Query No. 15

Subject: Presentation of interest income on Balance Annuity Payment (60% of completion cost) from grantor under Ind AS framework.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the Company') is a government company within the meaning of section 2(45) of the Companies Act, 2013. The Company was incorporated as a Special Purpose Vehicle (SPV) by I Limited – its holding company and a government company, on 11th May 2017, for executing the project works of 'Six – laning of certain stretch of NH-48 (old NH-4) in the State of Karnataka under Hybrid Annuity Model under (HAM) NHDP Phase – V' in accordance with the terms of the Concession Agreement, signed with the National Highways Authority of India (NHAI) on 19th June 2017. Concession Period for the project is 15 years excluding the project construction period of 912 days.

2. The Company prepares the financial statements in accordance with Indian Accounting Standards (Ind ASs), under section 133 of the Companies Act, 2013 read together with the Companies (Indian Accounting Standards) Rules, 2015.

3. The Company is recognising revenue using input method as per Appendix D, 'Service Concession Arrangements' 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.

4. The Company and its holding company (I Ltd.) being government entities, are subject to Comptroller and Auditor General (C&AG) audit including appointment of the independent auditors under the Companies Act for all the entities involved. C&AG conducts a supplementary audit over and above the audit as required under the Companies Act, 2013 (earlier Companies Act, 1956) and issues a supplementary audit report/note on the financial statements.

5. The Bid Project Cost of the Project was Rs. 1,177.00 crore plus escalation wherein 40% project cost is payable by NHAI and 60% is to be funded by SPV in the form of equity and debt during the construction phase. 40% of the Bid Project Cost (BPC), adjusted for Price Index Multiple, shall be due and payable by the NHAI to the Concessionaire in 5 equal installments 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 installments commencing from the 180th day of Commercial Operation Date (COD).

In addition to above, the Concession Agreement states that the interest shall be due and payable on the reducing balance of completion cost (viz., 60% of the bid project cost, a receivable due from the Authority) 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.

[1] Opinion finalised by the Committee on 1.8.2024.

6. The Company has accounted for revenues and costs relating to the construction phase of the contract in accordance with Appendix D, 'Service Concession Arrangements' of Indian Accounting Standard (Ind AS) 115, 'Revenue from Contracts with Customers'. A financial asset is recognised during the construction activity and is measured at amortised cost. Moreover, the financial asset is reduced when the amounts are received. At Present, the construction phase of the project has been completed and the Company has received the provisional completion date with effect from May 28, 2021.

Now, the remaining completion cost of the Project, i.e., 60% of the bid project cost along with the interest is due and payable in 30 biannually installments by the Authority over the period of 15 years in the form of annuity commencing from COD. The interest revenue is accounted for as per Ind AS 109, 'Financial Instruments' in compliance of the requirements of Appendix D of Ind AS 115.

However, Appendix D of Ind AS 115 does not address the presentation of such interest income in the Statement of Profit and Loss. Therefore, clarification is required in respect of presentation of such interest income as 'Other Operating Revenue' or 'Other Income' in the Statement of Profit and Loss.

7. Technical Literature as referred by the querist:

The Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013 (Revised January, 2022 edition), issued by the ICAI (hereinafter referred to as 'the Guidance Note') states as follows:

> "**9.1.7.** Revenue from operations needs to be disclosed separately as revenue from
>
> (a) sale of products,
>
> (b) sale of services and
>
> (c) other operating revenues.
>
> It is important to understand what is meant by the term 'other operating revenues' and which items should be classified under this head vis-à-vis under the head 'Other Income'.
>
> **9.1.8.** The term 'other operating revenue' is not defined. This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services. *Whether a particular income constitutes 'other operating revenue' or 'other income' is to be decided based on the facts of each case and detailed understanding of the company's activities.*
>
> **9.1.9.** The classification of income would also depend *on the purpose for which the particular asset is acquired or held.* For instance, a group engaged in manufacture and sale of industrial and consumer products also has one real estate arm. If the real estate arm is continuously engaged in leasing of real estate properties, the rent arising from leasing of real estate is likely to be 'other operating revenue'. On the other hand, consider a consumer products company which owns a 10 storied building. The company currently does not need one floor for its own use and has given the same

temporarily on rent. In that case, lease rent is not an 'other operating revenue'; rather, it should be treated as 'other income'."

"9.2. Other income:

The aggregate of 'Other income' is to be disclosed on face of the Statement of Profit and Loss. As per Note 5 of General Instructions for the Preparation of Statement of Profit and Loss 'Other Income' shall be classified as:

(a) Interest Income;

(b) Dividend Income;

(c) Other non-operating income (net of expenses directly attributable to such income).

Ind AS 107, para 20(b) requires total interest revenue calculated using the effective interest method for financial assets that are measured at amortized cost and that are measured at FVOCI, to be shown separately.

Accordingly, 'Interest Income' for financial assets measured at amortized cost and for financial assets measured at FVOCI, calculated using effective interest method, should be presented in separate line items under 'Other Income'."

(Emphasis supplied by the querist.)

8. *Present Accounting Practice of the Company:*

Other operating income:

Other operating income represents income earned from the activities incidental to business and is recognised when performance obligation is satisfied and right to receive the income is established as per terms of contract.

Other income:

Interest income is recognised using Effective Interest Rate method.

During the financial year 2022-23, the Company has accounted Rs. 5,370.15 lakhs as interest income on the financial asset and presented it as 'Other Income' in the Statement of Profit and Loss as per the above stated policy. Accordingly, the Company has considered and classified the said interest income as cash flows from investing activities in the Statement of Cash Flows.

However, management wants to review this treatment as per the current industry practice.

9. The querist has stated that the views of the Company are as follows:

(i) The Company recognises the considerations given by the grantor, i.e., National Highways Authority of India (NHAI) in accordance with the Appendix D to Ind AS 115 under financial assets mode. Under financial assets mode, the Company has an unconditional contractual right to receive cash, i.e., fixed annuity including interest thereon. *Therefore, the interest income is in the nature of revenue* *received from contracts with customers and shall disclose separately from its other sources of revenue.*

(ii) Moreover, the finance income on the financial asset, i.e., amount due from the NHAI is the major portion of the total revenue of the Company in post construction phase of the Project, and thus, *finance income on financial asset is a key revenue generating activity of the Company*. Therefore, keeping in view the activities of the Company in the extant case, *finance income on financial asset can be considered to arise in the course of revenue generating activities of the Company.*

(iii) Also, the financial asset is created specifically to finance the annuity project and the interest income arises from the ongoing performance of the project; therefore, it might be considered an integral part of the overall operating activities related to the project.

(iv) The Company actively manages and participates in the development and operation of the annuity project, the interest income could be viewed as a form of compensation for its services and classified as 'other operating income'.

(v) Further, considering the requirements of paragraph 9.1.9 of the Guidance Note, regarding the *purpose for which the particular asset is acquired or held*, the financial asset (viz., a receivable due from the NHAI) in the extant case is the consideration for the services rendered by the Company and represents the outcome of principal revenue-generating activities of the Company; therefore, the management is of the view that it may be appropriate to disclose such finance income as 'other operating revenue' under 'revenue from operations' in the Statement of Profit and Loss.

(vi) As per the Company's understanding, the disclosure requirements as per Ind AS 107, 'Financial Instruments: Disclosure' regarding interest income calculated using effective interest method on financial assets measured at amortised cost as separate line item can be achieved by presenting such interest income as a separate line item 'Interest Income on Financial Asset under SCA' under 'revenue from operations', sub-head 'other operating revenue' in the Statement of Profit and Loss.

(vii) The industry practice is also such that even some of the leading infrastructure companies in HAM Projects are also classifying the said interest income under the head 'revenue from operations', sub-head 'other operating revenue'. Based on the facts and the relevant technical literature, the management of the Company is of the view that the said interest income shall be presented as a separate line item under 'revenue from operations', sub-head 'other operating revenue' and consequently, in the Statement of Cash Flows, the interest income on the amount due from NHAI (i.e. financial asset) shall be considered as 'Cash Flows from Operating Activities'.

B. Query

10. In view of the above facts, the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India is sought on:

(a) whether presentation of the interest income on the amount due from NHAI (i.e. financial asset) as per Service Concession Agreement (SCA) by the Company as a separate line item 'Interest Income on Financial Asset under SCA' under 'revenue from operations', sub-head 'other operating revenue' in the Statement of Profit and Loss is correct; and

(b) consequent treatment in Statement of Cash Flows as 'Cash Flows from Operating Activities' or as 'Cash Flows from Investing Activities'.

C. Points considered by the Committee

11. The Committee notes that the basic issue raised by the querist relates to the presentation of interest income on balance annuity payment (60% of BPC) to be received from NHAI as per SCA in the Statement of Profit and Loss and in the Statement of Cash Flows of the Company. 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, applicability of and accounting under Appendix D to Ind AS 115, 'Service Concession Arrangements', accounting for income/expenses incurred during project construction period, appropriateness of revenue recognition using input method, initial and subsequent recognition of financial asset, accounting for the project cost funded by the Company in the form of equity and debt during construction phase, accounting for bid project cost including escalation cost (if any), accounting for 5 equal installments received/receivable during construction period, accounting for remaining bid project cost adjusted for price index multiple received/receivable in 30 biannual installments commencing from the 180th day of commercial operation date (COD), appropriateness of the interest rate used and determination or measurement of interest income as per applicable Standards, accounting for any interest expense being incurred by the Company on the funds used (if any) and whether the same needs to be adjusted with interest income being earned by the Company, presentation of any other item (other than interest income) in the Statement of Cash Flows, etc. The Committee also wishes to mention that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended from time to time. Further, the opinion expressed is purely from accounting perspective and not from any legal or compliance perspective, such as, legal interpretation of the Concession Agreement, etc.

12. With regard to the presentation of interest income, the Committee notes that Appendix A of Ind AS 115 defines 'revenue' as "Income arising in the course of an entity's ordinary activities". The Committee also notes the following requirements of Ind AS 115 and Ind AS 1, 'Presentation of Financial Statements' and the 'Basis for Conclusions' to International Financial Reporting Standard (IFRS) 15 (corresponding to Ind AS 115), issued by the International Accounting Standards Board (IASB):

Ind AS 115

"65 An entity shall present the effects of financing (interest revenue or interest expense) separately from revenue from contracts with customers in the statement of profit and loss. Interest revenue or interest expense is recognised only to the extent that a *contract asset* (or receivable) or a contract liability is recognised in accounting for a contract with a customer."

Basis for Conclusions to IFRS 15

"BC246 The boards decided that an entity should present the effect of the financing (ie the unwinding of the discount) separately from revenue from contracts with customers, as interest revenue or interest expense, rather than as a change to the measurement of revenue. This is because contracts with financing components that are significant have distinct economic characteristics—one relating to the transfer of goods or services to the customer and one relating to a financing arrangement—and those characteristics should be accounted for and presented separately.

BC247 The boards noted that some entities (for example, banks and other entities with similar types of operations) regularly enter into financing transactions and, therefore, interest represents income arising from ordinary activities for those entities. The boards noted that the requirements in paragraph 65 of IFRS 15 do not preclude an entity from presenting interest as a type of revenue in circumstances in which the interest represents income from the entity's ordinary activities."

Ind AS 1

"82 In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:

(a) revenue, presenting separately interest revenue calculated using the effective interest method;

…"

From the above, the Committee notes that Ind AS 115 uses the expression 'interest revenue' for the effects of financing under contracts with customers. Further, Ind AS 115 read with requirements of Ind AS 1 requires to present such 'interest revenue' separately from 'revenue from contracts with customers' in the Statement of Profit and Loss.

13. In the above context, the Committee notes the following clauses from the Concession Agreement entered into between the Company and NHAI for execution of the said project:

“**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 account 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.”

“23.6.3 Each of the Annuity Payments due and payable during the years following the COD shall be as under:

Annuity following the COD	Percentage of Completion Cost remaining to be paid on COD
1st Annuity	2.10%
2nd Annuity	2.17%
…	
29th Annuity	4.75%
30th Annuity	4.75%

Each of the biannual installments payable hereunder shall be paid along with interest as specified in Clause 23.6.4.

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. For the avoidance of doubt and by way of illustration, the Parties agree that interest on the Completion Cost remaining to be paid, calculated from COD and until the 180th (one hundred and eightieth) day of COD, shall be due and payable to the Concessionaire along with the first Annuity Payment and interest on *[2]% (* per cent) of the Percentage of Completion Cost remaining to be paid on COD, calculated from first Annuity payment date and until the 1st (first) anniversary of COD, shall be due and payable along with the second Annuity Payment due and payable under this Agreement. 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 remains unchanged till the 2nd Annuity Payment Date, the interest

[2] To be finalised on the basis of outstanding Completion Cost Annuity pursuant to the payment of 1st Annuity as provided in the Annuity payment schedule in Clause 23.6.3.

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."

From the above, the Committee notes that Bid Project Cost inter alia includes interest during construction. Further, the terms of arrangement with NHAI state 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%, which shall be due and payable biannually along with the installments of remaining completion cost of the Project i.e., 60% of the bid project cost to be received by the Company from the NHAI after COD. It appears from the above that the interest element is an integral part of the overall arrangement with the NHAI and is being paid by the NHAI as compensation or consideration for overall services being rendered by the Company. Thus, it can be construed that the interest income in the extant case is arising from the operating activities of the Company. Therefore, in view of the requirements of Ind AS 115 and Ind AS 1, the interest income on balance annuity payment in the extant case can be presented as 'other operating revenue' in the Statement of Profit and Loss.

14. The Committee also notes the following paragraphs from the Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013, issued by the ICAI (hereinafter referred to as 'Guidance Note'):

"**9.1.7.** Revenue from operations needs to be disclosed separately as revenue from

(a) sale of products,

(b) sale of services and

(c) other operating revenues.

It is important to understand what is meant by the term "other operating revenues" and which items should be classified under this head vis-à-vis under the head "Other Income".

9.1.8. The term "other operating revenue" is not defined. *This would include Revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue-generating activities, but which is not revenue arising from sale of products or rendering of services.* Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities.

9.1.9. The classification of income would also depend on the purpose for which the particular asset is acquired or held. For instance, a group engaged in manufacture and sale of industrial and consumer products also has one real estate arm. If the real estate arm is continuously engaged in leasing of real estate properties, the rent arising from leasing of real estate is likely to be "other operating revenue". On the other hand, consider a consumer products company which owns a 10 storied building. The company currently does not need one floor for its own use and has given the same temporarily on rent. In that case, lease rent is not an "other operating revenue"; rather, it should be treated as "other income".

9.1.10. To take other examples, sale of Property, Plant and Equipment is not an operating activity of a company, and hence, profit on sale of Property, Plant and Equipment should be classified as other income and not other operating revenue. On the other hand, sale of manufacturing scrap arising from operations for a manufacturing company should be treated as other operating revenue since the same arises on account of the company's main operating activity.

9.2. Other income

The aggregate of 'Other income' is to be disclosed on face of the Statement of Profit and Loss. As per Note 5 of General Instructions for the Preparation of Statement of Profit and Loss 'Other Income' shall be classified as:

(a) Interest Income;

(b) Dividend Income;

(c) Other non-operating income (net of expenses directly attributable to such income).

Ind AS 107, para 20(b) requires total interest revenue calculated using the effective interest method for financial assets that are measured at amortized cost and that are measured at FVOCI, to be shown separately.

Accordingly, 'Interest Income' for financial assets measured at amortized cost and for financial assets measured at FVOCI, calculated using effective interest method, should be presented in separate line items under 'Other Income'.

…"

(Emphasis supplied by the Committee.)

In view of the above requirements including exercising judgement with regard to nature of activities and other factors, and considering the fact that 'income' is a broader concept encompassing revenue, gains and other items recognised as income, the Committee is of the view that the interest income on balance annuity payment in the extant case can also be presented separately under 'other income'.

15. With regard to presentation of cash flows from interest income in the Statement of Cash Flows, the Committee notes the following requirements 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."**

"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."

From the above, the Committee notes that paragraph 33 of Ind AS 7 explicitly states that in case of an entity which is not a financial institution, it is more appropriate that interest received is classified as investing cash flows. Therefore, in the extant case, the cash flows arising from the interest income on balance annuity payment from the Authority should be classified as cash flows from investing activities.

D. Opinion

16. On the basis of above and subject to paragraph 11 above, the Committee is of the view that in the extant case, considering the requirements of the Ind AS and Guidance Note and the information and facts available with the Committee, interest income on balance annuity payment in the extant case can be presented as 'other operating revenue' in the Statement of Profit and Loss, as discussed in paragraphs 12 to 14 above. Further, the cash flows arising from the interest income on balance annuity payment from the Authority should be classified as cash flows from investing activities, as discussed in paragraph 15 above.

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