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Editorial

The Companies (Auditor's report) Order 2020 (CARO 2020) has introduced enhanced reporting requirements for auditors and companies. In our previous editions of the Accounting and Auditing Update (AAU) we have been focussing on various elements of CARO reporting. In this edition of AAU, we aim to discuss the reporting requirements relating to fraud reporting, whistle-blower complaints, unrecorded income disclosed in tax assessments and qualifications in audit reports. The article also points out the guidance provided by the Institute of Chartered Accountants of India (ICAI) in these areas.

Climate change has emerged as an important area to focus. October 2020 edition of AAU highlighted how it is rapidly emerging as a threat to the stability of the financial systems across the globe. It explained the guidance issued by the Task Force on Climate-related Financial Disclosures (TCFD) and highlighted that the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB) are also discussing this topic. Recently, the IASB has issued an education material which highlights some of the existing requirements in IFRS that would aptly reflect climate risks and other emerging risks in the financial statements. Our article on the topic summarises the education material and covers the financial disclosures to be considered by companies.

In order to promote the consistent application of IFRS and EU-specific reporting requirements, the European Securities and Markets Authority (ESMA) issues an annual public statement. This statement highlights the areas that it would be focussing on when reviewing listed companies' annual report. Recently, ESMA issued its enforcement priorities for 2020 annual financial reports. These priorities cover transparent and timely disclosure of information on the effects of the pandemic on a company's financial performance, position and cash flows. It covers areas like presentation of financial statements, leases, impairment of assets and financial instruments and disclosures. Additionally, ESMA also focussed on non-financial matters like climate change, business model and value creation and social and employee matters. These topics are equally relevant to companies in India while preparing their interim and annual financial statements.

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

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

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Chapter 1

CARO 2020: Fraud reporting and qualification in an auditor's report

This article aims to:

Discuss the reporting requirements under CARO 2020 relating to fraud committed on or by the company including whistle-blower complaints received by it and qualifications in audit reports of the components.

Introduction

In recent times, corporate frauds have shaken the confidence of various stakeholders, in particular the investors. Therefore, there is an increase in expectation from the auditors to bring to the fore instances of frauds or other such unethical practices which would be key for decision-making by investors. With this objective, the Companies (Auditor's Report) Order, 2020 (CARO 2020) has introduced reporting requirements relating to fraud by the company or on the company including whistle-blower complaints received by it during the year. Additionally, auditors are specifically required to report transactions which have not been recorded in the books of account but have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (IT Act).

Further, in order to provide a comprehensive view about company's operations at consolidated level, CARO 2020 also requires auditors to report about qualifications or adverse remarks in the auditors' reports of the companies included in the Consolidated Financial Statements (CFS) of the parent company.

In this article, we aim to cast our lens on these reporting requirements along with highlighting the key guidance provided by the Institute of Chartered Accountants of India (ICAI) in its guidance note issued in this regard.

Fraud reporting

CARO 2020 has modified the reporting requirement relating to fraud vis-à-vis CARO 2016. Earlier, reporting on fraud on the company was restricted to fraud by officers or employees of a company. The revised clause requires an auditor to report whether any fraud by the company or any fraud on the company has been noticed or reported during the year. Accordingly, fraud on the company by any person would now be reported. In case a fraud has been noticed/reported, then an auditor is required to disclose the nature of the fraud and the amount involved in its report.

Meaning of fraud

The term 'fraud' has been defined under Section 447 of the Companies Act, 2013 (2013 Act). In relation to the affairs of a company or body corporate, 'fraud' defines to include any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with the intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

Guidance by ICAI

Scope of reporting

As per the guidance note, detection of a fraud that has an intent to injure the interests of a company or cause wrongful gain or wrongful loss might not be possible for an auditor unless the financial effects of such acts are reflected in the books of account/ financial statements of the company. For instance, pay-offs received by an employee for favouring a specific vendor. However, an auditor is required to report all such instances noticed or reported to him/ her while conducting the audit. The term 'noticed or reported' indicates that the management of the company should have the knowledge about the frauds on the company or by the company that have occurred during the period covered by the auditor's report.

Reporting would also cover frauds which may have an indirect impact on financial statements of the company.

Separate reporting on fraud 'on' or 'by' the company

An auditor is required to report separately on the nature and amount involved with respect to:

- Fraud on the company i.e. fraud committed by the employees or third parties
- Fraud by the company i.e. fraud involving one or more members of management or those charged with governance.

Other considerations

Two types of intentional misstatements that are relevant to the auditor's consideration of fraud are:

- **Misstatements resulting from fraudulent financial reporting:** It involves intentional misstatements or omissions of amounts/ disclosures in financial statements to deceive financial statement users.
- **Misstatements resulting from misappropriation of assets:** It involves the theft of a company's assets.

For the purpose of reporting, an auditor would inquire from the management about any frauds on the company that it has noticed or has been reported to it. The auditor should also discuss the matter with other employees including officers of the company. Further, an auditor would also examine the reports of the internal auditor and minutes of audit committee to ascertain whether any fraud has been reported or noticed. A written representation from management acknowledging its responsibility for the implementation and operation of accounting and internal control systems and the fact that disclosure of all significant facts relating to any frauds or suspected fraud has been made by the management would be obtained by an auditor.

Filing of Form ADT-4

CARO 2020 has introduced a new reporting requirement wherein an auditor is required to state whether any report under Section 143(12) of the 2013 Act has been filed by the auditor in Form ADT-4 as prescribed under Rule 13 of the Companies (Audit and Auditors) Rules, 2014 (Audit Rules) with the Central Government (CG).

Requirements of the 2013 Act

Currently, Section 143(12) of the 2013 Act read with Rule 13 of the Audit Rules requires specific reporting by an auditor of a company in case of frauds. According to it, an auditor has to report a fraud committed in the company by its officers or employees involving an amount of INR1 crore or above to the CG in Form ADT-4 within 15 days from the date of receipt of reply or observations from the board of directors or audit committee.

In case fraud involves an amount less than INR1 crore, the matter needs to be reported to the audit committee or the board of directors of the company within two days of an auditor's knowledge of the fraud.

The reporting under Section 143(12) of the 2013 Act is also applicable to a cost auditor and secretarial auditor of a company.

Guidance by ICAI

For the purpose of reporting, an auditor would need to consider the frauds reported by him/her under Section 143(12) of the 2013 Act during the year up to the date of its report. An auditor would also need to consider the report (in Form ADT-4), if any filed by the cost auditor or secretarial auditor of the company and should report it under this clause.

As per the guidance note, the reporting requirement would also be applicable in cases where the predecessor auditor of the company has reported under Section 143(12) of the 2013 Act during the year before the appointment of the successor auditor.

Whistle-blower complaints

CARO 2020 has introduced a new reporting requirement which requires an auditor to consider whistle-blower complaints, if any, received by the company during the year under the audit.

Existing frameworks

Certain companies are required to maintain a vigil/ whistle-blower mechanism under the relevant provisions of the 2013 Act and the Securities and Exchange Board of India (SEBI) (Listing Obligation and Disclosure Requirements) Regulations, 2015 (LODR). Those are as follows:

- **Mandatory vigil mechanism (Section 177 and Schedule IV of the 2013 Act):** Following class of companies are mandatorily required to establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances:
  a. Listed companies
  b. Companies which accept deposits from the public
  c. Companies which have borrowed money from banks and public financial institutions in excess of INR50 crore.

Companies which are required to constitute an audit committee[1] should oversee the vigil mechanism through the committee. If any of the members of the committee have a conflict of interest in a given case, they should recuse themselves, and the others on the committee would deal with the matter on hand. In case of other companies, the board of directors should nominate a director to play the role of audit committee for the purpose of vigil mechanism to whom other directors and employees may report their concerns.

The vigil mechanism should provide for adequate safeguards against victimisation of employees and directors who avail of the vigil mechanism. In exceptional cases, it should also provide for direct access to the chairperson of the audit committee or the director nominated to play the role of audit committee, as the case may be.

Further, it is also the duty of an independent director of a company to ascertain and ensure that the company has an adequate and functional vigil mechanism and that the interests of a person who uses such mechanism are not prejudicially affected on account of its use.

- **Mandatory whistle-blower mechanism (Regulation 4(2)(d) of LODR):** Every listed company is required to devise an effective whistle-blower mechanism which would enable stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.
- **Disclosures (Regulation 46 and Schedule V of LODR/Section 177 of the 2013 Act):** The details of establishment of vigil mechanism/ whistle-blower policy need to be disclosed by the companies on their websites and board's report. Listed companies are also required to disclose the details in the corporate governance report of their annual reports along with the affirmation that no personnel have been denied access to the audit committee.

Guidance by ICAI

Reporting under this clause would cover:

- Whistle-blower complaints including anonymous complaints received by the company **during the year**; complaints pertaining to earlier years are not to be considered by an auditor
- Instances of frauds which have already been reported, identified/detected by the management or through the company's vigil/whistle-blower mechanism and has been/is being remediated/ dealt with by them during the year.

Companies which are mandatorily required to establish the vigil/whistle-blower mechanism should ensure compliance with the provisions of the 2013 Act and LODR. In case of companies which are not mandatorily required to establish any vigil/whistle-blower mechanism and they did not establish such process voluntarily, then management of such companies would be required to provide all whistle-blower complaints to an auditor for review.

Further, to facilitate reporting, companies would need to devise appropriate mechanism such as ethics/whistle-blower/hotline process with adequate procedures which could handle anonymous complaints (received from inside and outside the company) and accept confidential submission of concerns about questionable accounting, internal control, or auditing matters. Auditors would also evaluate whether whistle-blower complaints are investigated and resolved by the company in an appropriate and timely manner.

Unrecorded income disclosed in tax assessments

Another new reporting requirement that has been introduced by CARO 2020 requires an auditor to report on whether there are any transactions which have not been recorded in the books of account of a company but have been surrendered or disclosed as income during the year in the tax assessments under the IT Act. If yes, then an auditor would also need to report whether the previously unrecorded income has been properly recorded in the books of account during the year.

Undisclosed income

As per Section 158B of the IT Act, 'undisclosed income' includes any money, bullion, jewellery or other valuable article/thing or any income based on any entry in the books of account or other documents or transactions which represents wholly or partly income or property which has not been or would not have been disclosed for the purposes of IT Act. It also includes any expense, deduction or allowance claimed under the IT Act which is found to be false.

1. Following companies are required to constitute an audit committee under the 2013 Act:
   a. Every listed public company
   b. An unlisted public company (except a joint venture, a wholly-owned subsidiary or a dormant company) which meets either of the following conditions:
      i. Its paid-up share capital is INR10 crore or more
      ii. It has a turnover of INR100 or more
      iii. Its aggregate outstanding loans, debentures and deposits exceeds INR50 crore.

Guidance by ICAI

The term 'surrendered or disclosed' implies that the company must have voluntarily admitted to the addition of such income, which can be demonstrated on the basis of the returns filed by the company. Therefore, reporting under this clause would not cover situations, for instance, where additions have been made by income tax authorities and the company has disputed such additions or even where no appeal has been filed by the company in respect of the additions made by tax authorities.

The surrender or disclosure of unrecorded income might relate to any assessment year under the IT Act. Accordingly, for the purpose of reporting, an auditor would review the following:

- All tax assessments of a company completed during the year along with submission and statements filed by the company in the course of assessments.
- Tax assessments which have been completed subsequent to the balance sheet date but prior to signing of the auditor's report, if the surrendered or disclosed income relates to the year under audit or prior years.

An auditor would also evaluate the effectiveness of internal financial controls of a company, in particular those relating to recognition of revenue/income.

Once such unrecorded transactions have been identified, an auditor would ascertain whether proper recording of such transactions has been duly made in the books of account. Proper recording includes proper disclosure in the financial statements of the company i.e. disclosures are sufficient to enable users understand the impact of such transactions. The nature of disclosure would depend on the nature of undisclosed income and the treatment thereof if the same was duly disclosed and reported in the books of account in the year to which the undisclosed income relates to.

Qualifications in components' audit reports

CARO 2020 has introduced a new reporting requirement wherein an auditor is required to comment whether there have been any qualifications or adverse remarks in the CARO reports of the companies included in the CFS by the respective auditors. In case of qualifications/adverse remarks, an auditor is further required to provide the details of the companies and the paragraph numbers of the respective CARO report containing such qualifications or adverse remarks.

It is important to note that reporting requirements of CARO 2020 is not applicable on auditor's report on CFS, except reporting on qualifications for those entities included in CFS to whom CARO 2020 is applicable.

Guidance by ICAI

Reporting under this clause would cover:

- All entities included in the CFS to whom CARO 2020 is applicable including parent company's standalone CARO report
- Every qualification/adverse remark made by an individual component including the parent.

The responses to questions reported in CARO 2020 are responses to specific questions which are expected to be answered in affirmative or negative. Therefore, the term qualification/adverse remark used in the clause does not mean a qualification/adverse opinion as per principles enunciated in the Standard on Auditing (SA) 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report* which is issuance of an auditor's opinion on the financial statements as a whole. The principal auditor would need to apply professional experience and judgement while concluding whether the responses to various clauses are in the nature of qualifications or adverse remarks. For this purpose, inputs from component auditor could also be sought by the principal auditor.

In case where CARO report has not been issued by the component auditor by the date of principal auditor's report, the fact would be reported by the principal auditor along with the name of the component while reporting under this clause.

Conclusion

Reporting of frauds by the company or on the company could be an indicator of internal control failure and inefficient business operations. With the enhanced scope of reporting, there is an increasing need for companies to maintain adequate systems and controls, in particular those relating to financial reporting such that instances of fraud could be identified and addressed on a timely basis. Additionally, companies should also consider evaluating their whistle-blower mechanism/vigil mechanism to ascertain whether such a mechanism is able to capture and address all genuine grievances. These would also be subject to review by an auditor under CARO 2020. Companies should also ensure proper recording of transactions disclosed or surrendered as income in the income-tax assessments as such transactions would also now be reported in the auditor's report under CARO 2020.

Chapter 2

Climate change: Implications on financial reporting

This article aims to:

Highlight some of the existing principles and disclosure requirements in IFRS standards that would appropriately reflect the challenges posed by climate-related matters.

Background

Climate-related matters have directly or indirectly impacted or are likely to impact many industries on a global front. Considering the impact that climate change may have on a company's business models, cash flows, financial position and financial performance, it has garnered the interest of various stakeholders. Investors specifically are calling out for information on the financial impacts that climate change will have on the companies, as this would enable them to incorporate climate risks into their investment decision making. It has thus become pertinent to include climate-related matters in financial reporting.

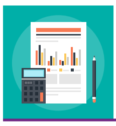
The existing International Financial Reporting Standards (IFRS) do not refer explicitly to climate-related matters. Considering this, the International Accounting Standards Board (IASB), issued an educational material in November 2020, which complements an article written by its member in November 2019[1]. The educational material articulates some of the existing requirements within IFRS that would aptly reflect climate change risks and other emerging risks in the financial statements.

In this article, we aim to highlight some of the existing principles and disclosure requirements of IFRS (as explained in the educational material) that would enable appropriate disclosures on climate-related matters in the financial statements.

1. 'IFRS Standards and climate-related disclosures' by Nick Anderson

IFRS requirements

Where the effect of climate-related matters is material in the context of the financial statements taken as a whole, companies should reflect these while reporting on financial matters. Some of the areas that may be impacted are given below:



IAS 1, *Presentation of Financial Statements*

- **Sources of estimation uncertainty and significant judgements**

  Companies are required to disclose information on assumptions made about the future, which could materially adjust the carrying amounts of assets and liabilities within the next financial year. Thus, assumptions about climate-related matters that may impact estimates (such as estimates of future cash flows when testing an asset for impairment or estimates of decommissioning obligations) should be disclosed along with sensitivity analysis performed.

  Companies are also required to disclose information on management judgements that have the most significant effect on the financial statements. For example, a company that operates in an industry particularly affected by climate change performs an impairment testing on its Cash Generating Unit (CGU) (the value of the CGU is material) and identifies that no impairment is required. The judgement made while identifying the CGU for impairment testing should be disclosed.

- **Going concern**

  Financial statements are prepared on a going concern basis. When assessing whether the going concern basis of preparation is appropriate, management should consider all available information pertaining to the future, which is at least, but not limited to 12 months from the end of the reporting period. Further, information pertaining to close call scenarios should also be disclosed. In this context, management should disclose climate-related matters that create material uncertainties related to events or conditions that cast significant doubt upon a company's ability to continue as a going concern.

- **Disclosure of relevant information**

  IAS 1 has certain overarching disclosure requirements. Companies are required to disclose in the notes to the financial statements, information that is not presented elsewhere in the financial statements but is relevant to an understanding of them. Information will be relevant if it could reasonably be expected to influence decisions made by investors.

IAS 2, *Inventories*

- **Inventories to be maintained at cost or Net Realisable Value (NRV)**

  As per IAS 2, inventories are required to be carried at the lower of cost or NRV. Climate-related events such as floods, cyclones, or other events may cause a company's inventories to become obsolete, their selling prices to decline or their costs of completion to increase. If, as a result, the cost of inventories is not recoverable, IAS 2 requires the company to write down those inventories to their NRV.

IAS 12, *Income Taxes*

- **Recognition of deferred tax assets**

  A deferred tax asset is recognised in respect of deductible temporary differences and unused tax losses and credits, to the extent it is probable that future taxable profit will be available against which these amounts can be utilised. Climate-related matters may affect a company's estimate of future taxable profits (for example, low profitability due to unavailability of resources). This may result in a company being unable to recognise deferred tax assets or being required to derecognise deferred tax assets previously recognised.

IAS 16, *Property, Plant and Equipment (PPE)* and IAS 38, *Intangible Assets*

- **Capitalisation of certain costs**

  Certain costs that meet prescribed criteria in IAS 16 and IAS 38 would be capitalised as assets (as PPE or as an intangible asset). Climate-related matters may prompt expenditures to change or adapt business activities and operations, including research and development. These new costs may not satisfy the definition of an asset, and hence would not be capitalised.

- **Depreciation and amortisation and related disclosures**

  Depreciation and amortisation of PPE and intangible assets respectively, are based on estimates made by management of the expected useful lives of the assets and their estimated residual value. These estimates are to be reviewed at least annually and changes in the estimates should be reflected in the financial statements. Climate-related matters may affect the estimated residual value and expected useful lives of assets, for example, because of obsolescence, legal restrictions or inaccessibility of the assets, and therefore, the amount of depreciation and amortisation recognised each year.

IAS 36, *Impairment of Assets*

- **Companies to assess impairment of goodwill and assets**

  As per IAS 36, (non-financial) assets should be measured at their carrying amount or their recoverable amount, whichever is lower. For this purpose, companies should assess each year, whether there is any indication of impairment at the end of the reporting period. Climate-related matters may give rise to indications that an asset (or a group of assets) is impaired. For example, a decline in demand for products that emit greenhouse gases could indicate that a manufacturing plant may be impaired, requiring the asset to be tested for impairment.

- **Computing recoverable amount using value-in-use**

  'Value in use' is the present value of the future cash flows expected to be derived from an asset or CGU. A company is required to base cash flow projections on reasonable and supportable assumptions that represent a management's best estimate of the range of future economic conditions. This requires companies to consider whether climate related matters affect those reasonable and supportable assumptions.

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* and IFRIC 21, *Levies*

- **Recognition, measurement and disclosure of liabilities**

  Climate-related risks and uncertainties may impact the recognition, measurement and disclosure of liabilities in the following manner:

  – Recognition of levies imposed by governments for failure to meet climate-related targets or to discourage or encourage specified activities

  – Costs to remediate environmental damage as per regulatory requirements

  – Contracts may become onerous (for example, due to potential loss of revenue or increased costs as a result of climate-related changes in legislation); or

  – Restructurings to redesign products or services to achieve climate-related targets.

- **Disclosures pertaining to provisions and contingent liabilities**

  Companies are required to provide a brief description of the nature of the contingent liabilities, an estimate of its financial effect (where practicable) and indication of uncertainties about the amount and timing of any related outflows of economic benefits. Accordingly, adequate disclosures should be made for potential litigations, fines or penalties that may be caused by climate-related events.

  Companies should also disclose major assumptions made about future events reflected in the amount of a provision. For this purpose, companies may need to disclose how climate-related risks have been factored in while making the provisions

IFRS 7, *Financial Instruments: Disclosures*

- **Disclosure of risks arising on financial instruments due to climate change**

  IFRS 7 requires companies to disclose the nature and extent of risks arising on its financial instruments, and how the company manages those risks. Climate-related matters may expose the financial instruments of a company to various risks, which would require adequate disclosures. For example:

  – Lenders may need to provide information about the effect of climate-related matters on the measurement of expected credit losses or on concentrations of credit risk

  – Holders of equity investments, may disclose information about industries or sectors exposed to climate-related risks, when disclosing concentrations of market risk.

IFRS 9, *Financial Instruments*

- **Classification and measurement of financial assets**

  Classification and measurement of financial assets is driven by a) the business model under which the financial assets are held, and b) the nature of cash flows[2] of the financial asset. Certain contracts, for example, loan contracts may include terms linking contractual cash flows to a company's achievement of climate-related targets. These terms would need to be assessed while classifying and measuring the financial assets[3].

- **Expected Credit Losses (ECL)**

  In recognising and measuring ECL, IFRS 9 requires the use of all reasonable and supportable forward-looking information, that is available without undue cost or effort. Climate-related matters such as wildfires, floods, or policy and regulatory changes could affect the range of potential future economic scenarios, and the lender's assessment of a significant increase in credit risk. Further, certain climate-related risks could make the assets inaccessible and uninsurable, affecting the value of collaterals. This would impact the ECL computation for a lender.

2. Nature of cash flows refers to whether the cash flows are solely payments of principal and interest on the principal amount outstanding (SPPI criteria).
3. The borrower, on the other hand may need to assess whether the contract includes embedded derivatives that need to be separated from the host contract.

IFRS 13, *Fair Value Measurement*

- **Fair value measurement of assets and liabilities**

  Market participants' views of potential climate-related legislation could affect the fair value of an asset or liability.

- **Fair value disclosures**

  IFRS 13 requires companies to provide detailed disclosures (including the disclosure of unobservable inputs used) while computing fair value of financial instruments (specifically with regard to fair value of financial instruments categorised within level 3 of the fair value hierarchy). The unobservable inputs should reflect the assumptions that market participants would use when pricing, including assumptions about risk which may include climate related risk.

IFRS 17, *Insurance Contracts*

- **Measurement of insurance contract liabilities**

  Companies generally insure businesses for business interruptions, property damage, illness, death and other events. Climate-related matters may increase the frequency or magnitude of these insured events or accelerate the timing of their occurrence, therefore, affecting the assumptions used to measure insurance contract liabilities applying IFRS 17.

- **Impact on disclosures**

  Climate-related matters may impact disclosures regarding significant judgements and changes in judgements made in applying IFRS 17 and disclosures of a company's risk, including concentration of the risk, how the company manages the risk and a sensitivity analysis.

Next steps

While the educational material highlights some of the existing principles and disclosure requirements in IFRS which would enable companies to disclose the impact of climate-related matters in the financial statements, this list is not exhaustive, and other instances may require reflection of climate related matters.

Additionally, it is important to have narrative reporting (often referred to as management discussion and analysis), as it would help in filling some information gaps and complement financial reporting.

Chapter 3

ESMA issues its enforcement priorities for 2020

This article aims to:

Highlight the financial and non-financial reporting areas that ESMA, together with national enforcers will be focusing on when reviewing the listed companies' 2020 annual reports.

Background

In order to promote the consistent application of IFRS standards and EU-specific reporting requirements, the European Securities and Markets Authority (ESMA) issues an annual public statement, to highlight the areas that it would be focussing on when reviewing listed companies' annual reports.

On 28 October 2020, ESMA issued its enforcement priorities for 2020 annual financial reports. Given the severe impact of the coronavirus pandemic (COVID-19), ESMA's key priority is transparent and timely disclosure of information on the effects of the pandemic on a company's financial performance, position and cash flows. ESMA has also focused on reporting of certain non-financial information disclosures. The areas of focus as mentioned in the report are given in figure 1 below

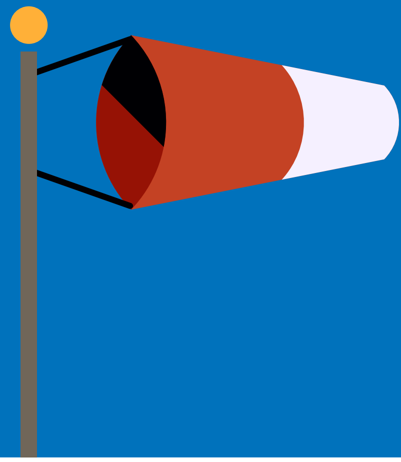
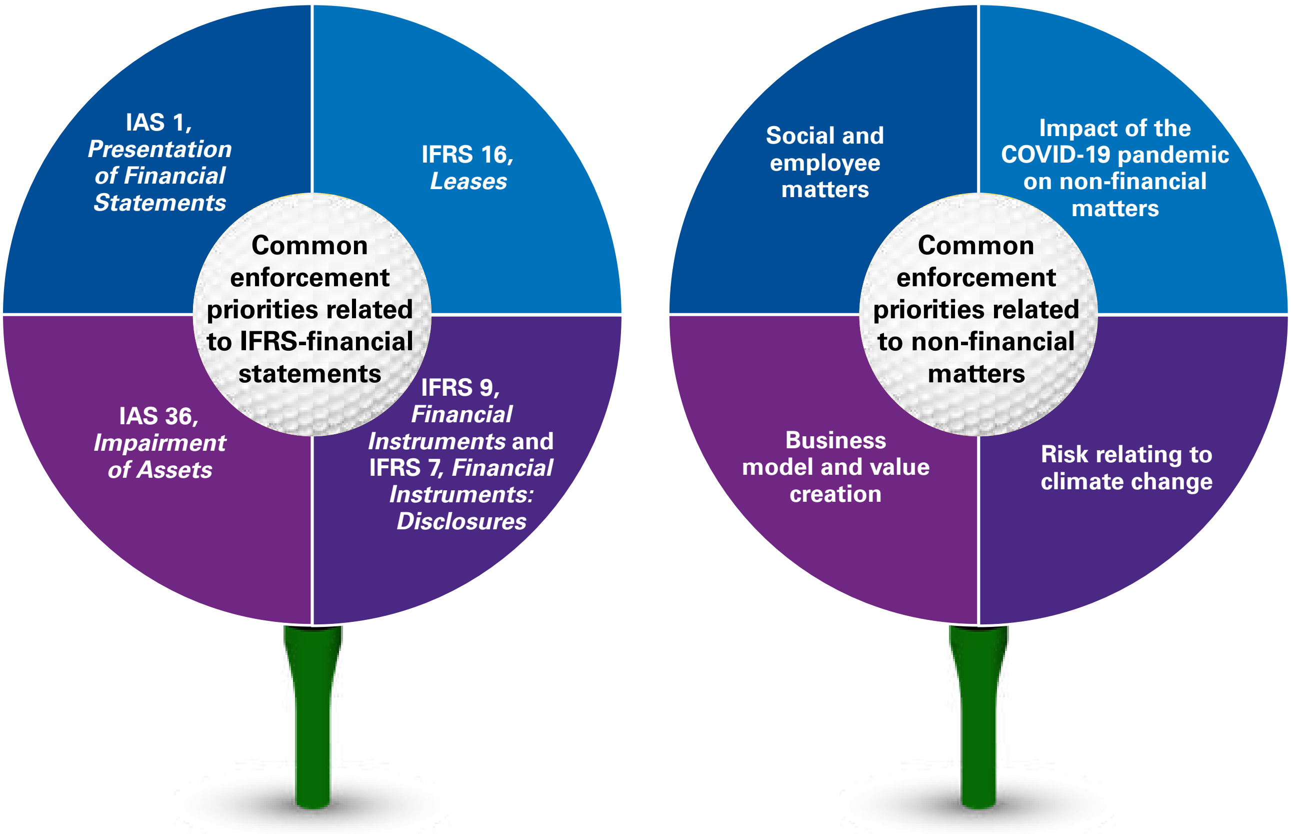


Figure 1: Areas of focus highlighted by ESMA in its Public Statement



Source: KPMG in India's analysis 2020 read with ESMA Public Statement dated 28 October 2020

ESMA has also emphasised the importance of applying its guidelines on Alternative Performance Measures (APM) while reporting on COVID-19.

Areas relating to financial reporting: Presentation of COVID-19 impact

As mentioned above, ESMA emphasised on the importance of transparency of information to further investor's confidence. It requires companies to focus on disclosures pertaining to significant assumptions and judgements made by management, in an environment of uncertainty. The focus areas highlighted by ESMA are:

IAS 1, *Presentation of Financial Statements*

- ***Going concern assumptions***

  Companies should provide sufficiently detailed[1] disclosures on the going concern assessment pertaining to a company, when such assessment requires significant judgement. While making such assessment, companies should consider all available information about the future, which is at least, but not limited to, 12 months from the end of the reporting date.

  Companies should disclose material uncertainties related to events or conditions that may cast significant doubt upon their ability to continue as a going concern (such as restricted access to financial resources due to the impacts of COVID-19). These disclosures should also include close call scenarios, where the companies conclude that there are no material uncertainties that would impact the going concern assumption.

  ESMA further expects the assumptions used in the going concern assessment to be consistent with those used in other areas of the company's financial statements – e.g. IFRS 7, *Financial Instruments: Disclosures* (on information about exposures to liquidity and other financial risks).

- ***Significant judgements and estimation uncertainty***

  Companies should disclose the assumptions underlying significant judgements and estimates made while applying their accounting policies, and the impact of COVID-19 on such judgements and estimates. For example, assumptions underlying impairment of assets, recoverability of deferred tax assets and valuation, and how the consequences of COVID-19 (such as market price volatility) have impacted these assumptions. Given the current market conditions, ESMA strongly recommends that entities should provide information about the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculations.

- ***Presentation of COVID-19 related items***

  Considering the pervasiveness of the impact of COVID-19 on the financial performance of a company, ESMA cautions companies that a separate presentation of COVID-19 impact may not faithfully represent an company's current and future overall financial performance. ESMA thus encourages companies to provide quantitative and qualitative information and a clear and unbiased picture of the multiple areas affected by COVID-19 either in a single note or in multiple notes, with appropriate cross references.

IAS 36, *Impairment of assets*

As per IAS 36, (non-financial) assets should be measured at their carrying amount or their recoverable amount, whichever is lower. For this purpose, companies should assess each year, whether there is any indication of impairment at the end of the reporting period. In this regard, ESMA reiterated[2] that the impact of COVID-19 should be considered while assessing the indicators of impairment.

Additionally, ESMA reminded companies that an impairment test performed for the last interim reporting period does not replace the requirement to perform another when there is an indication of impairment. It emphasises that the scale of reasonably possible changes in the key assumptions used in impairment testing may be larger than usual. It also reminds companies that the annual impairment test for a Cash Generating Unit (CGU) to which goodwill has been allocated is performed at the same time every year.

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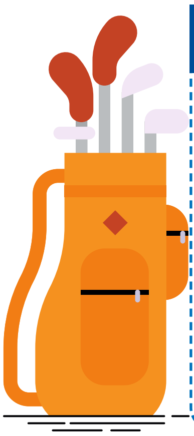
1. Level of detail would depend upon the situation of each company
2. ESMA had in its previous Public Statement relating to half-yearly financial reports asked companies to consider the effects of COVID-19 in assessing any indications of impairment for non-financial assets.

Considering the increased level of uncertainty, ESMA has issued certain considerations that companies may factor while reporting in their annual financial statements:



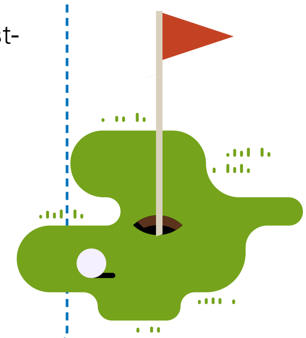
Measurement of recoverable amount of assets

Companies should:

- Model multiple possible future scenarios when estimating the future cash flows of a CGU. Alternatively, further adjustments may be made to the discount rate to reflect additional uncertainty (provided that cash flows have not already been adjusted for the same risk)
- Update assumptions used in previous interim periods to reflect the latest available information and evidence
- Emphasise on external evidence when determining cash flow projections
- Exclude expected cash flows from future uncommitted restructurings or asset enhancements in calculating value-in-use.

Disclosures pertaining to…

- How uncertainty has been factored into impairment testing
- Key assumptions and estimates underlying the impairment assessment, and how these have changed (if at all), compared to the last annual and interim reporting, for example:
  - If and when a return to pre-crisis cash flow levels is realistic, and
  - The time horizon considered in post-COVID-19 scenarios
- Sensitivity of recoverable amounts of CGU to significant changes in key operational and financial assumptions affected by COVID-19.



IFRS 9, *Financial Instruments and IFRS 7, Financial Instruments: Disclosures*

IFRS 9 for credit institutions

ESMA expects companies to reflect the significant uncertainty affecting the economic environment in the measurement of Expected Credit Losses (ECL) in an unbiased way. It reminds companies to use all reasonable and supportable information, including economic forecasts, that is available without undue cost and effort.

Risks arising from financial instruments

IFRS 7 requires adequate disclosure of risks arising from financial instruments. Given that COVID-19 may have given rise to new significant financial risks (for example, debt renegotiations that did not exist before, or were not as significant) these disclosures (in particular with regard to liquidity risks and sensitivities to market risks) are essential. ESMA further emphasised that all disclosures under IFRS 7 should be based on information used for internal reporting.

ESMA reminded companies that quantitative disclosures regarding financial risks should be accompanied by qualitative disclosures, as this would give an overall picture of the risks arising from financial instruments. It further highlighted some important disclosures required regarding:

- **Liquidity risks:** Disclosures pertaining to liquidity risks should:
  - Provide sufficiently detailed maturity analysis of the financial liabilities as well as, where relevant, of the financial assets used to manage liquidity risk
  - Disclose arrangements that take the form of supply chain financing or, more specifically, reverse factoring transactions
- **Other financial risk considerations:** Other disclosures should include:
  - How financial risks arise and how they are managed
  - The specific objectives, policies and processes put in place to address those risks
  - Financial risk concentrations, including how they are measured
  - Details of forbearance or payment moratoria from lenders.

- **Disclosures for credit institutions: Credit institutions should disclose the following:**
  - Approach adopted to measure ECL, along with any changes in approach (if any) from previous reporting periods
  - Information and assumptions underlying the measurement of ECL e.g. changes in macro-economic scenarios considered as compared to previous reporting period, rationale and methodology underlying post-model adjustments, their impact on ECL estimate and specific risks that they capture
  - Nature of changes in loss allowance e.g. due to sale or write-off of financial instruments, or any modifications
  - Granular information on credit risk exposures, their quality and their concentration, giving explanation for those linked to COVID-19
  - Support measures granted to debtors and their effects e.g. impact on the assessment of significant increase in credit risk and the extent to which these measures have mitigated credit risk
  - Sensitivity analysis of ECL calculations and staging.

IFRS 16, *Leases*

ESMA emphasises on specific disclosures required to be given by lessors and lessees as below:

- ***Disclosures required by lessors***
  - Nature of rent concession granted
  - Accounting policy adopted for rent concessions
  - Risks posed by current market conditions on assets subject to operating lease, and
  - Requirements of other standards for assets subject to operating lease.
- ***Disclosures required by lessees***
  - How companies have applied the practical expedient that provides relief to lessees when accounting for COVID-19 related rent concessions:
    - Concessions to which the practical expedient has been applied
    - Nature of the leases and/or concessions to which it has been applied, if it has not been applied to all eligible concessions
  - Depreciation and expenses e.g. variable lease payments recognised in income statement
  - Future cash flows not reflected in measurement of lease liabilities
  - Additional information on impact of COVID-19.

Non-financial matters

Considering the pervasive impact that COVID-19 has had on non-financial matters of entities, ESMA has encouraged companies in disclosing the consequences of the pandemic and mitigating actions taken in response. Disclosures on non-financial matters should be balanced, fact-based and provide evidence of concrete behaviours and actions to enable users of non-financial statements to assess how companies have addressed or plan to address relevant topics. ESMA encourages companies to disclose on the following matters in their reports disclosing non-financial matters:

- ***Social and employee matters***

  Companies should provide disclosures relating to social and employee matters and how their policies address issues highlighted by these matters. Some issues that have attracted attention from users of corporate disclosures include:
  - Inclusion and diversity, to ensure equality and to fight against racism
  - Health and safety of employees, including extensive use of remote working arrangements and strategies to bring employees back to workplace.
- ***Business model and value creation***

  There is a need to provide disclosures on the impact of the pandemic on the business model and value creation over the short, medium and long-term and on the policies put in place to address the non-financial matters. This can, for example, be contingency plans and employment measures as a consequence of the decreasing demand for products or services. While providing such disclosures, it may be particularly important to ensure a link between the company's non-financial and financial disclosure. This can be done, for example, by highlighting how the financial performance and position of the company have been impacted for the reporting year and how this can be put into the context of the ability of the company to continue creating value over time.

- ***Risk relating to climate change***

  ESMA encourages companies to explain risks associated with climate change and the related mitigating actions put in place in the context of their business models, environmental policy and any objective and targets that they are pursuing in this area. Disclosures should also be made with regard to opportunities that may arise in connection with climate change. The explanations should serve to contextualise disclosures on the degree to which pre-set targets can be achieved and to explain any uncertainty surrounding them.

Alternative performance measures

ESMA reminds companies of the requirements in its guidelines on APMs, which are aimed at promoting the usefulness and transparency of these measures. ESMA also highlights its guidance released in April 2020 to help companies apply these guidelines in the current environment.

Our comments

Although the topics included in the statement are those deemed by ESMA to be most relevant at a European level, they are of equal relevance to companies in India. Accordingly, companies should aim to provide adequate disclosures in their interim and year-end financial statements on current and potential impacts of COVID-19 on results of operations, liquidity and capital resources. The assessment should be based on both qualitative and quantitative factors affecting business activities, financial situation and economic performance of the company.

Discussion with the board of directors and the audit committee on potential impacts of COVID-19 and risk assessment would help in the preparation of the financial statements. In this regard, companies should refer to the advisory issued by the Securities and Exchange Board of India (SEBI)[3] and technical materials issued by the Institute of Chartered Accountants of India (ICAI)[4].

3. On 20 May 2020, SEBI issued an advisory and encouraged listed companies to evaluate the impact of COVID-19 on their business, performance and financial results, both quantitatively and qualitatively, to the extent possible and disseminate the same.
4. In March 2020, ICAI released an accounting and auditing advisory-' Impact of Coronavirus on Financial Reporting and the Auditors Consideration'. In May 2020, it issued Frequently Asked Questions (FAQs) on the impact of COVID-19 on Indian Accounting Standard (Ind AS).

Chapter 4

Regulatory updates

SEBI streamlines the framework for schemes of arrangement for listed companies

Background

Companies with listed specified securities (i.e. equity shares and convertible securities) are required to comply with the provisions of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) and the Companies Act, 2013 (2013 Act) while undertaking any scheme of arrangement including amalgamation, merger, reconstruction and reduction of capital.

Further, SEBI through its circular dated 10 March 2017 has laid down detailed requirements to be complied with by listed companies while undertaking schemes of arrangements.

New development

On 3 November 2020, SEBI has made certain amendments to the regulatory framework for schemes of arrangements by listed companies (laid down in its circular dated 10 March 2017). The amendments relate to the following areas:

- Documents to be submitted by the listed company to the stock exchanges before the scheme is submitted to the National Company Law Tribunal (NCLT)
- Obligations of the stock exchange(s) and processing of the draft scheme by SEBI
- Conditions for companies seeking relaxation under Rule 19(7) of the Securities Contracts (Regulation) Rules, 1957.

For a detailed read, please refer KPMG in India's First Notes on 'SEBI streamlines the framework for schemes of arrangement for listed companies' dated 19 November 2020.

(Source: SEBI circular no. SEBI/HO/CFD/DIL1/CIR/P/2020/215 dated 3 November 2020)

SEBI issues guidelines for due diligence and monitoring of charge by debenture trustees

Background

On 8 October 2020, SEBI issued certain amendments to the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (Debt Listing Regulations) and SEBI (Debenture Trustees) Regulations, 1993 (Debenture Trustees Regulations). The amendments, *inter alia*, required debenture trustee(s) to exercise independent due diligence before creating a charge on the security for the debentures to ensure that such security is free from any encumbrance or that it has obtained the necessary consent from other charge-holders if the security has an existing charge, in the manner as may be specified by SEBI.

New development

SEBI through its circulars dated 3 November 2020 and 12 November 2020 has issued guidelines with respect to performance of due diligence by debenture trustee(s) for creation of security at the time of issuance of debt securities and monitoring of security created/assets on which charge is created.

Key points to consider are as follows:

- **Due diligence by debenture trustee for creation of security:** The due diligence to be exercised by debenture trustee(s) with respect to creation of security should, *inter alia*, include the following:

  a. Verification of the assets provided by issuer for creation of security from registrar of companies, sub-registrar or other sources where charge is registered/disclosed.

  b. In case of personal guarantee, corporate guarantee and any other guarantees/form of security, verification of relevant filings available on websites of regulators and obtain appraisal report/necessary financial certificates.

  Debenture trustee(s) should also issue a 'due-diligence certificate' to the issuer as per the format specified in the circular, subject to the following conditions:

  a. Information on consents/permissions required for creation of further charge on assets are adequately disclosed in offer document or Private Placement Memorandum (PPM)/Information Memorandum (IM).

  b. All disclosures made in the offer document or PPM/IM with respect to creation of security are in confirmation with the clauses of debenture trustee agreement.

  c. All covenants proposed to be included in debenture trust deed (including any side letter, accelerated payment clause, etc.) are disclosed in the offer document or PPM/IM.

  Effective date: The provisions would be effective from 1 January 2021 i.e. for new issues proposed to be listed on or after 1 January 2021.

- **Monitoring of security created/assets on which charge is created:** Debenture trustees(s) should incorporate the terms and conditions of periodical monitoring in the debenture trust deed. As per the terms, listed entity would be liable to provide relevant documents/information to enable the debenture trustee(s) to submit the following reports/certification to stock exchange(s) within the timelines mentioned below:

Reports/certificate	Periodicity
Asset cover certificate	Quarterly basis within 60 days from end of each quarter
A statement of value of pledged securities	
A statement of value for Debt Service Reserve Account or any other form of security offered	
Net worth certificate of guarantor (secured by way of personal guarantee)	Half-yearly basis within 60 days from end of each half-year
Financials/value of guarantor prepared on the basis of audited financial statements, etc. of the guarantor (secured by way of corporate guarantee)	Annual basis within 75 days from end of each financial year.
Valuation report and title search report for the immovable/movable assets, as applicable.	

Effective date: The provisions would be effective from quarter ended 31 December 2020 for listed debt securities.

(Source: SEBI circular no. SEBI/HO/MIRSD/CRADT/CIR/P/2020/218 dated 3 November 2020 and circular no. SEBI/HO/MIRSD/CRADT/CIR/P/2020/230 dated 12 November 2020)

SEBI issues uniform structure for non-compliance with provisions related to continuous disclosures by issuers with listed NCDS/NCRPS/CPs

SEBI through a circular dated 13 November 2020 has issued a uniform structure for imposing fines and taking appropriate actions by the stock exchange(s) in respect of non-compliance with continuous disclosure requirements (as laid down in LODR and related SEBI circulars) by issuers of listed Non-Convertible Debt Securities (NCDS)/Non-Convertible Redeemable Preference Shares (NCRPS)/ Commercial Papers (CPs). Those, *inter alia*, includes the following:

Particulars	Fine payable and/or other action to be taken for non-compliance by an entity with listed NCDS/NCRPS/CPs
Non-submission of the financial results within the specified timeline by an issuer with listed NCDS/NCRPS/CPs	INR5,000 per day
Non-disclosure of extent, nature of security created and maintained with respect to secured listed NCDS in the financial statements	INR1,000 per day
Non-disclosure of information/submission of certificate regarding payment obligations.	INR1,000 per day per ISIN[1]

The fines specified in the structure would continue to accrue till the time of rectification of the non-compliance and to the satisfaction of the concerned recognised stock exchange. Such accrual would be irrespective of any other disciplinary/enforcement action(s) initiated by recognised stock exchange(s)/ SEBI.

Effective date: The provisions of the circular would be effective for compliance period ending on or after 31 December 2020.

(Source: SEBI circular no. SEBI/HO/DDHS/DDHS/CIR/P/2020/231 dated 13 November 2020)

1. International Securities Identification Number.

SEBI issues guidelines for rights issue of units by an unlisted InvIT

Currently, Chapter VIA of the of SEBI (Infrastructure Investment Trusts) Regulations, 2014 (InvIT Regulations) provides the framework for private placement of units by InvITs which are not eligible to be listed.

With a view to enable unlisted InvITs to raise further funds, SEBI through a circular dated 4 November 2020 has introduced a mechanism for raising of funds by unlisted InvITs through rights issue of units and has also issued related guidelines.

Key requirements for the rights issue are as follows:

- **Conditions for issuance:** An InvIT is required to comply with following conditions for making a rights issue of its units:
  a. A resolution of the board of directors of the investment manager approving the rights issue of the units and determining the record date should be passed.
  b. The units proposed to be issued must be of the same class as those already issued by the InvIT.
  c. None of the promoters, partners, or directors of the sponsor(s) or investment manager or trustee of the InvIT is a fugitive economic offender.
  d. None of the respective promoters, partners, or directors of the sponsor(s) or investment manager or trustee of the InvIT is:
     i. Debarred from accessing the securities market by SEBI
     ii. A promoter, director or person in control of any other company or a sponsor, investment manager or trustee of any other InvIT which is debarred from accessing the capital market under any order or directions made by SEBI.
- **Timeline:** The rights issue should open within three months from the record date. The subscription period would be minimum three working days and maximum 15 working days.
- **Pricing of units:** The investment manager should decide the issue price before determining the record date. Also, the issue price should be disclosed in the letter of offer.
- **Filing of the letter of offer:** The letter of offer is required to be filed by the investment manager with SEBI at least five days prior to opening of the rights issue.
- **Allotment:** The minimum allotment to any investor should be INR1 crore.
- **Restriction on further capital issues:** The InvIT is restricted from making any further issue of units between the date of filing of letter of offer and the allotment of units offered pursuant to the rights issue.

(Source: SEBI circular no. SEBI/HO/DDHS/DDHS/CIR/P/2020/223 dated 4 November 2020)

SEBI issues consultation paper on the applicability and role of a risk management committee

Background

Currently, LODR requires top 500 listed companies[2] to mandatorily constitute a Risk Management Committee (RMC). The majority of members of RMC should consist of members of the board of directors and in case of a listed company with outstanding SR equity shares[3], at least two thirds of the RMC should comprise of independent directors.

Further, the board of directors of the listed company is required to define the role and responsibility of the RMC.

New development

In view of the increasing importance of the risk management function, SEBI through its consultation paper dated 10 November 2020 has proposed certain amendments to LODR relating to the applicability and role of the RMC. Those are as follows:

- **Applicability:** SEBI proposed to extend the requirement of constituting RMC to top 1,000 listed entities on the basis of market capitalisation as at the end of the immediate previous financial year.
- **Role and responsibilities of RMC:** As per the proposals, the role and responsibility of the RMC should, *inter alia*, include the following:
  a. To formulate a detailed risk management policy which should include a framework for identification of internal and external risks specifically faced by the listed company, in particular including financial, operational, sectoral, sustainability information and cyber security risks

2. Determined on the basis of market capitalisation as at the end of the immediate previous financial year.
3. Equity shares of an issuer having superior voting rights compared to all other equity shares issued by that issuer.

b. To review the risk management policy on an annual basis, including consideration of the changing industry dynamics and evolving complexity

c. To keep the board informed about the nature and content of its discussions, recommendations and actions to be taken.

Further, the RMC should also coordinate its activities with the audit committee in instances where there is any overlap with audit activities.

- **Meeting of RMC and quorum:** The meetings of the RMC have been proposed to be held at least twice in a year (currently required once in a year). Further, the quorum for a meeting of the RMC would be either two members or one-third of the members of the committee, whichever is greater, including at least one member of the board of directors in attendance.

The consultation paper is open for public comments up to 10 December 2020.

(Source: SEBI 'Consultation Paper on the applicability and role of the Risk Management Committee' issued on 10 November 2020)

Consultation paper proposes changes to delisting of equity shares regulations

Background

On 10 June 2009, SEBI had notified the SEBI (Delisting of Equity Shares) Regulations, 2009 (delisting regulations), which provides delisting requirements of equity shares of a company from recognised stock exchanges, where such shares are listed. The delisting regulations have been amended from time to time as per the requirements in the securities market.

New development

On 20 November 2020, SEBI issued a consultation paper proposing amendments to delisting regulations. The objective of the proposed amendments is to further streamline and strengthen the delisting regulations/process.

Key areas of proposed amendments are as follows:

- **Disclosure of promoter/acquirer's intention to voluntarily delist the company:** Currently, promoter's/acquirer's proposal to voluntarily delist a company is disclosed to the recognised stock exchanges by the company's board of directors. It is proposed that the promoter/acquirer should make a public announcement of their intention to voluntarily delist the company to all the stock exchanges on which the company is listed on the same day when their said intention is intimated to the company.
- **Timeline for board's approval:** Currently, there is no prescribed time period for conducting a board meeting to consider and approve the delisting proposal. The proposal recommends that the board meeting for considering the delisting proposal should be held within 21 days from receipt of the delisting proposal.
- **Submission of reports:** To bring in transparency in the delisting process, it is proposed that the board of directors, while communicating their approval for delisting to the stock exchanges, should also submit a merchant banker's due diligence report and the audit report to the stock exchange.
- **Justification of delisting proposal:** In addition to the requirement of certification by the board of directors that the delisting is in the interest of the shareholders, the proposed amendment requires reasoned recommendations of the committee of independent directors and their voting pattern on the proposal for delisting.
- **Shareholders' approval by special resolution:** It is proposed that the shareholders' approval through special resolution may be obtained through postal ballot or through e-voting, as per the provisions of the Companies Act 2013. (Currently, special resolution only through postal ballot is permitted).
- **Indicative price:** In order to present the promoter's/acquirer's inclination to pay a higher price, it is proposed to allow promoter(s)/acquirer(s) to specify an indicative price which should not be less than the floor price calculated in terms of Regulation 8 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. Currently, there is no guidance with regard to indicative price.
- **Reverse book building:** The proposed amendment requires the outcome of reverse book building in terms of its success or failure to be disclosed within two hours of the closure of the tendering period. Unconfirmed bids should not be displayed in the reverse book building window.
- **Rationalising timelines:** The consultation paper proposes to rationalise the timelines pertaining to the delisting process.
- **Role of merchant banker:** It is proposed that the due-diligence work pertaining to the delisting process should be performed by an independent and peer-reviewed practicing company secretary. The merchant banker would continue to be appointed as the manager to the offer. The roles and responsibilities of the manager to the offer have also been outlined in the consultation paper.

- **Revisiting public shareholder's definition:** It is proposed to modify the public shareholding definition in line with the Securities Contracts (Regulations) Rules, 1957.
- **Computing book value of shares:** For the purpose of computing book value of the equity shares, the consultation paper clarifies, the consolidated or standalone financial results (whichever is higher) may be considered. Further, the latest quarterly financial results filed by the company on the stock exchanges, as on the date of public announcement for counter-offer should be referred.
- **Cooling-off period:** It is proposed that the cooling off period for relisting post delisting prescribed under the delisting regulations may be reduced to three years from five years. Cooling off period for voluntary delisting is proposed as a period of six months from completion of the last buy back or preferential allotment. (Currently the time period has not been prescribed).

The consultation paper is open for comments up to 21 December 2020.

(Source: SEBI-"Consultation paper on review of SEBI (Delisting of Equity Shares) Regulations, 2009" dated 20 November 2020)

Consultation paper on requirement of minimum public offer for large issuers

On 20 November 2020, SEBI issued a consultation paper on requirements of minimum public offer for large issuers and proposed amendment to the Securities Contracts (Regulation) Rules, 1957 (SCRR) on the basis of the representations and feedback from market participants. SCRR prescribes threshold limit of the minimum offer and allotment to public in terms of an offer document.

Key highlights of the proposal:

- It is proposed to reduce the requirement of minimum offer to public for large issuers (i.e. issuers with post issue paid up capital calculated at offer price (post issue MCap) exceeding INR10,000 crore) to sum total of INR 1,000 crore and 5 per cent of post issue MCap exceeding INR 10,000 crore. (Currently, all issuers with post issue MCap of INR4,000 crore and above are required to have a minimum public offer of 10 per cent of post issue MCap.)
- As part of continuous listing requirement, issuers are required to achieve Minimum Public Shareholding (MPS) of at least 25 per cent within three years from date of listing. In the event large issuers and very large issuers (explained in table below) fail to comply with 10 per cent MPS at the time of listing, the amendment has proposed revised thresholds and timelines as under:

Post issue MCap (INR crore)	Existing provision	Proposed
Large issuers INR10,000 < MCap ≤ INR 1,00,000	MPS of 25 per cent to be achieved in three years from date of listing	MPS of 10 per cent to be achieved in 18 months and 25 per cent within three years from the date of listing
Very large issuers MCap > INR1,00,000	MPS of 25 per cent to be achieved in three years from date of listing	MPS of 10 per cent to be achieved in two years and 25 per cent within 5 years from the date of listing

The consultation paper is open for comments up to 7 December 2020.

(Source: SEBI-" Consultation Paper-Review of requirement of Minimum Public Offer for large issuers in terms of Securities Contracts (Regulation) Rules, 1957" dated 20 November 2020)

Consultation paper on revision of provisions relating to re-classification of promoter/promoter group entities

Currently, Regulation 31A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR regulations) permits reclassification of promoters of listed entities as public shareholders in different scenarios, subject to the specified conditions. The reclassification scenarios, *inter alia*, include the following:

- When a promoter is replaced by a new promoter
- Where a company ceases to have any promoters (i.e. becomes professionally managed).

SEBI has received feedback regarding cases where promoters have desired re-classification but have found it difficult under current regulatory regime.

Relaxation from existing requirement on a case to case basis was given by SEBI.

Accordingly, on 23 November 2020, SEBI issued a consultation paper and proposed revision to the existing provisions of Regulation 31A of the LODR Regulations.

Overview of the proposed norms

- **Modification in conditions pertaining to minimum threshold of voting rights:** The re-classification condition on share-holding, may be amended such that the promoter(s) seeking re-classification and persons related to the promoter(s) seeking re-classification should not together hold 15 per cent or more of the total voting rights in the listed entity. (Currently, the threshold is 10 per cent.)
- **Reduction in time period between board and shareholders meeting:** Current time gap of a minimum of three months between the date of board meeting and the shareholders' meeting for considering the request of the promoter(s) seeking re-classification is proposed to be reduced to a minimum of one month.
- **Reclassification pursuant to an order/direction of Government/regulator:** The current relaxations applicable to the companies whose resolution plans have been approved under section 31 of the Insolvency and Bankruptcy Code, 2016 would be extended to re-classification pursuant to an order/direction of the Government/regulator and/or as a consequence of operation of law subject to the condition that such promoter(s) seeking re-classification should not remain in control of the listed entity.
- **Reclassification of existing promoter pursuant to open offer:** Exemption from the procedure for re-classification would be granted in cases where re-classification is pursuant to an open offer made in accordance with the provisions of SEBI (Substantial Acquisition of Shares and Takeover) Regulations 2011 (SAST Regulations) subject to the prescribed conditions.
- **Timeline for request before board:** The listed entity would be required to place the reclassification request before its board within one month of receiving the reclassification request from its promoter(s)/promoter group entities. Currently, no definitive timeline has been prescribed.
- **Disclosure for 'nil' shareholding:** All entities falling under promoter and promoter group would need to be disclosed separately even in case of 'nil' shareholding.
- **Quarterly declaration:** The listed entities would have to obtain a declaration on a quarterly basis from their promoters on the entities/persons that form part of the 'promoter group'.

The consultation paper is open for comments up to 24 December 2020.

(Source: SEBI-" Consultative paper on re-classification of promoter/ promoter group entities and disclosure of the promoter group entities in the shareholding pattern" dated 23 November 2020)

SEBI invites comments on report on disclosures pertaining to analyst meets, investor meets and conference calls

With a view to deal with issues concerning sharing of information with select investors and strengthening the disclosure framework, Primary Markets Advisory Committee (PMAC) in its meeting held in July 2020 deliberated on the issue and decided to form a sub-group under the chairmanship of Mr. Keki Mistry.

The sub-group deliberated various aspects with respect to information imbalance amongst various classes of stakeholders, best practices in Indian securities market, regulatory regimes in various overseas jurisdictions and the way forward to bridge the gaps of aforesaid information irregularity.

On 20 November 2020, SEBI issued the report on disclosures pertaining to analyst meets, investor meets and conference calls for public comment, in order to obtain views of various stakeholders on the subject.

Summary of key recommendations of the sub-group:

- The audio/video recordings should be made available on the website of the listed entity immediately after the post-earnings conference call/quarterly call before the next trading day or within 24 hours from the occurrence of event. Written transcripts of such calls should be made available on the website within five working days after the earnings call.
- The audio/video recordings and the written transcripts should be available on the websites of the listed companies for a period of at least eight years.

- Listed companies would be permitted to decide as to whether conference calls are open to everyone to attend or limit such calls to their existing shareholders.
- Listed companies would be required to provide number of one-to-one meetings with select investors as part of corporate governance report submitted by them to stock exchanges on a quarterly basis along with affirmation that no UPSI[4] was shared by any official of the company in such meetings. Such record would be required to be maintained for period of eight years.

It is proposed that the aforementioned recommendations be made applicable in a phased manner. The requirements would initially be recommendatory for a period of one year and mandatory thereafter for all listed companies.

The report is open for comments up to 21 December 2020.

(Source: SEBI-" Report on disclosures pertaining to analyst meets, investor meets and conference calls" dated 20 November 2020)

RBI issued regulatory framework for HFCs

Background

The provisions of the National Housing Bank (NHB) Act, 1987 were amended with effect from 9 August 2019 pursuant to the Finance (No. 2) Act, 2019 and conferred certain powers for regulation of Housing Finance Companies (HFCs) with the Reserve Bank of India (RBI).

Consequently, RBI on 17 June 2020[5] issued a draft regulatory framework for HFCs for public comments.

New development

Basis the comments received, on 22 October 2020, RBI through a circular issued a revised regulatory framework applicable to all HFCs. HFCs will continue to comply with all extant instructions issued by NHB, which are not covered in the framework.

Some of the key features of the framework are as follows:

- **Definition of HFC:** HFC shall mean a company incorporated under the 2013 Act that fulfils following conditions:
  a. It is an NBFC whose financial assets, in the business of providing finance for housing, constitute at least 60 per cent of its total assets (netted off by intangible assets).
  b. Out of the total assets (netted off by intangible assets), not less than 50 per cent should be by way of housing financing for individuals.
- **Transition:** Registered HFCs which do not currently fulfil the above criteria but wish to continue as HFCs, will be provided with the following timeline for transition:

Timeline	Minimum percentage of total assets towards housing finance	Minimum percentage of total assets towards housing finance for individuals
31 March 2022	50 per cent	40 per cent
31 March 2023	55 per cent	45 per cent
31 March 2024	60 per cent	50 per cent

  HFCs which are unable to fulfil the above criteria as per the timeline would be treated as NBFC-Investment and Credit Companies (NBFC-ICC) and they would be required to approach RBI for conversion of their Certificate of Registration (CoR) from HFC to NBFC-ICC. Application for such conversion should be submitted with all supporting documents meant for new registration together with an auditor's certificate on principal business criteria and necessary board resolution approving the conversion.

- **Minimum NOF for HFCs:** RBI specified INR20 crore as the minimum Net Owned Fund (NOF) for a company to commence or carry on housing finance as its principal business. HFC which hold a CoR with NOF of less than INR20 crore, may continue to carry on the business of housing finance, if such a company achieves NOF of INR15 crore by 31 March 2022 and INR20 crore by 31 March 2023.

  HFCs whose NOF stands below INR20 crore would be required to submit a statutory auditor's certificate with RBI within a period of one month evidencing compliance with the prescribed levels as at the end of the period indicated above.

4. Unpublished Price Sensitive Information
5. Press release on proposed changes in regulations applicable to HFCs for public comments

Co-lending by banks and NBFCs to priority sector

Background

On 21 September 2018, RBI had introduced a Co-Origination Model between banks and Non-Banking Financial Companies-Non-Deposit taking-Systemically Important (NBFC-ND-SIs) for providing competitive credit to priority sector. As per the model, all scheduled commercial banks (excluding regional rural banks and small finance banks) may engage with NBFC-ND-SIs to co-originate loans for the creation of priority sector assets subject to prescribed guidelines.

New development

RBI through a circular dated 5 November 2020 has revised the Co-Origination Model and reintroduced it as 'Co-Lending Model' (CLM). The primary focus of the revised scheme is to improve the flow of credit to the unserved and underserved sector and make available funds to the ultimate beneficiary at an affordable cost, considering the lower cost of funds from banks and greater reach of the NBFCs.

Key features of the CLM are as follows:

- Under CLM, banks are permitted to co-lend with all registered NBFCs (including HFCs) based on a prior agreement. The co-lending banks would take their share of the individual loans on a back-to-back basis in their books. However, NBFCs would be required to retain a minimum of 20 per cent share of the individual loans on their books.
- The banks can claim priority sector status in respect of their share of credit while engaging in the CLM adhering to the specified conditions.
- The banks and NBFCs would be required to formulate board approved policies for entering into the CLM and place the approved policies on their websites.
- The NBFC would be the single point of interface for the customers. It would enter into a loan agreement with the borrower, which should clearly contain the features of the arrangement and the roles and responsibilities of the NBFC and banks.
- The loans under CLM would be included in the scope of internal/statutory audit within the banks and NBFCs to ensure adherence to their respective internal guidelines, terms of the agreement and extant regulatory requirements.
- The CLM will not be applicable to foreign banks (including wholly-owned subsidiaries) with less than 20 branches. Further, banks will not be allowed to enter into co-lending arrangement with an NBFC belonging to the promoter group.
- The CLM scheme supersedes Co-Origination Model. However, outstanding loans under Co-Origination Model would continue to be classified under priority sector till their repayment or maturity whichever is earlier.

(Source: RBI circular no. RBI/2020-21/63 dated 5 November 2020)

Extension of due date of submitting IT returns and audit reports

The Ministry of Finance through a press release dated 24 October 2020 has extended the due dates for submission of Income-Tax (IT) returns and audit reports under the IT Act, 1961 (IT Act) as follows:

a. The due date for furnishing IT returns for the taxpayers (including their partners) who are required to get their accounts audited has been extended up to 31 January 2021 (due date as per IT Act is 31 October 2020).

b. The due date for furnishing IT returns for the taxpayers who are required to furnish report in respect of international/specified domestic transactions has been extended up to 31 January 2021 (due date as per IT Act is 30 November 2020).

c. The due date for furnishing IT returns for other taxpayers (for whom the due date as per the IT Act is 31 July 2020) has been extended up to 31 December 2020.

d. The date for furnishing tax audit reports under the IT Act including tax audit report and report in respect of international/specified domestic transaction has also been extended to 31 December 2020.

(Source: Ministry of Finance press release dated 24 October 2020)

ICAI publications

Guidance Notes

On 4 November 2020, the Institute of Chartered Accountants of India (ICAI) has issued guidance notes on the following topics:

- **Applicability of AS 25 and measurement of income tax expense for interim financial reporting (revised 2020):** The guidance note deals with the following issues:

  a. Whether AS 25 is applicable to interim financial results presented by an enterprise pursuant to the requirements of a statute/regulator, for example, quarterly financial results presented under LODR entered into between stock exchanges and the listed enterprises and

  b. The measurement of income tax expense for the purpose of inclusion in the interim financial reports.

  Pursuant to the issue of revised guidance note, 'guidance note on applicability of AS 25 to interim financial results' issued in 2008 and 'guidance note on measurement of income tax expense for interim financial reporting in the context of AS 25' issued in 2006 have been withdrawn.

  (Source: Guidance note on applicability of AS 25 and measurement of income tax expense for interim financial reporting (revised 2020) issued by ICAI on 4 November 2020)

- **Accounting for share based payments (revised 2020):** The guidance note deals with the share-based payment transactions with employees as well as non-employees with a focus on group-wide share-based payment transactions (e.g., grants by the parent company to employees of a subsidiary company). The guidance note is applicable to companies following AS under Companies (Accounting Standards) Rules, 2006, as amended under Section 133 of the 2013 Act.

  It would be applicable to share-based payment plans the grant date in respect of which falls on or after 1 April 2021. An enterprise is not required to apply the guidance note to share-based payment to equity instruments that are not fully vested as at 1 April 2021.

  Pursuant to the issue of the guidance note, 'guidance note on accounting for employee share-based payments' issued in 2005 stands withdrawn.

  (Source: Guidance Note on accounting for share-based payments (revised 2020) issued by ICAI on 4 November 2020)

Tax audit checklist

In October 2020, the ICAI has issued a checklist on 'Approach to Tax Audit under Section 44AB of the IT Act'. The checklist is broadly based on the text of the guidance note on tax audit under Section 44AB of the IT Act, implementation guide and technical guide on Income Computation and Disclosure Standards (ICDS) issued by ICAI. It also includes certain commonly found errors/non -compliances observed by the Taxation Audits Quality Review Board of ICAI while conducting review of tax audit reports.

(Source: Approach to tax audit under Section 44AB of the IT Act (checklist) issued by ICAI in October 2020)

Exposure draft on AS 21

On 3 November 2020, ICAI has issued an Exposure Draft (ED) of AS 21, *The Effects of Changes in Foreign Exchange Differences* which is formulated on the basis of AS 11, The Effects of Changes in Foreign Exchange Rates. The ED also includes major differences between draft AS 21, Ind AS 21, *The Effects of Changes in Foreign Exchange Rates* and AS 11.

Comments on the ED have been invited up to 3 December 2020.

(Source: Exposure draft on AS 21 issued by ICAI on 3 November 2020)

KPMG in India's IFRS institute

Visit KPMG in India's IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

First Notes

SEBI streamlines the framework for schemes of arrangement for listed companies

19 November 2020

Background

Companies with listed specified securities (i.e. equity shares and convertible securities) are required to comply with the provisions of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) and the Companies Act, 2013 (2013 Act) while undertaking any scheme of arrangement including amalgamation, merger, reconstruction and reduction of capital.

Further, SEBI through its circular dated 10 March 2017 has laid down detailed requirements to be complied with by listed companies while undertaking schemes of arrangements.

Recent development

On 3 November 2020, SEBI has made certain amendments to the regulatory framework for schemes of arrangements by listed companies (laid down in its circular dated 10 March 2017). The amendments relate to the following areas:

- Documents to be submitted by the listed company to the stock exchanges before the scheme is submitted to the National Company Law Tribunal (NCLT)
- Obligations of the stock exchange(s) and processing of the draft scheme by SEBI
- Conditions for companies seeking relaxation under Rule 19(7) of the Securities Contracts (Regulation) Rules, 1957.

In this issue of First Notes, we provide an overview of these amendments.

Voices on Reporting (VOR) – Special session

On 10 November 2020, KPMG in India held a special session of Voices on Reporting webinar on the technology sector and discussed some of the significant accounting issues arising due to recent developments in taxation matters, with the help of practical examples and case studies.

To access the presentation and recording, please click here.

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