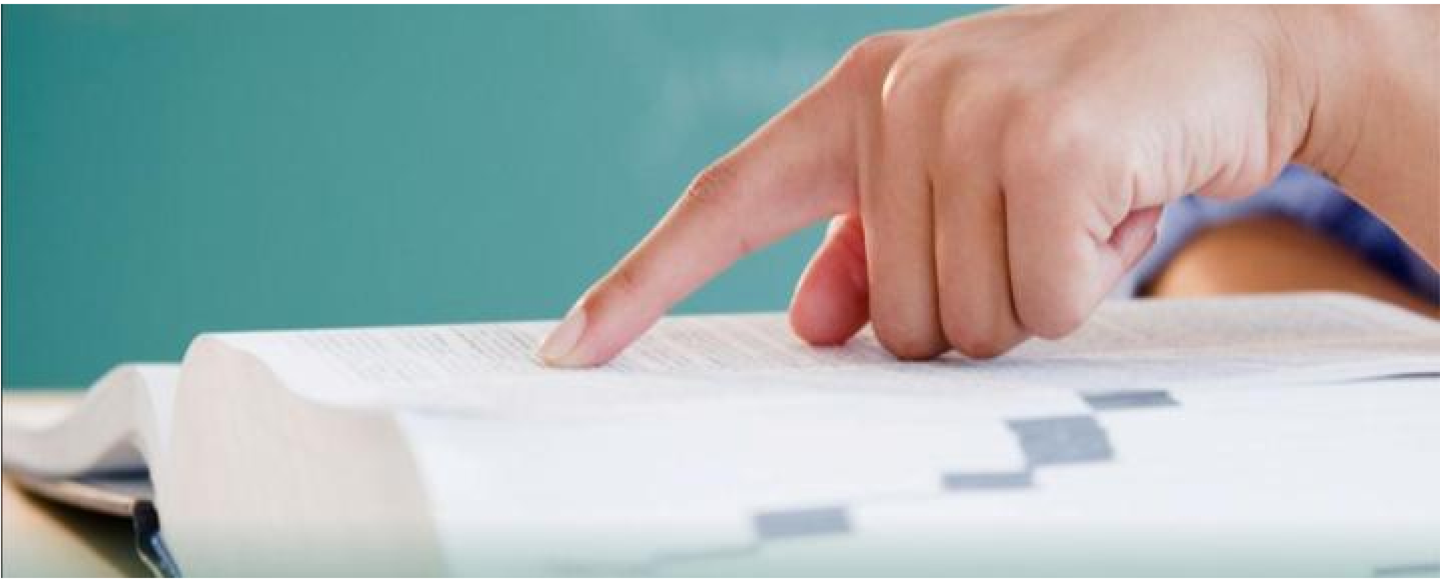
FIRST NOTES
KPMG in India

SEBI's discussion paper on material events and price sensitive information

22 August 2014



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Financial Reporting

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Sector:

All

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Relevant to:

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Transition:

Immediately

Within the next 3 months

Post 3 months but within 6 months

Post 6 months

The Securities and Exchange Board of India (SEBI) has observed disparities in disclosures made under clause 36 and other related clauses of the Equity Listing Agreement. The discussion paper issued by the SEBI on 19 August 2014 aims to improve continuous disclosure requirements and reduce disparity in disclosures which primarily stem from a perceived lack of clarity on the term 'materiality' and 'price sensitive information'. Comments are invited on the discussion paper by 12 September 2014.

This issue of First Notes summarises important aspects of the discussion paper and compares it with the present clause 36.

Clause 36 – the present form

Clause 36 requires a listed entity to disclose to the stock exchange, details of all events which are expected to have a bearing on its performance/operations, as well as 'price sensitive information'. Key material events illustrated under clause 36 as follows:

- change in the general character or nature of business
- disruption of operations due to natural calamity
- commencement of commercial production/operations
- developments with respect to pricing/ realisation arising out of change in the regulatory framework
- litigation/dispute with a material impact
- specific disclosures (as prescribed under other clauses of the Equity Listing Agreement) on events/information which may be material/price sensitive viz. clause 20, 22, 25, 27, 29, 30, 31, and 53.

Clause 36, at present, mentions an indicative and a broad list of 'material events'. It leaves to the discretion of a listed entity to determine whether a particular event would have a material bearing on its performance or whether particular information is price sensitive. SEBI felt that this discretion is making the requirements of clause 36 in practice somewhat voluntary in nature. Liberal interpretations taken by listed entities, on what constitutes 'materiality' and whether to disclose an event/information to the stock exchange, has resulted in inadequate disclosure levels in the securities market.

Clause 36 – proposals in the discussion paper

The discussion paper provides:

- an extensive list of events which may be material and/or price sensitive information
- guidance on determination of materiality thresholds and information which may be considered as price sensitive
- indicative list of information which may be disclosed on occurrence of such events/information.

Amendments proposed in clause 36

According to the proposals, a listed entity would be required to inform all events which are material and/or all information which are price sensitive and have a bearing on its performance/operation to the stock exchange, within one day from the occurrence of the event/information.

Any delay in making such disclosures would have to be explained to the stock exchange. Additionally, a listed entity would provide periodic disclosures on associated material development till such time the event is resolved/closed.

A listed entity would be required to disclose on its website all material events and/or all information which is price sensitive, that has been disseminated to the stock exchange, through links to the stock exchange website.

Additionally, a listed entity would also be required to disclose following information for its subsidiaries:

- the impact of material events/information of a listed subsidiary on its operations/performance, along with the link on the stock exchange website where the announcement made by the listed subsidiary is available
- all material events/information/transactions/ arrangements of unlisted subsidiaries.

The discussion paper has made additions to the key events/information that would be deemed to be material and/or price sensitive. Some of the important additional items are as follows:

- Material capacity addition or material product launch
- Awarding, bagging/receiving, amendment or termination of awarded/bagged material orders/ contracts
- Agreements (viz. agreements with/of shareholders, joint venture, family settlement, agreement(s)/ treaty(ies)/contract(s) with media companies), material loan agreements, or any other material agreements which are binding and revisions/ amendments/terminations thereof
- Material fraud/defaults, etc. by directors, employees, agents of a listed entity
- Any event affecting the reputation of a listed entity/ group e.g. arrest of key managerial personnel/ promoters on charges involving moral turpitude, etc.
- Any other information necessary to enable the holders of listed securities of a listed entity to appraise their position and to avoid the establishment of a false market in such listed securities.

Determination of material event/information

According to the proposals, materiality has to be determined on a case to case basis depending on the specific facts and circumstances relating to the event/ information. A particular event/information would be considered as material in nature if it satisfies either of the criteria proposed below:

- **Quantitative criteria** calculated based on audited consolidated financial statements* of the last audited financial year, would mean event/ information where the value involved or the impact:
  - exceeds five per cent of the gross turnover or revenue or total income, or
  - exceeds 20 per cent of the net worth,

  whichever is lower.

- **Qualitative criteria** would mean an event/ information:
  - the omission of which is likely to result in a discontinuity of information already available publicly, or
  - the omission of which is likely to result in significant market reaction if the said omission came to light at a later date, or
  - which in the opinion of the Board of Directors is considered to be material i.e. is significant to the operations or performance of a listed entity.

If particular information or event in question satisfies any of the 'qualitative' or 'quantitative' criteria, the listed entity would be under an obligation to disclose the same to the stock exchange.

* If a company has not prepared consolidated financial statements in the last financial year, then the threshold can be determined on the basis of standalone financial statements.

Determination of price sensitive information

According to the proposals, a listed entity would apply following tests to determine whether a particular information is price sensitive or not:

- **Price impact test**
  Any information directly or indirectly related to the listed entity, which if published is likely to materially affect the share price of the listed entity.
- **The reasonable investor test**
  This test points towards information which is likely to be used by a reasonable investor for making investment decisions, therefore, likely to have a significant effect on the price of shares of the listed entity e.g. any information affecting:
  - the assets, liabilities, or financial condition of the listed entity
  - major developments in the business of the listed entity/the industry in which the listed entity operates, or
  - information previously disclosed to the market.
- **The Board's judgement**
  In the opinion of the Board of Directors, an event/ information is considered price sensitive.

When does a material event/price sensitive information is said to have occurred

In order to determine whether an event/information is said to have occurred, it is important to consider the stage of discussion, negotiation, or approval, and at the time when the listed entity is aware of the event/ information (where no discussion, negotiation, or approval is required). Thus, the event can be said to have occurred:

- upon approval by the Board, where the discussion, etc. is in progress, or
- when the listed entity or its officer becomes aware of the events/information, or when the said officer ought to have reasonably come into possession of the information while performing his duties, if no discussion, etc. is required.

It is also proposed that an entity that is listed in India and overseas, any disclosures made to an overseas stock exchange shall be disclosed to an Indian stock exchange at the same time.

It might be possible that the listed entity or its officer, based on preliminary information about an event, can not reasonably determine whether the information is price sensitive or material. In such a case, the listed entity or its officer shall be construed to have become aware of the event/information when the probable impact of the event/information becomes known/ assessable to the extent of 75 per cent of materiality threshold, and not when the impact is finally and accurately assessed.

Our comments

- The SEBI has proposed rules based guidelines and has takes away discretion from the listed entities in deciding what is a material or price sensitive information. By providing such guidelines, SEBI expects that disparities observed in the past while examining disclosures under clause 36 will reduce.
- Section 143(12) of Companies Act, 2013 *inter alia* requires the auditor to report offence involving fraud which is being committed by the officers or employees of the company to the central government. The SEBI discussion paper, however, seems to focus only on frauds that have been unearthed or on occurrence of the default/litigation. Since suspected frauds would negatively impact the performance/operations of a listed entity, it is unclear whether suspected frauds should be disclosed by a listed entity to the stock exchange.

The bottom line

Submission of information relating to material events/price sensitive information will enable investors to make informed decisions. We would encourage that the comments are sent by 12 September 2014 to assist the SEBI to constructively address the inputs and concerns of all the stakeholders.

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Introducing Voices on Reporting

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 10 July 2014, the Finance Minister of India announced a roadmap and definite dates for convergence with the International Financial Reporting Standards (IFRS) for Indian companies as part of his Union Budget speech. The Finance Minister proposed to make Indian Accounting Standards (Ind AS) converged with IFRS mandatory for Indian companies from the financial year 2016-17. He also stated that 'income computation and disclosure standards' (tax accounting standards) would be notified separately. TAS are expected to take effect from 1 April 2015 and in relation to the assessment year 2015-16 and subsequent years.

This is a significant development and will most likely apply to several companies. We discussed the implementation challenges put forth by the convergence with IFRS and use of tax accounting standards for the corporate India.

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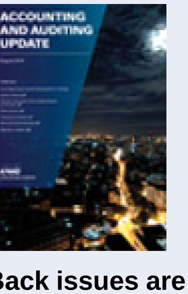

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