

## **Query No. 5**

**Subject:** *Accounting treatment for backstopping arrangement for compulsorily convertible debentures (CCDs).*<sup>1</sup>

### **A. Facts of the Case**

1. A Company (hereinafter referred to as ‘the Company’) is a schedule ‘A’ Miniratna, Central Public Sector Enterprise (CPSE) under the Ministry of Petroleum & Natural Gas. The Company owns a 15.0 MMTPA (Million Metric Tonne per annum) refinery, which has got a versatile design with complex secondary processing units and a high flexibility to process crudes of various API, delivering a variety of quality products. The shares of the company are listed and traded on stock exchanges of India.
2. The Company has promoted another company, ABC Ltd., jointly with another joint venture (JV) partner, XYZ Ltd., which is a public sector undertaking engaged in exploration, development and production of crude oil and natural gas and value-added products across India and abroad. The shares of the company are listed and traded on stock exchanges of India. The Government of India owns 68.07% of its shares through the President of India. The JV partner is the largest crude oil and natural gas company in India, contributing around 75 per cent to Indian domestic production. Crude oil is the raw material used by several downstream companies to produce petroleum products like petrol, diesel, kerosene, naphtha, and cooking gas-LPG.
3. ABC Ltd. owns a green field petrochemicals project, promoted by XYZ Ltd. (joint venture partner) and the Company. ABC Ltd. is subsidiary of the Company and was incorporated on 19<sup>th</sup> December 2006. It operates an Aromatics Complex, which is the largest single stream unit in Asia to produce 914 KTPA Para-xylene and 283 KTPA Benzene. This aromatic complex is situated in 442 acres of land in the Mangalore Special Economic Zone (MSEZ), and is fully integrated with the Company with feed streams predominantly supplied by the Company.
4. The Company acquired control over ABC Ltd. on 28.02.2015 by acquiring 51.0017 % equity shares, thus making it a subsidiary of the Company. The balance equity shares were held by the JV partner and other individual shareholders (0.0002%). Subsequently, Board of Directors of the Company at its 232<sup>nd</sup> meeting held on 19.10.2020 approved the acquisition of 48.9981% stake in the subsidiary company from the JV partner. The additional shares purchased from the JV partner were transferred in the name of the Company on 01.01.2021. With this, shareholding of Company in the subsidiary company has increased to 99.9998%.
5. The Aromatics Complex was commissioned by the subsidiary company (ABC Ltd.) in October 2014. Due to initial year challenges and market conditions, the subsidiary company incurred losses upto the financial year (F.Y). 2017-18 and during 2019-20 (during F.Y. 2018-19, earned profit). One of the group entities of the JV partner had issued CCDs which enabled it in net-worth shoring-up.

Therefore, in order to shore-up the net-worth of the subsidiary company, reduce the debt

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<sup>1</sup> Opinion finalised by the Committee on 13.4.2021.

levels and strengthen the subsidiary company's balance sheet during F.Y. 2019-20, the subsidiary company embarked on Capital Realignment Plan (CRP) with due approvals from the Board followed by the Promoter Company's (the Company & the JV company) Board's approvals. CRP among other arrangements, comprised of issuance of Compulsorily Convertible Debentures (CCDs) to investors with backstop support from Sponsors (Promoter Companies) with CCDs convertible into equity shares in the hands of Sponsors. Accordingly, during March 2020, the subsidiary company issued CCDs to investors (NBFCs and Bank) to the extent of Rs. 1,000 crore with backstop support from the Promoter companies.

The JV partner and the Company held shareholding in the subsidiary company in the ratio of 49% and 51%, respectively (with 0.0002% held by individuals) at the time of issue of compulsory convertible debentures (CCDs) by the subsidiary company.

The subsidiary company has the obligation to service the interest payouts during the tenure of the CCDs. It is also sponsors' (the Company and the JV Company) obligation to ensure that the subsidiary company meets the interest obligations on time.

The CCDs are not convertible in the hands of investors under any circumstance. Investors have an un-conditional irrevocable put option, which can be exercised by investors only on the sponsors and not on the issuer (the subsidiary company). These CCDs are convertible only in the hands of sponsors at the end of the tenure/buy out option or exercising of put option by the investors (mandatory and irrevocable put option available to investors on sponsors only) and the subsidiary company would be required to convert the same into equity shares of the subsidiary company ranking pari-passu with existing shares at the time of conversion by reckoning share price at that time as per conversion formula defined in the transaction documents.

6. *Existing Disclosures in the standalone financial statements of the Company for the year ended 31<sup>st</sup> March 2020:*

In view of the Company being sponsors to the CCDs of the subsidiary company, in the standalone financial statements of the company for the year ended 31<sup>st</sup> March 2020, the following disclosures were made:

**a. Notes to the financial statements (Under Note No. 11: Financial Assets: Non-Current Investments)**

**11.1.2** The Company has entered into an arrangement for backstopping support towards repayment of principal and cumulative coupon amount for three years compulsorily convertible debentures (CCD) amounting to Rs. 5,100 million (As at March 31, 2019 Rs. Nil) issued by the subsidiary Company and outstanding interest for the year ended March 31, 2020 amounting to Rs. Nil (As at March 31, 2019 Rs. Nil)

**b. Disclosure under Related party (Under Note No. 43: Related Party Disclosures)**

(Rs. in Million)

<b>Commitments</b>	<b>As at March 31, 2020</b>	<b>As at March 31, 2019</b>
(b) Backstopping support by the company for Compulsorily Convertible Debentures issued by the subsidiary company.	5,100.00	-
(c) Backstopping support for interest accrued on Compulsorily Convertible Debentures issued by the subsidiary company.	-	-

**c. Disclosure under Other Commitments (Under Note No. 47: Commitments)**

**47.2.3** The Company has entered into an arrangement for backstopping support towards repayment of principal and cumulative coupon amount for three years Compulsorily Convertible Debentures (CCD) amounting to Rs. 5,100 million (As at March 31, 2019 Rs. Nil) issued by subsidiary Company and outstanding interest for the year ended March 31, 2020 amounting to Rs. Nil (As at March 31, 2019 Rs. Nil).

**7. Existing Accounting and Disclosures in the Consolidated Financial Statements of the Company as a Group for the year ended 31<sup>st</sup> March 2020:**

As per the requirements of Ind AS 110, the Company consolidates the accounts of subsidiary company by combining like items of assets, liabilities, equity, income, expenses and cash flows.

As on 31<sup>st</sup> March, 2020, the subsidiary of the company has disclosed the liability towards CCDs as Compound Financial Instrument and the same is segregated into debt and equity component as per the requirement under Ind AS 32, Financial Instruments: Presentation. Equity and debt components of compound financial instrument presented in the subsidiary company financials for Rs. 7,740.67 million (gross of deferred tax adjustments) (refer Note No. 18 (c) of the subsidiary company's financials) and Rs. 2,196.46 million (refer Note No. 19 (d) of the subsidiary company's financials (shown as non-current and current for Rs. 1,507.59 and Rs. 688.87 million respectively)) respectively.

Upon recognition of equity component of compound financial instrument, the subsidiary company has also recognised Deferred Tax Asset amounting to Rs. 785.69 million and the same was adjusted against equity component and shown as deferred tax impact on equity component of compound financial instrument (refer Note No. 18 (c) of the subsidiary company's financials).

While consolidating the above figures of compound financial instrument in the company's group's consolidated financials, 49% (i.e. non-controlling interest) of equity component of compound financial instrument has been assigned to non-controlling interest (gross of deferred tax adjustments) and balance has been shown as equity component of compound financial instrument in the company's group's consolidated financials for Rs. 3,947.74 million and further to that, the adjustment on account of deferred tax on the same for Rs. 785.69 million has been recognised in group's other equity component and nothing has been assigned to the non-controlling interest (refer Note No. 21 (vi) of group's consolidated financials).

In addition to above, the entire portion of borrowings shown as a part of compound financial instrument in the financials of subsidiary company, has been consolidated in the group's financials (refer Note 22.7 of the consolidated financials) by combining like items.

8. *Observations of the Comptroller and Auditor General of India (C&AG) to the company's Standalone Financials Statements:*

During the audit of the accounts of the Company for the year ended 31<sup>st</sup> March 2020, the C&AG made the following observations regarding the accounting treatment of the CCDs in standalone financial statements:

“These CCDs are issued to private firms and the company has contractual obligation to discharge the debentures and simultaneously, get it converted into equity of the subsidiary company. The contractual obligation to deliver cash to another entity is not recognised as financial liability as per Ind AS 32. Further Accounting Policy (Note 3.20) of the company states, **“Financial Assets and Financial Liabilities are recognised when Company becomes a party to the contractual provisions of the instruments”**”.

The Company neither recognised the liability nor asset which has resulted in non-compliance of Ind AS 32 and Company's own accounting policy.”

9. *Response of the Company to C&AG:*

The Company along with its joint statutory auditors, have responded as follows:

“The key feature in determining the instrument as a financial liability as per Ind AS 32 is the contractual obligations to pay cash or other assets to third parties. In this case, the compulsory convertible debentures are issued by the subsidiary company and hence primarily the contractual obligation also lies with the subsidiary company. Being a compound financial instrument, which is later convertible to equity, the liability component and equity component should also be recognised by the subsidiary company in its books.

However in terms of the Put Option Agreement, the obligation of sponsors, i.e., the Company and XYZ Ltd. would arise in future, upon Put Option Exercise date, subject to transfer of CCDs and other applicable conditions. Mere serving of put-option notice cannot be considered as giving rise to liability to the sponsors at present. We would also refer to Para 3.6 of the option agreement dated 28<sup>th</sup> February, 2020 which states that “In the event the investors are unable to transfer the put securities free and clear of all encumbrances then nothing in this agreement shall be deemed to require the sponsors to put the put securities”. Hence there is no liability but only a Commitment as on current date which has been duly disclosed under Note 11.1.2.

This view also emerges from the legal opinion and expert views obtained by the subsidiary company and produced before the Company and Joint Statutory Auditors of the Company as mentioned in our reply to the preliminary enquiry.

In view of the above facts, we (the Company) are of the opinion that the accounting treatment followed is in compliance with the provisions of Indian Accounting

Standard (Ind AS 32) and there is no non-disclosure of liability nor asset in the financial statements of the company.

We (the Company) also note that similar accounting treatment w.r.t. CCDs were followed along with disclosures made in annual accounts by holding company while giving backstopping support to the subsidiary during F.Y. 2018-19. We (the Company) are also informed that the Company will advise its subsidiary company to take further opinion from Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India for the same and incorporate the necessary changes, if any, as per expert opinion in the accounts of the Company in the ensuing financial year.”

10. To address the C&AG observations in the Company’s standalone accounts, EAC opinion is intended to be sought on the correctness of the above accounting treatment/disclosures, in the accounts of the Company being Sponsor providing backstop support to CCDs issued by its subsidiary.

The CCDs are not convertible in the hands of investors under any circumstance and the put option can be exercised by investors only on the sponsors and not on the issuer (the subsidiary company). These CCDs are convertible only in the hands of Sponsors (the Company and the JV partner) at the end of the tenure/Buy out option or exercising of put option by the investors (mandatory and irrevocable put option available to investors on Sponsors only) and the subsidiary company would be required to convert the same into equity shares of the subsidiary company ranking pari-passu with existing shares at the time of conversion by reckoning share price at that time as per conversion formula defined in the transaction documents.

11. *The key terms of CCDs as follows:*

<b>Sponsor</b>	The two promoter shareholders of the Company
<b>Company/Issuer</b>	The Company
<b>Sponsor</b>	Oil and gas extraction company and OMC
<b>Type of Instrument</b>	Compulsorily Convertible Debentures (CCD)
<b>Nature of the Instrument</b>	The Debenture shall mean an instrument which is compulsorily convertible into equity capital of the Company by the Sponsor/nominees of the Sponsors in accordance with the terms mentioned herein.
<b>Mode of Issue</b>	Private Placement on a fully paid up basis
<b>Listing</b>	Unlisted
<b>Issuance Mode</b>	Demat only. Demat credit to be received within 15 days of the Debentures Pay-in-Date.
<b>Depository</b>	NSDL or CDSL
<b>Debenture Trustee</b>	S Trustee Company Limited
<b>Use of Funds</b>	The Company shall use the proceeds for repayment of existing credit facility(ies), availed by the Company and general working capital purposes.
<b>Face Value</b>	Rs. 1 Crore per Debenture.

<b>No. of Units</b>	1,000
<b>Tenure</b>	36 (thirty-six) months from the Deemed Date of Allotment; with mandatory Put / Call Option at the end of the 35 <sup>th</sup> month.
<b>Coupon Payment Date</b>	shall mean with respect to the first coupon period 31 March, 2020 thereafter on 30 <sup>th</sup> June, 30 <sup>th</sup> September, 31 <sup>st</sup> December and 31 <sup>st</sup> March of each year.
<b>Rating of Instrument</b>	The Debentures are expected to be assigned a rating of AAA (CE).
<b>Accelerated Buy Out Option with the Sponsor</b>	<ul style="list-style-type: none"> <li>▪ Upon signing of a binding term sheet for equity infusion in the Issuer at any time prior to the expiry of 35 months from the Deemed Date of Allotment, the Sponsor may, with a prior written notice of 15 days to the Debenture Trustee, buy-out Debentures at Face Value (“Accelerated Buy Out of Securities”) from the Investor (s);</li> <li>▪ Coupon amount accrued and due but unpaid till the date of the Accelerated Buy Out shall be paid to the Investor (s) as on the date of the Accelerated Buy Out.</li> <li>▪ The Sponsors will have a right to buy-out the CCDs (partly or fully at Face Value) at any point of time. On exercising such accelerated buy-out option prior to the 12th month of the instrument, the Investors will be compensated through Yield Protection Premium for the balance period until the end of 12 months from the Pay-in date.</li> <li>▪ The Yield Protection Premium will be calculated as follows for each Debenture –  <math display="block">\left[ \frac{\text{Face Value of a Debenture} \times (\text{Coupon rate} - 1 \text{ yr. G-sec rate}) \times (\text{No. of days till end of 12 months} / 365)}{(1 + 1 \text{ yr. G-sec rate})^{(\text{No. of days till end of 12 months} / 365)}} \right]</math> </li> </ul>
<b>“Put Option” or “Mandatory Buy-out by the Sponsor”</b>	<ol style="list-style-type: none"> <li>a) In the event that the Sponsor has not procured a Nominee who has, or the Sponsor by itself has not, acquired all the Debentures from the Investor (s) prior to the expiry of 35 months from the Deemed Date of Allotment of Debentures, the Sponsor will mandatorily, and without requiring any notice or intimation in this regard, buy the outstanding Debentures for the aggregate Face Value of the Debentures and the accrued/outstanding but unpaid amounts (including but not limited to unpaid coupon amount), if any, at the end of 35th month from the Deemed Date of Allotment (“Mandatory Buy-out”). Purchase of Debentures shall be undertaken mandatorily by the Sponsor for the entire outstanding Debentures amount;</li> <li>b) The Mandatory Buy-out set out above, shall be binding on the Sponsor and not optional in nature and shall not be dependent on any notice being delivered to the Sponsor; and</li> <li>c) The Debenture Trustee shall give a prior notice of 60 days to the Sponsor in regards to the Mandatory Buy-out. However, the obligation of the Sponsor under the Mandatory Buy-out shall remain, independent of any such notice being given to the Sponsor.</li> <li>d) Sponsors’ liability: The liability of each Sponsor shall be limited to its proportionate shareholding in the Company, i.e. the Sponsors</li> </ol>

	will not be joint and severally liable.
<b>Accelerated Put Option available to the Investor(s)</b>	<p>a) Accelerated Put Option may be exercised by the Investor(s) on the Sponsor in case of non-payment of coupon amount due and payable on the applicable Coupon Payment Dates wherein such default continues for a period of 1 (one) Business Days (including the Coupon Payment Date) from such Coupon Payment Date; and</p> <p>b) Accelerated Put Option shall be applicable on the entire outstanding principal amount of Debentures and any other dues due to the Investor(s).</p>
<b>Transfer</b>	<p>a) In case of exercise of Accelerated Buy-out Option, the Sponsor, by itself, or through any other affiliate or Nominee(s) nominated by the Sponsor, may acquire the outstanding Debentures.</p> <p>b) In case of Mandatory Buy-out and/or the Accelerated Put Option, the Sponsor or its Nominees shall be mandatorily required to buy the outstanding Debentures held by the Investor(s).</p> <p>c) The Debentures, if required by the Principal Investor (s), maybe transferred only to the Permitted Investor at any time during the Tenure. Provided that such Permitted Investor (s) shall be permitted to transfer the Debentures to any of the Principal Investor (s)/ other Permitted Investor(s).</p>
<b>Conversion Option</b>	<p>The Debentures will not have any conversion option for the period it is held by the Investor(s). On exercise of any of the following, the conversion option shall be effective:</p> <p>a) Accelerated Buy-out Option;</p> <p>b) Mandatory Buy-out;</p> <p>c) Accelerated Put Option.</p> <p>Sponsor/Nominee shall have the unilateral right to convert the Debentures held by them to equity of the Company.</p>
<b>Conversion Terms for Debentures</b>	<p>Debentures shall be automatically and compulsorily converted into ordinary equity shares of the Company at the end of the Tenure; provided however in the event that the Investors continue to hold the Debentures at the end of the Tenure, for any reason whatsoever, the conversion of the Debentures shall not happen until such time as the Sponsor has acquired the Debentures from the Investor. Further, in the event, the Sponsor exercises the Accelerated Buy-out Option or when the Debentures are transferred to Nominee(s), the Sponsor may require the Company to convert the Debentures including the coupon amount and any other fee paid to the Investor (s) by the Sponsor into ordinary equity shares of the Company, before the end of the Tenure of the Debentures. Such conversion shall occur at the Conversion Price.</p>
<b>Conversion Price</b>	<p>To be decided 35 months from date of issuance or within 30 days of the exercise of the following, whichever is earlier:</p> <p>a) Accelerated Buy-out Option;</p> <p>b) Mandatory Buy-out;</p> <p>c) Accelerated Put Option.</p>

<b>Ranking of shares</b>	The equity shares issued upon conversion of the Debentures shall rank pari-passu in all respect with the equity shares existing at the time of such conversion, including with respect to voting rights, bonus and rights shares.
<b>Transaction Documents</b>	<p>Customary documents for such Debenture issuance, including:</p> <ul style="list-style-type: none"> <li>▪ Debenture Trust Deed (DTD) setting out the terms of issuance of Debentures set out in this term sheet;</li> <li>▪ Option Agreement setting out the terms of the Mandatory Buy-out, Accelerated Put Option, and the Accelerated Buy-Out Option;</li> <li>▪ Debenture Trustee Agreement setting out the terms of appointment of Debenture Trustee and the rights and duties of the Debenture Trustee; and</li> <li>▪ Service Account Agreement setting out the terms of operation of the Service Account.</li> <li>▪ Private Placement Offer Letter (PAS-4)</li> </ul> <p>Pricing Supplement setting out the applicable coupon rate in respect of each series of debentures.</p>

## **B. Query**

12. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether the Company has to account for the back-stopping arrangement provided by it for the issue of CCDs by the subsidiary company as a liability and asset in its books of account and whether in the event of non-disclosure of asset and liability in the Company's standalone financial statements will attract non-compliance of Ind AS 32. If yes, what should be the disclosure/presentation (head-wise along with nomenclature) in the standalone financial statements of the Company?
- (ii) Whether the current accounting treatment and disclosures (refer paragraph 6 above) made by the Company of the backstopping arrangement are in compliance with Ind AS requirements. If the same is not in compliance with Ind AS requirements, what should be additional/changed accounting treatment and disclosures required under the Company's standalone financial statements?
- (iii) While doing consolidation of the Company's groups' financial statements as referred to in paragraph 7 above, the Company consolidates the subsidiary company's financials as per Ind AS 110, 'Consolidated Financial statements' by combining like items of assets, liabilities, equity, income, expenses and cash flows. Whether any further adjustments in the Company's consolidated financial statements are required in the accounting treatment/presentation currently followed by the subsidiary company on account of CCDs or subsequent changes based on the EAC opinion.

## **C. Points considered by the Committee**

13. The Committee notes that the basic issue raised by the querist relates to the accounting

treatment of the obligations arising out of the CCDs issued by the subsidiary company of the Company in the separate/stand-alone financial statements of the Company under Ind AS. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment including classification of the CCDs from the perspective of the issuer (the subsidiary company), accounting treatment of the financial guarantee obligation provided by the Company in the financial statements of the subsidiary company and the Investor of the CCDs, valuation of the CCDs, measurement of CCDs by the issuer/investor, accounting for the conversion option which gets triggered on exercise of put option by the investor or Accelerated/Mandatory Buy-out option by the Company, deferred tax implications, valuation of financial guarantee obligation, related party disclosures, etc. The Committee has only examined the issue from Ind AS perspective and has not examined the regulatory or legal classification and implications, including those arising under Income-tax Act and FEMA.

14. The Committee notes that Ind AS 109, 'Financial Instruments' states as follows:

**“3.1.1 An entity shall recognise a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs B3.1.1 and B3.1.2). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 4.1.1–4.1.5 and measure it in accordance with paragraphs 5.1.1–5.1.3. When an entity first recognises a financial liability, it shall classify it in accordance with paragraphs 4.2.1 and 4.2.2 and measure it in accordance with paragraph 5.1.1.”**

The Committee notes that the Company is a party to the Option agreement entered into with the investors and has entered into an arrangement for backstopping support towards repayment of principal and cumulative coupon amount for three years in respect of CCDs amounting to Rs. 5,100 million (As at March 31, 2019 Rs. Nil) issued by the subsidiary company. Further, the Company is identified as one of the 'promoters/sponsors' in the Debenture Offer letter/Agreement.

Based on the above, it is clear that the Company is a party to the Debenture Offer letter/Agreement and the Option Agreement. Therefore, the Company shall recognise the financial instrument.

15. The Committee notes that Ind AS 32, 'Financial Instruments: Presentation' states as follows:

**“A *financial liability* is any liability that is:**

**(a) a contractual obligation:**

**(i) to deliver cash or another financial asset to another entity; or**

**(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or**

- (b) **a contract that will or may be settled in the entity's own equity instruments and is:**
- (i) **a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or**
  - (ii) **a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Apart from the aforesaid, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.**

**As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.”**

The Committee notes from the above that the key feature in determining whether a financial instrument is a liability is the existence of a contractual obligation of one party to deliver cash or another financial asset to another party. When an instrument requires mandatory redemption by the issuer for a fixed or determinable amount, a contractual obligation to deliver cash at redemption exists and, therefore, the instrument includes, and is presented as, a financial liability.

In the extant case, as per the Debenture Offer letter/ Agreement, there is Put Option/ Mandatory Buyout clause, which read with clauses 3.1-3.4 of the Option Agreement require that, if the promoters/sponsors have not acquired the debentures issued by the subsidiary company from the investor prior to the expiry of 35 months from the Deemed date of Allotment of Debentures, the promoter/sponsor will mandatorily buy the outstanding debentures (including the outstanding interest). The purchase of debentures shall be undertaken mandatorily by the promoter/sponsor for the entire outstanding debenture amount. The Company has entered into an arrangement for backstopping support towards repayment of principal and cumulative coupon amount. This results in a contractual obligation on the Company. Therefore, the Company shall recognise a financial liability under Ind AS 109. Para 3.6 of the Option Agreement states that in the event the investors are unable to transfer

the put securities free and clear of all encumbrances then nothing in this agreement shall be deemed to require the sponsors to put the put securities. This clause relieves the sponsors from the put obligation only when the investors are unable to transfer the put securities free and clear of all encumbrances. Although this clause is conditional, but does not give an unconditional right to the Company to avoid delivering cash or another financial asset. Therefore, there would be a financial liability to be recognised by the Company. The nature of the financial liability has been dealt with in the subsequent paragraph.

16. Further, the Committee notes that Appendix A to Ind AS 109 defines a financial guarantee as:

<b>“financial guarantee contract</b>	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.”
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In the extant case, the Committee notes that the subsidiary company has the obligation to service the interest payouts during the tenure of the CCDs. However, it is the Sponsors’ obligation to ensure that the subsidiary company meets the interest obligations on time and if there is default by the subsidiary, the investors have a put option for the outstanding interest on the sponsor.

Further, the Committee notes that in the extant case, Accelerated Put Option may be exercised by the Investor on the Sponsor in case of non-payment of coupon amount due and payable on the applicable Coupon Payment Dates wherein such default continues for one business day (including the Coupon Payment Date) from such Coupon Payment Date. The Accelerated Put Option shall be applicable on the entire outstanding principal amount of Debentures and any other dues due to the Investor(s).

The Committee is of the view that these obligations that arise in case there is a default by the subsidiary company, would be a financial guarantee obligation and should be recognised and measured (initially and subsequently) as per the requirements of Ind AS 109 by the Company in its separate financial statements.

Since the Company is not charging any consideration from the subsidiary company for undertaking the obligation towards the investor, the obligation has been undertaken by the Company in its capacity as promoter/shareholder of the subsidiary company. The Company has a right to future economic benefits arising from its overall investments in the subsidiary. Therefore, upon initial recognition of the financial liability, the Company shall recognize deemed investment in the subsidiary as per the requirements of Ind AS 27.

The financial liability is settled/derecognised when the Company buys out the CCDs from the investor. Subsequently, when the Company converts the CCDs in equity shares of the subsidiary company, the deemed investment in the subsidiary company as discussed above would get derecognised and the Company shall recognise investment in subsidiary company. The Company shall comply with the relevant presentation and disclosure requirements of Ind AS 107 and Division II of Schedule III to the Companies Act, 2013 for financial liability.

17. Further, the Committee notes that Ind AS 110 states as follows:

**“19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.”**

“B86 Consolidated financial statements:

- (a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
- (b) offset (eliminate) the carrying amount of the parent’s investment in each subsidiary and the parent’s portion of equity of each subsidiary (Ind AS 103 explains how to account for any related goodwill).
- (c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. Ind AS 12, *Income Taxes*, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.”

The Committee notes that Ind AS 110 requires a parent company to consolidate the financial statements of the subsidiary company using uniform accounting policies and eliminating in full intragroup assets, liability, equity, income and expenses.

Ind AS 109 requires the guarantor to recognise the financial guarantee contract initially at its fair value. Since the Company is the parent company of the beneficiary, viz., the issuer/subsidiary company, there will be no impact of the financial guarantee obligation recognised in the separate financial statements of the Company, at the consolidated level. The financial guarantee obligation and the corresponding deemed investment in the stand alone financial statements of the Company (described in paragraph 16 above) shall be eliminated upon consolidation.

18. The Committee also notes that Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’ states as follows:

“41 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

**42 Subject to paragraph 43, an entity shall correct material prior period errors**

**retrospectively in the first set of financial statements approved for issue after their discovery by:**

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or**
- (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”**

The Committee notes from the above that as per Ind AS 8, material prior period errors are corrected retrospectively by restating the comparative amounts for prior period(s) presented in which the error occurred. If the error occurred before the earliest period presented, the opening balance of assets, liabilities and equity/retained earnings for the earliest period presented are adjusted. Therefore, the Company shall correct the accounting treatment of the CCDs as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error.

#### **D. Opinion**

19. The Committee is of the opinion that:

- (i) The current accounting treatment in the financial statements of the Company is not in line with the requirements of Ind AS 32, as discussed in paragraphs 14-16 above. The disclosures in the financial statements shall be provided based on the classification as financial liabilities, as discussed in paragraph 16 above. The Company shall comply with the relevant presentation and disclosure requirements of Ind AS 107 and Division II of Schedule III to the Companies Act, 2013.
- (ii) The Company shall correct the accounting treatment of the CCDs as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error, as discussed in paragraph 18 above.
- (iii) The Company shall follow the consolidation and elimination procedures under Ind AS 110 in its consolidated financial statements, as discussed in paragraph 17 above.

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