



Accounting and Auditing Update

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Editorial





The new lease standard (IFRS 16) significantly changes how a lessee accounts for real estate leases which may comprise lease of land, building or both. Lessees will now have to recognise most leases on the balance sheet. This is likely to require substantial effort to identify all leases with payments that should be included in the lease liability. In this edition of Accounting and Auditing Update (AAU), our lead article highlights the impacts of IFRS 16 on the real estate sector.

Continuing with our series of impact of the new revenue standard (Ind AS 115), we have covered the education sector. The article explains how an education institute would need to identify its performance obligations and whether the revenue would be recognised over time or point in time with the help of practical examples.

In December 2018, the American Institute of Certified Public Accountants (AICPA) held its annual conference on the latest developments relating to

financial reporting in relation to the U.S. Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB). The theme at the conference was centered around high quality financial reporting process. Our article on this topic summarises the key takeaways of the conference.

Audit Committees are one of the main pillars of corporate governance. The Institute of Chartered Accountants of India (ICAI) issued a technical guide summarising an audit committee's role and responsibilities. In this AAU, we have highlighted key points of the technical guide that the audit committees could use to define their framework of roles and responsibilities.

As is the case each month, we also cover a regular round-up of some recent regulatory updates in India and internationally.

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



Sai Venkateshwaran

Partner and Head

CFO Advisory
KPMG in India



Ruchi Rastogi

Partner

Assurance
KPMG in India

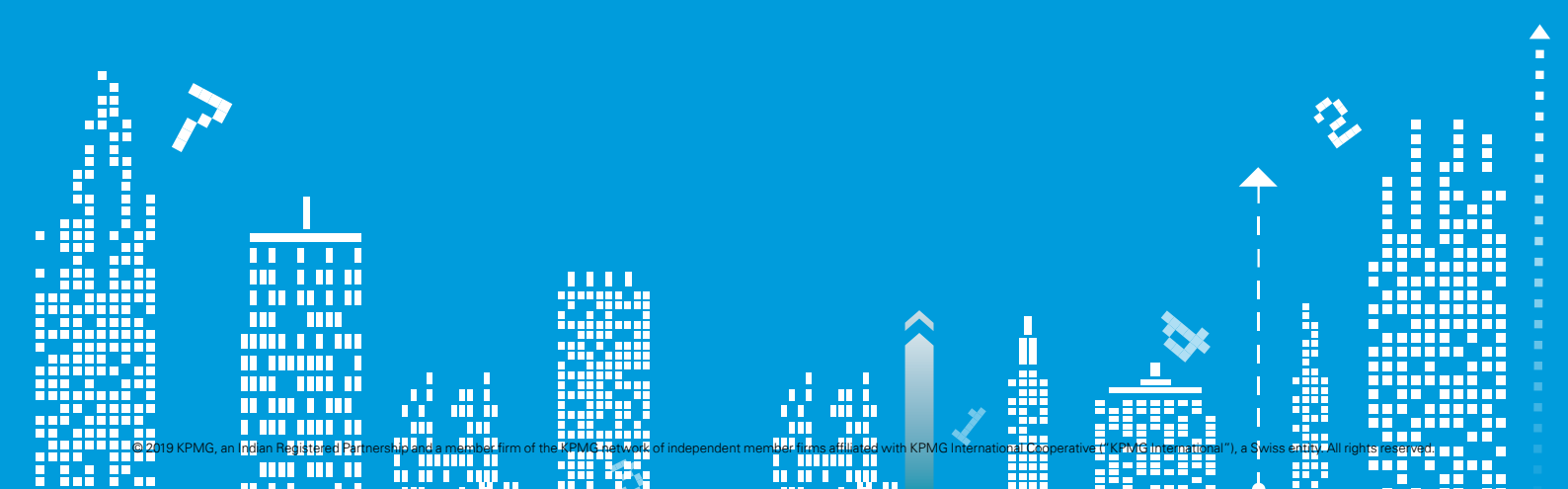
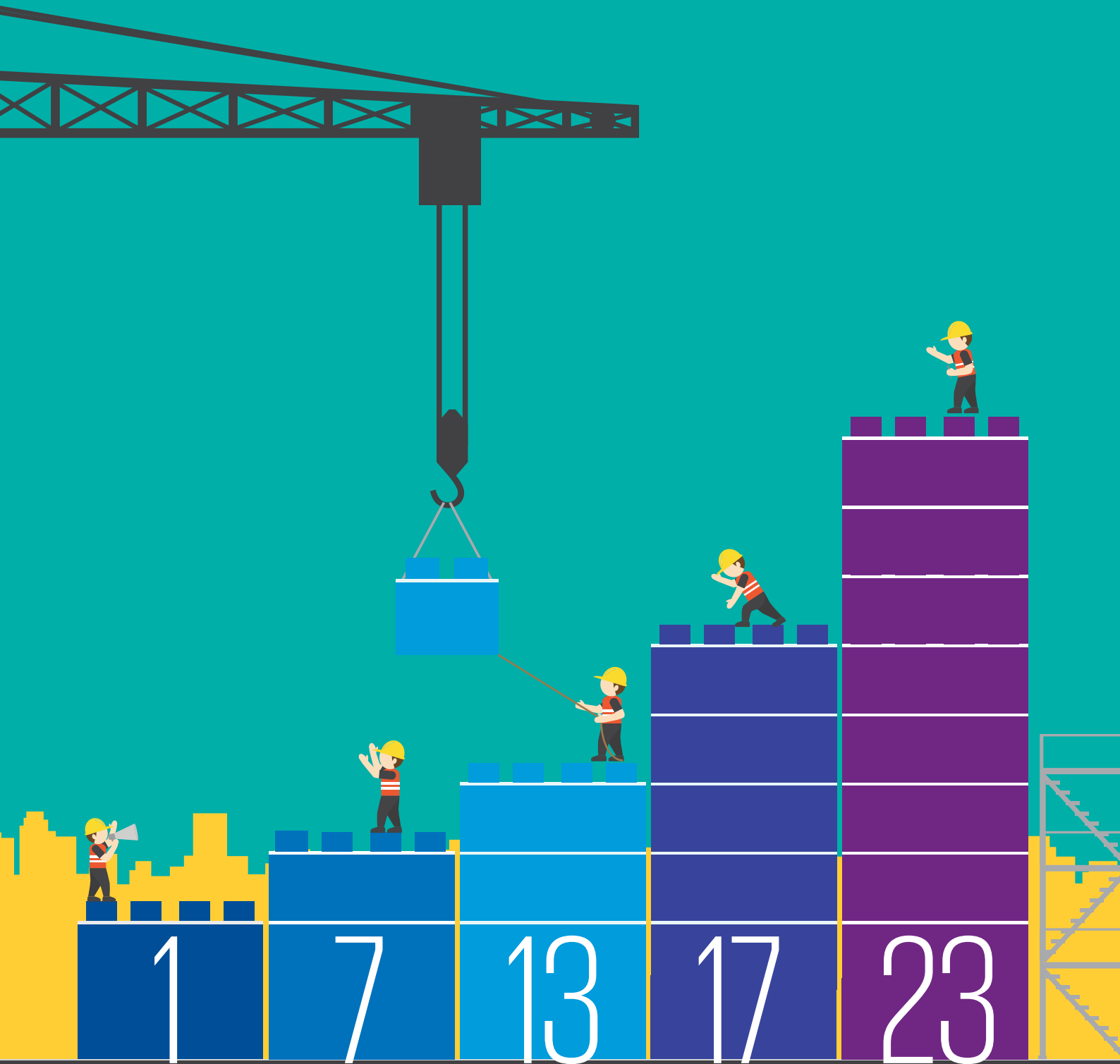




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IFRS 16, *Leases*: Impact on real estate sector

1



This article aims to:

- Provide an overview of the of IFRS 16 from the lessee's perspective and
- Discuss consequent impact of IFRS 16 on the real estate sector.

Background

The new standard on leases i.e. International Financial Reporting Standard (IFRS) 16, *Leases* was issued by the International Accounting Standards Board (IASB) in January 2016 and it replaces, International Accounting Standard (IAS) 17, *Leases*. IFRS 16 is effective from 1 January 2019, with early application being permitted (as long as IFRS 15, *Revenue from Contracts with Customers* is also applied).

On 18 July 2017, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) issued an Exposure Draft (ED) on Indian Accounting Standard (Ind AS) 116, *Leases*. The new standard once notified would supersede Ind AS 17, *Leases*, which is the currently applicable standard for accounting of leases.

Ind AS 116 will converge to the global standard on leases i.e. IFRS 16 and is expected to be effective for annual periods beginning on or after 1 April 2019. As per the IFRS convergence status issued by ICAI as on 19 December 2018, Ind AS 116 has been cleared by the National Advisory Committee on Accounting Standards (NACAS) and submitted to the Ministry of Corporate Affairs (MCA) for notification.

IFRS 16 sets out the principles for recognition, measurement, presentation and disclosure of leases. The principles for determination of whether a lease is a finance lease or an operating lease are no longer relevant for a lessee, though the lessor will continue to evaluate lease classification as operating or finance lease and account for it accordingly.

The core objective of the standard is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the entity.

In this article, we will discuss the impact of the new standard on the financial statements of a lessee in leasing arrangements.

Impact of the new standard on real estate sector

Real estate leases are varied in nature and generally comprise lease of land, building, or both and could also include lease of premises with interiors and furnishings (fully furnished leases). Accordingly, various types of properties in real estate lease based on the use can be broadly categorised as:

- Lease of commercial or office space
- Lease of retail space or warehouse space
- Lease of residential premises
- Lease of hotel rooms or service apartments
- Lease of car parking space.

The components of a leasing arrangement in a real estate sector generally include rent payments for lease of land, building, interiors and furnishings, payments towards maintenance, common area costs and utilities. Further, the lease rent charged can be fixed in nature, variable, or variable subject to minimum guarantee payment. The variable components are normally linked to revenue or

profits earned by tenants. Accordingly, following will be the key considerations in the real estate sector:

I. Identification of a lease arrangement

A lessee will need to identify various leasing arrangements, and evaluate applicability under IFRS 16. As per IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. A lessee may elect to exclude short-term leases and leases of low value items from recognition as leases under IFRS 16. Accordingly, a lessee should consider the following while evaluating a lease arrangement to determine whether it contains a lease:

- **Identified asset:** A contract contains a lease only if it relates to an identified asset. An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the lessee.
- **Substantive substitution rights:** Even if an asset is specified, a lessee does not have the right to use an identified asset if the lessor has the substantive right to substitute the asset for an alternative asset during the lease term. Therefore, a lessee would be required to evaluate at inception of the contract whether substitution rights are substantive.
- **Capacity portion:** A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset (i.e. cable) and thereby, provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

For example, an entity A has taken two floors in a commercial building on lease and has been allotted 10 parking spots along with the lease. The area for parking is identified, though this can be modified by the owner based on the availability at the premises. The 10 parking spots approximate 25 per cent of the total car parking spots (i.e. 40 parking spots in the given case).

Since the assets in the given case - two floors and car parking spots are physically distinct and can be used independently of each other, these will be evaluated separately. Whilst the floors are

identified, the spots in car park are not identified assets. The 10 parking spots represent part of the capacity of the total car parking area, and not substantially all of the capacity. Further, the owners' right of substitution could be substantive in the given case. The lessee will need to evaluate whether it obtains substantially all of the economic benefits from use of the 10 parking spots and also who has the right to direct the use of them to determine whether the arrangement will meet the criterion for lease.

II. Identifying components of lease

In practice, a lease may contain components towards rent for use of an asset and other components for example, charge for administrative tasks or other costs associated with the lease. A lessee is required to account for each lease component, separately from non-lease components.

As a practical expedient, the standard permits the lessee to elect, by class of the underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component.

For example, say lessee A enters into an agreement for lease of premises from lessor B for an annual rent of INR50 per square feet for a term of five years. The contract includes charges for Common Area Maintenance (CAM) of INR5 per square feet and charges for recoveries of water and electricity based on actual consumption. If lessee A elects to use the practical expedient of not separating the non-lease component of CAM charges and utilities of water and electricity, the lease is accounted as a single lease component. The fixed charges of CAM would be included for determining the lease liability, and the payments for water and electricity will be excluded since these are variable in nature and cannot be determined at inception. Water and electricity charges will be recognised in the statement of profit and loss as incurred.

If lessee A does not elect the practical expedient, then the payments towards CAM and water and electricity, would be recognised in the statement of profit and loss as operating expenses, as and when incurred.

A lessee considers the right to use an asset as a separate lease component if it meets both the following criteria:

- The lessee can benefit from using that underlying asset either on its own or together with other resources that are readily available and

- The asset is neither highly dependent on, nor highly inter-related with, the other assets in the contract.

Fees for activities or costs that do not transfer goods or services to the lessee, for example, maintenance, utilities costs, etc. are considered non-lease components and need to be identified and excluded from the lease.

Charges for administrative tasks or other costs associated with the lease that do not transfer a good or service do not give rise to a separate component. However, they are part of the total consideration that the lessee allocates to the identified components.

III. Assessment of lease term

The lease term is the non-cancellable period of lease and includes any rent-free periods provided to the lessee by the lessor.

As per IFRS 16, the lease term is the non-cancellable period of the lease, together with:

- Optional renewable periods which is reasonably certain that the lessee will exercise and
- The period after optional termination date if it is reasonably certain that the lessee will not terminate early.

A lease is no longer enforceable when the lessee and the lessor each have the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

The assessment of a lease term is based on the definition of a contract and the period for which the contract is enforceable. Inclusion of rent free periods, option to terminate with only lessor/only lessee/ both, option to renew/extend the lease at lower than market rent, option to purchase - the options which are reasonably certain to be exercised/not to be exercised are some of the factors that should be evaluated at the inception of the lease to determine the lease term.

IV. Discount rates

At the lease commencement date, a lessee is required to measure the lease liability at the present value of the lease payments that are not paid at that date. A lessee calculates the present value of the lease payments using the interest rate implicit in the lease. If the lessee cannot readily determine the interest rate implicit in the lease, then the lessee would be required to use its incremental borrowing rate.

Due to the nature of the property in a real estate lease, the assets generally have a high significant residual value. Further, in case of leases of land, the lease term



generally, tends to be long i.e. multiple decades or 99 years and so on. These characteristics make it difficult for lessees to determine an appropriate discount rate.

For leases of property, a property yield could be used as an input while determining the incremental borrowing rate. Property yields reflect the annual return expected on a property. They may be quoted before or after expenses (gross or net yield) and are a function of numerous factors, including but not limited to:

- a. The market rental rates for the type of property
- b. Expectations about growth (e.g. a low property yield is often associated with higher rental growth expectations)
- c. Expectations about renovation costs and
- d. Expectations about the risks associated with the property's value.

These factors indicate that property yields are specific to a particular property. However, property yields do not consider company-specific features that would affect the lessee's incremental borrowing rate. Therefore, certain adjustments to the property yield would be required to determine the lessee's incremental borrowing rate. These are length of the lease, lessee's credit rating vis-à-vis average market ratings of tenants, expectations about risks associated

with the property's value that are not related to the lessee's performance and others.

V. Lease payments including variable payments

Certain real estate leases, e.g. lease of retail premises comprise of a fixed lease rent, variable lease rent or a combination of both. In cases where the variability of the lease payments is subsequently resolved, then such payments will be considered as in-substance fixed payments and will be included in the initial measurement of right of use asset and lease liability.

Example: Company R, an established retailer, leases space for a store in a mature retail development from Company Q. Under the terms of the lease, R is required operate the store during normal working hours. R is not permitted to leave the store vacant or to sub-let it.

The contract states that the annual rentals payable by R will be:

- INR100 if R makes no sales at the store or
- INR1 million if R makes any sales at the store during the term of the lease.

R concludes that the lease contains an in-substance fixed lease payments of INR1 million per annum. R notes that this amount is not a variable payment that depends on sales. This is because there is no realistic possibility that R will make no sales at the store.

VI. Impact of the new leases standard on various laws and regulations

Certain lease contracts may be structured based on the applicable laws and regulations or the business practices followed. Due to the new standard, entities may revisit the transactions and contract terms, due to which departments beyond financial reporting such as tax, legal, etc. are likely to be impacted.

In practice, we have noted certain real estate leases include lease of premises along with interiors and fit-outs. Further, along with the lease of premises, the developer/lessor would provide services towards CAM, electricity including power back-ups, and other utilities such as car park facility, water, etc. The taxes (goods and services tax, service tax or value added tax, applicable withholding taxes) and the rates applicable on payments towards lease of premises, fit-outs, and utilities and other payments could be different based on the nature of expenses and the jurisdiction. With the change in the standard, an entity may need to revisit these transactions and the contract terms.

VII. Changes in systems and processes

Systems and processes change may be required to capture the data necessary to comply with the new requirements. Certain leases may be very old and could extend to periods in multiple decades. Entities will need to institute processes to capture data systematically and perform calculations including review mechanism to monitor the changes regularly.

VIII. Transition considerations

Entities will need to decide upon the transition options available under the new standard i.e. whether to apply the standard retrospectively to all leases or to use a modified retrospective approach. The extent of information required will depend on the transition approach chosen. For instance, a modified retrospective approach could be applied using only current period information i.e. the lessee's incremental borrowing rate at the beginning of the current and lessee's remaining lease payments. On the other hand, an entity would require extensive information about its leasing transactions to apply the

standard retrospectively. This will include historical information about lease payments and discount rates. The information will be required as at lease commencement and also as at each date on which an entity would have been required to recalculate lease assets and liabilities or modification of the lease.

Considering that the real estate leases are generally for long durations, collation of the historical data may pose challenges for the entity in this sector.

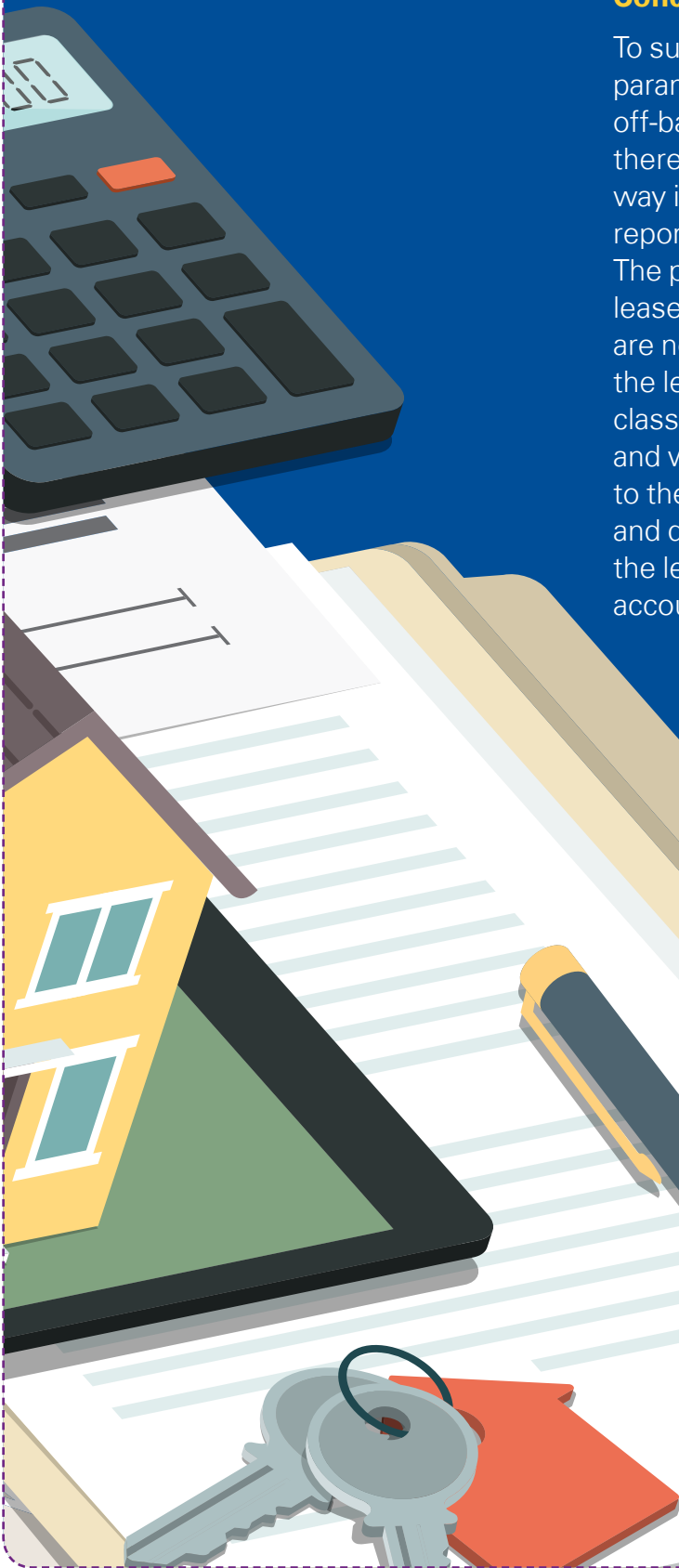
IX. Others

- The judgements, assumptions and estimates applied in determining how to measure the lease liability at the commencement date, as well as on reassessment, will require adequate documentation.
- Additionally, the new standard is expected to impact the Key Performance Indicators (KPIs), profitability ratios and compensation linked to such KPIs.
- Many companies would measure performance based on EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation), debt-equity ratio, and current ratio. EBITDA would improve due to elimination of rent expense, which is replaced by interest and depreciation costs. Debt-equity ratio will reduce due to increase in debt due to addition of lease liability, compensated by adjustments to equity on transition and subsequent measurements and current ratio will also reduce due to the increase in the current portion of lease liability.



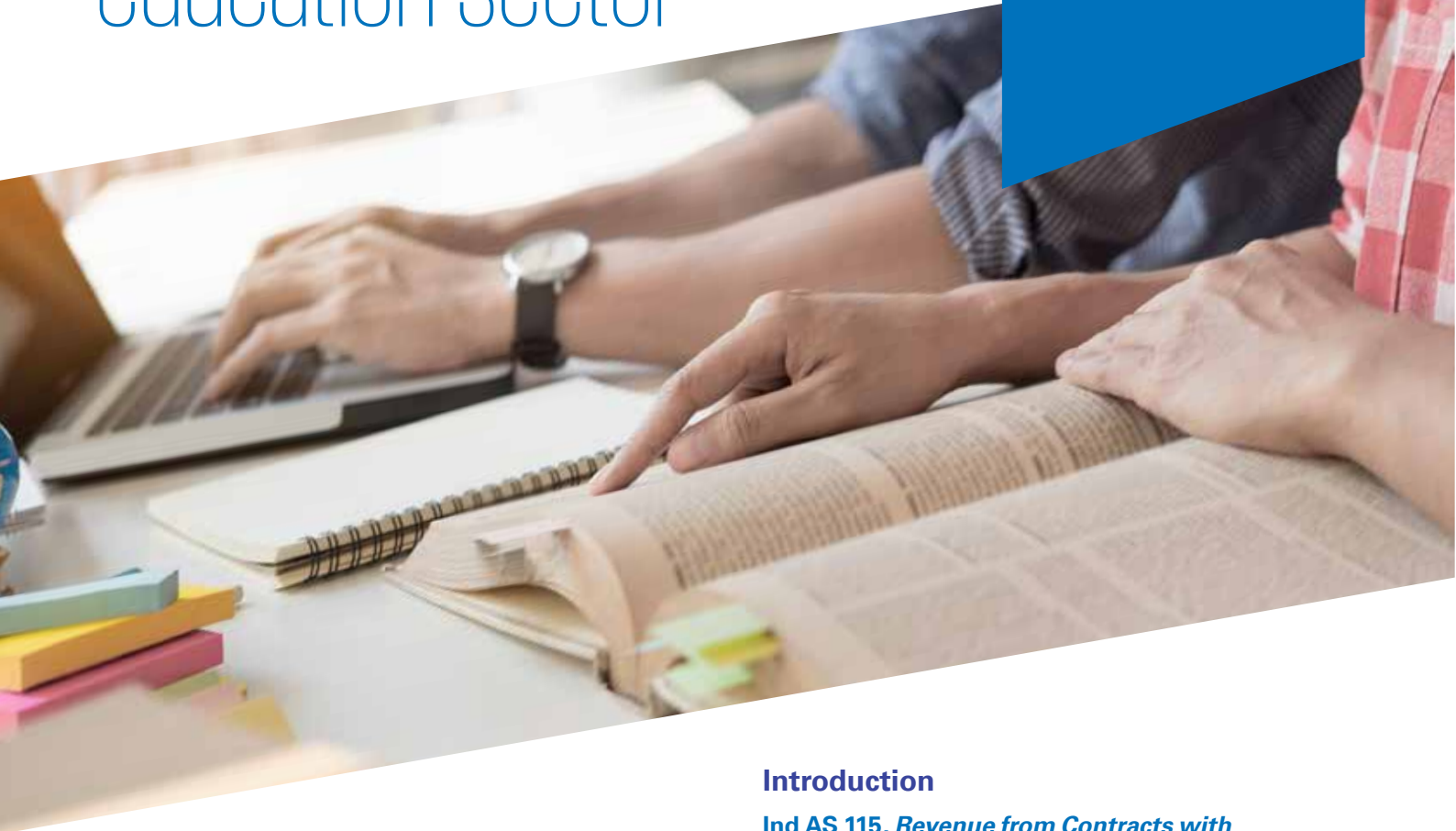
Conclusion

To summarise, IFRS 16 is likely to bring about a paramount shift in lease accounting by bringing off-balance sheet leases on the balance sheet, thereby making significant changes to the way in which lease transactions are being reported in a lessee's financial statements. The principles for determination of whether a lease is a finance lease or an operating lease are no longer relevant for a lessee, however, the lessor will continue to evaluate leases for classification as an operating or finance lease and will account them accordingly. In addition to the significant changes in the presentation and disclosures in the financial statements of the lessee, this standard is likely to impact key accounting ratios.



Impact of the new revenue standard on education sector

2



This article aims to:

- This article aims to highlight the key impact of Ind AS 115 on an education service providers

Introduction

Ind AS 115, *Revenue from Contracts with Customers* is the standard on revenue recognition that is converged with IFRS 15, *Revenue from Contracts with Customers*.

The core principle of Ind AS 115 is that revenue should be recognised when an entity transfers control of goods or services to a customer at an amount to which an entity expects to be entitled. To achieve the core principle, the new standard establishes a five-step model that entities would need to apply to determine when to recognise revenue, and at what amount. Therefore, a single model applies to contracts with customers across all industries.

The new revenue standard is likely to throw up challenges from an accounting perspective in the education sector, out of which we have attempted to provide our insights on specific issues confronting the companies in this sector.



Existence of an enforceable contract

Under the new standard, a contract is an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral or implied by an entity's customary business practices.

Enforceability is a matter of law. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities. An entity is generally unable to recognise revenue if an enforceable contract does not exist. In accordance with Ind AS 115, institutions will need to consider such practices and processes (including those related to the admission and registration of students) in determining whether and when an agreement with a student creates

enforceable rights and obligations between the institution and the student.

Generally, students enroll by signing a registration form which details the terms and conditions, types of coaching services available along with the fee structure for each course and the timing of instalments. The parties to the contract i.e. the institute and students approve the contract in writing and are committed to perform their respective obligations and adhere to the terms and conditions in the document. On signing of the document, the student is obligated to pay tuition fees and therefore, ensuring regular flow of income for the institution during the entire duration of the contract. Thus, creating an enforceable contract.



Performance obligations

Fees collected by institutes may include, tuition fees, application fees, enrolment fees, hostel fees and other tuition-related fees.

Tuition and hostel fees:

Institutions will need to determine whether tuition and hostel services are distinct services promised by the institution or whether they need to be combined. In many cases, tuition and hostel are considered as distinct services and, therefore, separate performance obligations.

Enrollment fee:

Depending on the terms and conditions relating to the enrolment fee, it is likely that such a fee does not relate to a separate performance obligation but is highly dependent on, or highly interrelated with, other goods or services promised in the contract (i.e., provision of tuition services over subsequent periods). In that case, the enrolment fee would represent an advance payment for future services and, therefore, would be recognised as revenue when those future goods or services are provided (that is, when the right is exercised). This may result in deferral of revenue in respect of that fee to later years.

Entrance fees:

Generally, institutions conduct assessment exams to identify the students eligible for enrolling in a course. If entrance fee relates entirely to the assessment process then, a single obligation is identified in such services i.e. assessment conducted.

In certain situations entrance fees may relate to IT equipment (e.g. laptops, other IT infrastructure and servicing), excursions or other outdoor or off-site activities and class resources. These fees fall within the scope of Ind AS 115 and separately identify the relevant performance obligations.

Distance learning course:

Students may enroll for distance learning wherein the learning material is sent to them by post. The institutes are obliged to only deliver the material to the student, and such courses would have a single performance obligation which shall be identified.

Sale of tablet with pre-loaded learning material:

Students can purchase a tablet and view the pre-loaded content offline thereafter (the content has a pre-configured expiry upto which the student can view the content). After completion of the course, the student is free to use the tablet for his/her personal needs wherein the chip containing the content becomes non-useable. The students purchase the tablet in order to view the learning material and the institutes generally provide only a standard warranty for the entire tutor package. The performance obligations identified in such a scenario could be sale of tablet and sale of SD card (Secure Digital card) with pre-loaded learning material.

Transaction price

An entity estimates the transaction price at the inception of the contract, including any variable consideration.

Under the new guidance, the transaction price is the amount the institutes 'expects to receive'.

Under the new standard, price concessions, discounts, etc. constitute 'variable consideration'. Under Ind AS 18, *Revenue* education service providers recognised revenues for the amounts billed to students. Often, this resulted in recognition of an amount of revenue for which collectability was doubtful. In practice, this led to recognition of provision for doubtful debts or bad debt expense at a future date.

An implicit price concession does not have to be specifically communicated or offered by the education service provider. Institutes need to use judgement to determine whether they have implicitly provided price concession to their patients.

The new model is expected to lower the volume of bad debt expense which were historically reported in such situations, and also result in a corresponding reduction in revenues. The reduction in revenues are likely to occur due to 'implicit price concession' while 'estimating the amount of variable consideration'.

In our experience, certain competitive institutions award high performing students with scholarships and cash rewards. Such education institutes may run various scholarship programmes wherein the students meeting the eligibility criteria are entitled for a refund of a part of the tuition fee. In other situations, fees could be

refunded to students in case they wish to withdraw from the course, based on certain thresholds e.g. full refund before the start of the course, 80 per cent refund within 20 days from the commencement of the course. Such scholarships and cash rewards are likely to make the consideration variable. Accordingly, a detailed analysis of the terms and conditions and the customary practices would need to be performed to identify such variable amounts in the contract.

As per Ind AS 115, if the consideration promised in the contract includes a variable amount, then an entity is required to estimate the amount of consideration which will not be subject to reversal later considering the 'expected value' or 'most likely' method (see diagram below).

Expected value

The sum of the probability-weighted amounts in a range of possible amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

Most likely amount

The single most likely amount in a range of possible consideration amounts. The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes.

An institution may receive a nonrefundable deposit from a potential student to secure a spot for enrollment. Ind AS 115 states that upon receipt of a prepayment from a customer, an entity would recognise a contract liability as the amount of the prepayment for its performance obligation to transfer, or to stand ready to transfer, goods or services in the future.

Consideration payable to customer: Certain competition oriented institutes conduct examination and award cash grant to high performing students. Since these cash awards are not towards any distinct goods or services, they shall be accounted for as a reduction from the transaction price.

Allocating transaction price to performance obligations

If tuition and hostel services are included in a single contract or combined contracts, institutions will need to consider the guidance in Ind AS 115 with respect to allocating the transaction price to the performance obligations in the contract.

Ind AS 115 indicates that the transaction price should be allocated to each performance obligation identified in the contract on a relative stand-alone selling price basis.

Regarding tuition and hostel services, institutions may sell tuition separately (for example, to day boarding students), but rarely would they sell hostel separately to a student not also enrolled in classes. As such, although the stand-alone selling price for tuition may be observable, this may not be the case for hostel.

Institutions may consider other similar hostel prices to estimate the Stand-alone Selling Price (SSP). When determining the transaction price, institutions will also need to consider whether any reductions in amounts charged for tuition and hostel (for example, financial aid awarded to the student) applies to tuition, hostel, or both.

For the sale of a tablet with preloaded learning material, the institutes would have to allocate the transaction price between the sale of the tablet and the chipset with loaded study material in proportion their SSP.

Recognising revenue

An entity would recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service to a customer. For each performance obligation identified, an entity needs to determine whether it satisfies the performance obligation

over time or at a point in time. Ind AS 115 provides the criteria, one of which would need to be met, in order for revenue to be recognised over time. For example, if a customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs, the entity transfers control of the good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time.

Tuition and hostel revenue:

Generally, students simultaneously receive and consume all of the benefits provided by an institution's performance because the institution provides instruction or hostel to the students throughout the academic period. It would be appropriate for institutions to recognise tuition and hostel revenues over time in these circumstances.

Entrance fees:

Revenue should be recognised once the exams are conducted.

Sale of tablet with preloaded learning material:

Revenue from sale of tablet shall be recognised at the delivery to the student and for the learning material, revenue recognition shall be over the duration of the course as the students will continue to receive the benefits over the duration of the course.

Distance learning course:

Revenue shall be recognised when performance obligation gets fulfilled, i.e. when learning material is provided to the student.



Contract costs

Certain institutes may enter into arrangements with various schools for getting student referred to them as part of their marketing strategy. Such schools charge a pre-determined commission for every student referred. The contract cost paid i.e. sales commission paid to schools for every successful referral should be recognised

as an asset since the service providers expect to recover that cost from students in form of coaching fees. Accordingly, institutes shall recognise the commission paid to the schools as contract costs and amortise them over the period of the contract i.e. period from course start/receipt to end of course.

Transition options

Ind AS 115 provides the following transition options:

- a. Retrospective method:** Under this method, entities recognise the cumulative effect of applying Ind AS 115 at the start of the earliest comparative period presented. As part of this method, an entity could use certain practical expedients for a smooth transition.
- b. Cumulative effect method:** Under this method, an entity recognises the cumulative effect of applying Ind AS 115 at the date of initial application, with no restatement of the comparative periods presented i.e., the comparative periods are presented in accordance with Ind AS 18. Entities using this method are required to disclose the quantitative effect of Ind AS 115 and an explanation of the significant changes between the reported results under Ind AS 115, and those that would have been reported under Ind AS 18.

Disclosures:

The stated objective of the revenue disclosures is to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

To meet this objective, the entity is required to provide the following disclosures about its contracts with customers:

- Disaggregation of revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Examples of disaggregation include: type of good or service, geography, market, type of customer and type of contract. The entity is also required to disclose sufficient information to enable users to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment
- Narrative disclosure to describe changes in contract assets, contract liabilities and contract costs
- Impairment losses recognised on any receivable or contract assets
- Information about the entity's performance obligations in its contracts with customers
- Amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognise the allocated amounts.



AICPA's¹ National Conference 2018 — An update

3



This article aims to:

- To summarise key takeaways of the conference.

Background

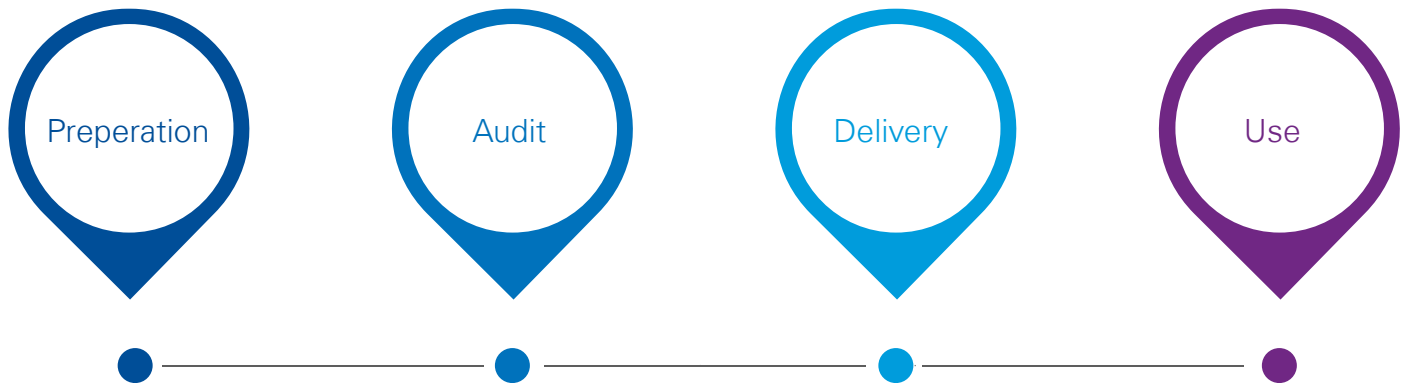
The annual AICPA conference was held in December 2018 which discussed developments relating to financial reporting in relation to SEC² and PCAOB³. The theme at the AICPA conference was centered around 'high quality financial reporting process'.

It was pointed out at the conference that a reliable audit is a shared responsibility of management, audit committees, auditors, standard setters and regulators. This article summaries some of the important discussions that took place at the conference.

SEC Chairman Jay Clayton and Chief Accountant Wes Bricker delivered a clear message on the Office of Chief Accountant's (OCA) blueprint

1. American Institute of Certified Public Accountants
2. The U.S. Securities and Exchange Commission
3. Public Company Accounting Oversight Board

of the US Financial Reporting Structure for Public Issuers. In Bricker's words "It takes a community to protect a community..... financial reporting really is the production of a community of accountants". The blueprint illustrates the financial reporting structure with the following four general stages (as described in diagram below).



He mentioned that more quality time and investment should be made in preparation of financial statements so that there is better audit and delivery process and thus, enhancing quality of financial statements.

The important discussions during the AICPA conference covered the following topics:

Adequate preparation for the new accounting standards

The new standards i.e. revenue recognition, leases and credit impairment were discussed at the conference from the perspective of preparedness for adoption and implementation by the companies. Following were the observations:

1. New revenue accounting standard

Three areas were highlighted which require significant judgement when applying the new revenue standard.

a. Principal versus agent guidance

Sheri York, Professional Accounting Fellow in OCA, observed that due consideration is given to control definition and inventory risk in principal versus agent model. Therefore, a company which never obtains physical possession of goods (i.e. goods are directly shipped from manufacturer to a third party or customer) can pose a challenge in revenue recognition.

b. Identifying performance obligations

Sarah Esquivel, Associate chief accountant, OCA observed that identifying a performance obligation in a revenue transaction that consist of commitment or promise to a customer to transfer a combined item or multiple items individually require significant judgement. She mentioned that in analysing the performance obligation a company should not merely evaluate one item by its nature, or dependence on other. Rather, the company should evaluate whether those items (i.e. goods and services) significantly affect each other. The

judgement required in this analysis may have a significant effect on the timing and amount of revenue recognised.

c. Assessing whether a contract has a significant financing component

Significant judgement is required to identify the financing component in arrangement and to identify the time value of money. Sarah Esquivel, Associate chief accountant, OCA mentioned that sometime the difference between the contract price and cash selling price can be on account of reasons other than financing component.

2. Lease accounting standard

Internationally the companies are scheduled to adopt the standard from 1 January 2019 and in India it is expected to apply from 1 April 2019. The general view of the panelist at the conference was that implementing the standard required more time and is proving to be a costly affair (i.e. considerable time is spent by companies in accumulation of the data points/necessary information). However, despite the challenges faced by the companies, Chairman of FASB⁴ and Deputy Chief Accountant of OCA both emphasised that there is no plan to postpone the effective date of lease standard. Panelists advised the participants and companies to quickly collaborate with other stakeholder (operations department or legal team) and address issues quickly with their auditors. Panelists also noted that the management needs to enhance the internal control system to support implementation of the lease standard.

4. Financial Accounting Standards Board

Technical issues that are currently been discussed by OCA staff with companies were on the following topics:

- a. Lessee transition- minimum rental payment composition and measurement
- b. Lessee and lessor accounting for certain costs relating to a lease.
- c. Determining appropriate incremental borrowing rate.

3. Expected Credit losses

OCA staff informed that they are currently in the process of evaluating conforming changes to Staff Accounting Bulletin (SAB) 102⁵ to align guidance with relevant concepts for an expected loss measurement model in the new credit impairment standard. OCA staff also emphasised that procedural discipline and documentation applicable under today's incurred loss model will continue to be relevant under the new standard.

OCA staff discussed issues with regards to implementation e.g. application of the subsequent event guidance when developing the forward looking estimate of expected credit losses following adoption of the new standard.

Best practice in internal control over financial reporting

At the conference there was an elaborate discussion on importance of effective Internal Control over Financial Reporting (ICFR) pursuant to adoption of new accounting standard. There was consensus that the management should define upfront appropriate processes and controls to mitigate the risk of financial misstatements.

The two guiding principles highlighted for management evaluation of effectiveness of ICFR are:

- a. Whether the control is operating effectively as designed
- b. Whether the nature, timing and extent of management test of control is commensurate with control risk and risk of material misstatement.

Evaluation of control deficiencies was also an area of focus at the conference. Management should consider holistic approach to determining the severity of identified control deficiencies. Management should evaluate the level of detail and assurance needed to support its conclusion and developing an effective remediation strategy and making appropriate disclosures, if required. The focus of management should be to evaluate the potential magnitude of a misstatement and not solely focus on occurred misstatement.



Material weakness disclosures

Material weakness disclosure is very important information for an investor and should provide more meaningful information including going beyond the trend of just disclosing the mere existence of material weakness. The disclosure should provide requisite information to understand the root cause of material weakness and its potential financial impact.

Emerging issues and risk

At the conference cybersecurity disclosure and Brexit disclosure were discussed as emerging issues and risks.

In February 2018, the SEC issued Commission Statement and Guidance for Public Company Cybersecurity disclosures. This guidance includes interpretative guidance to assist public companies in preparing disclosures to ensure investors are sufficiently informed about material cybersecurity risks and incidents.

Since Brexit is a complex issue and its adverse effects are not well understood by all, the SEC has recommended detailed disclosures on management assessment and its impact on their operations.

SEC development in 2018 and expectation in 2019

There were discussions on the use of Non-GAAP Financial Measures. The Non-GAAP Financial Measures should be consistently used and there should be controls in place to prevent error and manipulation.

5. Selected Loan loss Allowance Methodology and Documentation issues



Modification or waiver of financial statement's requirements

Rule 3-13 of regulation S-X, filing of other financial statement in certain cases allows the SEC to modify or waive of financial statement's requirements. The Division of Corporation Finance (DCF) staff clarified that registrants can contact them for waiver of financial statement's requirement if the required disclosures are burdensome to prepare and may not be material. Investor protection will be kept in mind before granting any waiver. The waiver can be applicable for financial requirement under Rule 3-05, financial statements of businesses acquired or to be acquired or financial statements requirements under Rule 3-09, separate financial statements of subsidiaries not consolidated and 50 per cent or less owned persons.

Auditor independence matter- Loan Rule

On 2 May 2018, SEC proposed to amend its auditor independence rules to refocus the analysis that must be conducted to determine whether an auditor is independent when the auditor has a lending relationship with certain shareholders of an audit client at any time during an audit or professional engagement period.

The proposed amendments would focus the analysis solely on beneficial ownership rather than on both record and beneficial ownership; replace the existing 10 per cent bright-line shareholder ownership test with a 'significant influence' test; add a 'known through reasonable inquiry' standard with respect to identifying beneficial owners

of the audit client's equity securities; and amend the definition of an 'audit client' for a fund under audit to exclude funds that otherwise would be considered affiliates of the audit client.

SEC proposed amendment to its auditor independence rule regarding lending relationship with a certain shareholder of an audit client in May 2018. 30 comment letters were received and reviewed by the SEC.

Auditing developments

A **Critical Audit Matter (CAM)** is any matter communicated or required to be communicated to the audit committee and that both relates to material accounts or disclosures that are material to the financial statements and involves especially challenging, subjective, or complex auditor judgement.

The auditor's report would change as there is new requirement to include a description of CAMs. This is a significant area of focus in the conference for management, regulators, auditors and standard setters. CAM will applicable for larger accelerated filers in second half of 2019, and in reports for many other filers in late 2020 and 2021.

At the conference representatives of PCAOB and SEC have made their expectations clear. While they understand judgements will be required in identifying what type of issues are appropriate for CAMs, they have some informal guidance and specially reiterated that CAM are matters that are challenging, subjective or involve complex auditor judgements.

Demystifying emerging technologies

Another agenda item at the conference was value proposition of data analytics. Data analytics panel, featuring Bob Dohrer, chief auditor of the AICPA highlighted four drivers behind the rapid increase in data analytics tools in audit of financial information. Those drivers are as follows:

- a. Volumes of data
- b. Data processing speed
- c. Artificial intelligence
- d. Synchronise technology.

Audit committee members want to learn more and are seeking information on use of these data analytical tools. Conference discussed the role of changing technology in auditing and its effects on managements, auditors and regulators. These analytical tools are expected to provide a lot of insight, analysis and exception report to management and auditor to capture outliers and timely pin down the control that needs to be addressed.

Source: SEC Issues & Trends AICPA Conference on Current SEC and PCAOB Developments, KPMG in the US's publication, December 2018

Audit committee role and responsibilities – An overview

4



This article aims to:

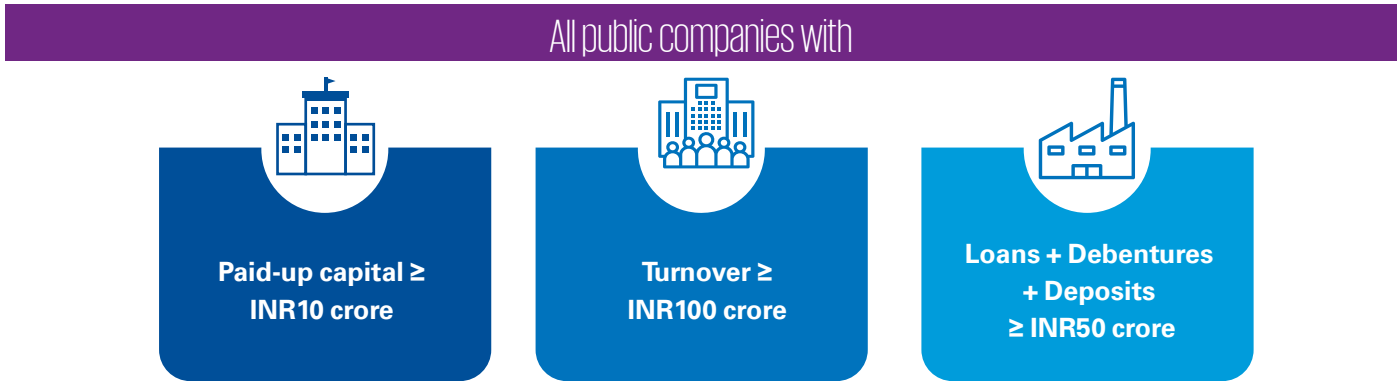
- Provides an overview of the requirements of AC
- Discusses the key guidance from the technical guide issued by ICAI.

The Audit Committee (AC) is one of the main pillars of corporate governance. The main function of an AC is oversight of financial disclosures, reporting, internal and external audits, internal control, accounting, regulatory compliance and risk management. Its core aim is to strengthen the confidence of stakeholders in the company's financial statements and announcements, its internal control process and the risk management process.

As per Section 177 of the Companies Act, 2013 (2013 Act), the Board of Directors (BODs) of every listed company and such other class or classes of companies, as may be prescribed, would need to constitute an AC. Additionally, Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014, requires BODs of every listed public

company and certain classes of companies should constitute AC and a Nomination and Remuneration Committee (NRC) of BODs. The figure below explains

the class of companies that need to constitute an AC and a NRC.



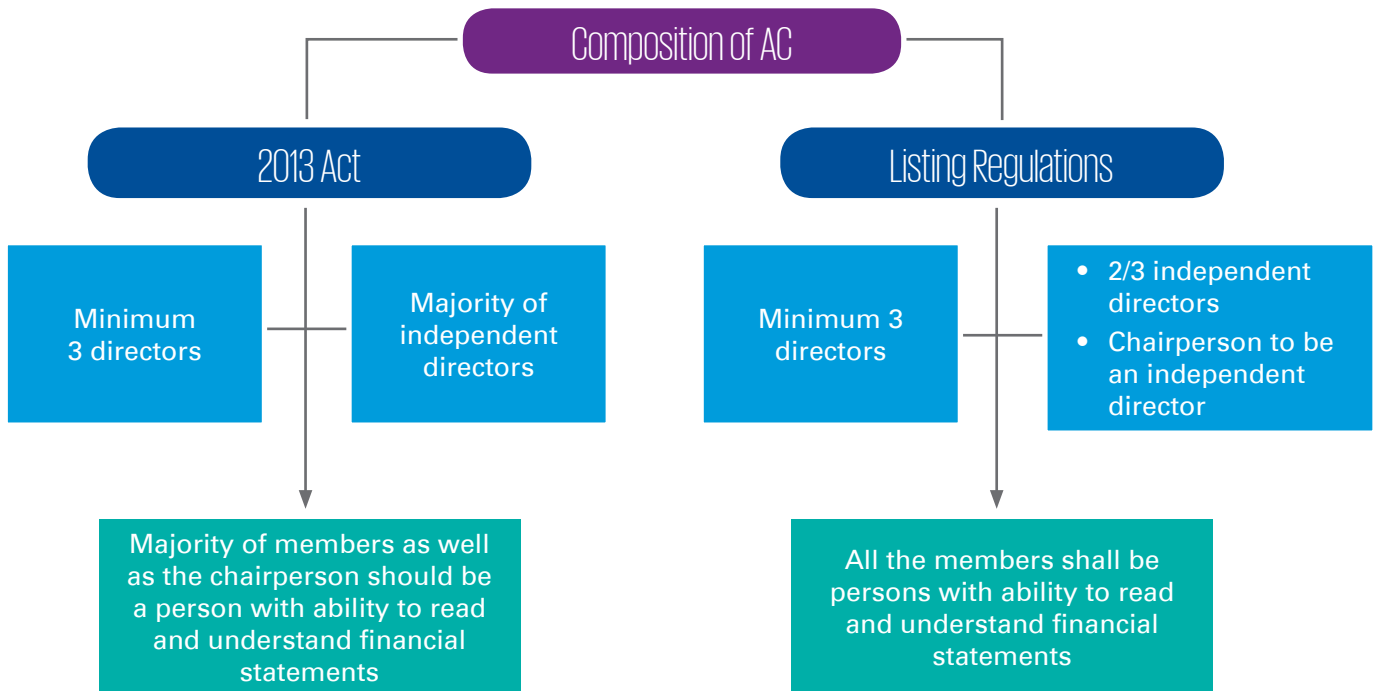
Source: KPMG in India's analysis, 2019

The paid-up share capital, turnover, outstanding loans, borrowings, debentures, or deposits, as the case may be, as existing on the date of last audited financial statements should be taken into account for the purposes of this rule.

Section 177 also provides that the members of the AC should elect a chairperson from amongst themselves who has the skills to understand financial statements. The auditors and the key managerial personnel should attend and participate at meetings of an AC but would not have the right to vote.

Further, as per the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) listed entities are duly required to constitute an AC with a prescribed set of responsibilities. The provisions regarding composition of an AC is slightly different under Listing Regulations.

The following figure explains the composition requirements under both the statutes



Source: Technical Guide on the Functioning of Audit Committee and its Review Checklist, issued by ICAI, July 2018

Recently, on 29 October 2018, the Institute of Chartered Accountants of India (ICAI) issued its first edition of 'Technical Guide on the functioning of Audit Committee and its Review Checklist'. The technical guide aims to provide comprehensive guidance on duties and role of AC for ensuring its effectiveness. Additionally the guide also comprises frequently asked questions and specimen checklist for performance evaluation of an AC.

The followings section discusses the key requirements discussed in the technical guide.



Purpose and authority of an AC

The main purpose of establishing an AC as committee of BOD is to provide a structured assistance to BOD in discharging its duties towards its

shareholders, potential shareholders and other stakeholders in respect of:

1. Ensuring integrity of reporting by examining and reviewing the financial statements
2. Protect the interest of minority shareholders by reviewing related party transactions
3. Evaluate internal control systems over financial statements
4. Identify possible risks which the company is exposed to and work in tandem with BOD any related committee to mitigate such risks
5. Performance of audit function i.e. of external and internal auditors and scrutiny of the non-audit function discharged by the external auditor
6. Ensure compliance with legal and regulatory requirements on matters of financial reporting, end-use application of funds borrowed or advances made by company.

The guide states that the function of AC is not independent of BOD, and its recommendations are not binding on BOD. Hence, where BOD are in disagreement with the recommendation of AC then the same should be recorded in writing and suitably disclosed.



Composition and meetings of an AC

The guide discusses the composition and meeting requirements for an AC. As discussed above, the committee should

consist of minimum of three directors and two thirds of whom should be independent directors. All members should be financially literate and at least one member

should have accounting or related financial management expertise. The chairperson of an AC would be an independent director and he/she should be present at Annual General Meeting (AGM) to answer shareholders' queries. The company secretary would be the secretary to an AC.

The AC would meet as many number of times and at such frequencies as the situation may warrant provided that under no circumstances the number of meetings would be less than four in a year and the time lapse between two meetings should not be more than 120 days. If required, an AC may request the presence of the auditor, any executive of the company, or any outside expert on matters concerning it.



Role and responsibilities of an AC

The SEBI Listing Regulations provide a list of roles of an AC and the information to be reviewed by the audit committee. The guide discusses that the AC should remain

flexible in carrying out its role and responsibilities.

The guide highlights that in addition to the role of the AC provided in the Listing Regulations, it should also include periodic comprehensive review of an auditor's performance and quality of the audit. The guide provides that the periodic review is a more appropriate and effective approach than measures such as mandatory change which might undermine the AC's role by limiting its freedom to decide which audit firm best meets the



company's and shareholders' needs, and in turn would restrict the committee's ability to offer good governance.

The following section discusses some of the key responsibilities of an AC:

- **Appointment and removal of auditors**

The AC would recommend to BOD, the appointment, reappointment and the replacement (if required) or removal of the statutory auditors, internal auditors and cost auditors of the company. It would also recommend regarding the fixing of fees for such auditors to BODs. Additionally, an AC should review with the management, performance of the auditor to be appointed. The guide also discusses key considerations, which should be ensured by the AC while considering the appointments of the specific auditors.

- **Interaction with the statutory auditors**

Considering the requirements of the 2013 Act, the Listing Regulations and global practices, the technical guide outlines that the AC should foster an environment of open and transparent communication with the auditors. To enable this the AC should meet with the auditors at least twice each year, i.e. once before the audit commences, to discuss the nature and scope of audit and second on completion of audit to cover the results of the completed audit.

The AC should discuss the proposed audit plan to address areas of financial reporting and internal control risk and the auditor may put forth his/her

points and plan of action pertaining to audit, as open communication is the first step for an audit engagement. The AC is expected to discuss key points with the auditor about the audit. Following are the examples of key facts that can be discussed with the auditor:

- Understand the methodology which the auditor plans to adopt, including the time frame and the team strength
- Discuss the management's perception of various risks, including any contingency risks
- Explain the basis of any significant accounting decision made during the year to which only the internal auditor has been privy to
- Explain the management's understanding and the changes it adopted to ensure smooth transitioning or seamless adoption of change in regulatory landscape.

Further with an aim to have robust interaction in the spirit of candour, an AC should include following in their discussion with the auditors:

- To improve the quality of balance sheet, the auditor should inquire about the extent to which audited financial statements are affected by management's accounting estimates and judgements
- To improve the quality of annual earnings, the error corrections, estimate adjustments, or one-time transactions that may distort actual performance for the year
- The nature and magnitude of significant year-end accounting adjustments made just before or during the audit
- The system of internal controls.

Interaction with cost auditors and internal auditors

The AC would have discussion with the cost auditors and internal auditors with regard to their findings and follow up thereon. It would also review the reports issued by such auditors. In relation to internal auditor, the AC should review the finding of any internal investigations by the auditors into matters where there is suspected fraud or irregularity or a failure of internal control system of a material nature.

Subsidiary company oversight

The AC is required to review the financial statements, in particular, the investments made by the unlisted subsidiary companies. The appointment, compensation, overseeing of the auditors' work, etc., for each subsidiary company should be the responsibility of the AC of



the respective subsidiaries. However, an AC of the holding company needs to satisfy itself regarding the effectiveness of the process of appointment by evolving working procedure which facilitates dual oversight/compliance.

Additionally, as provided under SEBI Listing regulations (applicable from 1 April 2019) AC would require to review the utilisation of loans and/or advances from/investment by the holding company in the subsidiary exceeding INR100 crore or 10 per cent of the asset size of the subsidiary, whichever is lower, including existing loans/advances /investments.

The following functions for each subsidiary company will be performed/reviewed by an AC of the respective subsidiary company and that of the holding company:

- a. In regard to statutory audit:
 - Appointment of the auditors
 - Fixation of remuneration of the auditors
 - Pre-approval of all services
 - Compliance regarding prohibited service, as specified in the company's policy
 - Review/oversight of the work done by the auditors.
- b. In regard to internal audit:
 - Review the adequacy of structure and function of the internal audit, status of audit plan and its execution
 - Review key internal audit observations along with management response thereto
 - Review the status on compliance with the resolution mechanism, risk management and the control environment.



Related party transactions

The AC is responsible to review the statement of significant related party transactions submitted by the management, including the significant criteria/thresholds decided by the management. The management should place before the AC relevant information to oversee the potential conflict of interest situation. The guide reiterates that the AC is not bound to approve all related party transactions.

Under such circumstances, the AC is required to make recommendations to BOD along with justification/reason for its disapproval/non-consideration of the item.

Others

- The committee should review the company's arrangements for its directors and employees to raise concerns about possible wrongdoings in financial reporting, accounting, auditing or other related matters
- The AC should take adequate steps and approve policies in relation to the implementation of the 'code of conduct for prevention of insider trading and code of corporate disclosure practices' and to supervise implementation of the code
- Keeping a check on compliance with regulatory requirements is another important responsibility of an AC
- The AC should be responsible for handling frauds involving such amounts as the BOD may decide. It should periodically review with the senior management the various anti-fraud measures and controls implemented
- The AC should enable the independent auditor to be able to communicate directly with the committee regarding any issue or concern that may arise in the course of its work
- The committee should ensure that the management has established an effective process for maintaining adequate internal controls and procedures for accurate financial reporting.



Duties of AC

The 2013 Act and SEBI Listing Regulations do not specify the specific duties for the AC. However, the technical guide highlights

following list of duties

- Ensure an effective and independent internal audit function, which works to provide assurance regarding the adequacy and operation of internal controls and processes intended to safeguard the company's assets, effective and efficient use of the company's resources and, timely and accurate recording of all transactions
- Meet the independent auditor at the end of each quarter and financial year to discuss key observations relating to the financial statements for the relevant period

- Provide an independent channel of communication for the Chief Compliance Officer, internal auditor and the independent auditor
- Invite members of the management, and at its discretion, external experts in legal, financial and technical matters, to provide advice and guidance
- Provide periodic feedback and reports to the BOD
- Meet at least four times in a financial year or as specified under any other regulation
- Periodically review its own charter, structure, processes and membership
- Review the risks which the company is exposed to, including the management's perception regarding looming risk
- Ensure that a whistle blower is provided an easy channel to report any fraud or anomaly and assure complete confidentiality during the course of investigation, if any.



Written charter to ensure effectiveness of an AC

The guide emphasises on the need for strong detailed written charter to ensure the effectiveness of an AC. The charter would predetermine the skill set and specialised experience, the AC members should mandatorily possess to achieve its goals. Further, the charter should include detailed role, responsibilities and duties for the an AC. It should specify frequency of meetings, the nature and frequency of communication with the organisation's senior managers, as well as its auditors. It should record the various powers and authorities a committee must possess, independent of the organisation's senior management. The guide also provides the specimen charter for the companies to consider and formulate their charter.

Additionally, the guide provides a specimen checklist for performance evaluation of an AC. The BOD and the management should evaluate the performance of an AC. The guide highlights the importance of the report of the AC. Although a report may not be required by organisations but the technical guide considers it to be a good practice for a committee to prepare one.



Regulatory update

5



Exposure drafts issued by ICAI

The Companies (Indian Accounting Standards) Rules, 2015 lays down the road map for entities for implementation of Ind AS converged with IFRS in a phased manner. For other class of companies not covered under the Ind AS road map (i.e. primarily unlisted entities with net worth less than INR250 crore,

including non-corporate entities) Accounting Standards (AS) as notified under Companies (Accounting Standards) Rules, 2006 continue to remain applicable.

The MCA had requested the Accounting Standards Board (ASB) of ICAI to upgrade AS to bring them nearer to the requirements of Ind AS. In this context, ICAI has recently issued the following exposure drafts:

- **AS 1, Presentation of Financial Statements**

The exposure draft of AS 1 is based on principles of Ind AS 1, *Presentation of Financial Statements* notified by MCA. The requirement of the proposed AS 1 are largely similar to Ind AS 1. However, there are certain differences such as, AS 1 exempts entities from the requirement of preparing the balance sheet at the beginning of preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. Additionally to simplify the disclosure requirements for the entities certain disclosure requirements have been omitted in the proposed AS 1.

Also, since AS 38, *Intangible Assets* does not allow a revaluation model for subsequent measurement of intangible assets under certain circumstances, therefore, principles of AS 1 have been amended to align with the requirements AS 38.

The period to provide comments on the exposure draft ends on 31 January 2019.

- **AS 37, Provisions, Contingent Liabilities and Contingent Assets**

The exposure draft of AS 37 is based on Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* with certain differences. The proposed AS 37 provides certain exemptions to the small and medium-sized companies and small and medium-sized entity (level II and Level III non-corporate entities), from providing certain disclosures regarding provisions.

Also the proposed AS 37 specifically excludes provisions, contingent liability and contingent asset that arise in an insurance entity from contracts with policyholders from its scope as standard corresponding to Ind AS 104, *Insurance Contracts*, has not been formulated yet. Also proposed AS 37 have been modified as compared to Ind AS 37 to incorporate revenue recognition principles of proposed AS 11 and 18.

Ind AS 37 has three appendices and they are - Appendix A, *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*, Appendix B, *Liabilities arising from Participating in a Specific Market— Waste Electrical and Electronic Equipment*, and Appendix C, *Levies*. The proposed AS 37 does not include these three appendices.

The period to provide comments on the exposure draft ended on 28 January 2019.

- **AS 11, Construction Contracts**

The exposure draft of AS 11 is based on principles of Ind AS 11, *Construction Contracts*, however, certain principles have been modified. The proposed AS 11 includes guidance on borrowing costs as per AS 23,

Borrowing Costs whereas Ind AS 11 does not include any reference to Ind AS 23.

Further, Appendix A, *Service Concession Arrangements*, and Appendix B, *Service Concession Arrangements: Disclosures*, of Ind AS 11 which provide guidance on accounting for service concession arrangements have not been included in the proposed AS 11.

The period to provide comments on the exposure draft ends on 4 February 2019.

- **AS 18, Revenue**

The proposed AS 18 is based on the revenue standard based on Ind AS 18, *Revenue*, however, certain principles have been modified. Under proposed AS 18, revenue measurement would be based on the concept of *transaction price*. As per proposed AS 18, transaction price is 'the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes. The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

The proposed AS 18 provides guidance to recognise contract revenue at transaction price and provides definition of transaction price. Whereas, Ind AS 18 requires that contract revenue should be measured at fair value of consideration received/receivable.

Also the proposed AS 18 specifically excludes revenue arising from insurance contracts entered into by the insurance companies from its scope as AS do not include a standard corresponding to Ind AS 104, *Insurance Contracts*.

Appendix A, *Revenue—Barter Transactions Involving Advertising Services*, Appendix B, *Customer Loyalty Programmes Disclosures*, and Appendix C, *Transfers of Assets from Customers* of Ind AS 18 have not been included as appendices to the proposed AS 18.

The period to provide comments on the exposure draft ends on 4 February 2019.

(Source: Exposure drafts issued by ICAI - AS 1 and AS 37 dated 29 December 2018, AS 11 and 18 dated 7 January 2019)

ICAI issued ITFG Bulletin 17

The Ind AS Technical Facilitation Group (ITFG) of ICAI issued its ITFG clarifications' bulletin 17 on 19 December 2018. It provides clarifications on the following 11 issues relating to various Ind AS.

- Clarification of interest related to delay in payment of taxes

- Guidance for accounting treatment in accordance with Ind AS 20, *Accounting for Government Grants and Disclosure of Government Assistance*
 - Amendment to Ind AS 20
 - Export benefits under a scheme of the Government of India
- Disclosure related to related party transactions
- Equity accounting in the CFS of investor in case of loss of control
 - Whether there is any contradiction between Ind AS 40, *Investment Property* and Ind AS 28, *Investment in Associates*
 - Whether the adjustment arising out of fair valuation of investment property as required under Ind AS 28 should be made in the CFS of the investor
- Debt equity classification
 - Optionally convertible preference shares with discretionary dividend and an embedded call option
 - Issue of right offer
 - Preference shares issued in foreign currency
- Inclusion of Dividend Distribution Tax (DDT) on preference shares in Effective Interest Rate (EIR)
- Recognition of dividend income on an investment on a debt instrument in the books of the investor
- Creation of deferred tax on land converted from fixed assets to inventory

Please refer KPMG in India's IFRS Notes, ITFG clarification's bulletin 17 dated 9 January 2019.

(Source: ITFG bulletin 17 issued by ICAI dated 19 December 2018)

Guidance Note on reports in company prospectuses

The SEBI has issued the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 which amended the SEBI ICDR 2009 to simplify the law, eliminate redundancies and inconsistencies and update references to the Companies Act, 2013 (2013 Act). The revised regulations have been reorganised for various issues of securities issues like Initial Public Offer (IPO), further public offers, rights issues, etc.

In view of the revised ICDR Regulations, 2018, ICAI has issued a revised Guidance Note on reports in the company prospectuses (Guidance Note).

The Guidance Note is issued for providing guidance relating to reporting requirements in relation to financial information to be included in the prospectus in case of an IPO in accordance with SEBI ICDR, 2018. This Guidance Note is also applicable to other type of filings for the issue

of securities (equity shares, debentures and notes, etc.) such as

- Letter of offer (in case of right issue)
- Placement document (in case of Qualified Institutional Buyers (QIBs)), etc.
- Filings for the issue of units under SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended and SEBI (Real Estate Investment Trusts) Regulations, 2014.

The Guidance Note also includes guidance relating to offer or sale of the securities in India. This Guidance Note will be applicable in relation to initial offer document and others which are filed on or after 21 January 2019. Earlier application is voluntary.

(Source: [Guidance Note on Reports in Company Prospectuses \(Revised 2018\)](#) issued by ICAI)

ICAI has issued education material on Ind AS 110

Ind AS 110, *Consolidated Financial Statements*, establishes principles for the preparation of Consolidated Financial Statements (CFS) when an entity controls one or more other entities. It defines the principle of control, provides how to apply the principle of control and sets out the accounting requirements for the preparation of consolidated financial statements. Recently, the Institute of Chartered Accountants of India (ICAI) has issued educational material on Ind AS 110, which explains the key requirements of the standard and Frequently Asked Questions (FAQs) covering the issues which are expected to be encountered frequently while implementing the standard.

(Source: Education material issued by ICAI – January 2019 edition)

IASB proposes clarifications for companies assessing whether contracts will be loss-making

The International Accounting Standards Board (Board) on 13 December 2018 proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to specify which costs a company should include when assessing whether a contract will be loss-making.

Currently, IAS 37 does not specify which costs to include in estimating the cost of fulfilling a contract. There are different views of including the cost such as:

- To include only the incremental costs of fulfilling that contract for example, the cost of materials and labour required to construct a building; or
- All costs that relate directly to the contract - both the incremental costs and an allocation of other costs that

relate directly to contract activities. For example, a company may include an allocation of:

- the depreciation charge for equipment the company uses to construct buildings; and
- the salary of a contracts supervisor.

Proposal

The IASB proposes to amend IAS 37 to:

- Specify that in assessing whether a contract is onerous, the cost of fulfilling the contract includes both the incremental costs and an allocation of other costs that relate directly to contract activities, and
- Include examples of costs that relate and costs that do not relate directly to a contract.

The proposed amendments would apply to all contracts within the scope of IAS 37.

Implications

The exposure draft specifies in IAS 37 that, in assessing whether a contract is onerous, companies should include all costs that relate directly to the contract, not only the incremental costs. The proposals are unlikely to affect companies that already apply the 'full cost' approach, but those who apply the 'incremental cost' approach may need to recognise more – and – bigger provisions in the future. This clarification would particularly affect construction, manufacturing and service companies.

Effective date

The exposure draft does not contain a proposed effective date. Early application would be permitted.

The period to provide comments on exposure draft ends on 15 April 2019.

(Source: IABS's exposure draft ED/2018/2 Onerous Contracts - Cost of Fulfilling a Contract dated 13 December 2018)

MCA has issued the Companies (Amendment) Ordinance, 2019

On 2 November 2018, the Ministry of Law and Justice issued the Companies (Amendment) Ordinance, 2018 (ordinance) and amended the 2013 Act based on the recommendations of the committee which was formed to review the existing framework dealing with offences under the 2013 Act and related matters. The ordinance became effective from 2 November 2018.

The changes brought by the ordinance have been introduced in the Lok Sabha as the Companies (Amendment) Bill, 2018 on 20 December 2018 and passed by the Lok Sabha on 4 January 2019 as the Companies (Amendment) Bill, 2019. However, the bill has not been passed in the Rajya Sabha.

The ordinance so issued has ceased to operate on 21 January 2019, so in order to have a continued effect of the amendments brought in by the ordinance till the Companies (Amendment) Bill, 2019 receives the president's assent, the ordinance has been replaced by Companies (Amendment) Ordinance, 2019 (ordinance 2019) on 12 January, 2019.

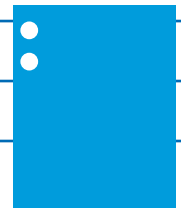
The following table provides the overview of the changes brought in the 2013 Act by the ordinance which is consequently replaced by ordinance 2019.

Topic	Key amendments
Changes in main provisions of the 2013 Act	<ul style="list-style-type: none"> • Power vested with the CG (instead of Tribunal) to approve changes to the financial year and alteration of articles pursuant to conversion of public companies into private companies • An additional disqualification has been added that would prevent a person to be appointed as a director • Additional events added which can lead to removal of name of a company from the register of companies • Revised timeline prescribed for registration of a charge by companies.
Changes in penal provisions	<ul style="list-style-type: none"> • Non-compliance with provisions relating to issue of shares at discount would amount only to a penalty, instead of imposition of fine, imprisonment or both • Furnishing false/incorrect information at the time of creating a charge would be liable to action under Section 447 of the 2013 Act (i.e. fraud) • Failure to file an annual return would result in a penalty instead of a fine or imprisonment.

Please refer KPMG in India's First Notes on 'MCA further amends Companies Act, 2013 through an ordinance' dated 28 November 2018 which discusses amendments brought by ordinance.

(Source: The Companies (Amendment) Ordinance 2019 dated 12 December 2019)

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4th Annual KPMG Accounting, Reporting and Compliance Conference (KARCC).

KPMG in India presents its 4th Annual KPMG KARCC

This conference is a platform to engage with industry professionals in the finance function on emerging issues on governance, accounting, regulation and compliance. The underlying theme of the conference is delivered through several sessions by eminent professionals from the industry and technical experts.

Please find below the location wise details for the conference:

Location	Date	Venue
Hyderabad	27 February 2019	ITC Kohenur
Mumbai	28 February 2019	Grand Hyatt
Pune	5 March 2019	JW Marriott
Delhi	6 March 2019	The Leela Ambience
Chennai	12 March 2019	ITC Grand Chola
Bengaluru	13 March 2019	ITC Gardenia

For registrations, please write to **harmeetmalhotra@kpmg.com**

We look forward to your presence at the conference.

KPMG in India

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000

Chandigarh

SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai

KRM Towers,
Ground Floor, 1, 2 & 3 Floor,
Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram

Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad

Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur

Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By Pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata

Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai

1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara

Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000



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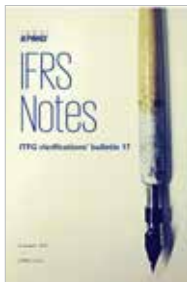
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IFRS Notes

ITFG clarifications' bulletin 17

9 January 2019



The Ind AS Technical Facilitation Group (ITFG) of the Institute of Chartered Accountants of India (ICAI) issued its ITFG clarifications' bulletin 17 on 19 December 2018. It provides clarifications on the 11 issues relating to various Ind AS.

This edition of IFRS Notes provides an overview of the 11 issues clarified by the ITFG.

First Notes

First Notes: SEBI proposes norms for direct listing of equity shares within and outside India



22 December 2018

On 12 June 2018, SEBI formed an 'Expert committee for listing of equity shares of companies incorporated in India on foreign stock exchanges and of companies incorporated outside India on Indian stock exchanges' (the committee). The

role of the committee, inter alia, was to make recommendations for a suitable framework to facilitate direct listing of equity shares of Indian companies on foreign stock exchanges and of foreign companies on Indian stock exchanges.

Accordingly, on 4 December 2018, SEBI released the report of the committee with a proposed framework for such direct listing.

Comments on the proposed framework have been invited up to 24 December 2018.

This issue of First Notes aims to provide an overview of the key recommendations made by the committee with respect to direct listing of equity shares in Indian and foreign stock exchanges.



Voices on Reporting

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

Voices on Reporting – quarterly update publication (for the quarter ended 31 December 2018) provides summary of key updates from the Ministry of Corporate Affairs, the Securities and Exchange Board of India and the Institute of Chartered Accountants of India.

We will continue to provide a summary of relevant updates in future also. We hope you find this summary to be of use and relevance.

The publication can be accessed at KPMG in India website.

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