision of Project Facilities as specified in Schedule-C, and in conformity with the Specifications and Standards set forth in Schedule-D;
- (b) operation and maintenance of the Project in accordance with the provisions of this Agreement; and
- (c) performance and fulfilment of all other obligations of the Concessionaire in accordance with the provisions of this Agreement and matters incidental thereto or necessary for the performance of any or all of the obligations of the Concessionaire under this Agreement”

“3.1.1 Subject to and in accordance with the provisions of this Agreement, Applicable Laws and Applicable Permits, the Authority hereby grants to the Concessionaire the concession set forth herein including the exclusive right, license and authority to construct, operate and maintain the project (the **“Concession”**) during the Construction Period of 912 (nine hundred and twelve) days and Operation Period of 15 (Fifteen) years commencing from COD, and the Concessionaire hereby accepts the Concession and agrees to implement the Project subject to and in accordance with the terms and conditions set forth herein.”

“5.8 Sole purpose of the Concessionaire

The Concessionaire having been set up for the sole purpose of exercising the rights and observing and performing its obligations and liabilities under this Agreement, the Concessionaire or any of its subsidiaries shall not, except with the previous written consent of the Authority, be or become directly or indirectly engaged, concerned or interested in any business other than as envisaged herein.”

“15.1.1 ... The Project shall enter into commercial service on COD whereupon the Concessionaire shall be entitled to demand and collect Annuity Payments in accordance with the provisions of this Agreement.”

“23.1 Bid Project Cost

The parties expressly agree that the cost of construction of the Project, as on the Bid Date, which is due and payable by the Authority to the Concessionaire, shall be deemed to be Rs. 1177.00 Crore (Rupees One Thousand One Hundred Seventy Seven Crore only) (The “**Bid Project Cost**”). The Parties further agree that the Bid Project Cost specified hereinabove for payment to the Concessionaire shall be inclusive of the cost of construction, interest during construction, working capital, physical contingencies and all other costs, expenses and charges for and in respect of construction of the Project, save and except any additional costs arising on accounts of variation in Price Index, Change of Scope, Change in Law, Force Majeure or breach of this Agreement, which costs shall be due and payable to the Concessionaire in accordance with the provisions of the Agreement. For the avoidance of doubt, the Bid Project Cost specified herein represents the amount due and payable by the Authority to the Concessionaire and may be less than, equal to, or more than the Estimated Project Cost.”

“23.3.1 40% (forty per cent) of the Bid Project Cost, adjusted for the Price Index Multiple, shall be due and payable to the Concessionaire in 5 (five) equal installments of 8% (eight per cent) each during the Construction Period in accordance with the provisions of Clause 23.4.

23.3.2 The remaining Bid Project Cost, adjusted for the Price Index Multiple, shall be due and payable in 30 (thirty) biannual installments commencing from the 180th (one hundred and eightieth) day of COD in accordance with the provisions of Clause 23.6.

23.4 Payment during Construction Period

Upon receiving a report from the independent Engineer certifying the achievement of the below mentioned Payment Milestones, the Authority shall disburse, within 15 (fifteen) days of the receipt of each such report, an installment equal to 8% (eight per cent) of the Bid Project Cost, adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of that report.

For the purpose of this Clause 23.4, the Payment Milestone for release of payment during Construction Period shall be as under:

- a) I (first) Payment Milestone – On achievement of 10% Physical Progress
- b) II (second) Payment Milestone – On achievement of 30% Physical Progress
- c) III (third) Payment Milestone – On achievement of 50% Physical Progress
- d) IV (fourth) Payment Milestone – On achievement of 75% Physical Progress
- e) V (fifth) Payment Milestone – On achievement of 90% Physical Progress

Provided that in case of Change of Scope, the Physical Progress shall be recalculated to account for the changed scope.”

“23.6 Annuity Payments during Operation Period

- 23.6.1 The (the “**Completion Cost**” shall be summation of A, B, C, D, E and F below:
- A. 10% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 10% Physical Progress.
 - B. Another 20% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 30% Physical Progress.
 - C. Another 20% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 50% Physical Progress.
 - D. Another 25% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 75% Physical Progress.
 - E. Another 15% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the date of report confirming 90% Physical Progress.
 - F. Another 10% of the Bid Project Cost adjusted for the Price Index Multiple as applicable on the Reference Index Date preceding the COD.

The Parties acknowledge and agree that the Authority has paid a portion of the Completion Cost as payments during Construction Period pursuant to Clause 23.4 of this Agreement. The balance Completion Cost remaining shall be due and payable during the Operation Period in accordance with provisions of Clause 23.6.2.

- 23.6.2 The Completion Cost remaining to be paid in pursuance of the provisions of Clause 23.6.1 shall be due and payable in biannual installments over a period of 15 (fifteen) years commencing from COD, (the “**Annuity Payments**”). The 1st (first) installment of Annuity Payments shall be due and payable within 15 (fifteen) days of the 180th (one hundred and eightieth) day of COD and the remaining installments shall be due and payable within 15 (fifteen) days of completion of each of the successive six months (“the **Annuity Payment Date**”). For the avoidance of doubt, the last Annuity Payment Date would be adjusted to in such a way that it falls at the end of the Operations Period.”

- “23.6.4 Interest shall be due and payable on the reducing balance of Completion Cost at an interest rate equal to the applicable Bank Rate plus 3% (three per cent). Such interest shall be due and payable biannually along with each installment specified in Clause 23.6.3. ... The Parties further agree that interest shall be calculated based on the number of days a particular Bank Rate was applicable during the period of calculation. For the purpose of illustration, assuming that the balance capital cost remaining to be paid is Rs. 100 crores on the 1st Annuity Payment Date, the applicable Bank Rate for the first 75 days is 8% and thereafter it is revised to 7.5% and remain unchanged till the 2nd Annuity Payment Date, the interest would be

calculated as $((100*11\%*75)/365)+((100*10.5\%*105)/365)$. For the avoidance of doubt, the interest would be calculated on simple interest basis and no compounding of the same would be undertaken.”

12. With regard to presentation in the statement of cash flows, 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.”

“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 sales 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.”

“20 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

- (a) changes during the period in inventories and *operating receivables* and payables;
- ...”

“31 **Cash flows from interest and dividends received and paid shall each be disclosed separately. Cash flows arising from interest paid and interest**

and dividends received in the case of a financial institution should be classified as cash flows arising from operating activities. In the case of other entities, 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.”

- “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 costs of obtaining financial resources or returns on investments.*”

(Emphasis supplied by the Committee.)

From the above, the Committee notes that an entity classifies its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business and allows users to assess the impact of those activities on the financial position of the entity. Cash flows derived from the principal revenue-generating activities are classified as cash flows from operating activities e.g. cash receipts from the sale of goods and rendering of services, royalties, commission, cash payments to suppliers for goods and services etc. The cash flows which represent the extent to which expenditure have been made for resources intended to generate future income and result in a recognised asset in the balance sheet are presented as cash flows from investing activities e.g. cash payments to acquire property, plant and equipment, intangibles, equity or debt instruments of other entities etc. In other words, in case of investing activities, the intent is to make expenditure for or invest in the resources/assets to generate future income and cash flows.

13. The Committee notes from the Facts of the Case and the Concession Agreement that the Company has been set up mainly for the purpose of construction, operation and maintenance of the Project for the Authority and other incidental activities under the Concession Agreement; and not for the purpose of investment in any asset to generate future income. The primary main revenue of the Company in the extant case arise from the construction, operation and maintenance services provided by the Company under the Concession Agreement. The Committee further notes that as per the terms of the Agreement, in lieu of the services rendered by the Company, it is entitled to 40% of the bid project cost in five equal instalments during the construction period. The remaining completion cost of the Project, viz., 60% of the bid project cost is payable in 30 biannual instalments over a period of fifteen years commencing from COD. Thus, the Committee notes that the consideration in lieu of rendering construction, operation and maintenance services by the Company is in the form of a financial asset, viz., a contractual right to receive cash. In other words, the financial asset (viz., the receivable due from the Authority) in the extant case is consideration for the services rendered by the Company and represents the outcome of principal revenue-producing activities of the Company. Accordingly, it can be considered as an operating receivable for the Company in the extant case. Consequently, since under indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of changes

during the period in operating receivables as per paragraph 20 of Ind AS 7, changes in non-current financial asset (receivable from the Authority) should be adjusted as ‘changes in operating receivables’ to determine the cash flow from operating activities under indirect method.

However, the Committee notes from the Facts of the Case and the Concession Agreement that interest shall be due and payable on the reducing balance of Completion Cost at an interest rate equal to the applicable Bank Rate plus 3% (three per cent) and that such interest shall be due and payable biannually along with each instalment. Thus, a portion of the financial asset, viz., receivable from the Authority contains an interest element also which is a financing component in the transaction. The Committee is of the view that such financing component which represents payment due to time value of money should be separated from the financial asset as per the relevant applicable Standard and should be considered and classified as cash flows from investing activities, considering the requirements of paragraphs 31 and 33 of Ind AS 7, as reproduced above.

D. Opinion

14. On the basis of the above, the Committee is of the opinion that in the statement of cash flows of the Company, as per the requirements of paragraph 20 of Ind AS 7, changes in non-current financial asset (receivable from the Authority) should be adjusted as ‘changes in operating receivables’ to determine the cash flow from operating activities under indirect method. Further, since a portion of the financial asset, viz., receivable from the Authority contains interest element also which is a financing component in the transaction; such financing component which represents payment due to time value of money should be separated from the financial asset as per the relevant applicable Standard and should be considered and classified as cash flows from investing activities, considering the requirements of paragraphs 31 and 33 of Ind AS 7, as discussed in paragraph 13 above.
