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Editorial

Going concern is one of the fundamental assumptions underlying the preparation of the financial statements. Given the economic disruptions caused by the novel coronavirus (COVID-19) for entities across almost all sectors, there is likely to be an increase in events and circumstances which may cast significant doubt on a company's ability to continue as a going concern. Therefore, management's assessment of the entity's ability to continue as a going concern might also undergo a change and would need to be updated. Recently, the International Accounting Standards Board (IASB) has issued an educational material which emphasised on the need of providing adequate disclosures relating to going concern by companies particularly in the current environment. In this edition of Accounting and Auditing Update (AAU), we will summarise key guidance provided by IASB on going concern related matters including disclosures to be considered by companies.

The instances of corporate fraud, particularly financial statement fraud have posed a greatest threat to the public trust and confidence in the capital markets and have impacted stakeholders across the financial reporting ecosystem. In January 2021, the Anti-Fraud Collaboration (AFC) has issued its report and identified the most common fraud financial statement fraud schemes basis the enforcement actions taken by the U.S. Securities and Exchange Commission (SEC) against companies, their employees, and outside auditors involving accounting or auditing issues. It also provides AFC's observations on higher risk areas that are susceptible to fraud along with their insights on what companies can do to identify and mitigate these types of fraud risks more effectively. Additionally, it addresses the changes to the current business environment resulting from the COVID-19 pandemic and its impact on fraud. Our article on the topic discusses the findings of AFC and other considerations relevant to fraud deterrence and detection by companies as provided in the report.

Currently, there is no guidance in International Financial Reporting Standards (IFRS) for business combinations under common control. In the absence of any specific guidance, significant diversity has emerged in how the receiving company accounts for the transaction in its financial statements. The diversity in practice makes it difficult for users of financial statements, in particular investors to understand the effects of these transactions and to compare companies that undertake them. With a view to address these concerns and to provide users of the financial statements with better information about these transactions, recently, the International Accounting Standards Board (IASB) has issued a discussion paper which sets out its preliminary views on the accounting of a common control business combination by a receiving company in its financial statements. Our article highlights the IASB's proposals in this regard.

As is the case each month, we have also included 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
Assurance
KPMG in India

Ruchi Rastogi
Partner
Assurance
KPMG in India

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Going concern disclosures: Guidance by IASB

This article aims to:
Discuss the guidance provided by IASB vis-a-vis going concern assessment and related disclosures under IFRS in its educational material.

Introduction

Going concern is one of the fundamental assumptions underlying the preparation of the financial statements. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future, unless management intends to liquidate the entity or cease operations or has no realistic alternative but to do so.

When the going concern basis of accounting is used, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and liabilities in the normal course of business.

Given the significant business disruptions caused by the novel coronavirus (COVID-19) for entities across almost all sectors, there is likely to be an increase in events and circumstances which may cast significant doubt on a company's ability to continue as a going concern for instance, significant decline in company's revenue, profitability and liquidity. In such a situation, it becomes important for the management to assess whether going concern assumption is still appropriate as a basis for the preparation of the company's financial statements. This area would require significant judgement.

Recently, the International Accounting Standards Board (IASB) has issued an educational material which aim to provide guidance on application of going concern requirements under the International Financial Reporting Standards (IFRS) by companies. As per IASB, management would need to consider wider range of factors before it can conclude whether preparing financial statements on a going concern basis is appropriate. For instance, in the current environment, it should consider relevant factors such as the effects of any temporary shut-down or curtailment of the entity's activities, possible restrictions on activities that might be imposed by governments in the future, the continuing availability of any government support and the effects of longer-term structural changes in the market (such as changes in customer behaviour).

Additionally, it also emphasised on the need of providing adequate disclosures relating to going concern by companies.

In this article, we aim to summarise key guidance provided by IASB on going concern related matters including disclosures in its educational material.

Dynamic assessment of going concern

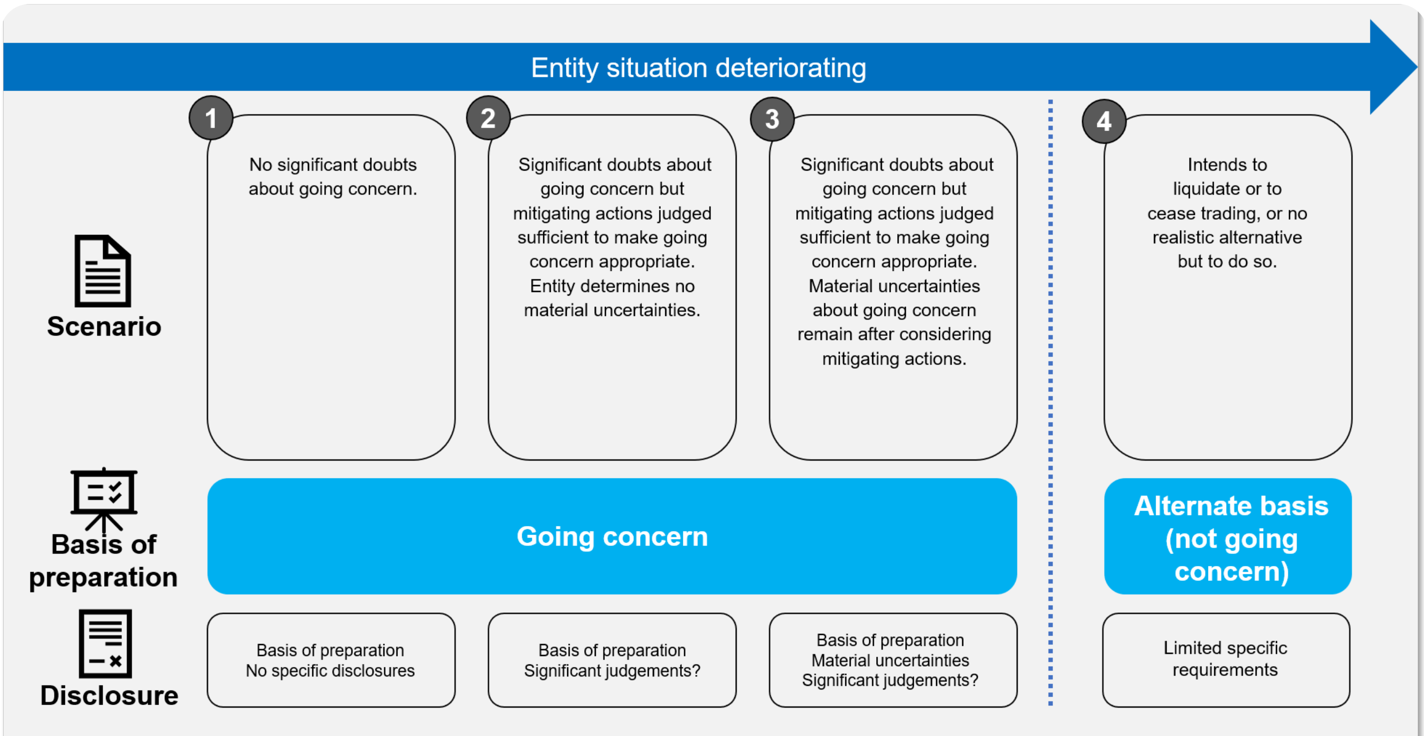
While assessing whether to prepare financial statements on a going concern basis, management is required to consider all available information about the future, for at least, but not limited to, 12 months from the end of the reporting period[1]. IASB in its educational material clarified that considering time periods longer than 12 months is not inconsistent with the requirements of IFRS, which establishes a minimum period, not a cap.

Management's assessment of the entity's ability to continue as a going concern might change rapidly in the current environment, therefore, management would be required to update the assessments of the going concern basis of preparation and decisions about which disclosures are necessary. If before the financial statements are authorised for issue, circumstances were to deteriorate so that management no longer has any realistic alternative but to cease trading, then the financial statements must not be prepared on a going concern basis.

Disclosures on going concern

Currently, IAS 1 requires an entity to disclose material uncertainties related to events or conditions that may cast significant doubt upon an entity's ability to continue as a going concern, if the management is aware of those uncertainties. It also requires disclosure of the judgements made in applying an entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Basis above, the IASB requires companies to consider not only the specific disclosure requirements relating to going concern but also the overarching disclosure requirements of IAS 1, in particular disclosures relating to significant judgements to conclude its position on going concern assessment.



(Source: IASB's educational material on 'Going concern - a focus on disclosure' issued in January 2021)

1. International Accounting Standard (IAS) 1, *Presentation of Financial Statements.*

Also, the circumstances in which an entity prepares its financial statements on a going concern could vary widely. Accordingly, following guidance has been provided in each of the given scenarios:

Scenario 1: No significant doubts about going concern

Example: An entity with profitable operations and no liquidity concerns and for which there are no significant doubts about its ability to continue as a going concern.

Guidance: For such an entity apart from the need to describe the basis of preparation, there are no specific disclosure requirements relating to going concern. It is also less likely that significant judgements would be involved in reaching the conclusion to prepare the financial statements on a going concern basis.

Scenario 2: Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Entity determines no material uncertainties.

Example: An entity is loss-making, demand for its goods or services has decreased rapidly and its funding facilities are due to expire in the next 12 months. After considering the feasibility and effectiveness of the planned actions, management concluded that the material uncertainties are expected to be mitigated. For example, management might have started executing a turnaround strategy that is showing sufficient evidence of success including identifying feasible alternative sources of financing.

Guidance: As per IASB, if, after considering planned mitigating actions, management concludes that there are no material uncertainties that involve significant judgement, then the disclosure requirements of IAS 1 would apply to the judgements made in concluding that no material uncertainties remain.

In such a close call scenario, an entity should also consider disclosing information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Scenario 3: Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Material uncertainties about going concern remain after considering mitigating actions.

Example: An entity is loss-making, demand for its goods or services has decreased rapidly and its funding facilities are due to expire in the next 12 months. Management has concluded after considering all relevant information including the feasibility and effectiveness of the actions it plans to take that preparing the financial statements on a going concern basis is appropriate.

However, management has concluded that there are material uncertainties relating to events or conditions that may cast significant doubt upon an entity's ability to continue as a going concern - for example, there might be considerable uncertainty about management's ability to execute its turnaround strategy to address the reduced demand and to renew or replace funding.

Guidance: In such a situation, in addition to disclosing the material uncertainties, the entity is required to apply the disclosure requirements of IAS 1 relating to the judgement that the going concern basis is appropriate. The conclusion to prepare the financial statements on going concern basis is likely to have involved significant judgement. An entity would disclose material uncertainties and disclose judgement that going concern basis is appropriate. While applying these requirements, an entity should consider what information is material about:

a. The events or conditions that cast significant doubt upon an entity's ability to continue as a going concern and

b. The feasibility and effectiveness of management's actions or plans in response to those events or condition.

Scenario 4: Intends to liquidate or to cease trading, or no realistic alternative but to do so	**Example:** An entity which intends to liquidate or to cease trading, or no realistic alternative but to do so and is no longer a going concern. **Guidance:** In such a situation, going concern basis of accounting is not appropriate. However, IAS 1 does not specify an alternate basis for preparing financial statements if the entity is no longer a going concern. Companies are required to disclose the fact that the financial statements have not been prepared on a going concern basis and the reasons why the entity is not regarded as a going concern. Also, the basis on which the financial statements have been prepared need to be disclosed.

Conclusion

Given the rapidly changing economic and business circumstances and the impact of COVID-19, it is imperative for the companies to provide adequate disclosures about these judgements and the assumptions used in making the assessment including disclosures about uncertainties identified in the going concern assessment where relevant. The required disclosures will depend on the facts and circumstances of each entity and their exposure to the current evolving environment. Robust and entity-specific disclosures around going concern would help achieving transparency and provide users with the relevant information.

02

Common financial statement frauds: Insights from SEC enforcement actions

This article aims to:

Discuss the common financial statement fraud schemes identified by the Anti-Fraud Collaboration (AFC) basis analysis of the SEC enforcement actions and measures to mitigate instances of fraud.

Introduction

Corporate fraud, in particular financial statement fraud over the years have posed greatest threat to the public trust and confidence in the capital markets and have impacted stakeholders across the financial reporting ecosystem. The Anti-Fraud Collaboration (AFC)[1] issued its report in January 2021 called 'Mitigating the Risk of Common Fraud Schemes: Insights from SEC Enforcement Actions'. The report identifies common financial statement fraud schemes. It analyses the enforcement actions[2] taken by the U.S. Securities and Exchange Commission (SEC) against companies, their employees, and outside auditors involving accounting or auditing issues where the SEC has issued an Accounting and Auditing Enforcement Release (AAER). This report provides observations on higher risk areas that are susceptible to fraud. It also provides insights into what companies can do to identify and mitigate these types of fraud risks more effectively.

The report also highlights the global economic disruption caused by the pandemic (COVID-19) which can also significantly contribute in rise in fraud by companies. This could be due to enormous pressure on a company's leadership, managers, employees, and business partners to meet or adjust financial targets, minimise the damage caused by revenue declines and manage stakeholders' expectations. The report mentions that some of the common fraud schemes prevalent in COVID-19 environment could include - fabrication of revenue to offset losses, manipulation of compliance with debt covenants and over- or understated accounting estimates to meet projections.

In this article, we aim to summarise the findings of AFC vis-à-vis common financial statement fraud schemes and related accounting and reporting issues. We will also highlight other considerations relevant to fraud deterrence and detection by companies along with measures to mitigate fraud risks as provided in the report.

1. AFC was formed in October 2010 by the Center for Audit Quality (CAQ), Financial Executives International (FEI), The Institute of Internal Auditors (The IIA), and the National Association of Corporate Directors (NACD). AFC is dedicated to advancing the discussion of critical anti-fraud efforts through the development of thought leadership, awareness programs, educational opportunities, and other related resources focused on enhancing the effectiveness of financial fraud risk management.
2. AAERs released between 1 January 2014 and 30 June 2019.

Common financial statement fraud schemes

The most common types of fraud identified by AFC are highlighted in the diagram below:

1. Improper revenue recognition

The greatest number of fraud schemes identified in the review was related to improper revenue recognition. These schemes often included:

a. Falsifying customers or their contracts

b. Accelerating revenue in a current period even though all recognition criteria were not met

c. Recognising revenue when inventory was shipped on consignment

d. Failing to account for extended terms, concession, or discount side-agreements

e. Percentage of completion and

f. Engaging in channel stuffing - i.e., sending customers more goods than they can be expected to sell to inflate sales figures - and failing to properly account for returns.

2. Reserves manipulation

The second most common type of fraud scheme identified involved reserves related issues. These mainly involve:

a. Manipulation of company's expenses

b. Manipulating items on the income statement (e.g., moving costs out of cost of goods sold to inflate margins)

c. Improperly calculating accruals and

d. Improper reduction or manipulation of reserves (e.g., accounts receivable, warranties, and rebates).

3. Inventory misstatement

The misstatements related to inventory typically aligned with increasing inventory on the balance sheet to manage financial metrics or overall results. This could be achieved in a number of ways including:

a. Overcapitalising costs into inventory and inflating the value

b. Recording fake inventory

c. Timing of recording inventory reserves and

d. Failing to record losses when cost exceeds market value.

4. Loan impairment deferral

This involved instances where creditors failed to recognise loan impairments and their associated reserve allowances or improperly reclassified loans to specific categories that do not require review for impairment or other issues. Both impairment reserve amounts and timing of recognition appear to be issues facing creditors.

Other areas identified are non-GAAP measures, misappropriation of assets and company funds, concealment of assets, related party transactions, business combinations and divestitures, material omission of information and disclosures and deceiving and/or misleading auditors.

AFC pointed out that companies should identify and address risks in most complex areas of accounting such as revenue, impairment and hedging. Risks may result from lack of familiarity with the new accounting standards/guidance/rules as well as from any opportunities for employees to manipulate the new rules in ways that organisations have not yet identified or adopted.

Other accounting and reporting issues

In addition to the above mentioned top fraud schemes, AFC identified that certain fraud schemes included misleading and inaccurate financial statement disclosures, material weakness in internal controls and unsupported journal entries.

Inaccurate and misleading disclosures

The disclosure issues related to financial reporting, in general, may signal how a fraud might be carried out or indicate a result of fraud's existence. The report emphasises that in the wake of uncertainty being posed by the pandemic, it becomes more important for companies to keep investors informed about how they assess, plan for, and take steps to address the effects of the pandemic. Therefore, companies should consider evaluating whether COVID-19 related disclosures are accurate when tied to poor performance, impairment, or failing to meet expectations and not an effort to mask other problems, including fraud. Most importantly, companies should avoid being tempted to use the pandemic to cover up past accounting issues or performance problems.

Material weakness in internal controls

The report points out that fraud may involve the circumvention of internal controls as companies may allow, encourage, or take advantage of internal control weaknesses. The weaknesses could include, inadequate segregation of duties, financial statements prepared by employees with insufficient training or accounting knowledge, and failure to reconcile significant account balances. Further, outright management override of controls also poses a significant risk.

Unsupported journal entries

Unsupported journal entries could be used to perpetrate the frauds. Improper journal entries can be found in a wide variety of frauds, including schemes with inventory inflation or fabricated purchases.

Fraud factors

The report identifies that while analysing AAERs, there was rarely a single root cause for each matter, as each scheme typically encompassed multiple issues. Accordingly, the AFC has observed following root causes for fraud basis the enforcement actions issued by the SEC:

Tone from above

Poor tone at the top could foster an environment or culture more conducive to fraud. Problematic tone at the top can manifest itself in many ways including:

a. Focussing on revenues and profits at all cost.

b. Tying compensation or bonuses to unrealistic goals that may incentivise employees to engage in misconduct.

c. Condoning an acceptance or culture of lax procedures (e.g., corner cutting) or disregard of controls.

Therefore, leaders who set and follow ethical standards will have a positive influence on the standards their employees follow. The report highlights that companies are also recognising the importance of middle managers in promoting a culture of compliance and preventing fraud. These employees play a critical role in overseeing and enhancing a company's corporate culture and values by filtering down the right ethical tone to the rest of the employees within a company. Tone in the middle can also have a significant impact on a company's fraud risk.

High pressure environment

An unnecessarily or unhealthy high pressure environment can lead to intentional or inadvertent failures of control activities and can be a potential contributor to fraud. In a high pressure environment where employees perceive that delivering bad news is unacceptable, they may rationalise that it is expected, or implicitly encouraged, to make numbers or take whatever steps they need to meet earnings projections and other expectations.

However, certain actions including training and better transparency can counter-balance the risk from a high pressure environment. Pressure to skirt the rules is potentially reduced in an environment where targets and achievements are clearly reported, so that observers from the top or other parts of the organisation have a chance to understand how they are or can be achieved. Similarly, companies can offer employees training on the organisation's ethical expectations as well as compliance requirements and can also reward those who follow the rules as it will demonstrate that meeting them is important to a company's leadership.

Additionally, in the current remote work environment, it is important for leaders to not knowingly or unknowingly squash bad news, rather they should address bad news such as failure to meet analyst expectations, and what positive steps the organisation will take to address it.

Lack of personnel with sufficient accounting experience or training

Experienced and well-trained accounting staff are often better equipped to identify and address fraud than those who have less expertise. On the other hand, inexperienced staff may not have sufficient knowledge of certain components of their functions or tasks. As a result, they may not recognise inadequate supporting documentation, non-compliance with policies or revisions in standards, or irregularities in journal entries. Therefore, it is important for companies to keep employees informed and up to date on best practices, new guidance, and potential emerging risks.

Mitigating fraud risk – key considerations

The observation of the fraud factors suggests a need for a company's board and audit committee, management, internal and external auditors to be attuned to both quantitative and qualitative metrics. Qualitative assessments of management's integrity would play a critical role in identifying audit and misstatement risks. Therefore, companies should consider following qualitative factors to timely identify yellow and red flags and more effectively mitigate fraud risks.

Culture and skepticism

Companies should be diligent in effectively implementing and enhancing a positive, ethical culture in an effort to mitigate fraud risk and deter misconduct. This should be communicated both within the organisation as well as externally with customers, suppliers and regulators.

Companies can more effectively mitigate fraud risks by encouraging an appropriate level of skepticism throughout the financial reporting process. For example, maintaining a questioning mindset and being willing to challenge and verify information - even if it is received from a supervisor, upper management, or an apparently reliable source can also help in early detection of potential fraud.

Executive and board oversight

An executive and board oversight for assessing management's integrity, would help mitigate a company's fraud risks. Some of the ways in which the board or management can enhance their oversight includes:

a. *Asking the right questions* specifically during challenging times, such as COVID-19 crisis.

b. *Assessment of the identified risks* by evaluating whether the control activities are being properly carried out.

c. *Monitoring and guiding a company's culture* as a proactive approach to corporate culture can deter various types of misconduct and promote behaviours that can enhance morale and productivity.

d. *Paying attention to red flags* i.e. identifying warning signs for financial statement fraud or the environment in which they may occur. For example, unusual levels of employee turnover or firings in certain areas, increases in whistle-blower or employee hotline complaints, rise in employee social media complaints and compensation practices that reward behaviour that can lead to fraudulent or inappropriate activities

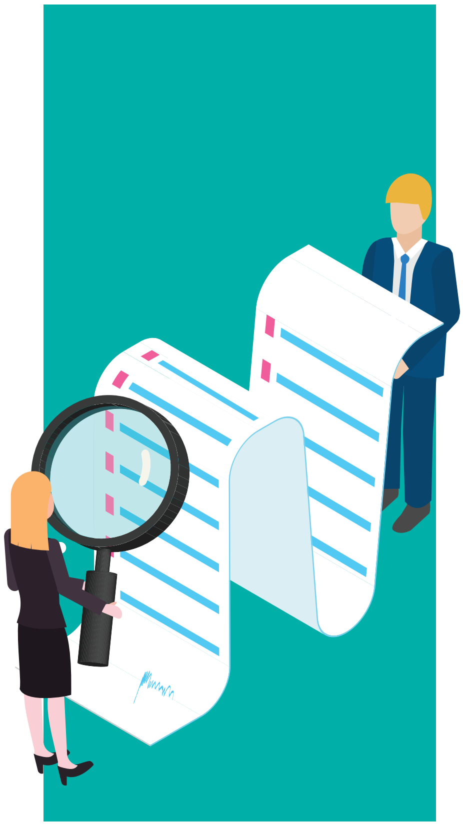
Risk assessment and analytics

The use of data analytics can also help with early fraud detection and can offer insights into the effectiveness of internal controls of a company. Some of the common data sources to consider when mining for financial statements fraud risks include sales journal entries, accounts receivable, customer and vendor master lists and sub-ledgers comprising inventory, capital expenses and outstanding loans.

Conclusion

Though there is no perfect formula for preventing or detecting every instance of fraud, however the analysis revealed that the most common schemes and higher risk areas are not necessarily new. The business challenges that were frequently present in enforcement cases i.e. pressure to meet analyst expectations, increased supplier costs, slowing demand for products, are exacerbated during a crisis like COVID-19. These challenges create enhanced risks for companies and auditors alike.

Therefore, it is important for companies and other members of the financial reporting ecosystem to continue to pay attention to risk areas such as revenue recognition, establishing reserves, expense timing and categorisation, accruals, inventory, recording impairments, and other areas which are most susceptible to judgement and manipulation. The key to protecting companies against fraud is vigilance, a continued resolve to exercise skepticism, and attention to the potential risks. Accordingly, companies should remain focussed on the fundamentals - controls, processes, and environments that impact financial record-keeping and decision-making and company-specific risks by conducting regular risk assessments.



03

Business combination under common control - IASB's proposed accounting

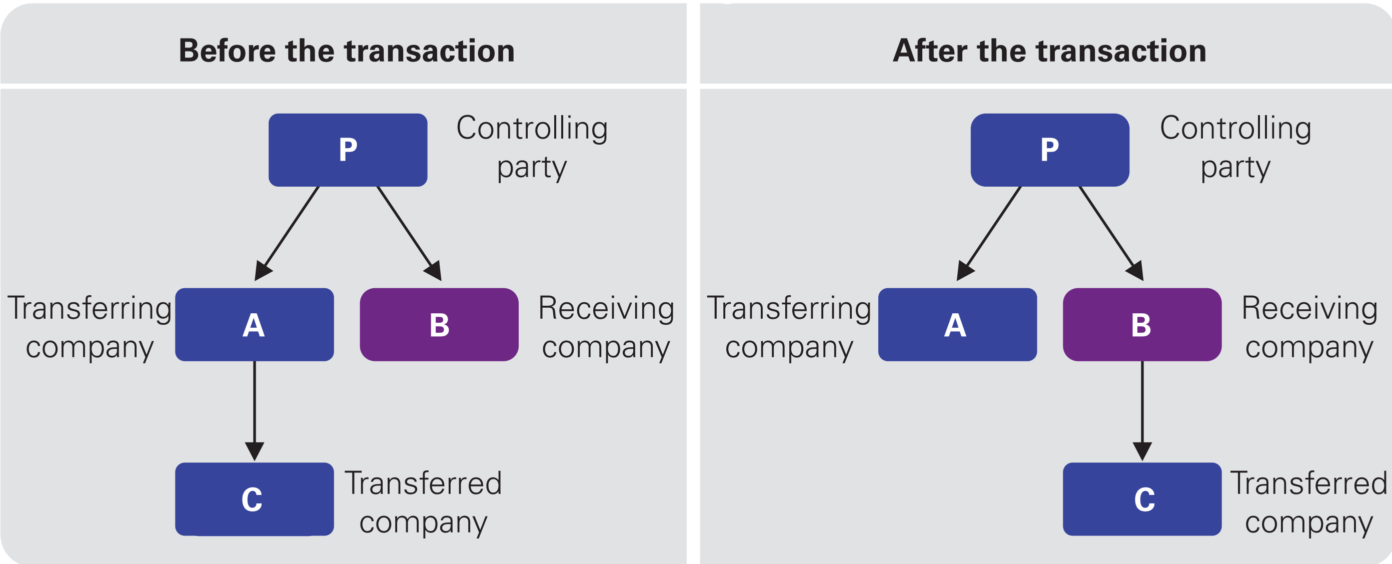
This article aims to:

Provide an overview of the accounting for business combination under common control transactions and related disclosures as proposed by the IASB in its discussion paper.

Introduction

Currently, the International Financial Reporting Standards (IFRS) 3, *Business Combinations* provides guidance on accounting for business combinations under the acquisition method. A business combination is a transaction or other event in which a reporting entity (the acquirer) obtains control of one or more businesses (the acquiree). The date of acquisition is the date on which the acquirer obtains control of the acquiree.

However, there is no guidance in IFRS standards for business combinations under common control - i.e. transactions in which the combining businesses are ultimately controlled by the same party both before, and after the combination. Such a transaction has been illustrated in the given diagram.



Source: IASB Discussion Paper on 'Business Combinations under Common Control' issued in November 2020

In the above diagram, control of company C is transferred from company A to company B (receiving company). However, all three companies are ultimately controlled by company P, the controlling party, both before and after the transaction. These transactions are outside the scope of IFRS 3. Therefore, significant diversity has emerged in how the receiving company (i.e. company B) accounts for the transaction in its financial statements. In the absence of a specifically applicable IFRS standard, the receiving company is required to develop its own accounting policy for these transactions. Basis the facts and circumstances of the case, some companies use the acquisition method[1] and others use a book-value method[2] for accounting such transactions. Also, a variety of book-value methods are used in practice.

Further, the diversity in practice makes it difficult for users of financial statements, in particular investors to understand the effects of these transactions and to compare companies that undertake them.

With a view to address these concerns and to provide users of the financial statements with better information about these transactions, recently, the International Accounting Standards Board (IASB) has issued a Discussion Paper (DP)[3] and proposed reporting requirements for a receiving company[4] in a common control business combination. The proposals would cover all transfers of businesses in which all of the combining companies are ultimately controlled by the same party, irrespective of whether the transfer is:

- Preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group) or
- Conditional on a sale of the combining companies to an external party, such as in an Initial Public Offering (IPO).

1. Assets and liabilities received in the combination are measured at fair value and goodwill is recognised.
2. Assets and liabilities are measured at their existing book values.
3. DP/2020/2 - Business Combinations under Common Control issued in November 2020.
4. The term 'receiving company' refers not only to the immediate receiving company in the combination. It also refers to those parent companies (if any) of that immediate receiving company that did not control the transferred company before the combination.

Additionally, the proposed accounting would be applicable to group restructurings that involve a transfer of a business under common control but does not meet the definition of a business combination under IFRS 3. For example, some transactions might not meet that definition if they involve transferring a business to a newly established parent company.

In this article, we aim to provide an overview of the DP which sets out IASB's preliminary views on following aspects relating to accounting by a receiving company in case of a business combination under common control in its financial statements[5]:

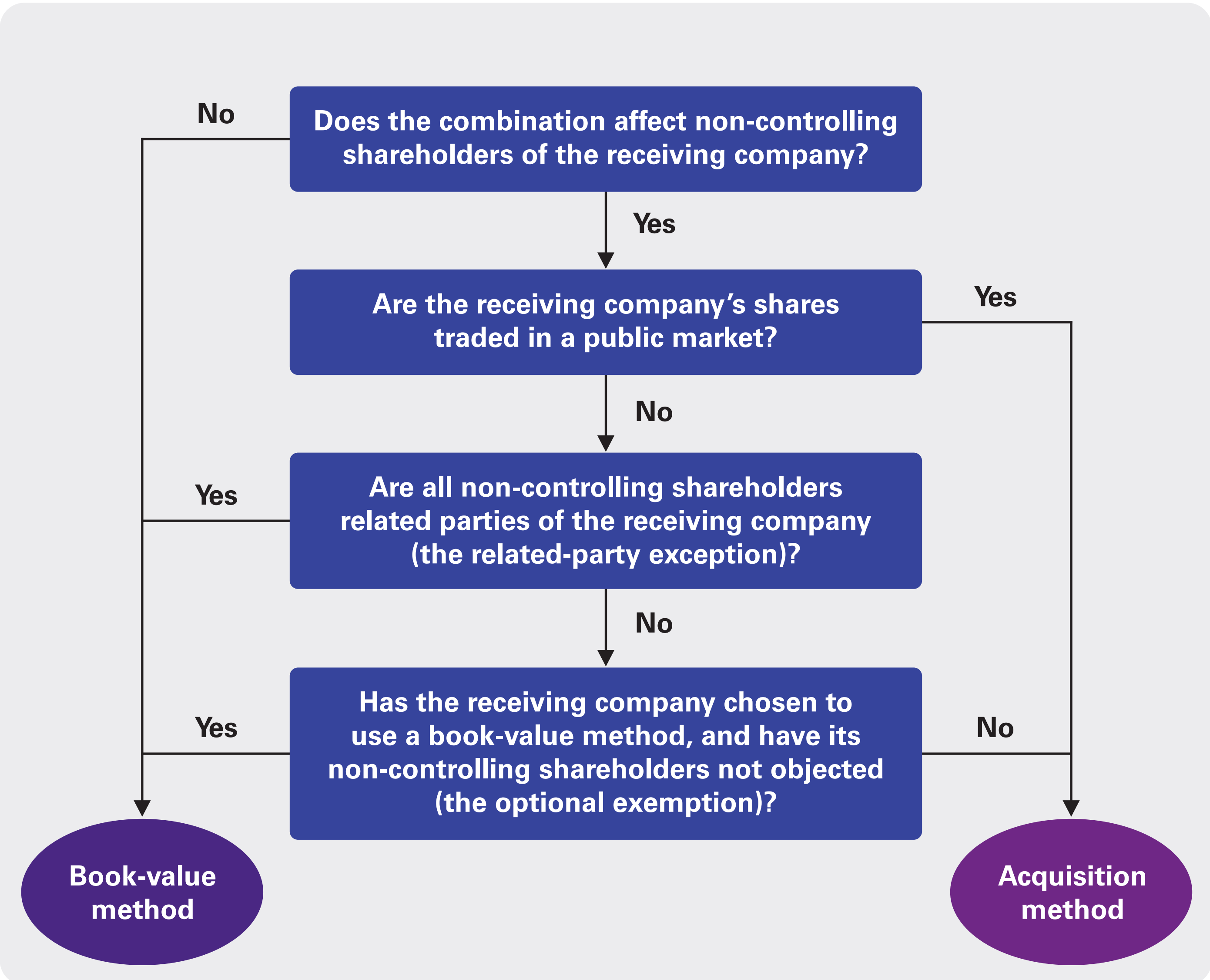
- Selection of the measurement method
- Application of each measurement method and
- Disclosure of information about these combinations.

Comments on the proposals can be submitted up to 1 September 2021.

Selection of the measurement method – Acquisition or book-value

As per IASB, one size does not fit all. Therefore, for some business combinations under common control, the acquisition method should be used, and for the others a book-value method should be used.

The following diagram depicts circumstances in which each of the method should be adopted:



Source: IASB Discussion Paper on 'Business Combinations under Common Control' issued in November 2020

5. It covers all financial statements prepared by the receiving company to which the possible reporting requirements would apply. However, the proposals do not address how a receiving company should report in its separate financial statements an investment in a subsidiary received in a business combination under common control.

Acquisition method

As per IASB, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations.

Combinations that affect non-controlling shareholders

When non-controlling shareholders of the receiving company acquire an ownership interest in the economic resources transferred in a business combination under common control, the combination has a substantive effect not only on the receiving company but also on its shareholders. As per IASB, if such a transfer occurs, that transaction is similar to business combinations covered by IFRS 3.

Cost-benefit trade-off

The costs of applying the acquisition method would be justified for publicly traded companies. Typically, listing requirements or capital market regulations would:

- Prevent the listing of a 'small' number of shares and
- Limit how many shares can be held by a company's related parties.

Therefore, IASB recommended that the receiving company whose shares are traded in a public market should be required to apply the acquisition method.

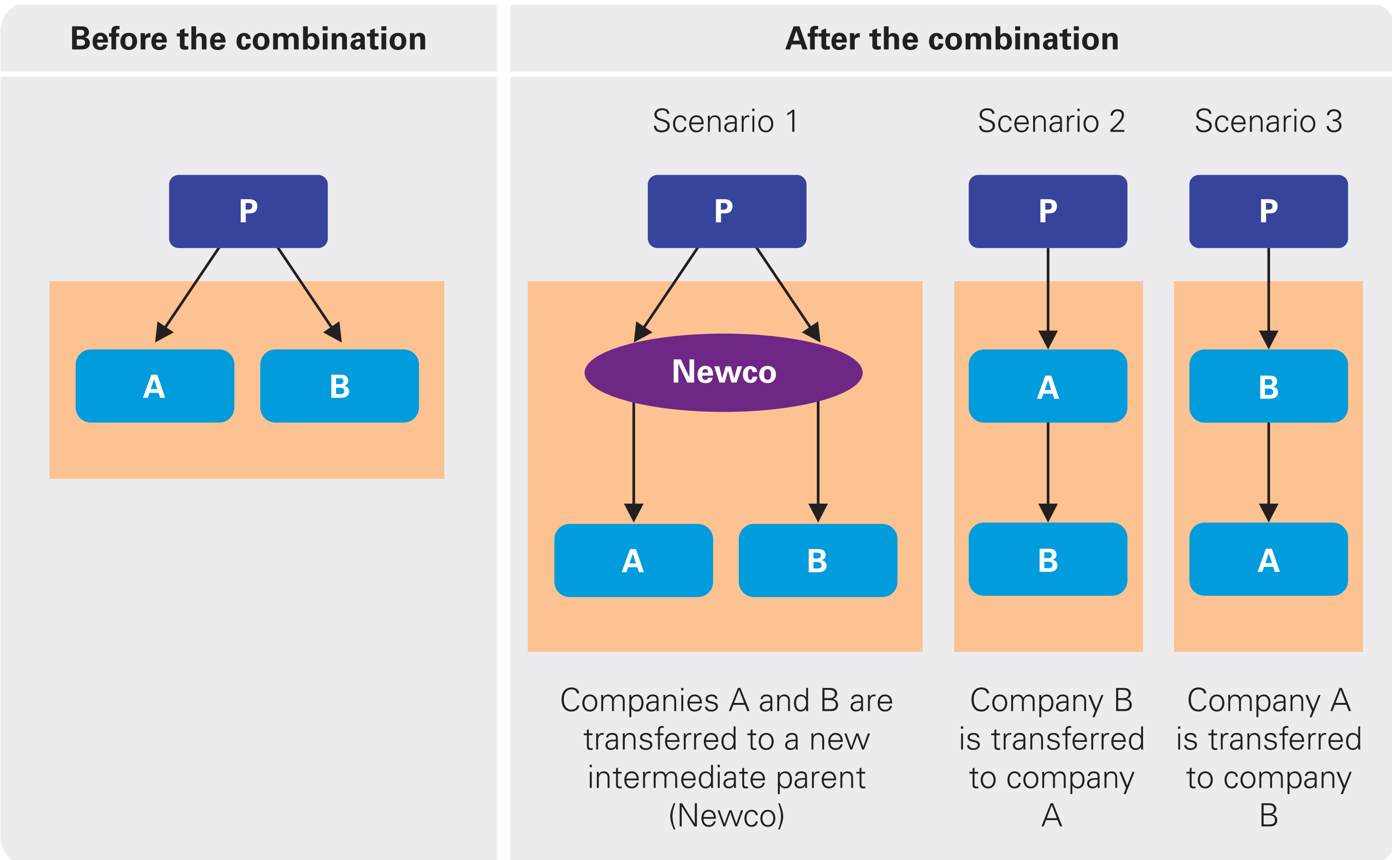
Book value method

On the other hand, book-value method should be applied to business combinations under common control that do not affect non-controlling shareholders of the receiving company including combinations that affect potential shareholders or lenders or other creditors of the receiving company.

Combinations that do not affect non-controlling shareholders

If the receiving company does not have non-controlling shareholders (such as in a business combination under common control involving wholly-owned companies), there is no change in the ultimate control of the combining companies and also no change in the ultimate ownership interests in the economic resources transferred in the combination. This is explained in the below diagram.

Group restructuring in preparation for an IPO



Source: IASB Discussion Paper on 'Business Combinations under Common Control' issued in November 2020

In the diagram, the controlling party, company P, decides to restructure its wholly-owned subsidiaries, company A and B, in preparation for an IPO. It could undertake that restructuring in various ways. However, in all scenarios potential shareholders would be investing in the same economic resources, as indicated by the shaded area in the diagram. Therefore, a book value method would provide useful information about these combinations to potential shareholders of the combining companies, because the information produced by the method does not depend on how the combination is legally structured.

A book-value method would also avoid the difficulties that could arise if the acquisition method was applied to combinations that do not affect non-controlling shareholders. For example, it would avoid the need to decide which company is the 'economic' acquirer. That decision is fundamental in applying the acquisition method but could be difficult to make for combinations like group restructuring illustrated in the above diagram.

Further, the costs of applying the acquisition method might not always be justified for privately held companies (i.e. companies whose shares are not publicly traded). Therefore, IASB suggested following special conditions for such companies:

An optional exemption

A privately held receiving company would be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use that method and they have not objected.

A related-party exception

A privately held receiving company would be *required* to use a book-value method if all non-controlling shareholders are related parties of the company, as defined under IAS 24, *Related Party Disclosures*. This is because the receiving company's related parties might not need to rely on its general-purpose financial statements to meet their information needs.

Also, use of book value method in such cases would prevent opportunities to structure a combination by issuing shares to related parties for the sole purpose of qualifying for the acquisition method.

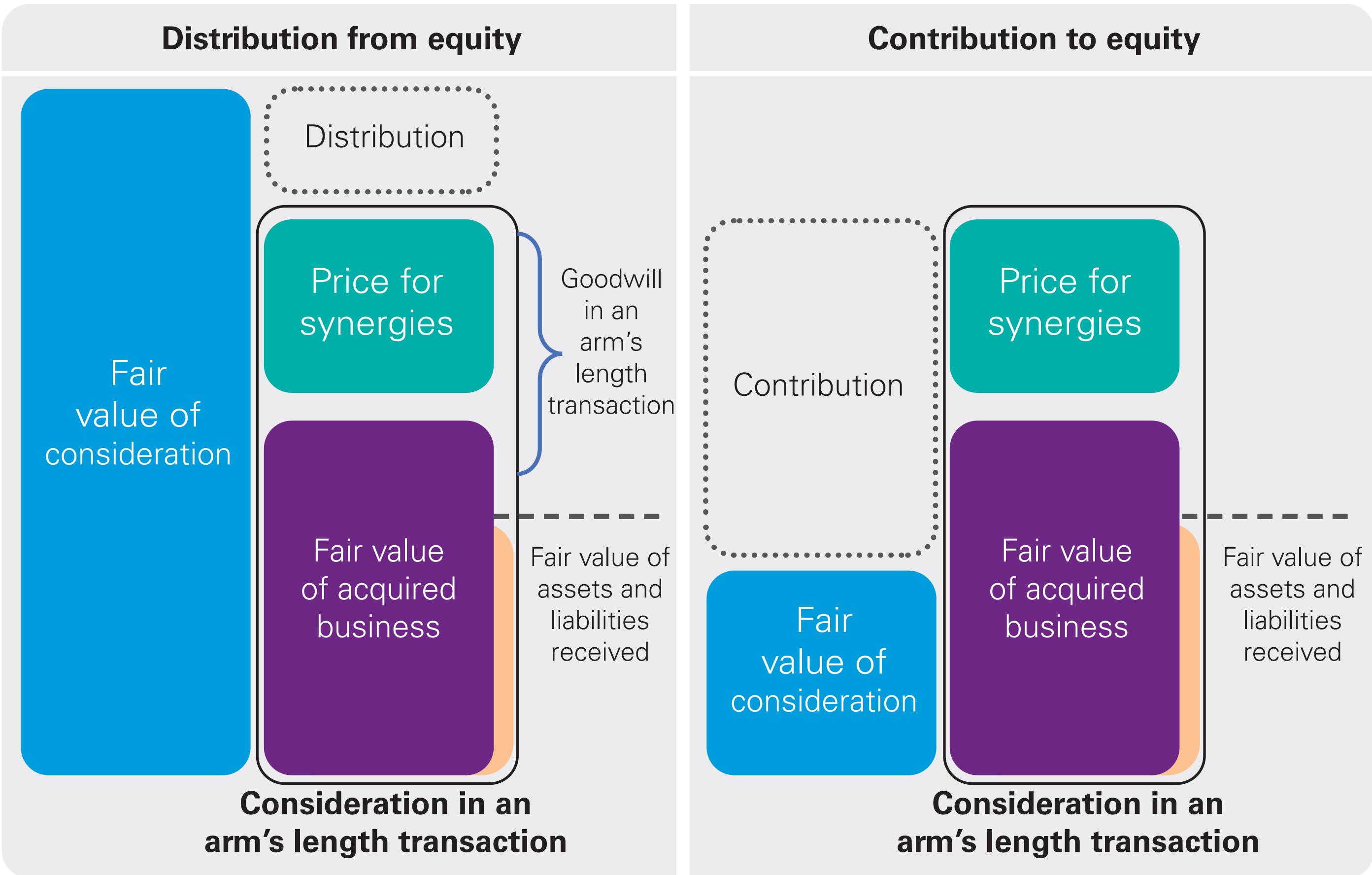
Application of the measurement method

Acquisition method

The acquisition method set out in IFRS 3 assumes that the consideration paid in the combination is negotiated at an arm's length and reflects the fair value of the acquired business and the price paid for any synergies expected from the combination. However, in a business combination under common control, the consideration paid might be determined by the controlling party and thus, might differ from an arm's length price that would have been negotiated between unrelated parties in a business combination covered by IFRS 3. The difference would indicate that the combination includes an additional component - a transaction with the owners acting in their capacity as owners. Accordingly,

a. *If the consideration paid is higher than in an arm's length transaction:* The excess constitutes a distribution from equity by the receiving company to the transferring company, and ultimately to the controlling party.

b. *If the consideration paid is lower than in an arm's length transaction:* The difference constitutes a contribution to equity of the receiving company from the transferring company, and ultimately from the controlling party.



Source: Snapshot of Discussion Paper on 'Business Combinations under Common Control' issued by IASB in November 2020.

Distribution from equity

As per IASB, the receiving company should not be required to identify, measure and recognise a distribution from equity (point (a) above) when applying the acquisition method to a business combination under common control. Instead, the receiving company should disclose information about the terms of the combination, including how the transaction price was set. Any 'overpayment' would be included in goodwill that would be subject to impairment testing, just as it occurs in reporting a business combination covered by IFRS 3.

Contribution to equity

IASB is of the view that the receiving company should recognise a contribution to equity if the fair value of the assets and liabilities received in a business combination under common control exceeds the fair value of the consideration paid, instead of recognising that difference as a gain on a bargain purchase in the statement of profit and loss, as required by IFRS 3.

Book value method

IFRS standards do not provide guidance on book-value methods and do not specify how such a method should be applied. In practice, a variety of book-value methods are used. The variations, in particular, relate to:

- **Measuring the assets and liabilities received:** Receiving company uses either the transferred company's book values or the controlling party's book values to measure those assets and liabilities.
- **Providing pre-combination information:** The receiving company includes the transferred company's assets, liabilities, income and expenses in its financial statements.

Accordingly, IASB has provided guidance on the following aspects relating to application of book value method:

- **Measurement of the assets and liabilities by the receiving company:** The receiving company should measure the assets and liabilities received at their book values reported by the transferred company. This is expected to provide the most useful information to users of the receiving company's financial statements at a cost justified by the benefits of that information.
- **Measurement of the consideration paid:** In practice, when a book-value method is applied, the consideration paid is measured either at fair value or at book value. In case the consideration is paid in receiving company's own shares, at their par value or a nominal value. As per IASB, while applying the book value method, the receiving company should measure the consideration paid as follows:
  - *If consideration is paid in assets:* At the receiving company's book values of those assets at the combination date.
  - *If consideration is paid by incurring or assuming liabilities:* At the amount determined on initial recognition of that liability at the combination date applying IFRS standards.

  IASB is of the view that it should not prescribe how the consideration paid in the receiving company's own shares should be measured. This is because the reporting of components within a reporting company's equity and the measurement of issued shares for the purpose of that reporting are often affected by national requirements and regulations and are generally not prescribed in IFRS standards.
- **Reporting the difference between the consideration paid and the book value of the assets and liabilities received:** When applying a book-value method to a business combination under common control, the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received. The approach is consistent with the current practice.
- **Reporting transaction costs:** Companies might incur certain transaction costs while undertaking business combinations under common control such as, advisory, legal, accounting, valuation and other professional fees. The IASB is of the view that while applying a book-value method to a business combination under common control, the receiving company should recognise such transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS standards. This is consistent with the current approach provided under IFRS 3 for accounting such costs.
- **Providing pre-combination information:** The IASB has prohibited the restatement of pre-combination information in case of a business combination under common control. Accordingly, while applying a book-value method to a business combination under common control, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information. This would represent a change from current practice for some companies.

Disclosures

In the IASB's preliminary views, while accounting business combinations under common control under:

- **Acquisition method:** The receiving company should be required to comply with the disclosure requirements in IFRS 3, including any improvements to those requirements resulting from the Discussion Paper 'Business Combinations—Disclosures, Goodwill and Impairment'[6].
- **Book-value method:** In case of application of book value method to business combinations under common control, some but not all of the disclosure requirements of IFRS 3 would be appropriate.

6. The Discussion Paper was issued in March 2020 and was open for comments until 31 December 2020

Accordingly, the receiving company should, inter alia, make the following disclosures when a book-value method is applied:

a. The name and a description of the transferred company, the combination date, the percentage of voting equity interests transferred to the receiving company, the primary reasons for the combination and a description of how the receiving company obtained control.

b. The carrying amount of any non-controlling interest in the transferred company.

c. Aggregate information for individually immaterial combinations that are material collectively.

Additionally, it should disclose:

a. The amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received and

b. The component, or components, of equity that includes this difference.

However, the disclosure of pre-combination information would not be required.

Next steps

The proposals are expected to reduce the diversity in practice in case of accounting business combinations under common control, more particularly by the receiving company in such combinations. IASB has deliberated and proposed that one size cannot fit all. Therefore, it would be relevant for some companies to apply acquisition method, specifically those whose non-controlling shareholders are affected by such combinations subject to the cost-benefit trade-off and other practical considerations, while others may apply the book-value method. Also, an optional exemption has been provided to enable privately held companies to use book-value method, if none of their non-controlling shareholders object to such method.

The IASB has also proposed to prohibit restatement of pre-combined information. This implies that the financial information of the transferred company would be included in the financial statements of the receiving company prospectively - i.e. from the date of the transaction. The change is expected to affect current practice being followed by some companies which combine the assets, liabilities, income and expenses of the transferred company retrospectively.

In India, Indian Accounting Standard (Ind AS) 103, *Business Combinations* is largely based on IFRS 3. While IFRS 3 excludes from its scope business combinations of entities under common control, Ind AS 103 provides guidance in this regard (Appendix C). As per the guidance, business combinations involving entities or businesses under common control should be accounted for using the pooling of interest method. Under the method, the assets and liabilities of the combining entities are reflected at their carrying amounts and the financial information in the financial statements in respect of prior periods are restated as if the business combination had occurred from the beginning of the preceding period. For application of the guidance, the Ind AS Technical Facilitation Group (ITFG) of the Institute of Chartered of Accountants of India (ICAI) has also issued various clarifications.

With regard to the discussion paper, ICAI has also invited comments on the IASB's proposals up to 15 July 2021.

It should be noted that the proposals in the DP are preliminary and may change. Basis the comments it receives in response to the DP up to 1 September 2021, IASB would consider whether to develop an exposure draft containing proposals to implement any or all of its preliminary views. Companies should watch out for the developments in the area and provide their comments to ICAI.

04

Regulatory updates

MCA amended CSR provisions under the Companies Act, 2013

Recently, the Ministry of Corporate Affairs (MCA) has notified certain provisions of the Companies (Amendment) Act, 2019[1] relating to Corporate Social Responsibility (CSR) with effect from 22 January 2021. Additionally, MCA has issued certain amendments to the Companies (CSR Policy) Rules, 2014 (CSR Rules). In this section, we discuss the key features of the notified provisions and the amendments to CSR Rules.

As per the notified amendments, a company would be mandatorily required to utilise the unspent amount earmarked for CSR activities, failing which it would be transferred to a fund specified in the Schedule VII of the Companies Act, 2013 (2013 Act). Until a fund is specified in Schedule VII of the 2013 Act, the unspent CSR amount, if any, should be transferred by the company to any fund included in Schedule VII of the 2013 Act[2].

The notified provisions are as follows:

- **Unspent amount of CSR on ongoing CSR projects (Section 135(6)):** In case the CSR amount remains unspent pursuant to any ongoing CSR project undertaken by a company as per its CSR policy, then the company should transfer such unspent amount to a special account within a period of 30 days from the end of the Financial Year (FY). The company should spend the amount transferred to the unspent CSR account within a period of three FYs from the date of such transfer as per its obligation towards the CSR policy.

  In case it fails to spend the amount within the specified period, it would be required to transfer the same to a fund specified in Schedule VII of the 2013 Act, within a period of 30 days from the date of completion of the third FY.

- **Unspent amount on CSR activities (Section 135(5)):** In other cases when there is no ongoing project, the unspent amount should be transferred to a fund specified in Schedule VII of the 2013 Act within a period of six months from the expiry of the FY.

- **Revised definitions (Rule 2 of CSR Rules):** The amendments have revised definitions of certain terms relevant to the applicability of CSR provisions under the 2013 Act. These, *inter alia*, include:

  – *CSR:* Currently, CSR has been defined[3] to include*:*

    a. Projects or programs relating to activities, areas or subjects specified in Schedule VII to the 2013 Act

    b. Projects or programs relating to activities undertaken by the board of directors of a company in pursuance of recommendations of the CSR committee of the board as per declared CSR policy of the company subject to the condition that such policy will include activities, areas or subjects specified in Schedule VII of the 2013 Act.

  Amendment

  The amendments have revised the CSR definition under the CSR Rules. As per the revised definition, CSR would mean the activities undertaken by a company in pursuance of its statutory obligation laid down in Section 135 of the 2013 Act but should not include the following:

  a. Activities undertaken in pursuance of normal course of business of the company

  b. Any activity undertaken by the company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level

  c. Contribution of any amount directly or indirectly to any political party

  d. Activities benefitting employees of the company as defined in Section 2(k) of the Code on Wages, 2019

  e. Activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services

  f. Activities carried out for fulfilment of any other statutory obligations under any law in force in India.

  The amendments clarify that companies engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for FYs 2020-21, 2021-22, 2022-23. However, certain conditions have to be fulfilled:

  a. Such research and development activities should be carried out in collaboration with any of the institutes or organisations given under Schedule VII (point (ix)) to the 2013 Act

  b. Details of such activity should be disclosed separately in the annual report on CSR included in the board's report.

1. The Companies (Amendment) Act, 2019 got the presidential assent on 31 July 2019. The amendments relating to CSR were not notified at that time.
2. Amendments made to the CSR Rules.
3. Definition under the Companies (CSR Policy) Rules, 2014 (CSR Rules).

- *CSR policy:* As per CSR Rules, CSR policy relates to the activities to be undertaken by the company in areas or subjects specified in Schedule VII to the 2013 Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company.

  Amendment

  As per the revised definition, CSR policy would mean a statement containing the approach and direction given by the board of a company, taking into account the recommendations of its CSR committee, and includes guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan.

- *Ongoing project:* A new definition has been included in the CSR Rules on 'ongoing project'. An ongoing project has been defined to mean a multi-year project undertaken by a company in fulfilment of its CSR obligation with timelines not exceeding three years (excluding the FY in which it was commenced). It should also include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification.

- **CSR implementation (Rule 4 of CSR Rules):** Currently, a company can undertake CSR activities either through itself or through a company/trust/ society established under Section 8 of the 2013 Act.

  Amendment

  As per the amendments, every entity who intends to undertake any CSR activity should register itself with the Central Government (CG) by filing the form CSR-1 electronically with the Registrar of Companies (ROC) with effect from the 1 April 2021. However, the provisions would not apply to the CSR projects or programmes approved prior to 1 April 2021.

  Form CSR-1 should be signed and submitted electronically by the entity and should be verified digitally by a Chartered Accountant (CA) in practice, Company Secretary (CS) in practice, or a cost accountant in practice.

  Additionally, a company may engage international organisations for designing, monitoring and evaluation of the CSR projects or programmes as per its CSR policy as well as for capacity building of their own personnel for CSR.

  The board of a company should satisfy itself that the funds so disbursed have been utilised for the purposes and in the manner as approved by it. It should be certified by the Chief Financial Officer (CFO) or the person responsible for financial management.

- **CSR committee (Rule 5 of CSR Rules):** Currently, every company required to make a CSR spend should constitute a CSR committee. **The CSR committee is required to institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company**.

  Amendment

  The amendments require a CSR committee to formulate and recommend an annual action plan in pursuance of its CSR policy to the board of directors, which should include the following:

  a. The list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the 2013 Act
  b. The manner of execution of such projects or programmes
  c. The modalities of utilisation of funds and implementation schedules for the projects or programme
  d. Monitoring and reporting mechanism for the projects or programmes and
  e. Details of need and impact assessment, if any, for the projects undertaken by the company.

  The board of directors may alter such plan at any time during the FY, as per the recommendation of its CSR committee, based on the reasonable justification to that effect.

  (Emphasis added to highlight the change)

- **Surplus funds from CSR activities (Rule 7 of CSR Rules):** As per the amendments, any surplus arising out of the CSR activities would not form part of the business profit of a company and should either be ploughed back into the same project or should be transferred to the unspent CSR account and spent in pursuance of CSR policy and annual action plan of the company. It can also transfer the surplus amount to a fund specified in Schedule VII of the 2013 within a period of six months of the expiry of the FY.

- **Creation/acquisition of an asset (Rule 7 of CSR Rules):** As per the amendments, the CSR amount may be spent by a company for creation or acquisition of a capital asset, which should be held by:

  a. A company established under Section 8 of the 2013 Act, or a registered public trust or registered society with charitable objects and CSR registration number

b. Beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities or

c. A public authority[4].

With respect to the capital asset created by a company prior to the commencement of the Companies (CSR Policy) Amendment Rules, 2021, the company should comply with the prescribed requirement within a period of 180 days from such commencement which may be extended by a further period of up to 90 days with the approval of the board of directors based on reasonable justification.

- **Impact assessment (Rule 8 of CSR Rules):** The amendments requires every company with an average CSR obligation of INR10 crore or more (in the three immediately preceding FYs) to undertake an impact assessment of their CSR projects with outlays of INR1 crore or more and which have been completed not less than one year before undertaking the impact study. The assessment should be done through an independent agency. The impact assessment reports should be placed before the board of directors and should be annexed to the annual report on CSR.
- **New format of annual report on CSR (Annexures to CSR Rules):** The amendments have also introduced a new format for the annual report on CSR activities to be included in the board's report for FY commencing on or after 1 April 2020. It also provides the format of e-form CSR-1 for registration of entities undertaking CSR activities.

Effective date: The amendments are effective from the date of their publication in the official gazette i.e. 22 January 2021 except for filing of form CSR-1 which is effective from 1 April 2021.

(Source: MCA notification no. S.O. 324(E) and notification no. G.S.R. 40(E) dated 22 January 2021)

MCA clarification on spending CSR funds on COVID-19 vaccination programme

The MCA through a circular dated 23 March 2020 has clarified that spending of funds earmarked for CSR for carrying out awareness campaigns/programmes or public outreach campaigns on COVID-19 vaccination programme is an eligible CSR activity under the provisions of the 2013 Act. Companies may undertake these activities subject to the fulfilment of the requirements of the CSR Rules and circulars related to CSR issued by MCA from time to time.

(Source: MCA general circular no. 01/2021 dated 13 January 2021)

MCA issued further relaxations for companies amid COVID-19

Conduct of board meetings through VC

Board meetings to discuss the matters specified in Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014 (i.e. those relating to approval of financial statements, board's report, prospectus, etc.) can be held through Video Conferencing (VC) or Other Audio-Visual Means (OAVM) up to 31 June 2021 (earlier allowed up to 31 December 2020)..

(Source: MCA notification no. G.S.R. 806(E) dated 30 December 2020)

Conduct of AGMs through VC

The MCA has allowed companies whose Annual General Meetings (AGMs) were due to be held in the year 2020 or become due in the year 2021 to conduct their AGMs through VC/OAVM on or before 31 December 2021. It has been further clarified that the circular should not be construed as conferring any extension of time for holding of AGMs by the companies under the 2013 Act. Companies which have not adhered to the relevant timelines would remain subject to legal action under the 2013 Act.

(Source: MCA general circular no. 02/2021 dated 13 January 2021)

Conduct of EGMs through VC

The MCA has extended the timeline for conduct of Extraordinary General Meetings (EGMs) by companies through VC/OAVM or transact items through postal ballot up to 30 June 2021 (earlier allowed up to 31 December 2020). These meetings should be conducted in accordance with the framework provided in the circulars dated 8 April 2020, 13 April 2020, 15 June 2020 and 28 September 2020.

(Source: MCA general circular no. 39/2020 dated 31 December 2020)

4. Public authority means 'public authority' as defined in Section 2(h) of the Right to Information Act, 2005.

MCA notified certain provisions of the Companies (Amendment) Act, 2020

Background

The Ministry of Finance introduced the Companies (Amendment) Bill, 2020 (the Bill) which proposed extensive amendments in the 2013 Act. The Bill was passed by the Lok Sabha and Rajya Sabha on 19 September 2020 and 22 September 2020 respectively.

On 30 September 2020, the Companies (Amendment) Act, 2020 (2020 Act) received the assent of the President of India. The 2020 Act incorporates amendments suggested by the Company Law Committee (CLC) in its report.

Recently, the CG has notified certain sections of the 2020 Act effective from 21 December 2020. The notified amendments mainly relate to the following:

- Decriminalisation of certain compoundable offences i.e., rationalisation of 46 compoundable offences and adoption of a principle-based approach to decriminalise the offences and
- Rationalisation of penalties.

For a detailed read, please refer KPMG in India's First Notes on 'MCA notified certain provisions of the Companies (Amendment) Act, 2020' dated 13 January 2021.

New development

Some of the other key amendments notified with effect from 22 January 2021 are as follows:

- **Amendment to definition of listed company (Section 2(52)):** The 2020 Act empowers CG in consultation with the Securities and Exchange Board of India (SEBI) to exclude certain listed companies and private companies with the intention of getting listed certain class of securities, from the category of 'listed companies'.
- **Periodical financial results (Section 129A):** The 2020 Act inserted a new Section 129A relating to requirement of periodical financial results. The section enables CG to prescribe such class or classes of unlisted companies to:
  a. Prepare periodical financial results in such form (period and form to be prescribed)
  b. Obtain approval of the board of directors
  c. Complete audit or limited review of such periodical financial results (manner to be prescribed)
  d. File a copy with the ROC within 30 days of completion of the relevant period (fees to be prescribed).
- **Exemption from forming a CSR committee (Section 135(9)):** If the amount to be spend by a company on CSR is less than INR50 lakh then a CSR committee is not required to be formed. In this case, the board of directors of such a company would discharge the functions of a CSR committee.
- **Excess CSR spend (Section 135(5)):** The amendments also permit a company which spends an amount in excess of the prescribed amount of two per cent on CSR activities, to set-off excess amount against the requirement to spend for such number of succeeding FYs and in such manner, as may be prescribed. The amendments to the CSR Rules further clarified that the excess amount can be carried forward up to immediately succeeding three FYs. However, following conditions have to be fulfilled:
  a. The excess amount available for set off should not include the surplus arising out of the CSR activities, if any and
  b. The board of the company should pass a resolution to that effect.
- **Penalty for non-compliance with CSR provisions (Section 135(7)):** Following penalty provision has been inserted for non-compliance of provisions relating to CSR:
  a. *On a company:* Twice the amount required to be transferred by the company to the fund specified in Schedule VII of the 2013 Act, the unspent CSR account or INR1 crore whichever is lower, and
  b. *On every officer in default:* One-tenth of the amount required to be transferred to the fund specified in Schedule VII of the 2013 Act, the unspent CSR account or INR2 lakh, whichever is lower.

Some of the other notified amendments relates to:

Section	Particulars
Section 62(1)	Reduction of timelines for rights issue process
Section 89(11)	Declaration in respect of beneficial interest in any share
Section 117(3)	Resolutions and agreements to be filed with the ROC by the company
Section 393A	CG empowered to exempt any class of foreign companies or companies incorporated or to be incorporated outside India, from any of the provisions of Chapter XXII.
Section 410	Removal of restriction on the appointment of the number of judicial and technical members in the Appellate Tribunal
Section 418A	Constitution of additional benches of NCLAT and related provisions
Section 435	Exclusion of punishment for wrongful withholding of property from the applicability of Section 435 i.e. special courts
Section 446B	Lesser penalties for start-up company, producer company, one-person company or small company
Section 452	Punishment for wrongful withholding of property
Section 454	Adjudication of penalties

Source: MCA notification no. S.O. 4646(E) dated 21 December 2020 and notification no. S.O. 325(E) dated 22 January 2021.

Amendments to the SEBI regulations

Listing Regulations

Background

Currently, a listed company is required to disclose certain events in relation to the Corporate Insolvency Resolution Process (CIRP) of a listed corporate debtor under the Insolvency and Bankruptcy Code, 2016 (the code) with the stock exchanges as deemed material events in accordance with the requirements of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) (Schedule III- Part A). The events, *inter alia*, include:

a. Filing of application by the corporate applicant for initiation of CIRP, also specifying the amount of default

b. Admission of application by the Tribunal, along with amount of default or rejection or withdrawal, as applicable

c. Any other material information not involving commercial secrets.

Amendments

SEBI through a notification dated 8 January 2021 has issued certain amendments to the Listing Regulations. The amendments have modified the disclosures relating to material information not involving commercial secrets under the code. As per the revised requirement, a listed company is now required to disclose specific features and details of the resolution plan as approved by the Adjudicating Authority under the code, not involving commercial secrets, including details such as:

a. Pre and post net-worth of the company

b. Details of assets of the company post CIRP

c. Details of securities continuing to be imposed on the companies' assets

d. Other material liabilities imposed on the company

e. Detailed pre and post shareholding pattern assuming 100 per cent conversion of convertible securities

f. Details of funds infused in the company, creditors paid-off

g. Additional liability on the incoming investors due to the transaction, source of such funding, etc.

h. Impact on the investor – revised Price-Earnings (P/E), Return on Net Worth (RONW) ratios, etc.

i. Names of the new promoters, key managerial persons(s), if any and their past experience in the business or employment. In case where promoters are companies, history of such company and names of natural persons in control

j. Brief description of business strategy.

Additional disclosures to be made by a listed company are as follows:

a. Proposed steps to be taken by the incoming investor/acquirer for achieving the Minimum Public Shareholding (MPS)

b. Quarterly disclosure of the status of achieving the MPS

c. The details as to the delisting plans, if any approved in the resolution plan.

Effective date: The amendments are effective from the date of their publication in the official gazette i.e. 8 January 2021.

(Emphasis added to the highlight the change)

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2021/02 dated 8 January 2021)

ICDR Regulations

SEBI through a notification dated 8 January 2021 has issued certain amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations). The key amendments are as follows:

- **Additional exemption from minimum promoter's contribution (Regulation 112):** Currently, requirements of minimum promoters' contribution is not applicable in the following cases:

  a. An issuer which does not have any identifiable promoter

  b. The equity shares of the issuer are frequently traded on a stock exchange for a period of at least three years and the issuer has a track record of dividend payment for at least three immediately preceding years.

  Amendment

  The amendments have modified the exemption given to an issuer whose equity shares are frequently traded on a stock exchange from minimum promoter's contribution. As per the revised requirement, minimum promoter's contribution will not be applicable in case where the equity shares of the issuer are frequently traded on a stock exchange for a period of at least three years immediately preceding the reference date and the issuer is in compliance with the following conditions:

  a. The issuer has redressed at least 95 per cent of the complaints received from investors till the end of the quarter immediately preceding the reference date.

  b. The issuer has been in compliance with the Listing Regulations for a minimum period of three years immediately preceding the reference date.

  In case an issuer has not complied with the provisions of the Listing Regulations relating to composition of board of directors for any quarter during the last three years immediately preceding the date of filing draft offer document/offer document, but has complied with the same at the time of filing of document with adequate disclosures about such non-compliances (during the three years immediately preceding the date of filing the draft offer document/offer document) being made in the offer document, then the issuer will be deemed to have complied with the said condition.

- **Lock-in period for equity shares issued pursuant to any resolution of stressed assets (Regulation 167(4)):** Currently, equity shares issued on a preferential basis pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India (RBI) or a resolution plan approved by the NCLT under the Insolvency and Bankruptcy Code, 2016 should be locked-in for a period of one year from the trading approval.

  Amendment

  As per the amendments, the above lock-in provision will not be applicable to the specified securities to the extent to achieve 10 per cent public shareholding.

Effective date: The amendments are effective from the date of their publication in the official gazette i.e. 8 January 2021.

(Emphasis added to the highlight the change)

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2021/03 dated 8 January 2021)

FAQs on disclosure of information related to forensic audit of listed companies

Background

SEBI through a notification dated 8 October 2020 required companies with listed specified securities (i.e. equity shares and convertible securities) to make following disclosures to the stock exchange(s) as deemed to be material events, in case of initiation of forensic audit (by whatever name called):

a. The fact of initiation of forensic audit along-with name of entity initiating the audit and reasons for the same, if available

b. Final forensic audit report (other than for forensic audit initiated by regulatory/enforcement agencies) on receipt by the listed entity along with comments of the management, if any.

New development

Recently, SEBI has issued certain clarifications relating to the application of the said disclosures by listed companies in the form of Frequently Asked Questions (FAQs). The clarifications are as follows:

- **Scope of forensic audits:** Forensic audits would refer to those audits (by whatever name called), which are initiated with the objective of detecting any misstatement in financials, misappropriation/ siphoning or diversion of funds. It does not seek to cover disclosure of audit of matters such as product quality control practices, manufacturing practices, recruitment practices, supply chain process including procurement and matters that would not require any revision to the financial statements disclosed by the listed company.

- **Disclosure of initiation of forensic audit:** The fact of initiation of any forensic audit, (or an audit by whatever name called), by the management of listed company, lenders, regulatory/enforcement agencies are required to be disclosed.

- **Applicability:** The new requirement is applicable prospectively and applies to all audits which are initiated and audit reports which are finalised after 8 October 2020.

- **Exclusions:** In the disclosure of the final forensic audit report, any personally identifiable information including names of individuals and commercially sensitive information, if any, may be expunged.

(Source: FAQs by SEBI dated 27 November 2020)

SEBI issued further relaxations amid COVID-19

- **Requirement of sending physical copies of annual report to shareholders:** Regulations 36 and Regulation 58 of the Listing Regulations requires listed companies to send their annual reports to the shareholders in the following manner:

  a. Soft copy of full annual report to shareholders who have registered their email address(es)

  b. Hard copy of statement containing salient features of all the documents, as prescribed in Section 136 of the 2013 Act to the shareholders who have not registered their email addresses and

  c. Hard copies of full annual reports to those shareholders, who request for the same.

  Relaxation

  SEBI has exempted listed companies from sending hard copies of annual reports/statement of salient features to their members up to 31 December 2021.

- **Requirement of proxy for general meetings:** Regulation 44(4) of the Listing Regulations requires a listed company to send proxy forms to holders of securities in all cases mentioning that a holder may vote either for or against a resolution.

  Relaxation

  The requirement of sending proxy forms has been temporarily dispensed with up to 31 December 2021, in case of meetings held through electronic mode.

  (Source: SEBI circular no. SEBI/HO/CFD/CMD2/CIR/P/2021/11 dated 15 January 2021)

- **Creation of security in issuance of listed debt securities and due diligence by debenture trustees:** SEBI through its circular dated 3 November 2020 has issued guidelines with respect to creation of security in issuance of listed debt securities and performance of due diligence by debenture trustee(s) pursuant to the amendments to the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and SEBI (Debenture Trustees) Regulations, 1993. The guidelines were made applicable from 1 January 2021.

  Relaxation

  In view of the challenges arising out of the prevailing business and market conditions due to COVID-19, SEBI has decided to extend the implementation date of the provisions of the said circular to 1 April 2021.

  (Source: SEBI circular no. SEBI/HO/MIRSD/CRADT/CIR/P/2020/254 dated 31 December 2020)

Risk based internal audit framework for banks

Background

Currently, banks are required to put in place a Risk-Based Internal Audit (RBIA) system as part of their internal control framework that relies on a well-defined policy for internal audit, functional independence with sufficient standing and authority within the bank, effective channels of communication, adequate audit resources with sufficient professional competence, among others. The requirement has been laid down in the Guidance Note on Risk-Based Internal Audit issued by RBI in 2002.

The guidance note lays the basic approach for risk based internal audit functions. Banks are expected to re-orient their approach, in line with the evolving best practices, as a part of their overall governance and internal control framework. Banks are also encouraged to adopt the International Internal Audit standards, like those issued by the Basel Committee on Banking Supervision (BCBS) and the Institute of Internal Auditors (IIA).

New development

With a view to bring uniformity in approach followed by the banks and to align the expectations on internal audit function with the best practices, on 7 January 2021, RBI through a notification has issued certain guidelines for the banks. The guidelines, *inter alia*, relates to:

- **Authority, stature and independence:** The internal audit function must have sufficient authority, stature, independence and resources within the bank, thereby enabling internal auditors to carry out their assignments with objectivity. Accordingly, the head of internal audit should be a senior executive of the bank who should have the ability to exercise independent judgement.
- **Competence:** Banks should ensure that internal audit function has the requisite skills to audit all areas of the bank.
- **Staff rotation:** The board should prescribe a minimum period of service for staff in the internal audit function. The board may also examine the feasibility of prescribing at least one stint of service in the internal audit function for the staff possessing specialised knowledge useful for the audit function, but who are posted in other departments, so as to have adequate skills for the staff in the internal audit function.
- **Remuneration:** The remuneration policies should be structured in a way that it avoids creating conflict of interest and compromising audit's independence and objectivity.
- **Others:** The internal audit function should not be outsourced. However, where required, experts, including former employees, could be hired on contractual basis subject to the Audit Committee of Board (ACB) being assured that such expertise does not exist within the audit function of the bank. Ownership of audit reports in all cases should rest with regular functionaries of the internal audit function.

Additionally, banks must ensure and demonstrate that their risk-based internal audit framework captures all the significant criteria/principles suited for their organisational structure, the business model and the risks through proper documentation.

Effective date: The guidelines are effective from 7 January 2021.

(Source: RBI notification no. RBI/2020-21/83 dated 7 January 2021)

Extension of due dates of submitting IT returns and audit reports

The Ministry of Finance through a press release dated 30 December 2020 has further extended the due dates for submission of Income-Tax (IT) returns, declaration under Vivad Se Vishwas Scheme and payment of self-assessment tax as follows:

Extension of due date of IT returns for Assessment Year (AY) 2020-21

a. For the taxpayers (including their partners) who are required to get their accounts audited and companies (whose due date under Section 139(1) of the IT Act was 31 October 2020), the due date has been extended to 15 February 2021 (earlier 31 January 2021).

b. For the taxpayers who are required to furnish report in respect of international/specified domestic transactions (whose due date under Section 139(1) of the IT Act was 30 November 2020), the due date has been extended to 15 February 2021 (earlier 31 January 2021).

Declaration under Vivad Se Vishwas Scheme

The last date for making a declaration under Vivad Se Vishwas Scheme has been extended to 31 January 2021 (earlier 31 December 2020). Further, the date of passing orders under Vivad Se Vishwas Scheme, which are required to be passed by 30 January 2021 has been extended to 31 January 2021.

Others

a. The date for passing an order or issuance of notice by the authorities under the Direct Taxes and Benami Acts which are required to be passed/issued/made by 30 March 2021 has been extended to 31 March 2021.

b. The due date for payment of self-assessment tax for taxpayers (with self-assessment tax liability up to INR1 lakh) who are required to get their accounts audited and those who are required to furnish report in respect of international/specified domestic transactions has been extended to 15 February 2021 (earlier 31 January 2021).

c. The due date for furnishing an annual return under Section 44 of the Central Goods and Service Tax Act, 2017 for the FY2019-20 has been extended to 28 February 2021 (earlier 31 December 2020).

(Source: Press release by Ministry of Finance dated 30 December 2020)

ICAI publications

Technical guide on the provisions of independent directors from corporate governance perspective

Recently, the Institute of Chartered Accountants of India (ICAI) has issued a technical guide on the 'provisions of independent directors from corporate governance perspective'. The guide aims to provide comprehensive guidance on the role, responsibilities, duties and powers of independent directors with regard to the 2013 Act, Listing Regulations and various other laws. The guide also covers specific issues and questions that should be considered in a performance evaluation of the entire board by independent directors/parameters for evaluation of board of directors/performance evaluation of independent director/self-appraisal checklist.

(Source: Technical guide on the provisions of independent directors from corporate governance perspective issued by ICAI in January 2021)

Technical guide on charges - registration, modification and satisfaction under the Companies Act, 2013 and LLP Act, 2008

Every company creating a charge on its property, assets or any of its undertakings (whether tangible or otherwise) is required to register the particulars of the charge with the ROC within a prescribed period in accordance with the provisions of the 2013 Act. Any modification or satisfaction of the same also need to be intimated by the company to ROC. Any delay or failure to adhere the requirements attracts penal consequences.

In order to facilitate the understanding, interpretation and procedural formalities relating to creation, modification and satisfaction of charge, recently, ICAI has issued a technical guide on 'charges-registration, modification and satisfaction under the 2013 Act and LLP Act, 2008'. The publication outlines the procedural aspects involved in registration of charges.

(Source: Technical guide on charges - registration, modification and satisfaction under the Companies Act, 2013 and LLP Act, 2008 issued by ICAI in January 2021)

Educational material on Ind AS 23

On 27 January 2021, ICAI issued an educational material on Ind AS 23, *Borrowing Costs*. The publication provides guidance on the implementation of the standard for recognising the borrowing costs incurred by entities in the form of Frequently Asked Questions (FAQs). It also highlights major differences between Ind AS 23 and AS 16/IAS 23, *Borrowing Costs*.

(Source: Educational material on Ind AS 23 issued by ICAI on 27 January 2021)

Handbook on audit of CSR activities

Recently, ICAI has released a 'Handbook on audit of CSR activities' which provide detailed guidance on the auditing aspects of CSR spends. The handbook also incorporates relevant provisions of the 2013 Act and reporting requirements under the Companies (Auditor's Report) Order, 2020 (CARO 2020) relating to CSR.

(Source: Handbook on audit of CSR activities issued by ICAI in December 2020)

FASB issued an update clarifying the scope of Topic 848 - Reference rate reform

The Financial Accounting Standards Board (FASB) has recently issued an Accounting Standards Update (ASU) that clarifies the scope of the Topic 848, *Reference Rate Reform*. The amendments in the ASU clarified that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting will apply to derivatives that are affected by the discounting transition. Specifically, certain provisions in Topic 848, if elected by an entity, will apply to derivative instruments that use an interest rate for margining, discounting or contract price alignment that is modified as a result of reference rate reform. The amendments in the ASU to the expedients and exceptions in Topic 848 also capture the incremental consequences of the scope clarification and tailor the existing guidance to derivative instruments affected by the discounting transition.

The amendments are elective and applies to all entities that have derivative instruments that use an interest rate for margining, discounting, or contract price alignment that is modified as a result of reference rate reform. The amendments also optionally apply to entities that designate receive-variable rate, pay-variable-rate cross-currency interest rate swaps as hedging instruments in net investment hedges that are modified as a result of reference rate reform.

Effective date: An entity may elect to apply the amendments on a full retrospective basis as of any date from the beginning of an interim period that includes or is subsequent to 12 March 2020. An entity may also apply the amendments on a prospective basis to new modifications from any date within an interim period that includes or is subsequent to the date of the issuance of a final update, up to the date that financial statements are available to be issued.

If an entity elects to apply any of the amendments for an eligible hedging relationship, any adjustments as a result of those elections must be reflected as of the date the entity applies the election.

The amendments do not apply to:

a. Contract modifications made after 31 December 2022

b. New hedging relationships entered into after 31 December 2022 and

c. Existing hedging relationships evaluated for effectiveness in periods after 31 December 2022, except for hedging relationships existing as of 31 December 2022, that apply certain optional expedients in which the accounting effects are recorded through the end of the hedging relationship (including periods after 31 December 2022).

(Source: ASU no. 2021-01 issued by FASB in January 2021)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First Notes

MCA notified certain provisions of the Companies (Amendment) Act, 2020

13 January 2021

The Ministry of Finance introduced the Companies (Amendment) Bill, 2020 (the Bill) which proposed extensive amendments in the Companies Act, 2013 (2013 Act). The Bill was passed by the Lok Sabha and Rajya Sabha on 19 September 2020 and 22 September 2020 respectively.

On 30 September 2020, the Companies (Amendment) Act, 2020 (2020 Act) received the assent of the President of India. The 2020 Act incorporates amendments suggested by the Company Law Committee (CLC) in its report.

Recently, the Central Government notified certain sections of the 2020 Act effective from 21 December 2020. The notified amendments mainly relate to the following:

- Decriminalisation of certain compoundable offences i.e., rationalisation of 46 compoundable offences and adoption of a principle-based approach to decriminalise the offences and
- Rationalisation of penalties.

This issue of First Notes provides an overview of the notified sections of the Companies (Amendment) Act, 2020.

Voices on Reporting (VOR) – Quarterly updates publication

On 18 January 2021, KPMG in India released the VOR - Quarterly updates publication. The publication provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Institute of Chartered Accountants of India (ICAI) and the Reserve Bank of India (RBI) that are expected to be relevant for stakeholders for the quarter ended 31 December 2020.

To access the publication, please click here.

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000.