Assurance EYe

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01

Uncommon issues in common control transactions

The application of Indian Accounting Standards (Ind AS), particularly Ind AS 103 Business Combinations to business combinations outside the common control and its Appendix C to common control business combinations, has brought significant standardization and improvements to accounting for such transactions. As more and more companies undertake such transactions as well as with the evolution of new/ emerged structure and other related developments, accounting for common control transactions continues to pose peculiar/ uncommon issues. In this article, we explore a few peculiar issues and possible accounting views.

Merger of entities under common control: merged entity does not meet definition of business

Many sectors such as real estate and renewable power generation involve structures whereby the parent entity sets-up a separate special purpose vehicle (SPV) to carry out a particular project. The experience suggests that whilst these SPVs have separate assets/ inputs and generate revenue, they do not have substantial number of employees, nor do they have any substantive processes. Hence, these SPVs may not meet the definition of business as per Ind AS 103, Business Combination. As part of internal group restructuring, these SPVs may merge with the parent entity/ fellow subsidiary. To illustrate, ABC is a parent entity primarily engaged in the business of generating and selling power from solar power projects through multiple subsidiaries/ SPVs, with each SPV having one power project. The parent proposes to merge one of its wholly owned subsidiaries (WOS/SPV) with itself to simplify the group structure.

Accounting issue

How should the merger be accounted for in separate financial statements of the parent entity? Assume that merged/ merging SPV is a home-grown subsidiary of ABC and there are no transitory control issues.

Possible views

The following views seem possible on this matter:

Barter transaction/ exchange accounting at fair value

One may argue that pursuant to merger transaction, the parent entity is giving up its investment in the SPV and receiving underlying assets and liabilities of the SPV in exchange. The parent entity accounts for exchange transaction in its separate financial statements in below manner:

- Recognize identifiable assets and liabilities (including intangible assets) at fair value.
- Derecognize the carrying amount of investment given up.
- Difference, if any, between fair value of the net assets received and carrying amount of investment given up is gain/ loss to be recognized in P&L.

The counter argument to this view is that the parent is merging its wholly owned subsidiary with itself and there is no substance to the transaction. Hence, recognition of gain/ loss is not appropriate.

Asset acquisition accounting at book value

Under Ind AS, a transaction involving acquisition of multiple assets for a consolidated price is accounted for by allocating consideration paid to the assets acquired and liabilities assumed. Also, under transactions having no economic substance, there should be no gain/ loss recognition. It may be argued that transaction involving merger of the wholly owned subsidiary with the parent does not have any economic substance with the consequence that there should be no gain/ loss on merger. Hence, the parent should apply below accounting in its separate financial statements:

- Determine fair value of all identifiable assets acquired and liabilities assumed (including previous unrecognized assets/ liabilities) as part of the merger transaction.
- Allocate the consideration paid (investment cancelled) to the assets and liabilities based on the fair value.
- Recognize assets and liabilities at allocated amounts such that there is no gain/ loss on the merger.

The counter argument is that considering lack of economic substance, recognition of new assets and liabilities appears counter intuitive. Also, this view may be unduly complicated to apply in practice.

Apply Appendix C to Ind AS 103

Unlike business combination definition in Ind AS 103, Appendix C to Ind AS 103 defines '*Common control business combination*' as `… business combination involving entities or businesses in which all the combining entities …'. This seems to suggest that only for the purpose of Appendix C to Ind AS 103, the scope goes beyond business combination, and it even includes combination of entities under common control which may not meet the definition of business in accordance with Ind AS 103.

Considering the above, it may be argued in case of merger transaction between entities under common control where there is no transitory control issue, pooling of interest method as prescribed in Appendix C to Ind AS 103 can be applied. This view, if adopted, will apply only for merger/ combination of entities under common control.

This view should strictly be applied in the case of a merger or amalgamation under common control and should not be generalized to other mode of common control transactions such as where group of assets and liabilities are acquired through slump sale and the entity is not merged or amalgamated.

Debate among various possible viewpoints, viz., barter accounting, asset acquisition accounting and pooling of interest method accounting, underscores diverse accounting on the date of merger which will have an ongoing impact on the financial statements.

Concluding remarks

The issue is quite common. We recommend that the Ministry of Corporate Affairs (MCA)/ the National Financial Reporting Authority (NFRA)/ the Institute of Chartered Accountants of India (ICAI) should provide an appropriate clarification or guidance on how to deal with this situation. Till the time such guidance is provided, it is imperative that the companies consider substance of their transaction in evaluating various possible views. They should also discuss and agree view with their auditors upfront. Irrespective of view adopted at the separate financial statements, merger of subsidiary with the parent will not impact consolidated financial statements (CFS).

Merger accounting: use of SFS vs. CFS numbers

Appendix C to Ind AS 103 prescribes the pooling of interest method requiring use of carrying amount as per the financial statements to account for common control business combination. However, the Appendix does not specify whether the carrying amounts to be used for such accounting should be taken from standalone financial statements (SFS) of the merging entity or from the CFS of the parent entity. To illustrate, assumed that a parent has acquired a subsidiary, which is business as per Ind AS 103, several years ago. On the date of acquisition, the parent applied Ind AS 103 and recorded assets and liabilities of the subsidiary at fair value and the said fair value is cost of the respective assets and liabilities for subsequent accounting in the CFS of the parent. However, the fair value accounting in CFS of the parent did not have any impact on accounting in the subsidiary's own financial statements and they continue to be prepared as per the historical cost. The subsidiary is now merging with the parent which results in an issue whether the parent should use carrying amount of assets and liabilities as per its CFS or as per SFS of the subsidiary to recognize merger in its SFS. It may be noted that, irrespective of approach used in the parent's SFS, the merger will not have any impact on CFS of the parent.

Whilst Appendix C to Ind AS 103 does not explicitly deal with the issue, the Ind AS Transition Facilitation Group (ITFG) in its Clarification Bulletin 9, Issue 2, stated that in case of subsidiary merger with the parent, it would be appropriate to recognize the carrying value of the assets, liabilities and reserves pertaining to subsidiary as appearing in the consolidated financial statements of the parent. Separate financial statements to the extent of this common control transaction will be considered as a continuation of the consolidated group. The ITFG had also clarified that in case of a merger between two fellow subsidiaries, the carrying amount of assets and liabilities as per the SFS of the merged entity is used.

Recently, the *Expert Advisory Committee* (EAC) has published an opinion on the subject '*Accounting treatment and disclosure of Debit Balance of Capital Reserve arising on merger*' which deals with the same issue in a scenario of subsidiary merging with the parent. In this opinion, the EAC has stated that in the case of subsidiary merger with the parent, the use of carrying amount as per SFS of the merging entity (subsidiary) can also be a possible view. To support this view, the EAC noted that Appendix C to Ind AS 103 defines 'transferor' and 'transferee' as separate entities and paragraphs 11 and 12 of Appendix C require preserving identity of the reserves in the financial statements of the transferee as they appeared in the transferor's financial statements. Hence, it may be argued that Appendix C contemplates recognizing assets and liabilities at carrying amounts as per the SFS of the merging entity.

Considering the ITFG clarification and the EAC opinion read with Appendix C to Ind AS 103, the following views seem plausible:

- **Merger of subsidiary with the parent**: Companies have an accounting policy choice to use either carrying amounts as per SFS of the merged entity or those as per CFS of the parent. The selected accounting policy should be applied consistently.
- **Merger of fellow subsidiaries**: Need to use carrying amount as per SFS of the merging entity only. There is no option to use carrying amount as per CFS of the parent.

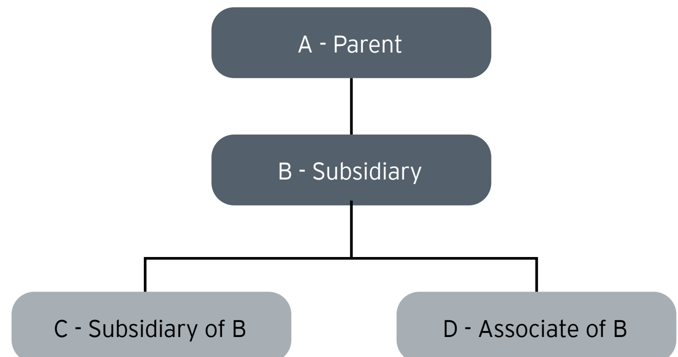
Merger of parent with subsidiary

Whilst the EAC Opinion and ITFG Clarification deal with merger of the subsidiary with the parent and merger of fellow subsidiaries, they do not specifically deal with the scenario where a parent is merging with the subsidiary. In such a case, whether the carrying amount of assets and liabilities as per SFS of the merging entity (parent) or those as per CFS of the parent should be used. Though the matter is not specifically addressed, it may be noted that the carrying amount of assets and liabilities pertaining to the parent as appearing in the parent's SFS will not be different from the amounts appearing in the CFS of the parent. Whilst the parent may have accounted for subsidiary acquisition at fair value in its CFS, the subsidiary is a surviving entity and cannot change carrying amount of its own assets and liabilities as appearing in its SFS. Hence, we believe that in this scenario, for merger accounting in SFS of the subsidiary, to use the carrying amount as per SFS would be more appropriate.

Post merger, the subsidiary will generally need to prepare the CFS of the group in addition to its own SFS. From the group CFS perspective, nothing has changed and it is continuation of the same old group. Hence, the CFS of the subsidiary should reflect continuation of the parent CFS, with minimal logistic changes such as to update names and to reflect share capital structure of the surviving entity.

Use of CFS carrying amounts: practical challenges

Consider that an acquired subsidiary is merging with the parent and the parent has decided to use the carrying amount as per the CFS of the parent. Given below is pre-merger group structure.



In this scenario, when parent A applies CFS carrying amounts to account for subsidiary B merger, it is clear that assets and liability as well as reserves of subsidiary B pertaining to its standalone operations will appear at carrying amounts taken from CFS of parent A. In the SFS of merged entity A, investment in C and D will still appear as investment in subsidiary and associate, respectively. The issue is how the carrying amount of these investments should be arrived at? Neither the ITFG nor the EAC opinion has specifically dealt with this issue. In the absence of specific guidance, given below are various possible views on this matter.

Companies often face practical challenges in applying CFS numbers consistently across different types of mergers under common control, highlighting a need for additional guidance.

<table>
<tr><th>Sl.No.</th><th>Particulars</th><th>Remarks</th></tr>
<tr><td colspan="3">Investment in C</td></tr>
<tr><td>1.</td><td>Carrying amount of investment as appearing in SFS of B</td><td>Since parent A has chosen to use CFS carrying amounts for applying merger accounting, one may argue that the same approach should be used for the entire merger accounting. Hence, this view may not be acceptable.</td></tr>
<tr><td>2.</td><td>Carrying amount of net assets of C as appearing in CFS of A</td><td rowspan="2">Both these options ensure that carrying amounts as appearing in CFS of A are used for merger accounting. However, in option 2, post-acquisition profit and other reserves of C get included in reserves of A, whilst C itself is not merged with A. One may question whether it is an acceptable outcome or reserves of C should continue to be separate? In our view, it may be preferable to keep post-acquisition profit and other reserves of C separate. Thus, option three seems to be a more appropriate view.</td></tr>
<tr><td>3.</td><td>Carrying amount of net assets less reserves pertaining to C as appearing in CFS of A</td></tr>
<tr><td colspan="3">Investment in D</td></tr>
<tr><td>1.</td><td>Carrying amount of investment as appearing in SFS of B</td><td>Since parent A has chosen to use CFS carrying amounts for applying merger accounting, one may argue that the same approach should be used for the entire merger accounting. Hence, this view may not be acceptable.</td></tr>
<tr><td>2.</td><td>Carrying amount of investment in D by applying the equity method as appearing in CFS of A</td><td rowspan="2">Both these options ensure that carrying amounts as appearing in CFS of A are used for merger accounting. However, in option 2, post-acquisition profit and other reserves of D get included in reserves of A, whilst D itself is not merged with A. One may question whether it is acceptable outcome or reserves of D should continue to be separate? In our view, it may be preferable to keep post-acquisition profit, OCI and other changes in equity of D separate. Thus, option three seems more appropriate.</td></tr>
<tr><td>3.</td><td>Carrying amount of investment in D by applying the equity method as appearing in CFS of A less profit, other comprehensive income (OCI) and other change in equity added to investment through use of equity method in current and earlier years</td></tr>
</table>

It is crucial for companies to maintain consistency in their approach to use either SFS or CFS numbers for similar transactions and ensuring that the chosen method aligns with their overall financial reporting strategy and complies with regulatory requirements.

How we see it

Accounting for common control business combination poses many practical challenges and this article describes only a few of them. Till recently, it was expected that the International Accounting Standards Board (IASB) is developing a separate guidance on Business Combinations under Common Control (BCUCC) and the proposed guidance will deal with all practical aspects in a comprehensive manner. However, the IASB has recently decided not to develop requirements for reporting BCUCC and discontinued its work on the project, leaving the area unaddressed. We recommend that considering importance of such transactions in the Indian scenario, the MCA, the NFRA and the ICAI should revise Appendix C to Ind AS 103 and provide more comprehensive guidance on this topic.

02

Key accounting considerations for share-based payments

Employee Stock Options and other share-based payment plans (collectively, referred to as 'ESOPs') serve as a valuable tool to reward employees among various organizations from startups to established corporates. Over periods, an increased number of organizations are using ESOPs for retaining talent as well as for allowing employees to partake in the organization's value growth akin to equity shareholders. Key drivers for implementing ESOPs are high performance, retention of employees, wealth creation and creating a feeling of ownership among employees. Also, many start-up companies provide a significant portion of employee compensation through ESOP as they may not have readily available cash or need to preserve cash for other business needs. Also, companies are using more innovative terms in ESOP to achieve the desired business and employee remuneration impact.

Considering significance of ESOP accounting for financial statements and related challenges, this article deals with certain commonly occurring practical challenges related to ESOP accounting.

Classification of share-based payments (Equity vs. cash settled)

Classification of ESOP as equity or cash-settled is a critical step in deciding an appropriate accounting for ESOP, as accounting requirements for these two types of transactions differ significantly. In case of equity-settled transaction, ESOP expense to be recognized is fixed upfront on the grant date and subsequent changes in the fair value of shares do not impact measurement of ESOP expense. In contrast, in a cash-settled transaction, ESOP cost needs to be remeasured through-out the vesting period and subsequently till final settlement date. A company whose share prices are generally increasing will be expected to recognize significantly higher expense if ESOP were classified as cash settled.

The classification of an ESOP as equity or cash settled depends on the nature of the entity's obligation toward the counterparty providing goods or service. An equity-settled transaction is a share-based payment transaction in which the entity (i) receives goods or services in exchange for its own equity shares, or (ii) receives goods or services but has no obligation to settle the transaction with the supplier. In contrast, cash-settled transaction is a transaction in which the entity acquires goods or services in exchange for a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the equity shares of the entity or another group entity.

Ind AS 102 requires an entity to look beyond the simple issue of whether an award entitles an employee to receive instruments that are in the form of shares or options to the terms of those instruments. For example, an award of shares or options over shares whose terms provide for their redemption either mandatorily or at the employee's option would be treated as a cash-settled and not equity-settled award. Further, under Ind AS 102, obligation to pay cash/ settle in cash can also arise from past practice or constructive obligation. Overall, there is a need to see substance rather than mere legal form to decide equity vs. cash settled.

Where an individual provides services to more than one group entity, an assessment will need to be made as to which entity or entities are receiving the individual's services in return for the award. This will depend on the precise facts and circumstances of a particular situation.

Several practical issues arise regarding classification of share-based payment awards. Refer below the key considerations of certain common arrangements:

ESOPs issued by an unlisted entity

ESOPs issued by unlisted entity might appear to be equity-settled in form but may need to be analyzed more carefully, such that classification reflects true economic substance arising from formal or informal arrangements put in place by the entity for the employees/ service providers to sell their shares. This may require the entity to carefully consider aspects such as whether it has directly or indirectly committed cash payment to employees, past practice of the entity to provide cash, whether the entity is allowed to issue shares on exercise of ESOP, whether other shareholders are willing to dilute their stake pursuant to issuance of shares to ESOP holders, alternate current or potential avenues for the employees to get cash against shares say through proposed listing and employees' ability/ willingness to hold shares. It is recommended that entities exercise such judgment with due care. They should also evaluate whether judgment exercised needs to be disclosed, considering Ind AS 1 requirement for disclosure of significant judgments.

Market purchases of own equity used to satisfy awards:

In certain cases, an entity may choose to settle equity-settled ESOP using shares purchased now or previously in the market rather than by issuing new shares. In our view, this does not mean that the transaction is cash-settled, since there is no obligation to deliver cash to the counterparty. The purchase

of own shares is accounted for in accordance with the requirements of Ind AS 32 *Financial Instruments: Presentation* relating to treasury shares.

Broadly speaking, so long as there is no obligation (explicit or implicit) for the entity to settle in cash with the counterparty, such market purchase arrangements will not require a scheme to be treated as cash-settled under Ind AS 102. This will be the case even where the entity, as a means of managing the dilutive impact on earnings per share of equity-settlement, routinely buys back shares broadly equivalent to the number issued in settlement. However, in our view, there might be situations in which post-settlement market share purchases are indicative of an obligation to the counterparty, such that treatment as a cash-settled scheme may be appropriate. For example, the shares might be quoted in a market which is not very deep, or in which the entity itself is a major participant. If the entity were to create an expectation to the employees that any shares awarded can always be liquidated immediately, because the entity will ensure that there is sufficient depth in the market to do so, then it could well be appropriate to account for such a scheme as cash settled.

One more extreme example of such a situation would be where the entity has arranged for the shares delivered to the counterparty to be sold on the counterparty's behalf by a broker but has at the same time entered into a contract to purchase those shares from the broker. In that situation, in our view, the substance is that:

- The entity has created an expectation to the counterparty of a right to receive cash.
- The broker is no more than an agent paying that cash to the counterparty on behalf of the entity.

Besides the above, a question sometimes asked is whether the entity is required to recognize some form of liability to repurchase its own equity in situations where the entity has a stated policy of settling equity-settled transactions using previously purchased treasury shares. To illustrate this point, a public commitment to settle equity-settled transactions by purchasing treasury shares is no different in substance to a commitment to a share buyback program. There would be no question under Ind AS 32 of recognizing a liability to repurchase own equity on the basis merely of a declared intention. It is only when the entity enters into a forward contract or a call option with a third party that some accounting recognition of a future share purchase may be required.

How we see it

Situations where an entity makes a market purchase of its own shares shortly after issuing a similar number of shares in settlement of an equity-settled transaction will require detailed analysis to determine appropriate classification of the share-based payment award. This will require the entity to go beyond stated terms of ESOP grant and find out substance of the transaction. This will involve significant judgment.

Share-based payment with a choice of settlement

The classification of awards will differ depending on whether the choice rests with the counterparty (i.e., employee, etc.) or the entity.

If a counterparty chooses settlement of the award in either shares or cash, Ind AS 102 treats it as a compound award. A compound award is split into two components: a liability component (the counterparty's right to demand settlement in cash) and an equity component (the counterparty's right to demand settlement in shares).

Transactions with non-employees are normally measured by reference to the fair value of goods and services supplied at service date (i.e., the date at which the goods or services are supplied). Accordingly, where an entity enters into such a transaction where the counterparty has choice of settlement, it determines the fair value of the liability component at the service date. The equity component is the difference between the fair value (at service date) of the goods or services received and the fair value of the liability component.

All other transactions, including those with employees, are measured by reference to the fair value of the instruments issued at 'measurement date', being grant date in the case of transactions with employees and service date in the case of transactions with non-employees. In such a case, the entity will measure the fair value of the liability component first and the said fair value will equal the fair value of the liability under the cash alternative. After measuring liability component, the fair value of the equity component is measured and such measurement considers whether the employee will forfeit its right to the cash alternative to receive equity shares. If yes, then the incremental value of the equity component is generally zero. However, if the employee will get any additional discount by choosing the equity alternative, then equity settlement option will have such an incremental value. Once split, the entity accounts for the two components separately.

If an entity chooses the settlement method, it treats the whole award as either cash-settled or equity-settled, depending on whether or not the entity has a present obligation to settle in cash. An entity has a present obligation to settle in cash and ESOP is treated as cash settled, if any of the following apply:

- The choice of settlement has no commercial substance (e.g., because an entity is prohibited by law from issuing shares).
- An entity has a past practice or stated policy of settling in cash.
- An entity generally settles in cash whenever the counterparty asks for cash settlement.

Contingently cash-settleable equity instruments

Sometime ESOP needs to be settled in cash only on occurrence and non-occurrence of contingent events such as IPO or change in control, which are not within the control of either party. Ind AS 102 does not provide clear guidance on classification of such awards. In the absence of clear guidance, there is a need to exercise judgment on this matter. Basis judgment, below two approaches seem possible on this matter.

Approach 1: Treat as cash-settled if contingency is outside entity's control

One approach might be to observe that the underlying principle which determines whether an award is accounted for as equity-settled or cash-settled under Ind AS 102 appears to be whether the entity can unilaterally avoid cash-settlement. Under this approach, any award where the counterparty has a actual or potential right to cash-settlement is always treated as a liability, irrespective of the probability of cash-settlement, since there is nothing that the entity could do to prevent cash-settlement. By contrast, an award where the choice of settlement rests with the entity is accounted for as a liability only where the entity's own actions have effectively put it in a position where it has no real choice but to settle in cash.

Approach 2: Treat as cash-settled if contingency is outside entity's control and probable

ASC 718 under the US GAAP states that a cash settlement feature which can be exercised only upon the occurrence of a contingent event outside the employee's control does not give rise to a liability until it becomes probable that the event will occur. In our view, an approach based on the probability of a contingent event that is outside the control of both the counterparty and the entity is also acceptable under Ind AS. The implied rationale is that Ind AS 102 clearly notes a number of inconsistencies between Ind AS 102 and Ind AS 32 and so there is no requirement to follow Ind AS 32 in respect of contingent cash settlement arrangements. It is therefore appropriate to have regard to the principles of Ind AS 37 in determining whether an uncertain future event gives rise to a liability. Ind AS 37 requires a liability to be recognized only when it is probable (i.e., more likely than not) to occur.

In our view, in the absence of specific guidance in Ind AS 102, the two different approaches stated above could be applied to awards which offer no choice in settlement but instead require cash settlement in certain specific and limited circumstances (i.e., awards with contingent cash settlement).

Group share-based payments and inter-company recharges

Many groups operate a single ESOP scheme covering employees of parent and several subsidiaries. For example, the group may formulate an ESOP scheme whereby parent shares will be given to the employees of the parent as well as other subsidiaries of the group if they meet specified vesting conditions. It is observed in practice that whilst overall construct of the Schemes is same, there are differences with regard to specific aspects such as who is obligated toward the counterparty to settle the scheme and whether the group entity settling ESOP scheme has a right to recover from the entity who actually receives those goods or services.

Ind AS 102 is clear that such ESOP schemes are also covered under Ind AS 102. From the consolidated financial statements of the group perspective (which include both the receiving and settling entities), the accounting will be relatively simple and normal principles of Ind AS 102 will apply to recognize ESOP expense. Peculiar issues arise from the perspective financial statements of receiving or settling entity, which does not include the other entity. Ind AS 102 provides guidance on dealing with such issues. It clarifies that:

- The receiving entity, i.e., the entity which receives goods or services, will recognize ESOP expense if the grant meets criteria for expense recognition particularly the employees meet vesting condition(s). The corresponding impact is adjusted based on relationship between the receiving and the settling entity. For example, if the parent is settling ESOP with the employees, the subsidiary which receives employee services recognizes the corresponding amount as capital contribution.
- The settling entity, i.e., the entity which settles ESOP grant with the counterparty, will not recognize ESOP expense if it has not received good or service. The corresponding impact is adjusted based on relationship between the receiving and the settling entity. For example, if the parent is settling ESOP granted to the employees of the subsidiary, the parent in its separate financial statements treats the amount as an additional investment in the subsidiary.
- As already stated, in the consolidated financial statements of the group (which includes both the receiving and settling entities), the entries related to capital contribution and additional investment will eliminate and accounting as per Ind AS 102 will apply.

Share-based payment awards issued by unlisted entities need to be carefully analyzed, in light of their peculiar facts and circumstances, to decide equity-settled or cash-settled classification.

In applying the above accounting in financial statements of receiving and/ or settling entity, the following two common issues arise.

Classification of share-based payments

Ind AS 102 is clear that an entity receiving goods or services will account for the ESOP as equity-settled if:

- The awards granted are the entity's own shares, or
- The entity has no obligation to settle an ESOP grant. For this purpose, an entity needs to consider a settlement obligation only toward the counter-party. The fact that the entity may be required to pay management recharge to the parent/ other group entity settling the award will not change the classification or is ignored for this purpose.

In all other situations, the entity receiving the goods or services should account for the award as cash settled. The following table summarizes the classification as equity or cash-settled ESOP in a group scenario.

SL.No.	Who grants the award?	Entity receiving goods or services?	Entity settling the award?	Entity whose shares are awarded	Manner of settlement	Classification by receiving entity	Classification in group CFS
1.	Parent	Subsidiary	Parent	Parent	Shares	Equity - No obligation to settle	Equity - Own shares
2.	Shareholder	Subsidiary	Shareholder	Parent	Shares	Equity - No obligation to settle	Equity - No obligation to settle
3.	Subsidiary	Subsidiary	Subsidiary	Parent	Shares	Cash - obligation to settle with Parent shares	Equity - Own shares
4.	Subsidiary	Subsidiary	Subsidiary	Subsidiary	Shares	Equity - Own shares	Equity - it is settled in equity instrument of the Group.
5.	Parent	Subsidiary	Parent	Subsidiary	Shares	Equity - No obligation to settle	Equity - it is settled in equity instrument of the Group.
6.	Parent	Subsidiary	Parent	Parent	Cash	Equity - No obligation to settle	Cash as cash is paid
7.	Shareholder	Subsidiary	Shareholder	Parent	Cash	Equity - No obligation to settle	Equity - No obligation to settle

The entity accounts for the transaction as equity-settled when either the awards granted are the entity's own equity instruments, or the entity has no obligation to settle the share-based payment transaction.

Inter-company recharges

Ind AS 102 does not address the appropriate accounting for intragroup recharges, except to say that intragroup payment arrangements should not affect the accounting for the underlying share-based payment arrangement. Hence, the above classification and accounting for ESOP will apply irrespective of whether settling entity cross charges expense to the receiving entity through inter-company recharge arrangement.

Determining the appropriate accounting for recharge arrangement requires consideration of specific aspects and circumstances. This may have an impact on two key aspects of accounting.

Where to recognize inter-company charge

The first important question is where should the subsidiary receiving goods or services recognize amount paid through inter-company recharge arrangement? Should it be recognized as an expense in the statement of profit and loss (P&L)? Since the subsidiary has already recognized ESOP expense, this may result in recognition of double expense in the P&L. To avoid this, can the subsidiary debit inter-company recharge to the capital contribution recognized against ESOP expense?

In our view, this will depend on whether the recharge is clearly linked to ESOP awards. This will particularly be the case where recharge arrangement is based directly on the value of the underlying ESOP - typically at grant date, vesting date

or exercise date. If this is the case, it may be appropriate accounting treatment to offset the amount of recharge against the capital contribution arising for ESOP in separate financial statements of the subsidiary by recognizing a corresponding payable. In certain cases, it may so happen that the amount of recharge is higher or lower than ESOP expense recognized, e.g., ESOP expense is based on grant date measurement and exercise date measurement is used for the recharge. We believe that even in such cases, the subsidiary will debit full recharge amount to the equity, i.e., it should not split recharge amount between partly equity and partly as an expense in the statement of profit and loss. However, in this case, the parent could choose whether to credit the carrying amount of its investment in subsidiary (up to the capital contribution previously debited to the carrying amount of investment) with the excess recognized in profit or loss or the full receipt recognized in profit or loss.

There may be certain cases where there is no clear link between ESOP and the recharge from the parent, e.g., because there is a general overall management recharge. In such cases, the amount of general recharge will be debited to the statement of profit and loss of the subsidiary and credited to the statement of profit and loss of the parent. Hence, in this scenario, both Ind AS 102 charge and the management charge will be adjusted in the statement of profit and loss only.

How we see it

In our view, whilst Ind AS 102 as currently drafted does not explicitly require subsidiary to charge cross recharge in equity, this is likely to be the more appropriate analysis for most cases where the amount of the recharge or management charge to a subsidiary is directly related to the value of the share-based payment transaction. Indeed, the only alternative, 'mechanically' speaking, would be to charge the relevant amount to profit or loss. This would result in a double charge (once for the Ind AS 102 charge, and again for the management charge or recharge) which we consider not only less desirable for most entities, but also less appropriate in cases where the amounts are directly related.

Timing of the inter-company recharges

A further issue that arises in practice is the timing of recognition of the recharge by the parties to the arrangement. The treatment adopted might depend to some extent on the precise terms and whether there are contractual arrangements in place. An evaluation based on this generally results in either of the below two approaches in practice:

- To account for the recharge when it is actually levied or paid (which is consistent with accounting for a distribution).
- To accrue recharge over the life of the award or the recharge agreement even if, as is commonly the case, the actual recharge is only made at vesting or exercise date.

An entity should choose the more appropriate treatment for its particular circumstances. The first approach is often the more appropriate in a group context where recharge arrangements might be rather informal and therefore not binding until such time as a payment is made. The second approach is likely to be more appropriate approach when a liability is considered to exist in advance of the payment date.

How we see it

Applying Ind AS 102 requires significant analysis in respect of classification, measurement and disclosures. It is therefore crucial that those involved in designing employee share-based payment plans are familiar with requirements of Ind AS 102 and the related ramifications to avoid unexpected accounting consequences in the future.

03

Accounting solutions

Should director's sitting fees be classified 'employee benefits expense' or 'other expenses' in the statement of profit and loss?

Neither Ind AS 1 *Presentation of Financial Statements* nor the format of Statement of Profit and Loss (P&L) given under Schedule III (to the Companies Act, 2013 ('SIII' or 'Schedule III') provides any specific guidance on the matter. The format of P&L given under Schedule III requires the aggregate of 'Employee benefits expense' and 'Other expenses' to be disclosed on the face of P&L. Hence, it is important to evaluate whether directors are employees of the entity requiring payment made to them to be disclosed as employee benefit expense.

Whilst Ind AS 1 or Schedule III does not provide any specific definition of the term 'employee,' Ind AS 19 provides below clarification in this regard:

> "An employee may provide services to an entity on a full-time, part- time, permanent, casual or temporary basis. For the purpose of this Standard, employees include directors and other management personnel."

A reading of the above clarification suggests that the term 'employee' is used in a wide manner, and it does not specifically require a contract of employment for an individual to be considered as an employee. Based on this paragraph, the following two interpretations seem possible:

a) All directors, including those in whole-time or part-time employment of the company as well as non-executive and independent directors are covered under the definition of employees. Hence, Directors' Sitting Fees to all directors is included as part of employee benefit expense. This view is also supported by below key arguments:

- Ind AS 24 *Related Party Disclosures* requires an entity to disclose key management personnel compensation under various categories of employee benefit expense. It is clear that under Ind AS 24, all directors are treated as key managerial personnel (KMP).
- The ITFG of Ind AS Implementation Committee had also clarified in its bulletin 11 issue 9 that sitting fees paid to independent director and non-executive director should be disclosed in the Related Party Transactions (RPT) note as remuneration paid to KMPs.
- In its recent observations, the FRRB of the ICAI has commented on the matter and stated that companies have disclosed sitting fees as "Other Expense", whereas it should have been presented under the head 'Employee benefit expense'.

b) Employees include directors who are either in whole-time or part-time employment of the company. To support this view, it is pertinent to note that *Guidance Note on Schedule III to the Companies Act, 2013 (Division I, II and III)* (Guidance Note) provides a specific guidance to make a distinction between persons engaged under a contract of service and those engaged under a contract for services. Only compensation payable to the former should be included in employee benefit expenses. For example, a person who purely acts as a consultant or adviser without having any direct or indirect employment relationship with the company should be excluded from definition of the term 'employee'. Accordingly, the definition of the term 'employee' may exclude directors who attend only Board meetings and are not in any kind of employment service to the company, such as independent directors. Under the view, companies may consider using below indicators to identify whether employment relationship exists:

- The individual is considered an employee for tax purposes.
- Services must be performed by a particular individual who has no discretion to arrange for someone else to perform them.
- Services must be performed at a location specified by the entity.
- There is a large amount of oversight and direction by the entity.
- Necessary tools, equipment and materials are provided by the entity.
- Individuals are paid on a time basis, rather than a project/fixed price basis.
- Individuals receive benefits of a nature typical for employees (e.g., paid holidays, paid sick leave, post-retirement benefits, or death and disability benefits).

These are only indicators. Some or all of them, potentially with other indicators, will help companies to determine whether director should be treated as employee. The judgment exercised should be appropriately documented. Depending on materiality, companies may also evaluate whether there is a need to disclose the judgment exercised in the financial statements.

How we see it

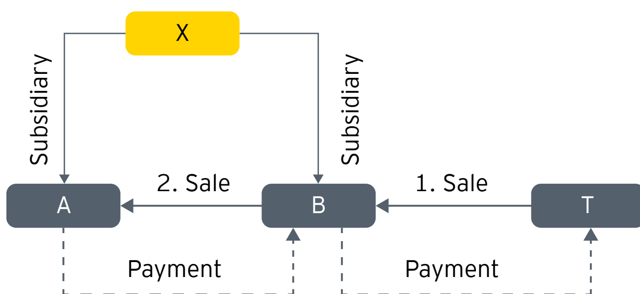
The issue at hand is widespread. Whilst arguments supporting view (a) appear appropriate and stronger; however, the issue is not beyond doubt. Also, there appears to be differing practices on the matter. We suggest that the Ministry of Corporate Affairs (MCA), the National Financial Reporting Authority (NFRA), or the Institute of Chartered Accountants of India (ICAI) provide guidance on how to address this scenario.

Disclosure of related party transactions: pass through arrangements

Scenario 1:

X Ltd. has two subsidiaries – A Ltd. and B Ltd. Both are pharmaceutical companies. B Ltd. has entered into a contract with an unrelated third-party T Ltd. for purchasing certain products which will meet the requirements of both A Ltd. and B Ltd.

T Ltd. invoices B Ltd. which in turn charges A Ltd. for its portion of products or services. A Ltd. transfers the amount payable to B Ltd., which then makes a consolidated payment to T Ltd. In this case, B Ltd. has made a consolidated purchase and supplied a portion of products to A Ltd. back-to-back without charging any fees or margin.



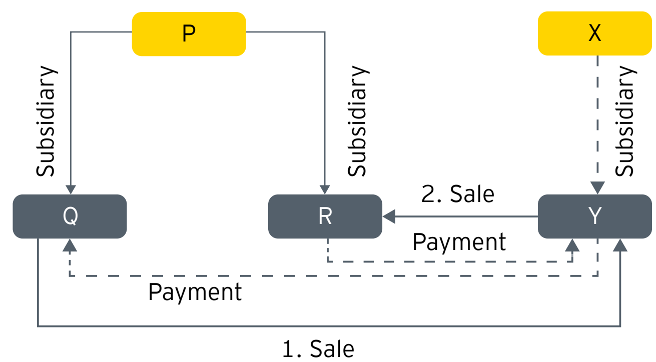
Issue:

A Ltd. and B Ltd. believe that B Ltd. has acted as an intermediary or an agent to make consolidated purchase and payment to third party without charging any fees or margin or providing any service. Accordingly, B Ltd. did not recognize purchase and sale toward this transaction; rather, the amounts were presented on net basis in A Ltd.'s financial statements. Accordingly, parties need not disclose the transaction as a related party transaction. Do you agree?

Scenario 2:

P Ltd. owns 100% of Q Ltd. and R Ltd. X Ltd. owns 100% of Y Ltd. P Ltd. and X Ltd. have no relationship and they are completely independent third parties.

Q Ltd. owns a building, with a carrying amount of INR5,00,000 and a fair value of INR15,00,000. Q Ltd. sells the building to Y Ltd. for INR5,00,000, and Y Ltd. immediately sells it on to R Ltd. for INR5,00,000.



Issue:

Q Ltd. and R Ltd. did not disclose the transaction as a related party in its financial statements as there was no direct dealing between them. Do you agree with the position?

Accounting considerations

Gross vs. net presentation of revenue and expense in scenario 1 needs to be evaluated separately as per the applicable Ind AS particularly Ind AS 115 *Revenue from Contracts with Customers*. The same is not covered in this accounting solution. Further, it may be noted that section 188 of the *Companies Act, 2013* (as amended) and the SEBI Regulations contain specific requirements, amongst other matters, regarding related party transaction approval and disclosure. Companies need to evaluate and ensure compliance with those requirements separately.

With regard to identification and disclosure of related party transactions, Ind AS 24 *Related Party Disclosures* contains very specific requirements and the same need to be considered carefully. In this case, it is clear without further

analysis that A Ltd. and B Ltd. are fellow subsidiaries and related parties. Similarly, in scenario 2, Q Ltd. and R Ltd. are fellow subsidiaries and related parties.

Paragraph 9 of Ind AS 24 defines the term 'related party transaction' as 'a transaction involving transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.'

In paragraph 21, Ind AS 24 provides certain examples of related party transactions. These examples include:

(i) Commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognized and unrecognized) ; and

(ii) Settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.

The combined reading of the above paragraphs clearly suggests following attributes for related party transactions:

- A transaction between related parties is not only the provision of services, but also includes any transfer of resources.
- Substance of the relationship is important and not merely the legal form.
- If there has been a transfer of resource from a related party to an unrelated party for the benefit of related party, then the same needs to be disclosed as a related party transaction.

Conclusion to Scenario 1

According to paragraph 21(j) of Ind AS 24, the settlement of a liability on the account of the reporting entity through a related party requires disclosure. In this case, A Ltd. has settled a liability on behalf of B Ltd. Thus, the transaction qualifies as a related party transaction requiring disclosures under Ind AS 24, regardless of whether Company A Ltd. received a margin or transfer fee.

It may be noted that the European Securities and Market Authority (ESMA), in its *29th Extract from the FRWG (EECS)'s Database of Enforcement*, a report on corporate reporting and its enforcement published on 27 May 2024, has expressed the same view on a similar issue.

Conclusion to Scenario 2:

Careful judgement needs to be exercised for arrangements involving more than two parties in determining whether contracts are in substance between related parties. In a series of transactions involving three or more parties in which two parties are related, one is required to carefully evaluate whether in substance all the transactions should be seen as one arrangement between related parties.

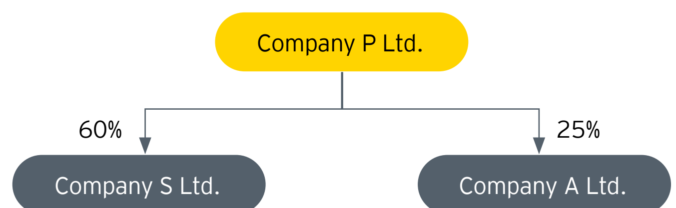
In Scenario II, R Ltd. transferred building to Y Ltd. for a consideration which is significantly lower than the fair value and subsequently Y Ltd. has transferred the same building to Q Ltd. for exactly the same consideration at which it procured from R Ltd. This clearly suggests that both these transactions are linked with each other and need to be seen together else none of these two transactions makes an economic sense. In this case, Q Ltd. is transferring economic benefit in favor of its fellow subsidiary R Limited using Y Ltd. as mere intermediary. Accordingly, the transaction should be treated as a related party transaction in the books of Q Ltd as well as R Ltd based on the economic substance of the transaction.

Identification of related parties

Fact Pattern

P Ltd. is holding 60% and 25% in S Ltd. and A Ltd. respectively.

S Ltd. is a subsidiary of P Ltd. whereas A Ltd. is an Associate of P Ltd.



Issue:

Whether S Ltd. and A Ltd. are related parties.

Accounting considerations

Given below are relevant extracts from definition of the term 'related party' provided in Ind AS 24 Related Party Disclosures:

"A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the reporting entity).

a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) ...

(ii) ...

b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) ..."

Viewpoint

As per the definition above, entities are related to each other if one entity is associate of the other or that of a member of the group.

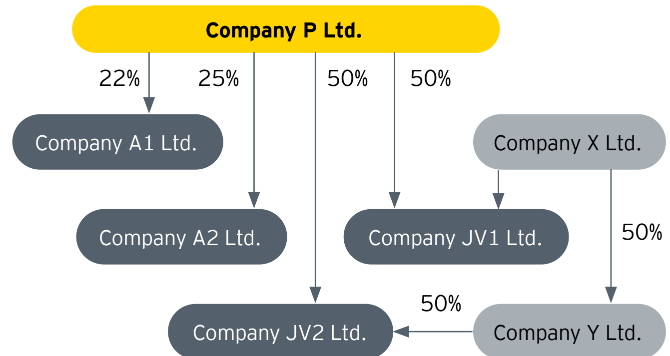
In this case, S Ltd. is a subsidiary of P Ltd. and, therefore, it forms part of the same group as P Ltd. On the other hand, A Ltd. is an associate of P Ltd. and hence A Ltd. and P Ltd. are related parties.

Let us consider S Ltd. as the reporting entity. In this case, A Ltd. is an associate of P Ltd. (parent of S Ltd. and member of the same group as S Ltd.). Accordingly, A Ltd. is a related party for S Ltd.

The definition of the term related party under Ind AS 24 is reciprocal and consequently, A Ltd. is also a related party for S Ltd.

Therefore, A Ltd. and S Ltd. are related parties for each other.

Fact Pattern



P Ltd. is holding 22% and 25% in A1 Ltd. and A2 Ltd. respectively, such that A1 and A2 are associates of P Ltd.

JV 1 Ltd. is a joint venture between P Ltd. and X Ltd.

JV 2 Ltd. is a joint venture between P Ltd. and Y Ltd.

Except the above, P Ltd. and X Ltd., P Ltd. and Y Ltd. as well as X Ltd. and Y Ltd. are not related to each other.

Issue 2(a): Whether JV 1 Ltd. and JV 2 Ltd. are related parties to each other?

Issue 2(b): Whether A1 Ltd. and A2 Ltd. are related parties of JV 1 Ltd.?

Issue 2(c): Whether A1 Ltd. and A2 Ltd. are related parties to each other?

Accounting considerations

Given below are relevant extracts from the definition of the term 'related party' provided in Ind AS 24 Related Party Disclosures:

"A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the reporting entity).

a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) ...

(ii) ...

b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party

(iv) One entity is a joint venture of a third party and other entity is an associate of the third party

(v) ..."

Viewpoint

As per the definition above, two joint ventures of the same investor/ reporting entity are related parties to each other. Also, an associate and a joint venture of the same investor/ reporting entity are related parties to each other. However, two associates of the same investor/ reporting entity are not related parties to each other.

Issue 2(a):JV1 and JV2 are joint ventures of the same third party, viz., P Ltd. Thus, they are related parties to each other.

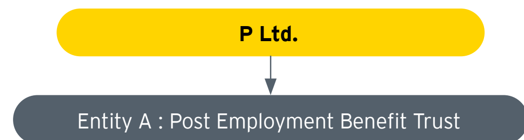
Issue 2(b): A1 Ltd. and A2 Ltd. are associates and JV1 Limited is joint ventures of the same reporting entity, viz., P Ltd. Hence, A1 Ltd. and A2 Ltd. both are related parties to JV1 Ltd. and JV 2Ltd. Also, Hence, JV1 Ltd. and JV2 Ltd. both are related parties to A1 Ltd. and A2 Ltd.

Issue 2(c): As stated above, the definition does not consider two entities which are associates of the same legal/ reporting entity to be related parties to each other. It is understood that such distinction was made between joint ventures and associates because significant influence was not considered as strong or as close a relationship as control or joint control. Thus, associate A1 Ltd. and associate A2 Ltd. are not related parties to each other. This is assuming there are no other triggers which can make A1 Ltd. and A2 Ltd. related parties to each other.

Fact Pattern

Issue:

P Ltd has established a Post Employment Benefit Trust (Entity A) for the benefit of its employees.



Accounting considerations

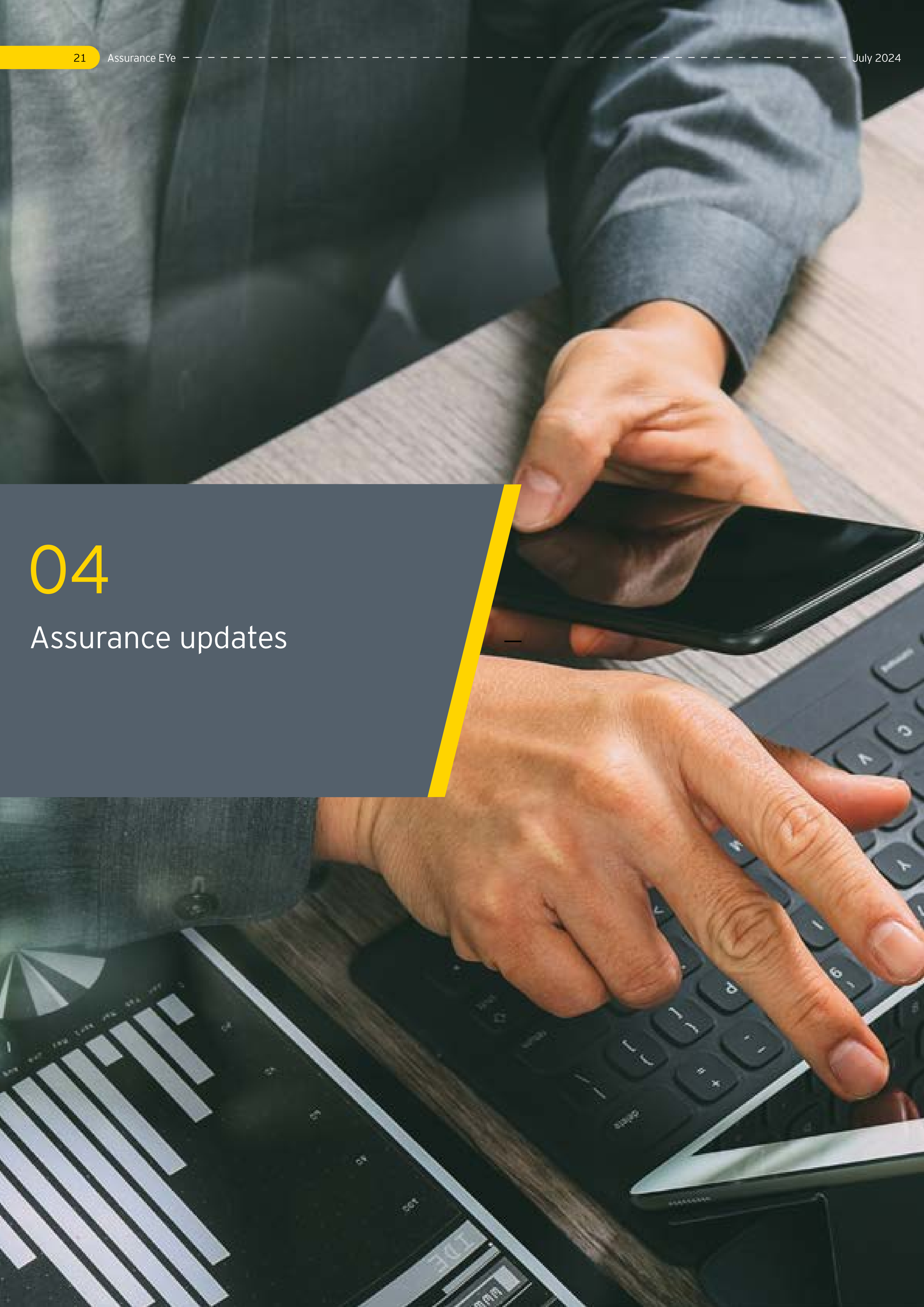
As per paragraph 9(b)(v) in definition of the term related party in Ind AS 24, an entity is related to a reporting entity if the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

Viewpoint

The definition is quite wide-ranging and includes post-employment benefit plans of any entity related to the reporting entity. This includes, for example, post-employment benefit plans of an associate or joint venture of the reporting entity or a post-employment benefit plan of an associate of the reporting entity's parent. Thus, Post Employment Benefit Trust and P Ltd. are related parties to each other.

Any fees paid by the sponsoring employers (for example, to the investment manager) on behalf of the pension fund would be a related party transaction. Sponsoring employers is generally taken to mean the entity which has a legal duty to ensure that funds are available in the pension fund when the payment of pensions falls due. Sponsoring employers are also related parties of a post-employment benefit plan.

It is important to note that if an entity's employees participate in an industry-wide pension scheme that is accessible to all employees of entities operating within that industry, the pension scheme is unlikely to be considered a related party of the entity. This is because it is unlikely that any single entity controls, jointly controls, or significantly influences the industry-wide pension scheme. Such schemes are designed to benefit all employees within the industry, rather than being specifically for the benefit of employees of the reporting entity or its related entities.



04

Assurance updates

Securities and Exchange Board of India (SEBI)

Verification of market rumors

With an objective to avoid false market sentiment or impact on securities of the listed entity, the SEBI, vide its notification dated 14 June 2023, had amended clause 30(11) of the *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* (LODR Regulations) requiring top 100 and 250 listed companies by market capitalization to confirm, clarify or deny any reported event or information in the mainstream media. As per the original notification, such confirmation, clarification, or denial was required based 'materiality' of the event or information, irrespective of whether it had any material impact on market price of securities. Considering practical challenges pointed out by the industry and the fact that industry standards on the matter were still under finalization, the application of these requirements for **top 100 and top 250 listed entities was deferred to 01 June 2024 and 01 December 2024**, respectively.

Separately, the Industry Standards Forum (ISF), comprising three industry associations, viz., ASSOCHAM, CII and FICCI, took up the rumor verification requirement as one of pilot projects for formulating standards for effective implementation of the requirement, in consultation with the SEBI. Based on discussions with ISF and consultations with various stakeholders, a proposal was presented to the SEBI Board. After due consideration, the SEBI Board has approved a uniform approach to verify market rumors by equity listed entities. The approach, as approved by the SEBI, has now become part of the LODR Regulations vide the notification dated 17 May 2024. The updated LODR regulations require top listed entities by market capitalization to confirm, deny or clarify any reported event or information to the stock exchange within 24 hours from the trigger of material price movement if:

- There is material price movement as may be specified by the stock exchange
- The event or information is reported in the mainstream media
- The event or information is not general in nature, and
- The event or information indicates rumors of impending specific nature is circulating amongst the investing public

The notification requires that if a listed entity confirms any reported event or information, it shall also provide information regarding current stage of event or information. The notification has also added a new clause in the LODR Regulation whereby it has been made obligatory for the promoters, directors, key managerial personnel and/ or senior management to provide adequate, accurate and timely response to queries raised or explanation sought by the listed entity so that the entity can comply with the reporting requirements.

The requirements post amendments will apply to the top 100 and top 250 listed companies by market capitalization from **01 June 2024** and **01 December 2024**, respectively.

Consequent to the above amendments to LODR Regulations, below additional Circulars have been issued for effective implementation of the requirement:

Framework for material price movement

The National Stock Exchange (NSE) vide its circular dated 21 May 2024 has prescribed framework to calculate material price movement triggering reporting requirements. Some key features of the framework are as below:

a) An acceptable range/ percentage of price variation has been prescribed based on price of the underlying share. Any variation within acceptable range will not trigger reporting requirements.

b) To factor market dynamics, the price variation criteria will be compared with benchmark index. Price benchmarking for NSE prices shall be NIFTY 50 Index and for BSE prices shall be Sensex Index. Price benchmarking will be done at the start of day, i.e., 9:30 a.m.

c) Rumors will be verified only if the security prices have moved in the direction of the news, i.e., if the security price has witnessed a positive movement for a positive news and vice versa.

d) In case of intraday price movement (i.e., after 9:30 a.m.), only price range-based price variation will be considered, without any comparison to the Index movement. However, in case of inter-day price movement, percentage variation in share price and the benchmark index movement will be calculated from the closing price of the immediately preceding trading day.

Framework for considering unaffected price

The SEBI vide circular dated 21 May 2024 has issued a framework for considering unaffected price for transactions upon confirmation of market rumor. Key requirements of the circular are as below:

a) The circular prescribes methodology to calculate weighted average price (WAP) and the adjusted WAP (unaffected price). The methodology broadly requires that variation in daily WAP from the day of material price movement till the end of the next trading day after confirmation of the rumor will be attributed to the rumor and, therefore, excluded from the WAP to calculate the unaffected price.

b) The unaffected price will be applicable only if the listed entity has confirmed the rumor pertaining to the transaction within 24 hours from the trigger of material price movement.

c) The unaffected price will be applicable for a period of 60 days or 180 days, based on stage of the transaction, from the date of confirmation of the market rumor till the 'relevant date' under the existing regulations (public announcement, board approval, etc.).

d) In case rumor pertaining to a transaction has been confirmed by the listed entity and subsequent rumors are reported in the mainstream media with material update to the transaction which require confirmation once again, then the unaffected price will be applicable for each instance of confirmation of rumor.

Industry standards on verification of market rumors

For effective implementation of the requirements, the SEBI vide its circular dated 21 May 2024 has directed listed entities covered under the requirement to follow Industry Standards being formulated by the ISF. Such standards will be published by the industry associations and the stock exchanges on their websites. The Industry Standard Note (ISN) prepared in consultation with the SEBI by the ISF is available on the industry associations and the stock exchanges websites. The ISN provides below key clarifications:

a) (i) Mainstream media will only cover the specific news sources that are set in the ISN. The criteria for identification of the news sources, along with the list of specific news sources for each category of media, have been identified based on inputs received from AdFactors. (ii) News aggregators will not fall within the purview of mainstream media. (iii) Social media platforms (including but not limited to WhatsApp, X (Twitter), Instagram, Facebook and Telegram) will be excluded from the ambit of mainstream media. However, social media handles of the identified news sources will be covered within the purview of 'mainstream media'.

b) For a market rumor to require a confirmation/ denial/ clarification, it must (i) provide specifically identifiable details of the matter/ event, or (ii) provide quotes or be attributed to sources who are reasonably expected to be knowledgeable about the matter. Further, if a specific rumor is false, the company will issue a statement to deny the rumor. Various examples are included in the note to help users better understand and determine when rumor provides specifically identifiable details of the matter/ event.

c) Even if the market rumor is specific and impending, the market rumor will require a specific confirmation/ denial/ clarification only if the market rumor results in a material price movement.

d) If there is a market rumor during the time-period between issuance of the pre-intimation notice of a Board meeting and conclusion of the Board meeting, no confirmation/ denial/ clarification will be required. Rather, appropriate disclosures may be made by the entity as per the other requirements of the LODR Regulations, after conclusion of the Board meeting. However, if the rumor is in respect of actions/ events distinct from the subject of the pre-intimation notice, then a specific confirmation/ denial/ clarification of the rumor may be required.

How we see it

The SEBI has adopted a collaborative approach, which included significant involvement of three major industry associates, toward finalization of requirements to confirm, deny or clarify market rumors if they result in material price movement. This should address various concerns being raised by stakeholders in implementing the earlier requirements. Hence, the revised framework for confirmation, denial or clarification of market rumors is a step in the right direction.

Whilst the SEBI has currently notified the applicability date of this requirement for top 250 companies by market capitalization, it is possible that even more companies need to follow this requirement going forward. The entities impacted or likely to be impacted must implement appropriate technology and other appropriate solutions to identify and track news sources as well as price movement of securities. They need to set up appropriate internal systems for prompt identification, coordination and communication between investor relations, corporate communications, and compliance teams.

Consultation Paper on Business Responsibility and Sustainability Report (BRSR)

The Expert Committee for facilitating ease of doing business with respect to BRSR has submitted a report containing certain recommendations for BRSR. The SEBI has issued a Consultation Paper on 22 May 2024 seeking comments from the public and other stakeholders on recommendations of the Expert Committee. Key proposals of the report are summarized below:

Proposals pertaining to value chain (VC) partners

The current SEBI Regulations require that value chain will encompass top upstream and downstream partners of a listed entity cumulatively comprising 75% of its purchases and sales by value. It is proposed to redefine VC partners by providing either of the below thresholds. As per the Consultation Paper, this should bring down the maximum possible number of covered value chain partners:

(i) Upstream and downstream partners of a listed entity, individually comprising 2% or more of the listed entity's purchases and sales by value respectively, or

(ii) Upstream and downstream partners of a listed entity, individually comprising 2% or more of the listed entity's purchases and sales by value respectively and cumulatively comprising at least 75% of the listed entity's purchases and sales by value.

The consultation papers also propose below changes:

a) For the first year of reporting ESG disclosures for value chain, i.e., FY 2024-25, reporting previous year numbers will be voluntary.

b) The existing provision in the BRSR Core dealing with disclosure and assurance on key performance indicators (KPIs) for VC partners be undertaken on a voluntarily basis instead of using 'comply or explain' approach.

c) An additional disclosure is proposed to increase transparency. The additional proposed disclosure is percentage of total sales and purchases covered by the value chain partners for which ESG disclosure is made.

Proposal relating to Green Credits

It is proposed to add a voluntary disclosure (leadership indicator) under principle 6 of BRSR, i.e., "*Business should respect and make efforts to protect and restore the environment*". The proposed disclosure pertains to quantification of Green Credits generated by the Company and the VC partners under Green Credits Programme notified by the *Ministry of Environment, Forest, and Climate Change*.

Proposal relating to replacing Assurance with Assessment

It is proposed to replace the requirements of 'Assurance' with 'Assessment' in the LODR Regulations and SEBI Circulars on BRSR and the listed entities can undertake either:

(i) 'Assurance' or 'assessment' in FY 2023-24 and mandatory 'assessment' from FY 2024-25 onwards, or

(ii) 'Assurance' or 'Assessment' from FY 2023-24 onward.

It is believed that the above proposal will provide flexibility to listed entities to undertake either assessment (which is cost-effective and not burdensome) or assurance (which may be requested by investors/ clients).

The last date for submission of comments was 12 June 2024.

National Stock Exchange (NSE)

FAQs and general observations / guidelines for filing of BRSR

Currently, top 1,000 listed companies in India, based on market capitalization, are mandatorily required to furnish BRSR to the stock exchange as part of their annual report. The National Stock Exchange (NSE) has reviewed BRSR disclosures filed by listed entities with the NSE for the year 2022-23 and noted certain observations. In order to ensure consistent, comparable and useful reporting to the investors and to provide guidance to listed entities, the NSE has issued a circular containing annexure on General Observations, FAQs and Guidelines on filing of BRSR. The guidelines are not and should not be construed as substitution/ clarification/ explanation on any matter on which provision of law, regulation or the SEBI/ Exchange circular were issued.

The circular should be read in conjunction with the already issued SEBI circular dated 12 July 2023 and clause 34(2)(f) of the LODR Regulations.

Some general clarifications provided in the NSE circular are as below:

- If a listed entity was previously covered under top 1,000 companies and therefore, required to file BRSR related information with the Exchange, then it will continue to file BRSR related information with the Exchange going forward also. This is even though the entity may no longer be covered under top 1,000 listed entities.
- Listed entities, which are not covered under top 1,000 entities by market capitalization, can opt to file BRSR related information on a voluntary basis.
- If a listed entity is covered in the list of top 1,000 listed entities for one Stock Exchange and not the second one, then the listed entity is required to file BRSR with both the Exchanges.
- Top 150 listed entities based on market capitalization are required to mandatorily obtain Reasonable Assurance on the BRSR Core. A copy of the Reasonable Assurance Certificate needs to be attached with the BRSR while submitting BRSR PDF and Annual Report with the Exchanges.
- The BRSR is to be submitted with the Exchange in PDF and XBRL mandatorily. BRSR PDF and XBRL will be submitted on the same day of submission of Annual Report with the Exchanges.
- BRSR Link can be provided in the Annual Report instead of publishing the whole report.
- Some of the disclosures sought under the BRSR XBRL may not be applicable to certain industries. In such a case, the entity can state that such disclosure is not applicable along-with reasons for the same. The reason should be provided in BRSR pdf and in BRSR XBRL under add Notes.
- The listed entities which prepare and disclose sustainability reports (as part of annual report) based on internationally accepted reporting frameworks such as GRI, SASB, TCFD, Integrated Reporting, can provide cross-reference of the disclosures made under such framework to the disclosures sought under the BRSR. Further, if the data sought in the reporting format is already disclosed in the annual report, the listed Company can provide a cross-reference

to the same. Thus, an entity need not disclose the same information twice in the annual report. However, the entity should specifically mention the page number of the annual report or sustainability report where the information sought under the BRSR format is disclosed as part of the report prepared based on an internationally accepted reporting framework.

- NSE has released guidance on 38 sector-specific integrated guides to BRSR format. This comprehensive guidance provides a detailed explanation of each parameter in the format and the objective for such disclosures, along with an elaborate guidance on how to measure and report such parameters.

In addition, the NSE has also provided observations on various points of BRSR submissions made by the listed companies along with the specificity on what entities must disclose, which will produce more useful information for the investors.

How we see it

The NSE has provided useful insights on various issues related to BRSR reporting. Listed entities must consider these observations carefully when preparing and submitting their BRSR report. Furthermore, they must ensure consistency between their XBRL information and PDF version to avoid any discrepancy.

Reserve Bank of India (RBI)

Fair practices code for lenders: charging of interest

During the onsite examination of regulated entities (REs) for the period ended 31 March 2023, the RBI came across instances of lenders resorting to certain unfair practices in charging of interest. In accordance with the RBI circular dated 29 April 2024, these unfair practices include:

a) Charging of interest from the date of sanction of loan or date of execution of the loan agreement and not from the date of actual disbursement of the funds to the customer.

b) In case of loans being disbursed by the cheque, interest is charged from the date of the cheque and not from the date of handing over the cheque to the customer.

c) In case of disbursal or repayment of loans during the month, interest was charged for the entire month and not merely for the period outstanding.

d) Some REs were collecting one or more installments in advance but considering a full loan amount for charging interest.

The RBI has observed that these and other similar non-standard practices of charging interest are not in line with the spirit of fairness and transparency while dealing with customers. Hence, wherever such practices have come to light, the RBI has advised REs to refund such excess interest and other charges for customers. The RBI has also encouraged REs to use online account transfers in lieu of cheques being issued for loan disbursal. The RBI has also directed all REs to review their practices on these matters and take corrective action, including system level changes, as necessary, to address these issues.

How we see it

The changes implemented by the RBI are a step in the right direction. It is imperative that all REs review their practices on priority and take corrective action as necessary. From an accounting perspective, REs may need to evaluate below key aspects:

a) Assume that as of 31 March 2024, a particular RE has collected excess interest or other charges which will need to be refunded to customers in future period pursuant to the RBI Circular. Whether the RE should treat such obligation arising pursuant to the RBI Circular as adjusting event and therefore recognize obligation in financial statements for the year ended 31 March 2024 or the obligation will need to be recognized in next period only?

   One may potentially argue that interest and/ or charges were *ab initio* charged in an unfair manner and therefore refund obligation needs to be recognized in financial statements for the year ended 31 March 2024.

b) Consider that in the current year, the RE has refund obligation not only for the current financial year but also for earlier years. The RE will need to evaluate carefully whether the obligation should be treated as current period event and therefore adjusted in financial statements for the current year or the refund amount (to the extent related to earlier years) should be treated as an error in accordance with Ind AS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

c) Regarding the scenario where the RE has sanctioned the loan or signed the loan agreement; however, disbursement has still not taken place, it may be noted that these arrangements are likely to be treated as loan commitment as defined under Ind AS 109 *Financial Instruments*. Ind AS 109 provides scope exclusion for most loan commitments, except few commitments meeting specific criteria. Loan commitments excluded from the scope of Ind AS 109 will generally be treated as executory contracts under Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Ind AS 37 requires that executory contracts are not recognized in the financial statements unless they are onerous. However, all loan commitments, whether in the scope of Ind AS 109 or not, are still subject to impairment and derecognition requirements of Ind AS 109 and disclosure requirements of Ind AS 107 *Financial Instruments: Disclosures*.

We recommend that REs impacted or likely to be impacted by the RBI Circular should carefully evaluate the accounting implications and proactively align with their auditors.

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- Vishal Bansal

EY offices

Ahmedabad
22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon Temple
Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru
12th & 13th Floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground & 1st Floor
11, 'A' wing
Divyasree Chambers
Langford Town
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Bhubaneswar
8th Floor, O-Hub, Tower A
Chandaka SEZ, Bhubaneswar
Odisha - 751024
Tel: + 91 674 274 4490

Chandigarh
Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai
6th & 7th Floor, A Block,
Tidel Park, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR
Ground Floor
67, Institutional Area
Sector 44, Gurugram - 122 003
Haryana
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad
THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jaipur
9th floor, Jewel of India
Horizon Tower, JLN Marg
Opp Jaipur Stock Exchange
Jaipur, Rajasthan - 302018

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

3rd Floor, Unit No 301
Building No. 1
Mindspace Airoli West (Gigaplex)
Located at Plot No. IT-5
MIDC Knowledge Corridor
Airoli (West)
Navi Mumbai - 400708
Tel: + 91 22 6192 0003

Pune
C-401, 4th Floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

10th Floor, Smartworks
M-Agile, Pan Card Club Road
Baner, Taluka Haveli
Pune - 411 045
Tel: + 91 20 4912 6800

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