Accounting and Auditing Update

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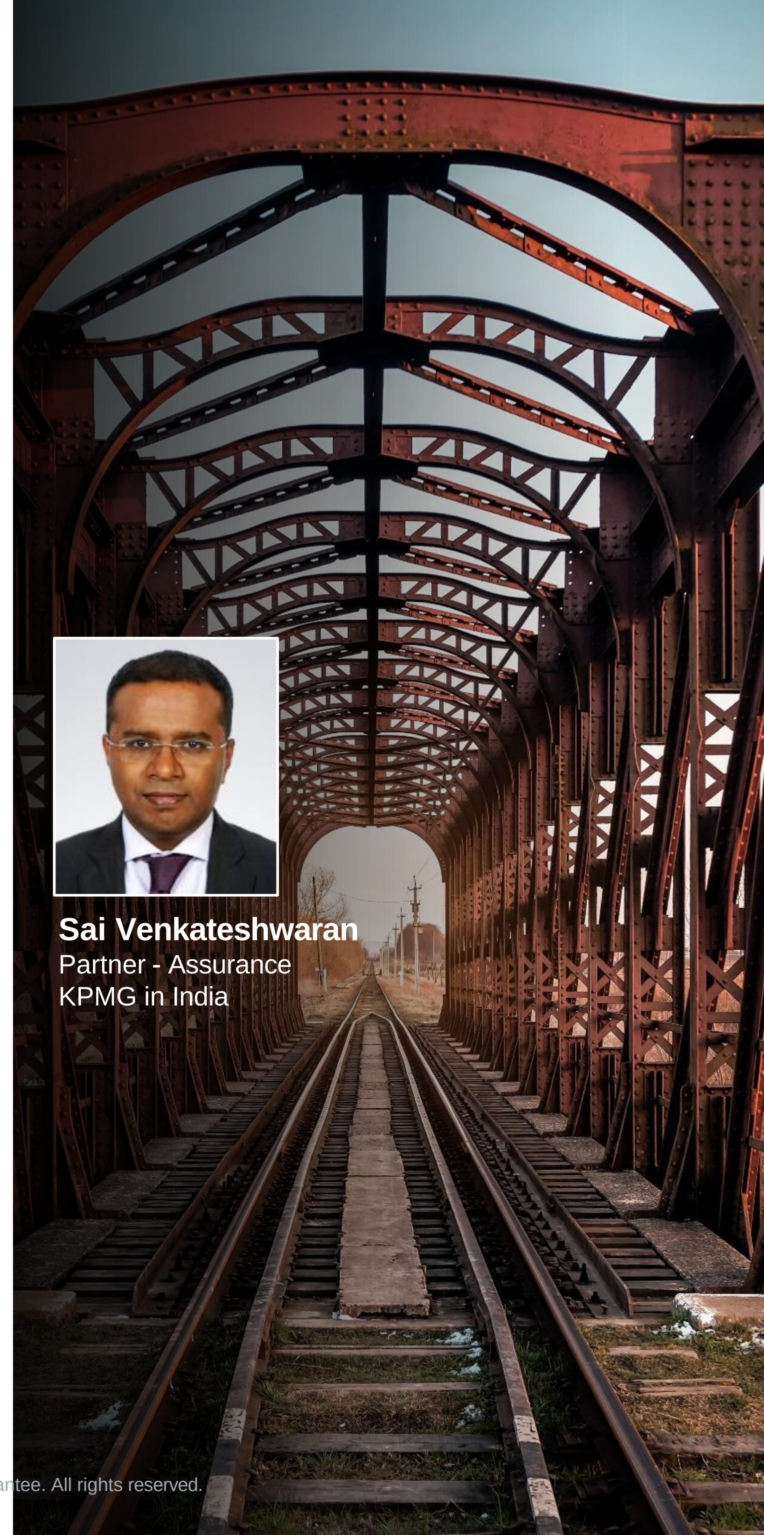
Editorial

The European Securities and Markets Authority (ESMA) has released its annual Public Statement outlining the European Common Enforcement Priorities (ECEP) for the 2024 annual financial reports of issuers trading on European Economic Area (EEA) regulated markets. ESMA, along with national enforcers in the EEA, will focus on these priorities when reviewing the application of relevant reporting requirements. The priorities emphasise the responsibility of management and supervisory bodies of issuers, highlighting the importance of audit committees in ensuring the internal consistency of annual financial reports, supervising internal controls, and contributing to high-quality reports. ESMA through these priorities aims to promote a consistent application of financial reporting and the newly effective sustainability reporting requirements. This year, as companies prepare their first set of sustainability reports under the newly effective European Sustainability Reporting Standards (ESRS), the focus is shifting. A number of financial reporting areas aimed at driving clarity on presentation and disclosures remain on the watch list; however, sustainability reporting is the main focus. ESMA also highlights the need for consistency in the annual report and the importance of similar governance over both sustainability reporting and financial reporting. This edition of Accounting and Auditing Update (AAU) summarises important considerations highlighted by ESMA for financial reporting for management of the companies, audit committees and auditors.

Ind AS 16, *Property, Plant and Equipment*, provides guidance on the accounting of Property, Plant and Equipment (PPE). Generally, for many companies, PPE is a significant item on the balance sheet. Spare parts are essential components of the PPE that ensure a smooth functioning of various equipment and machinery across industries. The accounting treatment of spare parts is a critical aspect of financial reporting that requires careful consideration and adherence to guidance under Ind AS requirements. The accounting of spare parts had been a subject matter of deliberation through various Expert Advisory Committees opinions (EACs) and under Ind AS Transition Facilitation Group (ITFG) bulletins issued by the Institute of Chartered Accountants of India (ICAI) in past. However, to reiterate the guidance related to accounting for spare parts, the ICAI has issued an EAC opinion recently on this topic. The publication carries an article on this topic to discuss the accounting of spares that meet the definition of PPE under Ind AS.

There have been various regulatory developments in India and internationally during the month. Recently, the Securities and Exchange Board of India (SEBI) issued a consultation paper to propose amendments to the provisions pertaining to corporate governance norms for High Value Debt Listed entities (HVDLEs). Additionally, SEBI through its circular provided that Indian mutual funds schemes may invest in overseas Mutual Funds (MFs) or Unit Trusts (UTs) that have an exposure to Indian securities subject to specified conditions. SEBI also proposed amendments to the definition of Unpublished Price Sensitive Information (UPSI) under the SEBI (Prohibition of Insider Trading) Regulations, 2015. The International Accounting Standards Board (IASB) has published a consultation paper to propose improvements to requirements of provisions under IAS 37, *Provisions, Contingent Liabilities and Contingent Asset*.
Our regulatory updates section covers these and other important regulatory developments.

We would be delighted to receive feedback/suggestions from you on the topics we should cover in the forthcoming editions of AAU.



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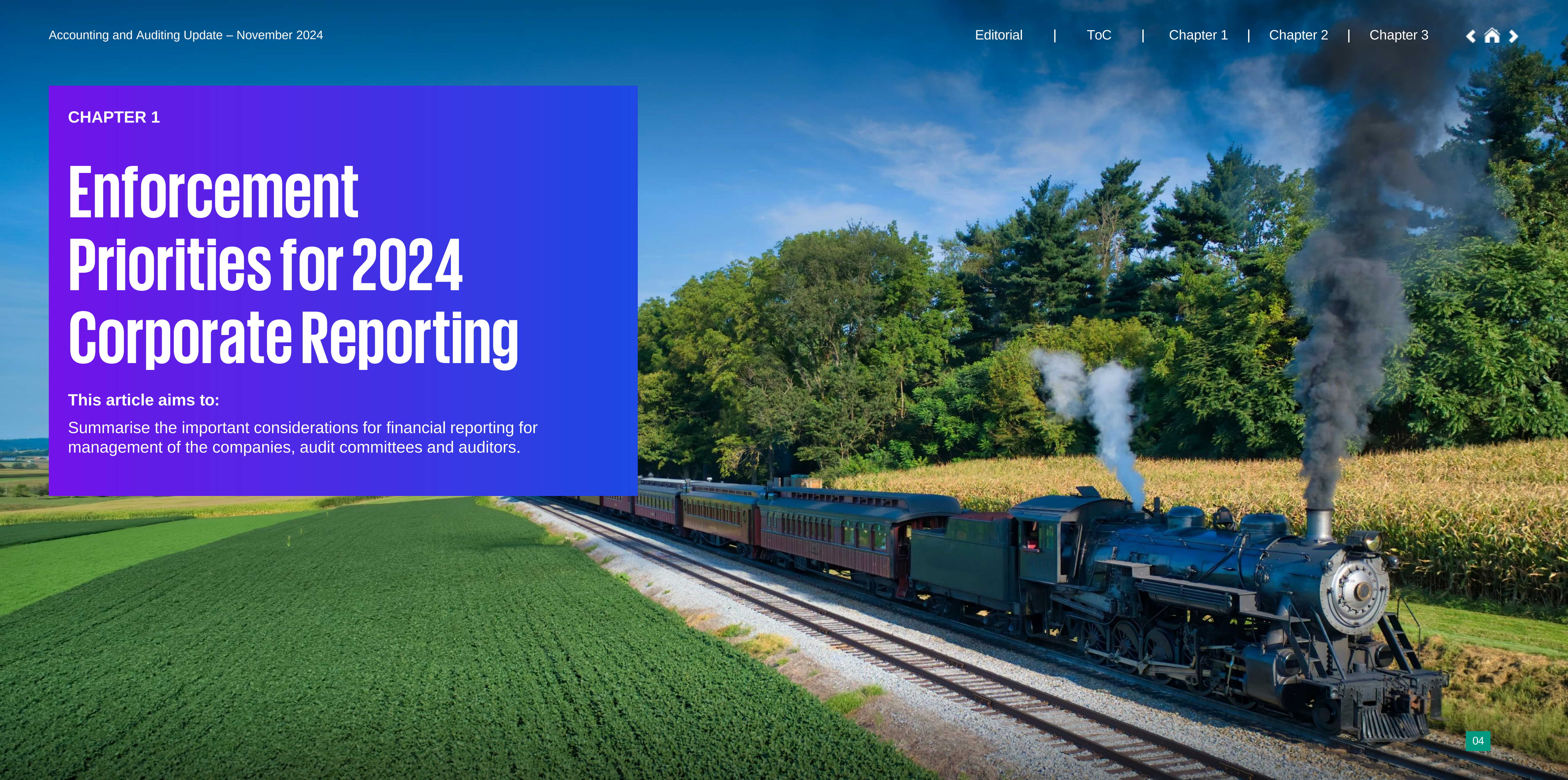


CHAPTER 1

Enforcement Priorities for 2024 Corporate Reporting

This article aims to:

Summarise the important considerations for financial reporting for management of the companies, audit committees and auditors.

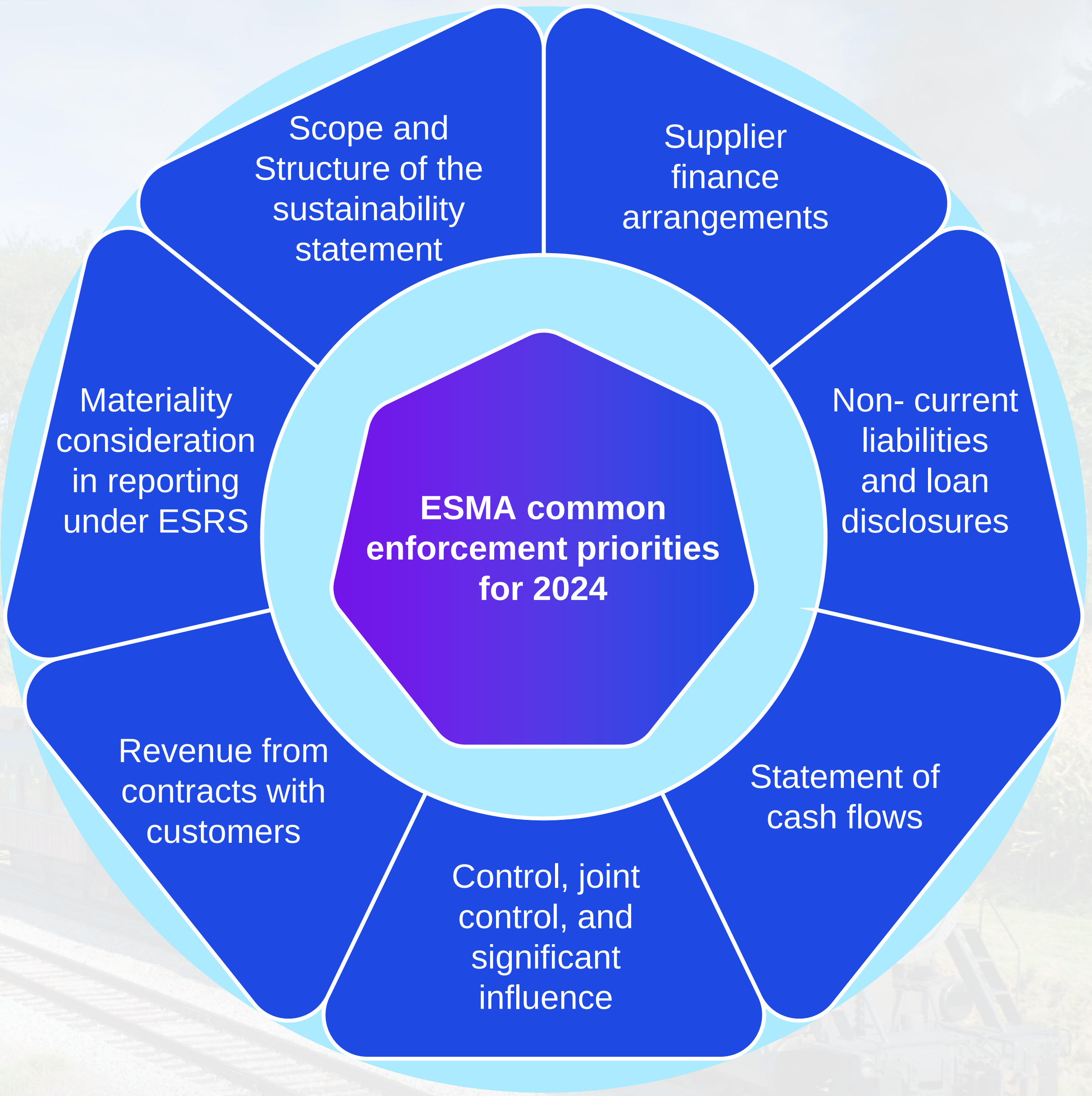
Introduction

The European Securities and Markets Authority (ESMA) has released its annual Public Statement outlining the European Common Enforcement Priorities (ECEP) for the 2024 annual financial reports of issuers trading on European Economic Area (EEA) regulated markets. ESMA, along with national enforcers in the EEA, will focus on these priorities when reviewing the application of relevant reporting requirements. They will also address other entity-specific issues and take enforcement actions if material misstatements are found, with ESMA reporting on their findings. Additionally, national priorities may be set by enforcers.

ESMA emphasises the responsibility of management and supervisory bodies of issuers, highlighting the importance of audit committees in ensuring the internal consistency of annual financial reports, supervising internal controls, and contributing to high-quality reports. Issuers, auditors, and supervisory bodies are urged to consider the topics and recommendations in the Public Statement when preparing, auditing, and supervising the 2024 annual financial reports, taking into account their materiality and relevance to the issuer's operations.

Key areas considered

ESMA considered topics from IFRS financial statements, sustainability statements, and annual financial reports. In this article, we have highlighted important IFRS financial statements and sustainability statements enforcement priorities.



Priorities related to IFRS financial statements

Liquidity considerations

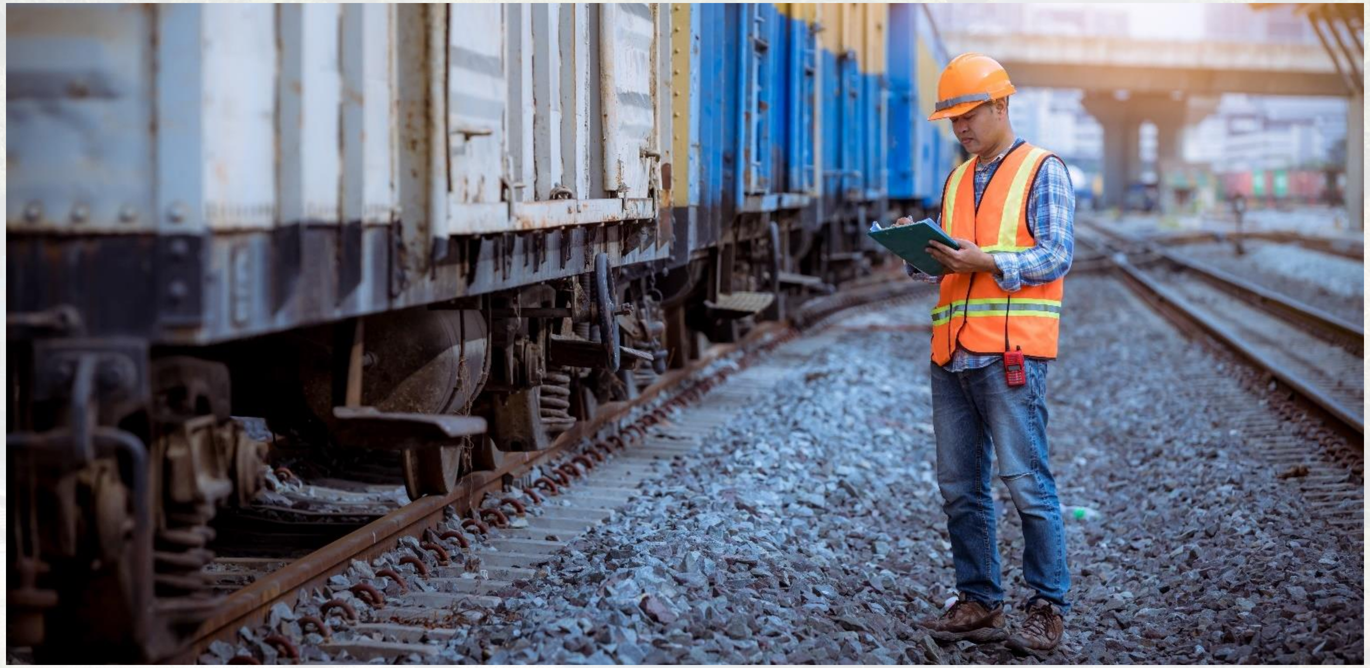
1. **Supplier Finance Arrangements (SFA):** Liquidity risk disclosures are important, focusing on new IAS 7, *Statement of Cash Flows* requirements for Supplier Finance Arrangements (SFA). Issuers must identify all material SFAs and disclose terms, conditions, and non-cash changes. Specific information on financial liabilities and payment due dates must be provided. Explanatory information is needed for wide payment ranges. Access to SFAs should be considered under IFRS 7 liquidity risk disclosures (IFRS 7, *Financial Instruments: Disclosures*).
2. **Clarifications on non-current liabilities and loan disclosures:** ESMA has issued a reminder to issuers regarding the clarifications and new disclosures under IAS 1, *Presentation of Financial Statements* related to non-current liabilities with covenants, as well as the disclosures required by IFRS 7 concerning loans payable. These reminders are particularly relevant in cases of defaults, breaches, or renegotiations of loan agreements. Paragraph 76ZA of IAS 1, mandates the disclosure of information that helps users of financial statements understand the risk that liabilities could become repayable within twelve months after the reporting period. This is crucial when issuers classify liabilities arising from loan arrangements as non-current, and when the right to defer settlement of those liabilities is subject to compliance with covenants within 12 months after the reporting period.
3. **Statement of cash flows:** ESMA also highlights several requirements where enforcers have previously identified non-compliance:
   - **Cash flows presentation:** Cash flows in the Statement of Cash Flows (SCF) must be presented on a gross basis. Non-cash transactions cannot be included in the SCF, and material non-cash transactions related to investing and financing must be disclosed elsewhere in the financial statements.
   - **Bank borrowings:** Bank borrowings are generally considered financing activities. However, bank overdrafts that are repayable on demand and form an integral part of an entity's cash management can be included as a component of cash and cash equivalents. Banking facility arrangements should be presented as financing activities unless there is frequent fluctuation between negative and positive balances.
   - **Transparency in accounting policies:** Issuers must be transparent about their accounting policies and judgements regarding the classification of cash flows, such as interest, dividends, cash flows from leases, and other complex or infrequent transactions, as well as components of cash and cash equivalents.

Accounting policies, judgements, significant estimates

1. **General remarks:** ESMA emphasises that disclosures of material accounting policies, judgements, and sources of estimation uncertainty should be entity-specific and consistent with other information within the financial statements. Issuers should avoid merely repeating IFRS requirements to prevent boilerplate disclosures that obscure relevant information. They should clearly disclose the judgements that have the most significant effect on the amounts recognised in the financial statements and the assumptions about the future that have a significant risk of resulting in material adjustments to the carrying amount of assets and liabilities within the next financial year. Additionally, issuers should assess and explain how estimation uncertainty is affected by significant current developments, such as macroeconomic, technological, social, climatic, and geopolitical factors.

2. **Control, joint control, and significant influence:** ESMA highlights that determining whether an issuer controls an entity or has significant influence over an investee often requires significant judgement. This is especially true when factors other than voting rights need to be considered. These factors include special rights under contracts, specific legal regimes, legal provisions limiting capital involvement, and temporary circumstances like holding options on the investee's equity. Issuers should adhere to the requirements of paragraphs 7-9 of IFRS 12, *Disclosure of Interests in Other Entities*, and provide clear and detailed disclosures about the significant judgements made when assessing control, joint control, and significant influence.

3. **Revenue from contracts with customers:** ESMA notes that assessing whether long-term contracts meet the definition of a contract with a customer may require significant judgement, and issuers should disclose these judgements. For long-term contracts, there is often uncertainty regarding revenues and costs, and issuers should ensure forecasts are reasonable and supportable. For onerous contracts, the present obligation should be recognised as a provision. ESMA also highlights the need for disclosures under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, including uncertainties about the amount and timing of outflows of economic benefits. When another party is involved in providing goods or services, the recognition of revenue depends on whether the issuer acts as principal or agent, requiring significant judgement. ESMA emphasises the importance of disclosing the amount and timing of revenue expected from existing contracts and providing reconciliations of remaining performance obligations. Issuers should comply with ESMA Guidelines on Alternative Performance Measures when including backlog measures in the management report.



Priorities related to sustainability statements

Materiality consideration in reporting under ESRS

Conducting a thorough materiality assessment is crucial for determining the information to be disclosed in the sustainability statement under European Sustainability Reporting Standards (ESRS). ESMA recommends following EFRAG's Implementation Guidance on Materiality Assessment. Detailed disclosures on the assessment process are essential for users to understand the steps taken to reach materiality conclusions. This includes information on activities, business relationships, geographies, and stakeholders considered. The sustainability due diligence process and stakeholder engagement are key aspects of the materiality assessment. ESMA emphasises the importance of transparency and the need to comply with mandatory disclosure requirements, even if the related topics are not found to be material. Issuers must also provide explanations for any omitted disclosures and include a content index for easier navigation.

Scope and structure of the sustainability statement

The sustainability statement must align with the financial statements, using the same scope of consolidation for both. It should cover material impacts, risks, and opportunities (IROs) related to the value chain. Transitional reliefs for value chain information are available for the first three years, but issuers must explain efforts to obtain necessary information. The structure of the sustainability statement is prescribed, with options for incorporation by reference. Issuers should ensure compliance with ESRS requirements and facilitate access and understanding of the information. Connections to other parts of corporate reporting must be clear, with references to corresponding financial statement information.

Conclusion

In conclusion, ESMA's enforcement priorities for 2024 emphasise the importance of transparency, accuracy, and compliance in both financial and sustainability reporting. Issuers must ensure that their disclosures are entity-specific, consistent, and provide a clear understanding of their financial position and sustainability practices. By adhering to these priorities, issuers can enhance the quality of their reports, build trust with stakeholders, and contribute to a more transparent and accountable financial market.

In the Indian context, the Securities and Exchange Board of India (SEBI) has also been emphasising the importance of transparency and accuracy in corporate reporting. Indian companies are required to comply with the Indian Accounting Standards (Ind AS), which are converged with IFRS. SEBI has been proactive in ensuring that companies provide detailed disclosures on financial and sustainability matters, similar to the requirements set by ESMA. Indian companies should take note of ESMA's enforcement priorities and align their reporting practices to meet global standards, thereby enhancing their credibility and attractiveness to international investors.

CHAPTER 2

Accounting for major spares

This article aims to:

- Discuss the accounting of spares that meet the definition of property, plant and equipment under Ind AS.

Ind AS 16, *Property, Plant and Equipment*, provides guidance on the accounting of Property, Plant and Equipment (PPE). Generally, for many companies, PPE is a significant item on the balance sheet. Spare parts are essential components of the PPE that ensure the smooth functioning of various equipment and machinery across industries. Proper accounting for PPE including spare parts is essential to ensure a true and fair view of the financial statements.

Ind AS 16 defines PPE as tangible items that:

a. Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and

b. Are expected to be used during more than one period.

Further, Ind AS 16 provides that spare parts, stand-by equipment and servicing equipment - e.g. tools and consumable lubricants are classified as PPE if they meet the definition, including the requirement to be used over more than one period. The principle of accounting that are followed for PPE are also being followed for spare parts under Ind AS framework.

Recognition criteria for PPE under Ind AS 16

The cost of an item of PPE or an intangible asset is required to be recognised as an asset if and only if it is probable that future economic benefits associated with the item flow to the entity and the cost of the item can be measured reliably. As specified above spare parts are recognised in accordance with Ind AS 16 when they meet the definition of PPE. Otherwise, such items are classified as inventory.

Accounting considerations for spare parts

The accounting treatment of spare parts is a critical aspect of financial reporting that requires careful consideration and adherence to guidance under Ind AS requirements. The accounting of spare parts has also been a subject matter of deliberation through various Expert Advisory Committees opinions (EACs) and issues under Ind AS Transition Facilitation Group (ITFG) bulletins issued by the Institute of Chartered Accountants of India (ICAI) in past.

Classification of spare parts

One of the primary considerations in spare parts accounting is their classification. Considering the guidance above, in a situation where an entity uses spare parts for an item of PPE, issues may arise on whether such spare parts should be recognised as inventory or capitalised as PPE and recognised as part of that equipment or whether depreciation should be computed separately for that spare part. In the cases, where spare parts meet the definition of PPE and satisfy the recognition criteria in Ind AS 16 then they, should be capitalised as PPE separately from the equipment with which it is intended to be used.

Initial recognition and measurement

The initial recognition and measurement of spare parts are crucial for accurate financial reporting. Spare parts should be recognised at cost, which includes the purchase price and any directly attributable costs necessary to bring the spare part to its present location and condition.

Depreciation

As per Ind AS 16, when an item of PPE comprises individual components for which different depreciation methods or rates are appropriate, each component is depreciated separately. Any item of PPE with finite useful life is depreciated/amortised on a systematic basis over its useful life. The depreciable amount of an asset is determined after deducting its residual value.

The depreciation of spare parts classified as PPE should be consistent with the depreciation policy for the related equipment or machinery. In this regard, ICAI in the past through its ITFG clarified that the depreciation on an item of spare part would begin when the asset is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. The spare parts may be readily available for use and may be depreciated from the date of its purchase. In determining the useful life of the spare part, the life of the machine (in respect of which it could be used) could be one of the determining factors.

Clarification through EAC

Though the accounting of spare parts and commencement of depreciation for such spare parts has been discussed by ICAI in past through ITFGs and EACs, many companies were still following the practice of capitalisation or commencement of depreciation of spare parts from the date of issue of such spare parts to the machinery which is not in line with guidance under Ind AS.

To reiterate the guidance related to accounting for spare parts, the ICAI has issued a EAC opinion recently on this topic. The EAC in its opinion pointed out that the major spares should be recognised as an item of PPE only when they meet the definition of PPE and satisfy the recognition criteria as per Ind AS 16. Further, once the spare parts are classified as PPE as per the above-mentioned principles, such items should follow the requirements of Ind AS 16 in all aspects. Accordingly, the spare parts should be capitalised, and their costs should be determined and depreciated as per the requirements of Ind AS 16.

With regard to depreciation, the EAC highlighted that the depreciable amount of an asset should be allocated on a systematic basis over its useful life[1]. Further, considering guidance under Ind AS 16, the spare part should be capitalised and depreciated from the date it becomes available for use (i.e. when it is in the location and condition necessary for it to be capable of being operated in the manner intended by the management). This can be explained with the help of fact-pattern on the next page.

1. As per Ind AS 16, useful life is the period over which an asset is expected to be available for use by an entity; or the number of production or similar units expected to be obtained from the asset by an entity.

Scenario

In the scenario discussed in the EAC, the company operates in multiple production lines where similar machines and spares are being used between machines used in different lines of production having different residual useful lives. The company procures various spares to be used in any of the similar machines of different residual useful life whenever required. To ensure uninterrupted plant operation, inventory of such major spares are kept at central location (central store) in each plant for consumption at a later date as and when called for replacement. Considering that, the management was depreciating the major spares from the date of issue to the intended machine rather than date of purchase and receipt of spares at store.

Clarification: EAC considered the guidance under Ind AS 16 and clarified the following with regard to accounting for spare parts:

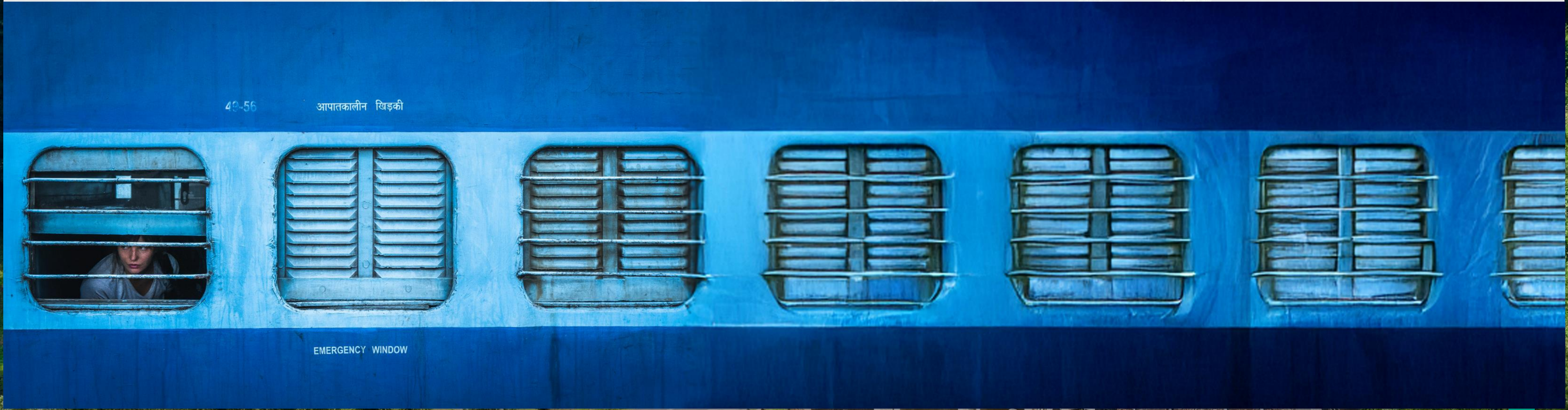
The intended use of spare part is to act as a stand-by for replacement of the original part in the plant and machinery in case of its damage/non-functioning/break-down and therefore, it is ready for its intended use on its purchase or acquisition though not on its actual use or replacement in the concerned plant and machinery. Such spare is in the location and condition for operating in the manner intended by management and is ready for its intended use of replacement. Accordingly, the spare part should be capitalised and depreciated from the date of its acquisition/purchase itself rather from the date when it is actually used/fitted.

As per the requirements of Ind AS 16, spare part should be depreciated considering its useful life, however, that useful life should be estimated in terms of its expected utility to the entity including both the periods of storage and use, considering factors such as, intended use, part to be replaced, historical data, expected obsolescence, etc.

With regard to accounting for installation or replacement cost of major spares that will be incurred at a later stage when the spare part is actually used for replacement in the concerned plant and machinery, it is provided that the depreciation is to be charged on the cost of spare part as determined as per the requirements of Ind AS 16. Such cost would not include installation and commissioning expenses to be incurred later during installation and commissioning of spares. Further, the company should determine accounting of such costs basis the materiality of such costs, and if these costs are not material, these may be recognised in the Statement of Profit and Loss.

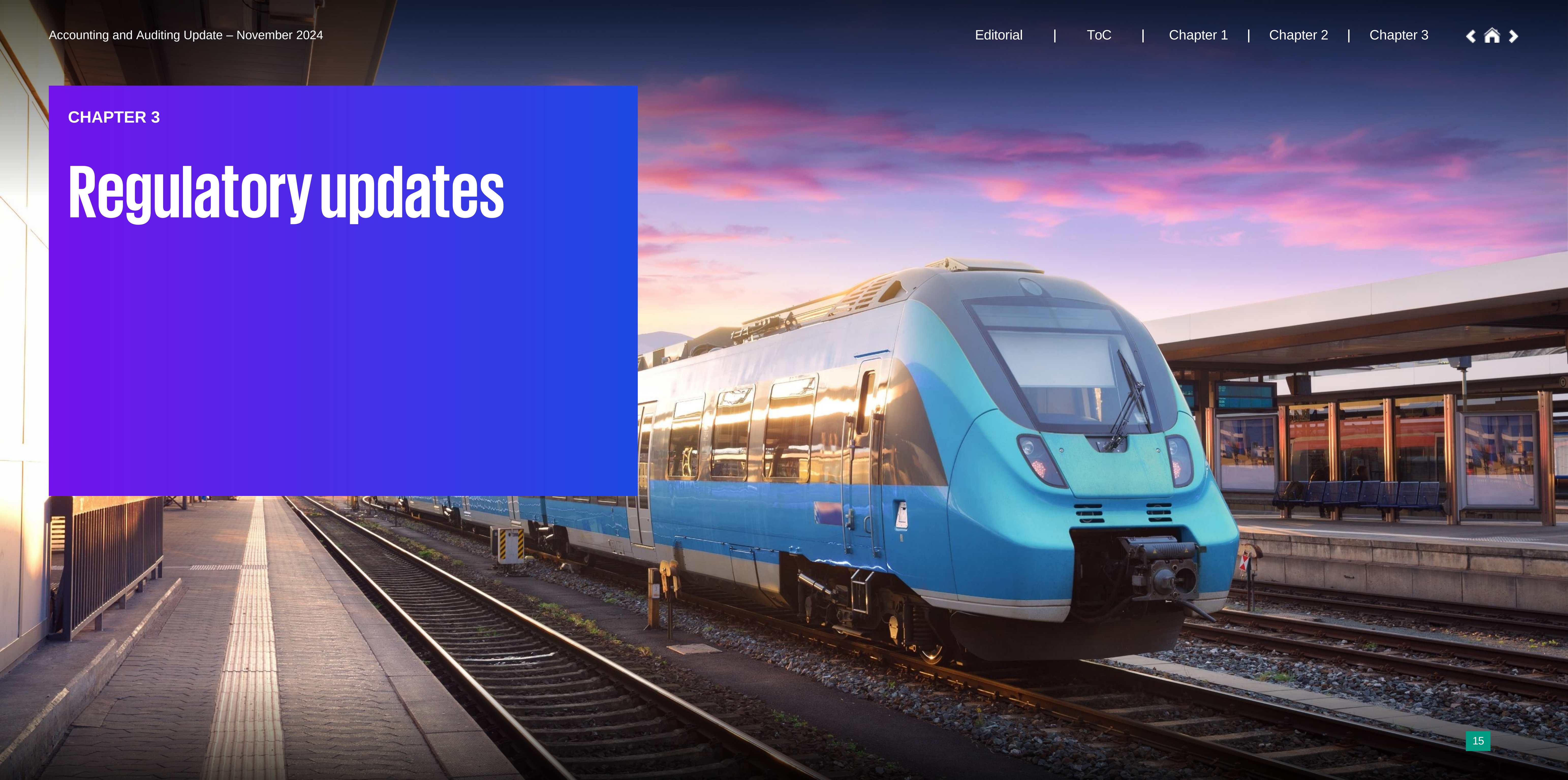
Conclusion

In conclusion, accounting for major spares under Ind AS 16 is a critical aspect of financial reporting that ensures a true and fair view of the financial statements. Proper classification, recognition, and measurement of spare parts as PPE are essential. Spare parts that meet the definition and recognition criteria of PPE should be capitalised and depreciated in line with the related equipment or machinery. The guidance provided by the Institute of Chartered Accountants of India (ICAI) through various EACs and ITFG bulletins emphasises the importance of adhering to these principles. By following the requirements of Ind AS 16, companies can ensure accurate financial reporting and better management of their assets.



CHAPTER 3

Regulatory updates



Inclusion of mutual funds in PIT Regulations

In November 2022, the Securities and Exchange Board of India (SEBI) announced the inclusion of mutual fund units under the SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations). The provisions pertaining to mutual funds are effective from 1 November 2024. To facilitate implementation of these newly enacted provisions, SEBI issued a circular on 22 October 2024, which provides clarifications regarding the mutual fund provisions. The key aspects of the circular are as follows:

- **Disclosure of holdings:** SEBI clarified that Asset Management Companies (AMCs) should disclose the holdings of designated persons, trustees, and their immediate relatives on a quarterly basis. For the initial disclosure of holdings as of 31 October 2024, AMCs should make such disclosure by 15 November 2024. For all subsequent quarters, AMCs are required to make quarterly disclosures within 10 calendar days from the end of the quarter.
- **Threshold based disclosure of transactions:** Any transaction or series of transactions in the units of its own mutual funds by the designated person of the AMC, its trustees, and their immediate relatives that exceed the threshold limit of INR15 lakh per quarter across all schemes should be reported by the concerned person to the compliance officer of the AMC within two business days from the date of the transaction.
- **Formats:** The SEBI has specified the formats in which various disclosures required under PIT Regulations are to be made.

(Source: SEBI Circular SEBI/HO/IMD/IMD-PoD-1/P/CIR/2024/144 dated 22 October 2024)

Clarifications with respect to research analysts

The SEBI (Research Analysts) Regulations, 2014 (RA Regulations) govern the framework for Research Analysts (RAs). SEBI has issued various notifications in the past outlining the advertisement code provisions that RAs are required to follow. In this regard, on 24 October 2024, SEBI clarified that research reports and recommendations are not considered as advertisements unless they promote the products or services offered by the RA.

Additionally, on 25 October 2024, SEBI issued a circular regarding the periodic reporting format for RAs and Proxy Advisers (PAs). Regulation 24(4) of the RA Regulations requires RAs to submit specified reports and information to SEBI within prescribed timelines. The recent circular specified the following requirements:

- RAs are required to submit their periodic reports to the Research Analyst Administration and Supervisory Body (RAASB), while PAs are to submit their reports to SEBI.
- RAs and PAs must submit periodic reports for half-yearly periods within 30 days from the end of the reporting period, i.e., 30 September and 31 March of each financial year. The first reporting requirement begins on 31 March 2025, with the report due by 30 April 2025.
- Provided specific reporting formats RAs and PAs.

(Source: SEBI Circulars SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2024/146, dated 24 October 2024 and SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2024/148, dated 25 October 2024)

Consultation paper on ease of doing business by ERPs

In July 2023, SEBI included framework for ESG Rating Providers (ERPs) under Chapter IVA of the SEBI (Credit Rating Agencies) Regulations, 1999 (CRA Regulations). Consequent to notification of framework related to ERPs, SEBI has received representation from ERPs, *inter alia*, seeking clarification on the applicability of certain provisions prescribed in the Regulations for ERPs related to pay model, ESG rating of issuers/products other than listed issuers/securities, etc.

In this background, with an aim to facilitate ease of doing business for ERPs, recently SEBI has issued a consultation paper to propose amendments in the provisions relating to ERPs in the CRA Regulations.

Following are the matters covered in the consultation paper:

a. Requirement of sharing draft ESG rating report with the issuer and the subscriber at the same time. Additionally, ERPs following a subscriber-pays model would ensure that the rated entity or issuer itself or its group companies or associates are not permitted to be a subscriber to ESG rating.

b. ERPs following a subscriber-pays model should grant an opportunity of appeal and representation to the rated issuer.

c. Dispensing with the requirement to disclose the ESG ratings to the stock exchange(s) where the issuer or the security is listed and ERPs that follow a subscriber-pays model.

d. Specifying activity-based regulation for ERPs wherein ERPs may undertake ESG rating of other products/issuers, including unlisted issuers or securities under specific guidelines of a financial sector regulator as specified by SEBI.

The period to provide comments on the consultation paper ended on 15 November 2024.

(Source: SEBI Consultation paper – Department of Debt and Hybrid Securities – POD III – Proposal for ease of doing business by ESG Rating Providers (ERPs) dated 31 October 2024)

Proposals related to corporate governance norms for HVDLEs

Regulation 15(1A) in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations) requires compliance of corporate governance norms by an entity having outstanding value of listed non-convertible debt securities of INR500 crore and above, referred to as 'High Value Debt Listed Entities' (HVDLEs). The said provisions are applicable on a 'comply or explain' basis until 31 March 2025.

To promote ease of doing business and reduce the compliance burden for HVDLEs, SEBI formed a working group in May 2023 to review the applicability of corporate governance norms under LODR Regulations. Based on the recommendations of working group and representations from various stakeholders, SEBI issued a consultation paper on 31 October 2024 – 'Consultation paper on review of provisions of LODR pertaining to corporate governance norms for HVDLEs'. Following are the key proposals from the consultation paper:

a. **Introduction of a separate chapter:** To include new chapter for corporate governance norms which will be applicable only to HVDLEs.

b. **Relaxation in the threshold for applicability:** It is proposed that the threshold of listed outstanding non-convertible securities for identification of a debt listed entity as HVDLE may be increased from INR500 crore to INR1000 crore.

c. **Introduction of the sunset clause:** The consultation paper proposes that if the corporate governance norms become applicable to a HVDLE on the basis of a specified threshold, they would continue to remain applicable till such time the value of outstanding listed debt securities reduces and remains below the specified threshold for a period of three consecutive financial years. For such a computation, the value of outstanding listed debt securities to be reviewed on the last day of every financial year. Further, the provision could become applicable if the value of outstanding listed debt reaches the specified threshold again. In such a scenario the HVDLEs would need to comply with the provisions within six months and disclosures of such compliance may be provided in the corporate governance compliance report on and from third quarter following the trigger.

d. **Relaxation:** For HVDLEs which are not companies, but a body corporate or are subject to regulations under other statues, the corporate governance provisions under LODR Regulations would apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant authorities.

e. **Relaxation regarding constitution of the Nomination and Remuneration Committee (NRC), Risk Management Committee (RMC) and Stakeholders Relationship Committee (SRC):** To avoid constitution of multiple committees by HVDLEs, it is proposed that the board of directors of a HVDLE may either choose to constitute NRC, RMC or SRC, or may ensure that the functions of such committees as specified under LODR Regulations is delegated and discharged by the Audit Committee.

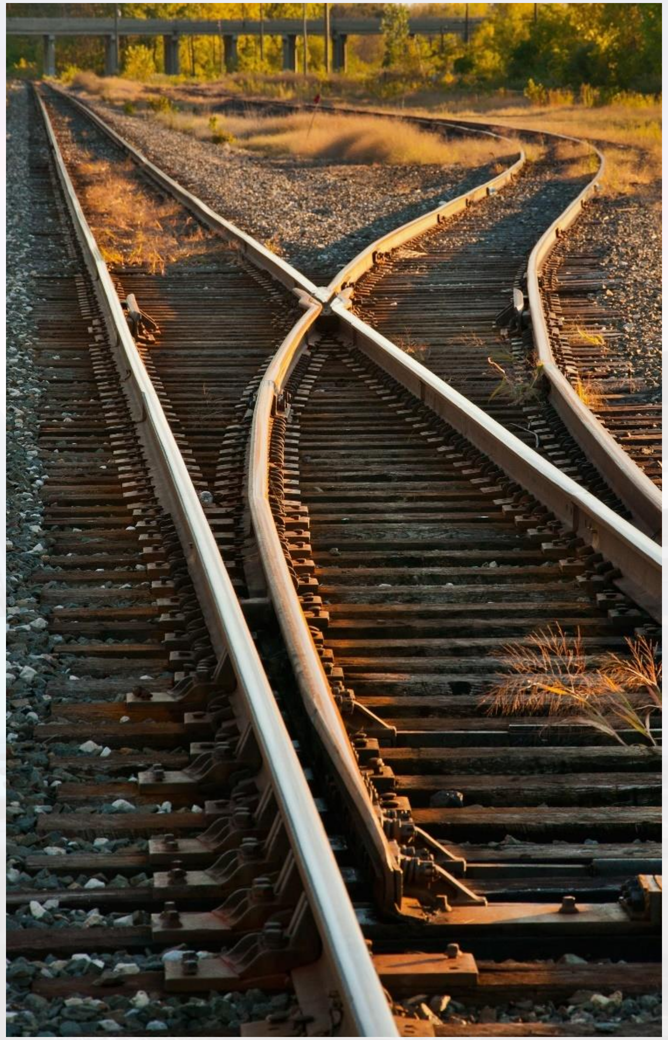
f. **XBRL:** Introduction of filing of corporate governance compliance report on quarterly basis in XBRL format and harmonisation of reporting formats with that specified for equity listed entities.

g. **BRSR:** Introduction of Business Responsibility and Sustainability Reporting (BRSR) for HVDLEs on a voluntary basis.

h. **Requirements relating to maximum number of directorships:** Regulation 17A of LODR Regulations, *inter-alia*, specifies restrictions related to directorship in listed entities. The consultation paper proposes to include directorships in HVDLEs along with directorships in equity listed entities while reckoning the number of directorships held by a person in listed entities.

i. **Requirements relating to number of memberships or chairpersonships in the committees by a director:** Regulation 26 of the LODR Regulations provides a maximum cap on the number of committees across all listed entities, a director can act as a member or chairperson. While determining the number of such listed entities, currently HVDLEs are excluded. In this regard, the consultation paper proposes that HVDLEs (along with equity listed entities) should be considered for the purpose of computing the maximum limit of committees, a director can act as a member or chairperson.

(Source: SEBI Consultation paper on Consultation paper on review of provisions of LODR Regulations pertaining to corporate governance norms for High Value Debt Listed entities (HVDLEs) dated 31 October 2024)



Investment in overseas mutual funds by Indian mutual funds

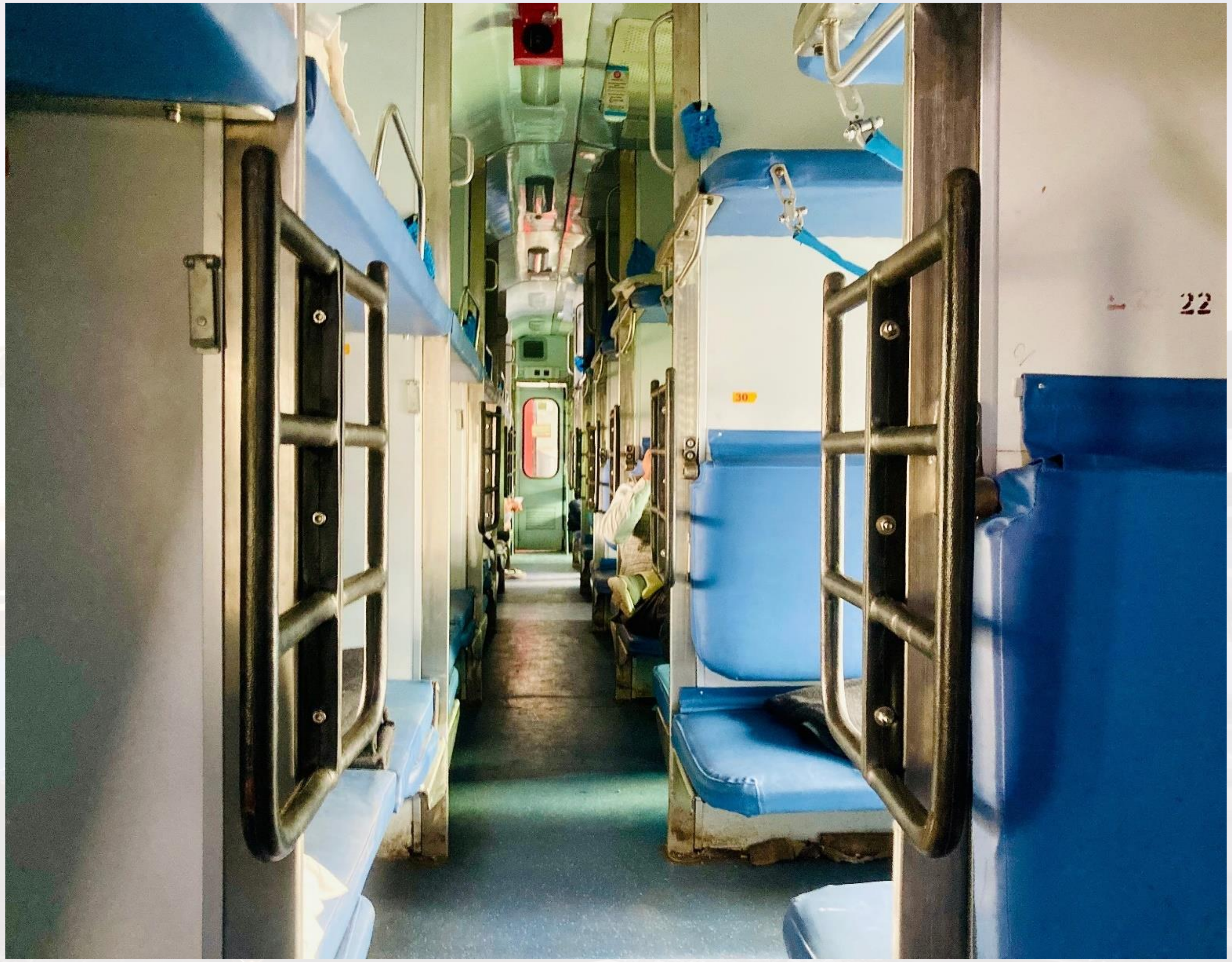
In order to facilitate ease of investment and to enable mutual funds to diversify their investments in overseas Mutual Funds (MFs) or Unit Trusts (UTs), SEBI through its circular dated 4 November 2024, has provided that Indian mutual funds schemes may invest in overseas MF/UTs that have exposure to Indian securities provided the total exposure to Indian securities by these MF/UTs should not be more than 25 per cent of their assets.

While investing in overseas MF/UTs, the India mutual fund schemes should ensure the following:

- **Pooling:** Contribution of all investors of the overseas MF/UT to be pooled into a single investment vehicle.
- **Pari-passu and pro-rata:** The corpus of the overseas MF/UT should consist of a common portfolio without segregated portfolios. All investors in the overseas MF/UT should have pari-passu and pro-rata rights i.e. they receive a share of returns/gains from the fund proportional to their contribution and have equal rights.
- **Independent investment manager/fund manager:** Overseas MF/UT should be managed by an independent fund manager to ensure investment are made without influence, directly or indirectly by any investor.
- **Public disclosure:** Such overseas MF/UTs disclose their portfolios at least on a quarterly intervals.
- **No advisory agreement:** To prevent conflict of interest or undue advantage to anyone, there should not be any advisory agreement between the Indian and overseas MF/UTs.

The circular also specifies the consequences in case of breach of the 25 per cent threshold as mentioned above, along with corrective actions that should be taken in the said scenario.

(Source: SEBI Circular, SEBI/HO/IMD/IMD-PoD-1/P/CIR/149 dated 4 November 2024)



Proposed amendment to the definition of UPSI

Recently, SEBI issued a consultation paper proposing amendments to the definition of Unpublished Price Sensitive Information (UPSI) under the PIT Regulations. The proposal aims to align the definition of UPSI as per PIT Regulations with definition under Regulation 30 of the LODR Regulations.

The SEBI in the consultation paper highlighted that companies restricting disclosure of UPSI to the items explicitly mentioned in the PIT Regulations and not complying with the law in spirit. Therefore, to broaden the scope of UPSI, SEBI proposed to include following events to be included in the illustrative list of events specified in definition of UPSI (aligning the same with events specified in Regulation 30 of LODR Regulations).

a. Change in ratings assigned to instruments issued by listed entities.

b. Fund raising proposed to be undertaken.

c. Agreements by whatever name called impacting management and control of the company.

d. Fraud or defaults by a listed entity, its promoter, director, key managerial personnel, senior management, or subsidiary or arrest of key managerial personnel, senior management, promoter or director of the listed entity, whether occurred within India or abroad.

e. Changes in key managerial personnel, other than due to superannuation or end of term, and resignation of a statutory auditor or secretarial auditor.

f. Resolution plan/restructuring/one-time settlement in relation to loans or borrowings from banks and financial institutions.

g. Admission of winding up petition filed by any party/creditors, admission of application by the corporate applicant or financial creditors for initiation of Corporate Insolvency Resolution Process (CIRP) of a listed corporate debtor and its approval or rejection thereof under the Insolvency Code.

h. Initiation of forensic audit (by whatever name called) by company or any other entity for detecting mis-statements in financials, misappropriation, siphoning or diversion of funds and receipt of final forensic audit report.

i. Actions initiated or orders passed by any regulatory, statutory, enforcement authority or judicial body against the listed entity or its directors, key managerial personnel, senior management, promoter or subsidiary, in relation to the listed entity.

j. Mergers, de-mergers, acquisitions, delistings, disposals and expansion of business, award or termination of order/contracts not in the normal course of business and such other transactions.

k. Outcome of any litigations or disputes which may have an impact on the listed entity.

l. Giving of guarantees or indemnity of giving a surety by whatever name called for a third party.

m. Granting, withdrawal, surrender, cancellation or suspension of key licenses or regulatory approvals.

(Source: SEBI Consultation Paper on proposed review of the definition of Unpublished Price Sensitive Information under SEBI (Prohibition of Insider Trading) Regulations, 2015 to bring regulatory clarity, certainty and uniformity of compliance in the ecosystem, dated 9 November 2024)

SEBI findings on royalty payments by listed companies to related parties

Recently, SEBI has conducted a study to analyse royalty payments made by listed companies to their related parties.
The analysis is based on royalty payments, amounting to less than 5 per cent of turnover to their related parties, during the period of 10 years (FY 2013-14 to 2022-23). The study covering 233 companies across sectors, resulted in various findings, some important ones being:

- *Royalty payments by net-profit making companies:* One out of four instances involved royalty payments being exceeding 20 per cent of the net profits and one out of two times listed companies that paid royalty did not pay dividend or paid more royalty to related parties than dividend paid to non-related party shareholders.
- *Royalty payments by net-loss making companies:* Continuous royalty payments by loss making companies including instances of incurring losses for at least for five years while paying royalty.
- *Consistent royalty-payers:* 79 companies consistently paid royalty to the related parties and 11 out of these consistently paid royalty exceeding 20 per cent of their net profits, throughout the tenure of the study.

The study highlighted concerns regarding poor disclosure, lack of justification for royalty payments, and significant payments to related parties labeled as management or technology fees, which fall outside ambit of royalty from regulatory perspective.

Proxy advisory firms flagged issues with respect to correlation between royalty payments and revenue or profits of companies, with some companies seeking perpetual approval for such payments contrary to principles of corporate governance. The study also noted that the performance of royalty-paying companies did not show any clear superiority over their peers, and there was a high level of subjectivity in royalty valuations. The findings raise concerns about corporate governance and transparency in related-party transactions.

(Source: PR No.29/2024 - SEBI study finds that 1 out of 4 times, listed companies paid royalty exceeding 20% of their net profits to Related Parties, dated 14 November 2024)

Proposed new environmental standards for aluminum plants

The Ministry of Environment, Forestry and Climate Change (MoEFCC) through its notification dated 1 November 2024, has proposed amendments to the Environment (Protection) Act, 1986 (the Act), to control air pollution caused by aluminum industry. The draft notification aims to reduce emissions by lowering emission limits for plants, refineries and furnaces by providing stricter emission standards. It mandates use of cleaner fuels like Low sulfur Diesel Oil (LDO) and minimises fluoride emissions impacting surrounding vegetation.

The proposal is open for comments till 31 December 2024.

(Source: MoEFCC Draft Notification G.S.R. 680(E), dated 1 November 2024)

MoEFCC streamlines process for environment violations

The MoEFCC has recently issued various rules as detailed below in order to introduce penalty clauses for non-compliance or violation of the provisions under various environmental Acts. The Rules have been introduced to establish a systematic approach for conducting inquiries into violations related to water management, waste management and air pollution. Following Rules have been issued to introduce procedures relating to creation of complaints against environmental regulation violators, initiation of inquiry and imposing penalties.

- Water (Prevention and Control of Pollution) (Manner of Holding Inquiry and Imposition of Penalty) Rules, 2024 related to water provisions under the Water (Prevention and Control of Pollution) Act, 1974.
- E-Waste (Management) Second Amendment Rules, 2024 under the E-Waste (Management) Rules, 2022
- Hazardous and Other Wastes (Management and Transboundary Movement) Second Amendment Rules, 2024 under Hazardous and Other Wastes (Management and Transboundary Movement) Rules, 2016
- Air (Prevention and Control of Pollution) (Manner of Holding Inquiry and Imposition of Penalty) Rules, 2024 under Air (Prevention and Control of Pollution) Act, 1981

(Sources: MoEFCC Notifications G.S.R. 696(E)., dated 11 November 2024; G.S.R. 699(E) dated, 12 November 2024; G.S.R. 698(E)., dated 12 November 2024 and G.S.R. 701(E)., dated 12 November 2024)

Biological Diversity Rules, 2024

With the objective of conserving biological diversity in India, MoEFCC issued the Biological Diversity Rules, 2024 (the Rules) under the Biological Diversity Act, 2002 (2002 Act) through a notification dated 22 October 2024. These new Rules will replace the existing Biological Diversity Rules, 2004. Key aspects of the Rules include:

- Establishing the National Biodiversity Authority (Authority), which will administer the National Biodiversity Fund (NBF) established under the 2002 Act, grant approvals for biodiversity-related agreements, and provide technical guidance and support to state bodies.
- Specifying the manner of selection and appointment of the chairperson for the Authority. The Chairperson will be appointed by the Central Government for a term of three years.
- Prescribing procedures to access biological resources.
- Prescribing procedures for registration and obtaining prior approval from the Authority before the grant of intellectual property rights.
- Prescribing procedures for obtaining a certificate of origin for cultivated medicinal plants.
- Measures and procedures prescribed for conducting non-commercial research or research for emergency purposes outside India by Indian researchers or institutions.
- Enhanced guidelines for the use of genetic resources, ensuring fair and equitable sharing of benefits arising from their use.

The rules will come into effect from expiry of 60 days from the date of their notification in the Official Gazette i.e. 25 October 2024.

(Source: MoEFCC Notification no G.S.R. 665(E)., dated 25 October 2024)

Draft Insurance Fraud Monitoring Framework

In 2013, the Insurance Regulatory and Development Authority of India (IRDAI), issued the Insurance Fraud Monitoring Framework to provide a regulatory supervision and guidance on the adequacy of measures taken by insurers to address and manage risks emanating from fraud.

However, considering the substantial change in the nature and intensity of fraud over the years and revised insights from practices followed by other financial sector regulators such as revised framework for Banks and NBFCs issued by RBI and international best practices in this domain, IRDAI has issued an exposure draft of revised fraud management framework. The exposure draft proposed an enhanced framework that includes advanced measures for fraud detection, efficient fraud handling, robust fraud prevention, and other relevant aspects.

The period to provide comments ended on 13 November 2024.

(Source: Exposure draft - IRDAI/IIDD/TF-Fraud/2024, dated 23 October 2024)

Revised criteria for classification of non-company entities

The Institute of Chartered Accountants of India (ICAI) has revised the criteria for classification of non-company entities for applicability of accounting standards (issued by the ICAI). The classification would determine the extent of compliance required with the accounting standards by each category of the non-company entities. This revised scheme of applicability of Accounting Standards will come into effect for accounting periods beginning on or after 1 April 2024.

For this purpose, the non-company entities are classified into two categories:

1. Micro, Small and Medium Enterprises (MSMEs) and
2. Large entities.

The MSME means a non-company entity:

i. Whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India

ii. Which is not a bank, financial institution or an insurance company

iii. Whose turnover (excluding other income) does not exceed INR250 crore in the immediately preceding accounting year

iv. Which does not have borrowings in excess of INR50 crore at any time during the immediately preceding accounting year, and

v. Which is not a holding or subsidiary of an entity which is not a micro, small and medium-sized entity.

Larger entity is a non-company entity and it not an MSME. Such large entities are required to comply with all the Accounting Standards in full. However, ICAI has provided certain exemptions/relaxations to the MSMEs from applicability of Accounting Standards which are as follows:

1. Accounting standards not applicable to MSMEs in their entirety are:

- AS 3, *Cash Flow Statements*
- AS 17, *Segment Reporting*
- AS 20, *Earnings per Share*
- AS 24, *Discontinuing Operations.*

Further AS 18, *Related Party Disclosures* and AS 28, *Impairment of Assets* not applicable in their entirety to following MSMEs

a. Whose turnover (excluding other income) does not exceed INR50 crore in the immediately preceding accounting year

b. Which does not have borrowings in excess of INR10 crore at any time during the immediately preceding accounting year and

c. Which is not a holding and subsidiary of an MSME not covered above.

2. Accounting standards wherein relaxation from certain requirements of the standards have been given as an option to the MSMEs are:

- AS 10, *Property, Plant and Equipment*
- AS 11, *The Effects of Changes in Foreign Exchange Rates*
- AS 15, *Employee Benefits*
- AS 19, *Leases*
- AS 22, *Accounting for Taxes on Income*
- AS 26, *Intangible Assets*
- AS 28, *Impairment of Assets*
- AS 29, *Provisions, Contingent Liabilities and Contingent Assets.*

Further, a non-company entity which are required to apply Accounting Standards under any other relevant regulatory requirement, will not be eligible to benefit from these exemptions/relaxations. The MSMEs are required to disclose their status as an MSME and the fact that they have availed these exemptions in a note to its financial statements. The announcement also provides other disclosure requirements and guidelines for MSMEs under different scenarios.

This new classification replaces the old criteria issued in March 2021 and it mandates clear financial disclosures, aiming to simplify compliance for MSMEs while ensuring transparency.

(Source: ICAI Announcement - Revised Criteria for classification of Non-company entities for applicability of Accounting Standards.)

FASB issued ASU on income statement expense disclosures

The Financial Accounting Standards Board (FASB) has issued Accounting Standards Update (ASU) on 4 November 2024 that aims to improve financial reporting by requiring public companies to disclose, in interim and annual reporting periods, additional information about certain expenses in the notes to financial statements. The ASU provides following:

i. Disclose the amounts of (a) purchases of inventory; (b) employee compensation; (c) depreciation; (d) intangible asset amortisation; and (e) depreciation, depletion, and amortisation recognised as part of oil- and gas-producing activities (or other amounts of depletion expense) included in each relevant expense caption.

ii. Include certain amounts that are already required to be disclosed under current Generally Accepted Accounting Principles (GAAP) in the same disclosure as the other disaggregation requirements.

iii. Disclose a qualitative description of the amounts remaining in relevant expense captions that are not separately disaggregated quantitatively.

iv. Disclose the total amount of selling expenses and, in annual reporting periods, an entity's definition of selling expenses.

The amendments in the ASU will be effective for annual reporting periods beginning after 15 December 2026, and interim reporting periods beginning after 15 December 2027 with early adoption permitted.

(Source: FASB, News and Meeting, FASB Issues Standard That Improves Disclosures about Income Statement Expenses, dated 4 November 2024)

Proposed improvements to requirements for provisions under IAS 37

The International Accounting Standards Board (IASB) has published a consultation aimed at improving the requirements for recognising and measuring provisions on company balance sheets. Provisions are liabilities of uncertain timing or amount. One of the challenging questions in applying IAS 37, *Provisions, Contingent Liabilities and Contingent Asset* is when to recognise a provision, specifically how a company determines if it has a present obligation and what is a 'past event'. The proposed amendments to IAS 37 would include three new tests to determine whether a present obligation exists and specific guidance for threshold-based obligations.

The proposed amendments would clarify how companies assess when to record provisions and how to measure them. The amendments would also require companies to provide more information about the measurement. The IASB's targeted improvements would help companies apply the requirements more consistently and provide investors with more useful information.

The consultation is open for comments until 12 March 2025.

(Source: IFRS.org, News, IASB proposes targeted improvements to requirements for provisions, dated 12 November 2024)

First Notes

MCA amends order regarding information about payments to MSE suppliers

Micro and Small Enterprises (MSEs) play a pivotal role in the Indian economy. Over the years, numerous instances have come to light of delayed payments to MSEs, thereby affecting their overall financial stability. In order to address these issues, the Government has introduced several measures to enable timely realization of dues to the MSEs.

Recently, the Ministry of Corporate Affairs (MCA) issued the Specified Companies (Furnishing of information about payment to micro and small enterprise suppliers) Amendment Order, 2024 ('the Amendment Order 2024'), thereby amending the Specified Companies (Furnishing of information about payment to micro and small enterprise suppliers) Order, 2019 ('the erstwhile order'). In this issue of the First Notes, we aim to provide an overview of the key changes introduced by MCA through the Amendment Order 2024.

This issue of First Notes provides an overview of the key changes introduced by MCA through the Amendment Order 2024.

To access the First Notes, please click here

Voices on Reporting - Quarterly updates publication

Voices on Reporting –Quarter updates publication (for the quarter ended 30 September 2024) provides a summary of key updates. These updates relate to financial reporting and regulatory updates from the Ministry of Corporate Affairs (MCA), Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), National Financial Reporting Authority (NFRA) and the Institute of Chartered Accountants of India (ICAI).

To access the publication, please click here

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