# Update

VINOD KOTHARI & COMPANY

## SEBI introduces new format for quarterly disclosures- yet another amendment to Listing Agreement!!

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# Update

With increased complexity of business, mergers and acquisitions becoming an integral part of the corporate strategies and globalization of capital markets, there was a need for a standardized system of high quality financial reporting standards. With the emergence of International Financial Reporting Standards (IFRS) by International Accounting Standards Board this requirement is being fulfilled.

Companies across the world are embracing this standardized system of financial reporting and India also took its first major step towards the same with The Ministry of Corporate Affairs ("MCA") issuing a notification vide reference no. S.O. 447 (E)[1] dated February 28, 2011 revising the Schedule VI of the Companies Act, 1956 effective from April 01, 2011. Although the change is unrelated to convergence with IFRS, but never the less, the revised Schedule VI bridges the gap as India does not have its own equivalent of IAS 1 which relates to *presentation of financial statements* and lays down the minimum disclosure requirements with a break down for presentation of assets, liabilities income and expenses. However, it did not lay down any specific format for the same.

Taking this initiative further, the market regulator Securities Exchange Board of India ("SEBI") vide its circular CIR/CFD/DIL/4/2012[2] ("Circular") dated April 16, 2012 came up with consequential amendments under clause 41 of the Listing Agreement regarding interim disclosure of financial results by listed entities to the stock exchanges, applicable for financial year ended March 31, 2012 and for all filings made after the date of the circular.

One of the key highlights of the Circular is that it expressly provides that the "*The classification/ disclosure of items in the financial results shall be in accordance with the Revised Schedule VI of the Companies Act, 1956*"

Thus, the format of reporting for listed companies stands modified with this. This is on the same lines as envisaged by ICAI, whereby it stated that IFRS will be applicable to Indian companies in a phased manner. With this circular, the quarterly disclosure by listed companies has taken a step towards financial reporting on the lines of IAS 1.

The major changes in financial disclosures as prescribed by this circular are:

1. As provided earlier, since the disclosures are to be in accordance with the revised Schedule VI, listed companies which are in the nature of companies

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[1] http://www.mca.gov.in/Ministry/pdf/Schedule_VI_28feb2011.pdf
2 http://www.sebi.gov.in/cms/sebi_data/attachdocs/1334570703959.pdf

other than finance companies, shall disclose the following under the head" **income from operations**"

a) sale of products
b) sale of services
c) other operating revenue

Less:

d) Excise duty

Further, in case of finance companies, revenue from operations shall include revenue from:

a) Interest
b) Financial services

Schedule VI also prescribed the following as disclosure under the head of "**other income**"

a) Interest income (in case of company other than finance company)
b) Dividend income
c) Net gain/loss on investments
d) Other non-operating income (net of expenses directly attributable to expense)

**2.** The heads to be provided under Item no. 2 has been changed to include the heads of expenditure as provided in Part II of Schedule VI relating to profit and loss a/c.
Schedule VI does not contain any specific break up for the heads of expenditure as in item 2.

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**3.** The head to be mentioned in item 6 of Clause 41 has been modified to show "finance cost" in place of "interest".
This will provide investors with a fairer view of the accounts of the company as Schedule VI prescribes the following classification under the head "finance cost":

a) Interest cost
b) Other borrowing costs
c) Applicable net gain/loss on foreign currency transactions and translations.

**4.** Under Clause 41 (IV)(h) of the Listing Agreement, companies were to disclose extraordinary items, if any, in accordance with Accounting Standard-5 (AS-5) issued by the Institute of Chartered Accountants of India (ICAI)/Company (Accounting Standards) Rules, 2006. Neither the revised Schedule VI nor Clause 41 expressly defines what is meant by "extraordinary items". However, traditionally by extraordinary items we mean items which are not incurred in the normal course of business. The IAS 1 also does not have any clear definition of the same. In fact, according to IAS 1 para 87 no items of income and expense arising from the outside the entity's ordinary activities should be included. On similar lines, when the AICPA published ARB 43,*Restatement and Revision of Accounting Research Bulletins Nos. 1–42*, in 1953, the following items, when material, were specified as allowed to be excluded from net income if the inclusion would cause users to draw misleading conclusions from an analysis of net income:

- Nonrecurring amounts specifically related to prior years' operations, such as eliminating previously established retained earnings reserves or adjusting past income taxes;
- Amounts resulting from unusual sales of assets not of the type in which the company commonly deals;
- Losses from disasters not commonly insured against (e.g., wars, riots, and earthquakes), unless such losses are a recurrent business hazard;
- Losses from completely writing off intangibles, such as goodwill or trademarks; and
- Amounts from writing off unamortized bond discounts, bond premiums, or bond issue expenses when the related debt is retired or refunded before maturity.

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Thus, extraordinary items do have a definite effect on the net profits of the company. The statement to be provided under Clause 41 mirrors the effect of such items before and after considering the same.

**5.** The circular also requires profit/loss from discontinuing operations, if any, to be disclosed with details. The revised Schedule VI and Clause 41 do not clearly define "discontinuing operations", however, IFRS 5 defines the same as "*where the cashflows of an asset are likely to come from disposal rather than from continuing use of the asset.*"
Schedule VI requires the tax expenses on discontinuing operations to be also disclosed and the consequential effect on profit or loss.

## Our analysis:

With this circular, SEBI has attempted to bring corporate disclosures closer to international practices. Since the convergence with IFRS has been considerably delayed, revision of Schedule VI and consequent change in disclosure under clause 41 only takes us a step closer to the same.