KPMG

Accounting and Auditing Update

Issue no. 40/2019

November 2019

home.kpmg/in

Editorial

While preparing separate financial statements, a parent is required to determine whether an instrument held by it in a subsidiary, forms part of the 'investment in a subsidiary' and should be accounted for under Ind AS 27, *Separate Financial Statements* or it is a separate financial instrument within the scope of Ind AS 109, *Financial Instruments*. Assessment of application of standards when an entity holds instruments issued by a subsidiary requires significant judgement as the term 'investment in a subsidiary' is not defined in Ind AS 27. Accordingly, in January 2019, the IFRS Interpretations Committee (IFRIC) issued two agenda decisions and considered accounting of investment in a subsidiary in a given scenario. In this edition of Accounting and Auditing Update (AAU), our article covers the outcome of these IFRIC decisions.

The shift in the benchmark interest rates with alternative nearly risk-free interest rates is expected to have a cascading effect beyond contract terms into the operations and financial reporting of many entities. To address some of the pre-replacement issues, in September 2019, the International Accounting Standards Board (IASB) has issued amendments to certain IFRS.

The amendments would apply from annual reporting period beginning on or after 1 January 2020. Our article on the topic provides an overview of these amendments.

The revised International Standard on Auditing (ISA) 540, *Auditing Accounting Estimates and Related Disclosures* is applicable from accounting periods beginning on or after 15 December 2019. In November 2019, the International Auditing and Assurance Standards Board (IAASB) has issued an Audit Client Briefing to make chief financial officers, other senior management responsible for financial statement preparation and staff directly involved in determining accounting estimates aware of matters to consider in preparing for the auditor's requests pertaining to the revised ISA 540. Our article summarises the key aspects of the IAASB's Audit Client Briefing.

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.

Sai Venkateshwaran
Partner and Head
CFO Advisory
KPMG in India

Ruchi Rastogi
Partner
Assurance
KPMG in India

Table of contents

1

Accounting for investments in a subsidiary in separate financial statements

This article aims to:
Highlight two IFRIC agenda decisions in relation to separate financial statements.

Introduction

Indian Accounting Standard (Ind AS) 27, *Separate Financial Statements*[1] prescribes the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. Ind AS 27 defines separate financial statements as those presented by a parent (i.e. an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with Ind AS 109, *Financial Instruments*. A parent may hold various instruments issued by its subsidiary. If this is the case, then in preparing its separate financial statements, the parent needs to determine whether each instrument:

- Forms part of the 'investment in a subsidiary' and accounted for under Ind AS 27 or
- Is a separate financial instrument that falls in the scope of Ind AS 109.

The assessment of which standard to apply may be straightforward in some cases such as trade receivables or loans receivables from a subsidiary clearly fall under the scope of Ind AS 109. However, in other cases, such as preference shares, the assessment may require judgement because the term 'investment in a subsidiary' is not defined in Ind AS 27.

When an entity holds an initial financial asset accounted for under Ind AS 109 and subsequently obtains control of the investee by acquiring an additional interest, a question arises about how to determine the cost of the investment in the subsidiary. In January 2019, the IFRS Interpretations Committee (IFRIC) published two agenda decisions under International Accounting Standard (IAS) 27, *Separate Financial Statements* as below:

- Investments in a subsidiary accounted for at cost: Step acquisition
- Investments in a subsidiary accounted for at cost: Partial disposal.

The article discusses the outcome of these IFRIC decisions.

Investment in a subsidiary accounted for at cost: Step acquisition

Background

An entity preparing separate financial statements elects to account for its investments in subsidiaries at cost (as per IAS 27). The entity holds an initial investment in another entity (investee). The investment is an investment in an equity instrument (as per IAS 32, *Financial Instruments: Presentation)*. The investee is not an associate, joint venture or subsidiary of the entity and, accordingly, the entity applies International Financial Reporting Standard (IFRS) 9, *Financial Instruments* in accounting for its initial investment (initial interest).

The entity subsequently acquires an additional interest in the investee (additional interest), which results in the entity obtaining control of the investee i.e. the investee becomes a subsidiary of the entity.

An issue arose as to how the entity determines the cost of its investment in the subsidiary i.e. as the sum of:

- **Fair value as deemed cost:** The fair value of the initial interest at the date of obtaining control of the subsidiary, plus any consideration paid for the additional interest, or
- **Accumulated cost approach:** The consideration paid for the initial interest (original consideration), plus any consideration paid for the additional interest (accumulated cost approach).

Further, when an entity applies the accumulated cost approach it would need to account for the difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration. However, it is not clear how would an entity account for such a difference.

Determination of cost of investment

IAS 27 does not define 'cost', nor does it specify how an entity determines the cost of an investment acquired in stages. 'Cost' is defined in other standards such as IAS 16, *Property, Plant and Equipment,* IAS 38, *Intangible Assets* and IAS 40, *Investment Property.* The IFRIC noted that an entity may apply one of the following approaches, on a consistent basis to step acquisition transactions, to determine the cost of its investment in the subsidiary:

- **Fair value approach:** Under this approach, an entity determines the cost of its investment in the subsidiary as the sum of the fair value of the initial interest at the date of obtaining control plus any consideration paid for the additional interest making an analogy to IFRS 3, *Business Combinations*. Any fair value gains or losses recognised in Other Comprehensive Income (OCI) may be transferred to retained earnings or remain in OCI.

1. Ind AS 27 is converged with IAS 27, *Separate Financial Statements.*

- **Accumulated cost approach:** Under this approach, an entity determines the cost of its investment in the subsidiary as the sum of the consideration paid for the initial interest plus any consideration paid for the additional interest. Any difference between the fair value of the initial interest on the date of obtaining control and the consideration paid on the initial investment is recognised in profit or loss regardless of whether, before obtaining control, the entity had presented subsequent changes in fair value of the initial interest in profit or loss or OCI.

An entity may apply either of the above approaches on a consistent basis, when it holds an initial financial asset in an investee accounted for under IFRS 9 and subsequently obtains significant influence or joint control.

Disclosure requirements

Applying guidance in IAS 1, *Presentation of Financial Statements*, an entity should also make appropriate disclosures which would assist users of financial statements in understanding how step acquisition transactions are reflected in reporting financial performance and financial position.

Investment in a subsidiary accounted for at cost: Partial disposal

In a similar fact pattern, an entity prepares separate financial statements and elects to account for its investments in subsidiaries at cost as per IAS 27. The entity holds an initial investment in a subsidiary (investee). The investment is an investment in an equity instrument as per IAS 32. The entity subsequently disposes off a part of its investment and loses control on the investee. After the disposal, the entity has neither joint control of, nor significant influence over the investee.

Accounting issue

An accounting issue arose whether the investment retained (retained interest) is eligible for the presentation election as per IFRS 9 which permits the holder of particular investments in equity instruments to present subsequent changes in fair value in OCI.

Further, an entity would need to present the difference between the cost of the retained interest and its fair value on the date of losing control of the investee. However, it is not clear whether such difference should be presented in the profit or loss or OCI.

Accounting guidance

IAS 27 requires an entity preparing separate financial statements to apply all applicable IFRS except when accounting for investments in subsidiaries, associates, and joint ventures for which IAS 27 provides specific guidance.

In the given case, after the partial disposal transaction, the entity has neither joint control of or significant influence over the investee. IFRIC noted that the entity is eligible to apply IFRS 9 for the first time in accounting for retained interest in investee. The presentation election under IFRS 9 applies at the initial recognition of an investment in an equity instrument. An investment in an equity instrument within the scope of IFRS 9 is eligible for the election if it is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies.

Conclusion

In the given case, it was concluded that the retained interest is eligible for the presentation election of IFRS 9 and the entity should make this election when it first applies IFRS 9 to the retained interest (i.e. at the date of losing control of the investee). Any difference between the cost of the retained interest and its fair value is recognised in profit or loss regardless of the presentation election under IFRS 9 for subsequent changes in fair value.

Points to consider

IFRIC agenda decisions are viewed as additional guidance that provide new and persuasive information on the application of IFRS.

Since Ind AS 27 is converged with IAS 27, entities should analyse the impact of these agenda decisions and implement the resulting changes in a timely manner.

Entities should account for the resulting changes as a change in accounting policy in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Entities should consider appropriate disclosures as per Ind AS 8 if the accounting policy change resulting from an agenda decision has not been applied in financial statements issued after the publication of an agenda decision.

Interest rate reforms: Issue of first-phase IFRS amendments

This article aims to:
Provide an overview of the amendments (first-phase) made to IFRS pursuant to benchmark interest rate reforms.

Introduction

The shift in the benchmark interest rates (such as Inter-Bank Offer Rates (IBORs) with 'alternative nearly risk-free interest rates' (alternate interest rates) is expected to have a cascading effect beyond contract terms into the operations and financial reporting of many entities. The change in the benchmark reference rate is also expected to trigger accounting impacts including effects on hedge accounting, debt modification and discount rates for impairment testing, lease accounting and fair valuation.

Accordingly, in December 2018, the International Accounting Standards Board (IASB) added a project to consider the effects of the IBOR reform on financial reporting. There were two groups of issues that were identified that would have significant financial reporting implications:

Pre-replacement issues

Issues affecting financial reporting in the period before replacement of IBOR with an alternate interest rate

Replacement issues

Financial reporting issues arising once the IBOR had been replaced with an alternate interest rate

The IASB considered these issues as part of two different projects. As part of first-phase, it considered the pre-replacement issues and the possible impact on hedge accounting requirements. It evaluated how these issues would create uncertainties[1] regarding the amount and timing of future cash flows of the hedged items and hedging instruments. These uncertainties could result in discontinuation of hedge accounting for hedging relationships that would otherwise qualify for hedge accounting or prevent entities from designating new hedging relationships.

On 26 September 2019, the IASB issued amendments to IFRS 9, *Financial Instruments*, IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 7, *Financial Instruments: Disclosures.*

The amendments modify some specific hedge accounting requirements to provide relief from potential effects of the uncertainty caused by the IBOR reform. Additionally, the amendments require entities to provide additional information to investors about their hedging relationships which are directly affected by these uncertainties.

Overview of the amendments

The amendments can be categorised in the following areas:

- 'Highly probable' requirement for cash flow hedges
- Prospective assessments of hedge effectiveness
- Eligibility of certain risk components and
- Disclosures (for hedging relationships directly affected by IBOR reform).

In this article, we will discuss the amendments in the above areas.

'Highly probable' requirement for cash flow hedges

Existing hedging relationship

For a forecast transaction to qualify as an eligible hedged item in a cash flow hedge, it must be 'highly probable' (highly probable requirement). The requirement is intended to ensure that the changes in the fair value of designated hedging instruments are recognised in the cash flow hedge reserve/Other Comprehensive Income (OCI) only for those hedged forecast transactions that are highly probable to occur. The requirement provides a clear basis to account for the effects of the reform i.e., if the effects of the reform are such that the hedged cash flows are no longer highly probable, hedge accounting should be discontinued. However, as per IASB, discontinuing all affected hedging relationships solely due to such uncertainty would not provide useful information to users of financial statements.

Accordingly, the amendment to IFRS 9 and IAS 39 provide an exception to the highly probable requirement. As per the amendment, if the hedged future cash flows are based on an interest rate benchmark that is subject to the reform, an entity should assume that the interest rate benchmark on which the hedged cash flows are based is not altered when assessing whether the future cash flows are highly probable. For instance, for a future issuance of a London Interbank Offered Rate (LIBOR)-referenced debt instrument, an entity would assume that the LIBOR benchmark rate on which the hedged cash flows are based will not be altered as a result of the reform.

1. Uncertainties would be created with regard to decisions of what will be the alternate interest rate, and when will the existing IBOR be replaced.

Discontinued hedging relationship

The amendments also included an exception for discontinued hedging relationships. As per the amendment:

- When a hedging relationship is discontinued, any amount remaining in the cash flow hedge reserve/ OCI would be reclassified to the statement of profit and loss in the same period(s) during which the hedged cash flows affect profit or loss, based on the assumption that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the reform.
- Where the hedged future cash flows are no longer expected to occur, any amount remaining in the cash flow hedge reserve/OCI should be reclassified immediately to the statement of profit and loss.

The above exception would not exempt entities from reclassification of the amount that is not expected to be recovered into the statement of profit and loss such as loss on hedging instrument.

Prospective assessments of hedge effectiveness

A hedging relationship qualifies for hedge accounting only if there is an economic relationship between the hedged item and the hedging instrument. Demonstrating the existence of an economic relationship requires the estimation of future cash flows because the assessment is prospective in nature. Due to IBOR reforms, at some point of time, it is expected that entities would not be able to demonstrate the existence of an economic relationship/effectiveness of a hedge, resulting in prospective discontinuation of hedge accounting.

The amendments to IFRS 9 and IAS 39 provide an exception for the assessment of economic relationship/ effectiveness of a hedge. As per the amendment, an entity should perform a prospective assessment assuming that the hedged risk/interest rate benchmark on which the hedged item and hedging instrument are based is not altered as a result of the reform. The exception would also be applicable to a highly probable forecast transaction designated as the hedged item.

The exception addresses only the uncertainties arising from the reform. Therefore, if an entity is unable to demonstrate existence of an economic relationship between the hedged item and the hedging instrument for other reasons, it should discontinue hedge accounting as required under IFRS 9 and IAS 39.

Eligibility of certain risk components

An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship.

To be eligible for designation as a hedged item, a risk component[2] needs to be separately identifiable and reliably measurable. An entity's ability to conclude that an interest rate benchmark identifiable component requires a continuous assessment over the duration of the hedging relationship and could be affected by the IBOR reform. Discontinuing hedge accounting solely because the risk component is no longer separately identifiable will not provide useful information.

Therefore, the amendments to IFRS 9 and IAS 39 require entities to apply separately identifiable requirement for hedges of the benchmark component of interest rate risk only at the inception of those hedging relationships affected by the reform.

A similar exception is also provided for redesignation of hedged items in hedges where dedesignation and redesignation take place frequently, e.g. macro hedges. The hedged item that has been assessed at the time of its initial designation in the hedging relationship (whether at the time of hedge inception or subsequently) would not be reassessed at any subsequent redesignation in the same hedging relationship.

Effective date

The amendments are applicable from annual reporting periods beginning on or after 1 January 2020. Early application is permitted subject to disclosure of the fact.

The exceptions should be applied to all hedging relationships that are affected by the uncertainties arising from IBOR reform and should continue to be applied until the earlier of:

- When the uncertainty regarding the timing and the amount of interest rate benchmark based cash flows is no longer present and
- The discontinuation of the hedging relationship (or reclassification of all amounts from the cash flow hedge reserve).

The assessment of uncertainty should be performed on an item-by-item basis for hedges involving groups of items.

The exceptions to hedge accounting can be applied retrospectively. Retrospective application will apply only to those hedging relationships that existed at the beginning of the reporting period in which an entity first applies those requirements or were designated thereafter. It will be applied only to the amount accumulated in the cash flow hedge reserve/gain or loss recognised in OCI that existed at the beginning of the reporting period in which an entity first applies those requirements.

2. Risk component includes the changes in the cash flows or fair value of an item attributable to a specific risk or risks.

Disclosures (for hedging relationships directly affected by IBOR reform)

In order to provide users of financial statements with information about how an entity's hedging relationships are affected by the uncertainty arising from the IBOR reform, amendments to IFRS 7 require entities to disclose the following:

- The significant interest rate benchmarks to which hedging relationships are exposed
- The extent of risk exposure that is affected by IBOR reform
- How the transition to alternative benchmark interest rates is being managed
- A description of significant assumptions or judgements made in applying the amendments and
- The nominal amount of the hedging instruments in those hedging relationships.

Further, paragraph 28(f) of IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* which requires an entity to disclose (on the initial application of an IFRS or amendments to an IFRS) for the current period and each prior period presented, the amount of any adjustment for each financial statement line item affected, will not be applicable in the reporting period in which an entity first applies the amendments to IFRS 9 and IAS 39.

Conclusion

The first-phase amendments aim to provide targeted relief for financial instruments qualifying for hedge accounting in the lead up to IBOR reform. It is to be noted that the exceptions envisaged through amendments are intended to address only the uncertainties arising from the IBOR reform. Accordingly, if a hedging relationship fails any of the other criteria, then the entity must discontinue hedge accounting as required by IFRS 9 or IAS 39. Entities should provide adequate disclosures to depict the impact of the reforms.

Given the large volume of transactions and contracts that are based on LIBOR in India, similar amendments are expected in Indian Accounting Standard (Ind AS) 109, *Financial Instruments.* Entities should start assessing the impact of the changes and accordingly, should develop systems and processes to cater to the possible challenges.

The IASB has started its deliberations on second-phase issues commencing October 2019. The second phase of its project focuses on financial reporting issues that may arise when IBOR are either reformed or replaced. Entities should watch out for development in the area.

3

ISA 540 (revised) – considerations for management

This article aims to:
Summarise considerations that management of an entity should take into account when determining accounting estimates and related disclosures.

The International Auditing and Assurance Standards Board (IAASB) has issued revised International Standard on Auditing (ISA) 540, *Auditing Accounting Estimates* and *Related Disclosures* in October 2018. This ISA would apply to all accounting estimates in financial statements for periods beginning on or after 15 December 2019. The ISA was revised in response to the IAASB's outreach activities and which highlighted to them that auditing estimates is a key area where enhanced standards were needed to derive improved audit performance[1] .

Developments in the business environment and introduction of new accounting standards have given rise to greater use of accounting estimates. This is particularly in the case due to recent changes in accounting for expected credit losses, revised standards dealing with insurance contracts, revenue recognition and leases. These management estimates could be complex and involve judgements, accordingly, they need to be reported appropriately and be robustly challenged.

Therefore, the revised ISA responds to changes in financial reporting standards and a more complex business environment which together have increased the importance of accounting estimates to the users of the financial statements and introduced new challenges for preparers and auditors.

Recently, in November 2019 IAASB issued an Audit Client Briefing – *Considerations for Management When Determining Accounting Estimates and Related Disclosures.* This briefing aims to make entities aware of matters to consider in preparing for and responding to the significant revisions in, and the auditor's requests pertaining to ISA 540 (Revised).

In this article, we aim to summarise the key aspects of the IAASB's Audit Client Briefing.

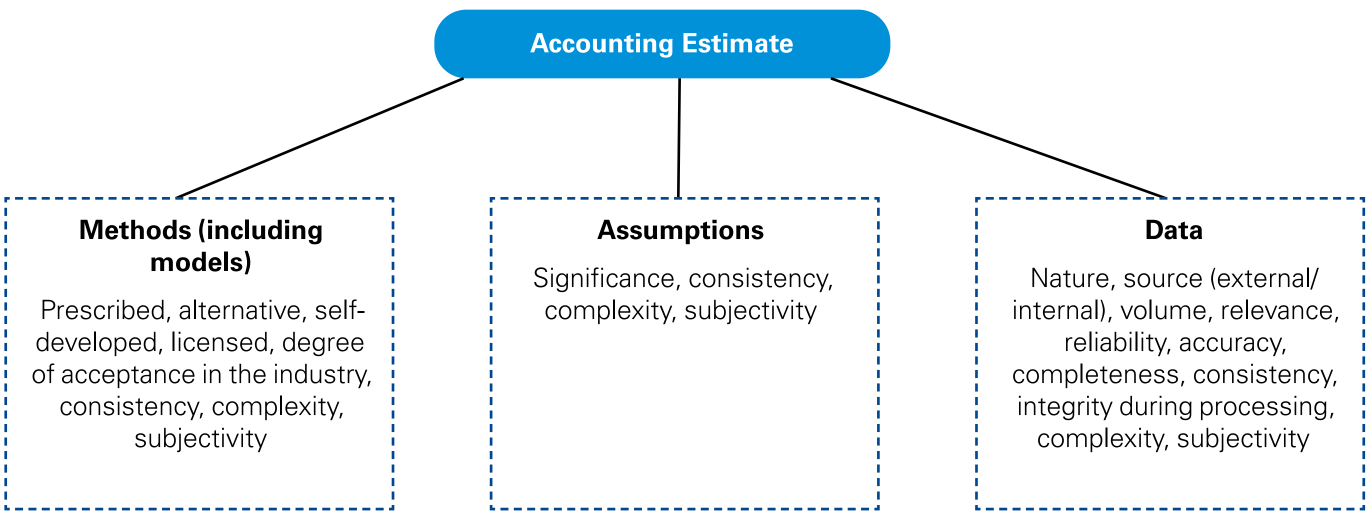
Accounting estimates

Accounting estimates are monetary amounts that are a fundamental part of the financial statements of many entities. The determination of whether accounting estimates are needed necessitates proper processes and controls to identify the transactions, conditions or events that give rise to such estimates. The types of accounting estimates an entity needs to make in accordance with the requirements of the applicable financial reporting framework, depend, for example, on the nature of the entity, the environment in which it operates, the transactions entered into and the occurrence of other events, conditions and circumstances. Once the need for an accounting estimate is recognised, the measurement of these monetary amounts is subject to estimation uncertainty because of inherent limitations in knowledge or data. As a result, there may be a wide range of measurement outcomes. Hence, these factors may make accounting estimates susceptible to material misstatement.

The more complex the estimate, the more the auditor will expect an entity to have a robust process in place. Hence, there are three main components of the process for determining accounting estimates and related disclosures:

- Methods (including models)
- Assumptions
- Data.

Figure 1 below showcases the inputs to accountingestimates along with their number of characteristics.



Source: IAASB's Audit Client Briefing – *Considerations for Management Determining Accounting Estimates and Related Disclosures*, November 2019

1. Refer to Accounting and Auditing Update, October 2018 for the article that summarises ISA 540 (Revised).

Key changes in ISA 540 (Revised) and its impact on an entity's management

The key changes and their impact are as follows:

Key changes	Impact on management
More emphasis on the need for the auditor to exercise professional skepticism	The auditor may increasingly challenge aspects of how an entity derives accounting estimates.
More granular assessments regarding risk accounting estimates are materially misstated	The auditor may place more emphasis on obtaining an understanding of the nature and extent of an entity's estimation process and key aspects of the related policies and procedures.
Focus on appropriately responding to the levels of estimation uncertainty, complexity and subjectivity in accounting estimates	If the auditor determines the risk of an entity's accounting estimate being materially misstated as high, then the work effort will increase, which in turn will likely impact how much, and the type of, information an entity would need to provide the auditor.
Audit work effort based on the selected approach(es) (testing management's process, developing own estimate, subsequent events), including a more detailed understanding of the significant matters considered in making key judgements and decisions affecting accounting estimates	An entity may receive more focussed requests from the auditor on each these matters. An entity may wish to consider retaining experts to assist with the related work. It may also consider documenting key judgements and d ecisions in anticipation of auditor requests. Such documentation is likely to provide basis for more efficient and effective discussions between an entity and its auditor.
More emphasis on auditing accounting estimate disclosures in the financial statements	If the auditor determines the risk of material misstatement is higher for certain disclosures, then the work effort will increase, which in turn will impact how much, and the type of, information an entity will need to provide the auditor.
More detailed written representations	An entity may receive requests for new or changed representations compared to previous years. Therefore, an entity may wish to ask the auditor to let them know as soon as practicable the details of the written representations they will request from them.

Source: IAASB's Audit Client Briefing – *Considerations for Management Determining Accounting Estimates and Related Disclosures*, November 2019

Broad questions auditors are likely to ask about an entity's estimation process

An auditor is likely to ask to obtain or confirm understanding of, and whether there have been changes to, key aspects of an entity's process for deriving accounting estimates.

HOW DO YOU ?

- Control your accounting estimation process?
- Make those responsible for deriving or changing your accounting estimates aware of relevant significant transactions, conditions or events?
- Review the outcome(s) of previous accounting estimates and respond to the results of that review?
- Identify and comply with the relevant requirements in the applicable financial reporting framework regarding your accounting estimates and related disclosures including how they are affected by complexity and your judgement?
- Account for regulatory factors relevant to the entity's accounting estimates, including, when applicable, regulatory frameworks related to prudential supervision?
- Identify the need for, and apply, specialised skills or knowledge related to accounting estimates, including with respect to the use of a management's expert?
- Identify and address risks related to accounting estimates through your risk assessment process?
- Identify relevant methods (including models). Assumptions and data and the need for changes in them and from those identified, select those to apply?
- Address the degree of estimation uncertainty in selecting your final point estimates?
- Describe in your financial statements matters related to your process for deriving your accounting estimates, and matters related to the degrees of estimation uncertainty underlying your accounting estimates?
- Ensure there is an oversight and governance in place over management's financial reporting process relevant to accounting estimates?

Source: IAASB's Audit Client Briefing – *Considerations for Management Determining Accounting Estimates and Related Disclosures,* November 2019

Way forward

The standard drives auditors to perform appropriate procedures in relation to accounting estimates and related disclosures. As the timeline for implementation of revised ISA 540 is approaching, it is important for entities to take note of the robust requirements and detailed guidance of the standard to foster audit quality.

4

Regulatory updates

MCA issues report of the Company Law Committee

Background

On 18 September 2019, the Ministry of Corporate Affairs (MCA) constituted the Company Law Committee (the committee) to provide recommendations on various provisions and issues pertaining to implementation of the Companies Act, 2013 (2013 Act).

New development

On 18 November 2019, MCA issued the report of the committee. The committee proposed recategorisation of certain 'criminal compoundable offences' to 'civil wrongs' carrying civil liabilities and other changes to facilitate and promote ease of doing business.

Key recommendations of the committee are as follows:

- **Financial statements and board's report (Section 134):** Currently, if a company contravenes with the provisions relating to preparation of financial statements and board's report, then there are certain consequences. These consequences are as folllows:

  a. The company would be punishable with a minimum fine of INR50,000 which may extend to INR25 lakh.

  b. Every officer who is in default would be punishable with an imprisonment for a term which may extend to three years or with a fine which would not be less than INR50,000 but which may extend to INR5 lakh, or with both.

  Recommendation

  The committee recommended that contravention of the requirements relating to financial statements and board's report should attract a fixed penalty of INR1 lakh for a company and INR25,000 for every officer in default.

- **Corporate Social Responsibility (CSR) (Section 135):** Currently, Section 135 of the 2013 Act requires every company with a net worth of INR500 crore or more, turnover of INR1,000 crore or more or a net profit of INR5 crore or more during the immediately preceding Financial Year (FY) to constitute a CSR committee. The CSR committee should consist of three or more directors, out of which at least one director should be an independent director.

  Recommendation

  The committee recommended insertion of a suitable provision in Section 135 which would enable Central Government (CG) to enhance the thresholds which trigger applicability of CSR provisions.

- **Debarment of an audit firm (Section 140):** Currently, if an auditor (individual or firm) whether directly or indirectly, acted in a fraudulent manner, abetted, or colluded in any fraud by, or in relation to, the company, its directors, or officers, and if such act has been established in the final order by National Company Law Tribunal (NCLT), then the auditor by virtue of the order of the NCLT is ineligible for appointment as an auditor of any company for a period of five years from the date of such order.

  Recommendation

  The committee recommended that debarment of an audit firm may be an exception rather than a rule. It should only take place in cases where the firm refuses to co-operate in the proceedings in question or if the higher management of the firm is involved in the fraud. Otherwise, debarment even in the case of an audit firm may be restricted to only those individuals/partners associated with the firm who were actually involved in the fraud.

- **Remuneration of non-executive directors in case of inadequate profits (Section 197 and 198):** The committee recommended that the non-executive directors (including independent directors) should be appropriately compensated even in case of inadequacy of profits or losses as is permissible for executive directors.

- **Revised definition of a 'listed company' (Section 2):** Under the 2013 Act, a listed company is defined to mean a company which has any of its securities[1] listed on any recognised stock exchange.

  Recommendation

  The committee recommended that the definition of a listed company should be amended to exclude certain classes of companies, listing such class of securities, as may be prescribed by the CG in consultation with the Securities and Exchange Board of India (SEBI).

Comments on the recommendations were invited up to 25 November 2019.

(Source: Report of the Company Law Committee dated 14 November 2019)

The Companies (Meetings of Board and its Powers) Second Amendment Rules, 2019

Currently, Section 188 of the 2013 Act requires that the transactions with related parties that are not in the ordinary course of business and which are not at an arm's length would require consent of the BoD of the company. Additionally, Rule 15(3) of the Companies (Meetings of Board and its Powers) Rules, 2014 (Board meeting Rules) prescribes certain transactions (with specified thresholds) which would require prior shareholders' approval by an ordinary resolution.

On 18 November 2019, MCA amended Rule 15(3) of the Board meeting Rules and specified revised thresholds for transactions with related parties which would require shareholders' approval by an ordinary resolution.

1. *Securities* includes shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or any other body corporate.

The table below provides summary of the revised thresholds:

Prescribed transaction categories	Amount beyond which shareholders' approval is required	
	Existing	Revised
Sale, purchase, or supply of any goods or materials (directly or through an agent)	10 per cent or more of the turnover or INR100 crore, whichever is lower*	10 per cent or more of the turnover*
Selling or otherwise disposing of, or buying, property of any kind (directly or through an agent)	10 per cent or more of the net worth or INR100 crore, whichever is lower*	10 per cent or more of the turnover*
Leasing of property of any kind	10 per cent or more of the net worth or 10 per cent or more of the turnover or INR100 crore, whichever is lower*	10 per cent or more of the turnover*
Availing or rendering of any services (directly or through an agent)	10 per cent or more of the turnover or INR50 crore, whichever is lower*	10 per cent or more of the turnover*
Appointment to any office or place of profit in the company, subsidiary company or associate company	Remuneration exceeding INR2.5 lakh per month	No change
Underwriting the subscription of any securities or derivatives of the company	Remuneration exceeding one per cent of net worth	No change

(Source: KPMG in India's analysis basis provisions of the 2013 Act and the MCA notification dated 18 November 2019)

(*Applies to transaction or transactions to be entered into either individually or taken together with the previous transactions during a FY.)

The amendments are effective from 18 November 2019.

(Source: MCA notification dated 18 November 2019)

Disclosure of defaults in payment of interest/repayment of principal amount on loans from banks/ financial institutions and unlisted debt securities by listed entities

SEBI through its circular dated 21 November 2019 requires all listed entities which have listed equity and convertible securities, Non-Convertible Debentures (NCDs) and Non-Convertible Redeemable Preference Shares (NCRPS) to provide a disclosure to the stock exchange in case of default[2] in payment of interest/ instalment obligations on loans (including revolving facilities like cash credit) from banks/financial institutions and unlisted debt securities in the following manner:

- *In case of default on loans (including revolving facilities like cash credit) beyond 30 days:* Disclose the fact to the stock exchange immediately but not later than 24 hours from the 30th day of such default.
- *In case of default on unlisted debt securities i.e. NCDs and NCRPS:* Disclose the fact to the stock exchange immediately but not later than 24 hours from the occurrence of the default.

The circular provides the formats in which the said disclosures are to be provided.

Additionally, if on the last date of each quarter, any loan (including revolving facilities like cash credit) from banks/ financial institutions is outstanding for more than 30 days or there is any outstanding debt security under default, then the listed entity is required to provide specified details of such default (in the prescribed format) within seven days from the end of each quarter.

The provisions of the circular are applicable from 1 January 2020.

(Source: SEBI circular no. SEBI/HO/CFD/CMD1/CIR/P/2019/140 dated 21 November 2019)

2. Default mean non-payment of the interest or principal amount in full on the date when the debt has become due and payable ('pre-agreed payment date'). For revolving facilities like cash credit, an entity would be in 'default' if the outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for more than 30 days.

SEBI board meeting

SEBI in its board meeting dated 20 November 2019, *inter alia*, took the following decisions:

- **Review of rights issue process:** SEBI approved the following proposals relating to rights issue:

  a. The timeline for completion of the rights issue has been reduced from T+55 days to T+31 days.

  b. Introduction of dematerialisation and trading of rights entitlement on stock exchange platform.

  c. Shareholders holding shares in physical form are required to provide details of demat account for credit of rights entitlement.

  d. Applications Supported by Blocked Amount (ASBA) facility has been made mandatory for all investors applying to rights issue.

- **Extension of business responsibility reporting requirement:** Currently, top 500 listed companies (based on market capitalisation) are mandatorily required to include a Business Responsibility Report[3] (BRR) as part of their annual reports.

  Now SEBI has extended the applicability of BRR to top 1,000 listed entities.

(Source: SEBI press release no.24/2019 dated 20 November 2019)

FAQs on SEBI (Prohibition of Insider Trading) Regulations, 2015

On 4 November 2019, SEBI issued Frequently Asked Questions (FAQs) to clarify certain aspects relating to the provisions of the SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations).

The clarifications are as follows:

- **Information to be maintained in a structured digital database:** Currently, Regulation 3(5) of the PIT Regulations require board of directors of a listed company to maintain a structured digital database. Such a database would contain the names of persons/ entities who receive Unpublished Price Sensitive Information (UPSI) (designated persons) (along with Permanent Account Number (PAN) or any other identifier, in case PAN is not available).

  The FAQ clarifies that in case the designated person is a fiduciary or intermediary, the data base of the listed entity should contain the names of the fiduciary or intermediary with whom they have shared information along with the PAN or other identifier, in case PAN is not available. Further, the fiduciary or intermediary will be required to maintain details of persons with access to UPSI as specified in Schedule C to the PIT Regulations.

- **Resignation of a designated person:** In case of resignation of a designated person, the listed company/intermediary/fiduciary would be required to maintain the updated address and contact details of such designated person for one year after resignation. Such data should be preserved by the company/ intermediary/fiduciary for a period of five years.

- **Pre-clearance for sale of shares under employee stock options:** The PIT Regulations requires use of a notional trading window to monitor trading by the designated persons. The trading window should be closed when the compliance officer determines that a designated person can reasonably be expected to have possession of UPSI. Designated persons and their immediate relatives should not trade in securities when the trading window is closed. However, trading window restriction is not applicable to certain specified transactions subject to pre-clearance by the compliance officer, for instance, transaction undertaken pursuant to the exercise of stock options.

  The FAQ further clarified that the sale of shares by designated employees obtained after exercise of stock options would not require any pre-clearance from the compliance officer.

- **Trading in depository receipts by designated persons:** It has been clarified that trading in American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) of listed companies is covered under PIT Regulations. Accordingly, employees of listed companies including foreign nationals (designated persons) are required to follow the code of conduct for trading in ADRs and GDRs.

(Source: FAQs on SEBI (PIT) Regulations, 2015 dated 4 November 2019)

Disclosure of divergence in the asset classification and provisioning by banks

Background

SEBI through its circular (no. CIR/CFD/CMD1/79/2019) dated 17 July 2019 required all banks with listed specified securities to disclose divergences in the asset classification and provisioning to the stock exchange(s), if either or both of the following conditions are satisfied:

a. The additional provisioning for Non-Performing Assets (NPAs) assessed by the Reserve Bank of India (RBI) exceeds 10 per cent of the reported profit before provisions and contingencies for the reference period and

b. The additional gross NPAs identified by RBI exceed 15 per cent of the published incremental gross NPAs for the reference period.

3. BRR should cover the initiatives taken by the listed companies from an environmental, social and governance perspective.

The disclosures are required to be made in the 'notes to accounts' to the annual financial results filed with the stock exchange(s).

New development

On 31 October 2019, SEBI through its circular required banks with listed specified securities to provide above disclosures to the stock exchange(s) within a reasonable time (not exceeding 24 hours) from the receipt of the 'final risk assessment report' of the RBI. Therefore, banks should not wait to publish them as part of their annual financial statements. The circular also prescribes the format in which disclosures are to be made.

The provisions of the circular are effective from 31 October 2019.

(Source: SEBI circular no. CIR/CFD/CMD1/120/2019 dated 31 October 2019)

Extension of the due date of GST annual return and reconciliation statement

Background

On 26 August 2019, the Central Board of Indirect Taxes and Customs (CBIC) through its press release, extended the due date for filing annual return in the FORM GSTR-9 and reconciliation statement in the FORM GSTR-9C for the FY 2017-18 up to 30 November 2019.

New development

The CBIC through its press release dated 14 November 2019 further extended the due dates for furnishing above returns/reconciliation statement for FY2017-18 by one month i.e. till 31 December 2019. The due dates for FY2019-20 has been extended by three months i.e. up to 31 March 2020.

(Source: CBIC- press release dated 14 November 2019)

Liquidity risk management framework for NBFCs

On 4 November 2019, RBI through a notification issued revised guidelines on liquidity risk management framework for NBFCs with an objective to strengthen and raise the standard of the Asset Liability Management (ALM) framework applicable to NBFCs.

The key features of the revised guidelines are as follows:

- **Introduction of Liquidity Coverage Ratio (LCR):** All non-deposit taking NBFCs with asset size of INR5,000 crore and above and all deposit taking NBFCs irrespective of their asset size are required to maintain an adequate level of unencumbered High Quality Liquid Assets (HQLA) that can be converted into cash to meet their liquidity needs for a 30 calendar-day time horizon under a significantly severe liquidity stress scenario. This requirement is not applicable to core investment companies, Type-1 NBFC-NDs, non-operating financial holding companies and stand-alone primary dealers.

  The LCR requirement would be binding on all non-deposit taking systemically important NBFCs with asset size of INR10,000 crore and above from 1 December 2020 with the minimum HQLAs to be held being 50 per cent of the LCR. The LCR percentage should progressively reach the required level of 100 per cent by 1 December 2024.

  All non-deposit taking NBFCs with asset size of INR5,000 crore and above but less than INR10,000 crore would also be required to maintain a minimum of 30 per cent of the LCR from 1 December 2020. The LCR percentage should progressively reach the required level of 100 per cent by 1 December 2024.

- **Granular maturity buckets and tolerance limits:** The 1-30 day time bucket in the statement of structural liquidity has been segregated into granular buckets of 1-7 days, 8-14 days and 15-30 days. The net cumulative negative mismatches in maturity buckets of 1-7 days and 8-14 days should not exceed 10 per cent of cumulative cash outflows and in case of maturity bucket of 15-30 days, it should not exceed 20 per cent of cumulative cash outflows. The requirements are also applicable to the interest rate sensitivity statement required to be submitted by NBFCs.

- **Liquidity risk monitoring tools:** NBFCs are required to adopt liquidity risk monitoring tools/metrics to capture strains in liquidity position which should cover the following:

  a. Concentration of funding by counterparty/instrument/currency

  b. Availability of unencumbered assets that can be used as collateral for raising funds and

  c. Certain early warning market-based indicators, such as, book-to-equity ratio, breaches and regulatory penalties for breaches in regulatory liquidity requirements.

(Source: RBI notification no. 2019-20/88 dated 4 November 2019)


KPMG
KPMG josh IT SHOWS
A LEADING AUTOMAKER NEEDED A DEALER CAPABILITY IMPROVEMENT PROGRAMME. THE SOLUTION SAW CUSTOMER SATISFACTION GROW PHENOMENALLY ACROSS 70 PLUS OUTLETS. A TURBO BOOST POWERED BY #KPMGJOSH
THIS ADVERTISEMENT FEATURES KPMG INDIA EMPLOYEES

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 mandates prompt disclosure by banks on NPA divergence

25 November 2019

Background

As per RBI circular (RBI/2018-19/157) dated 1 April 2019, banks are mandated to disclose divergences in their annual financial statements, if either or both of the following conditions are satisfied:

a. The additional provisioning for Non-Performing Assets (NPAs) assessed by RBI exceeds 10 per cent of the reported profit before provisions and contingencies for the reference period, and

b. The additional gross NPAs identified by RBI exceed 15 per cent of the published incremental gross NPAs for the reference period.

New development

SEBI through its circular (CIR/CFD/CMD1/120/2019) dated 31 October 2019 tightened the disclosure norms for banks after consultation with RBI. As per the circular now banks should provide the disclosure in case of NPA divergence and provisioning beyond specified threshold (as explained in the background sections), as soon as reasonably possible and not later than 24 hours upon receipt of the RBI's risk assessment report. They should not wait to publish these disclosures as part of their annual financial statements.

The SEBI circular comes into force with an immediate effect.

This issue of First Notes provides an overview of the SEBI circular..

Voices on Reporting

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

On 7 November 2019, KPMG in India organised a VOR webinar to discuss certain accounting and financial reporting impact areas of recent tax amendments and few challenges with regard to Ind AS 115, *Revenue from Contracts* with Customers with focus on technology sector.

#KPMG josh

Previous editions are available to download from:
home.kpmg/in

Feedback/queries can be sent to
aaupdate@kpmg.com

Follow us on:
home.kpmg/in/socialmedia

Introducing

'Ask a question'

write to us at
aaupdate@kpmg.com