

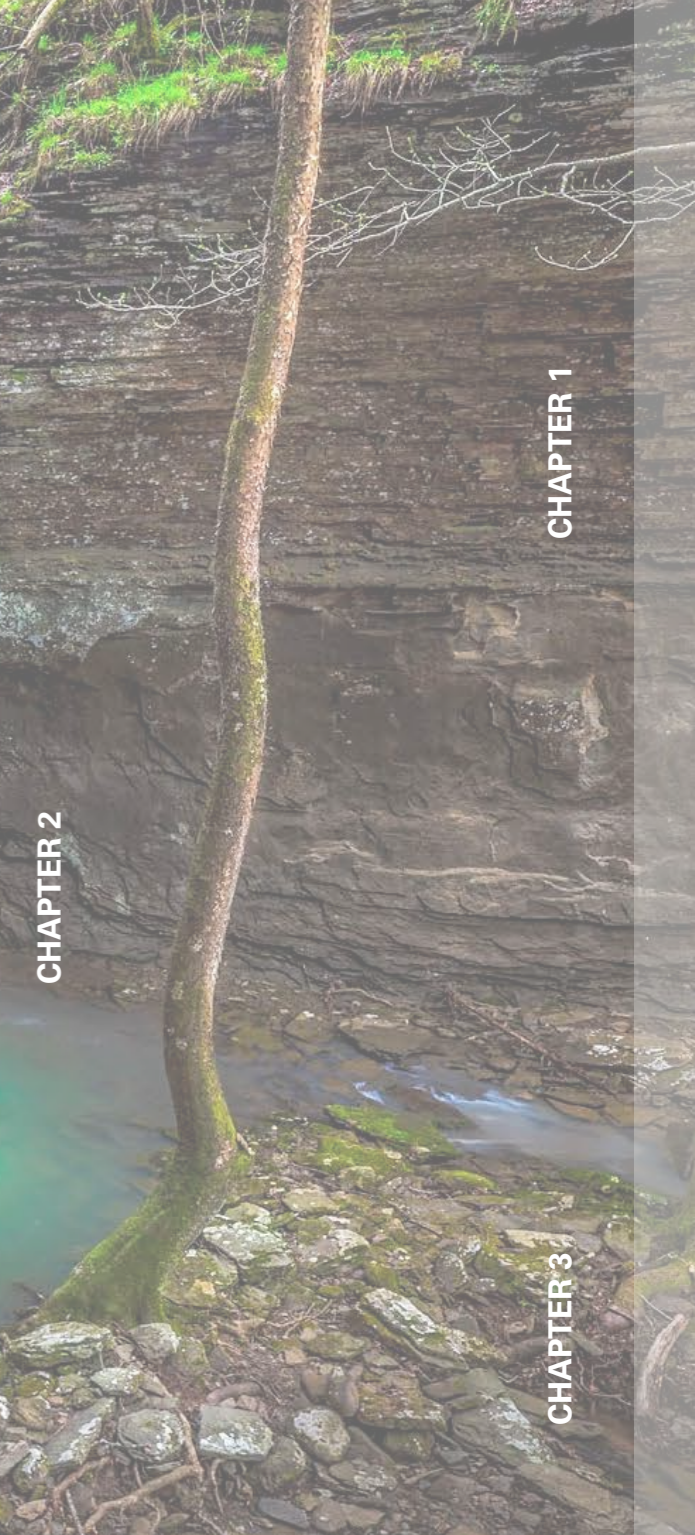


# Accounting and Auditing Update

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# Foreword

An interim financial report is a complete or condensed set of financial statements for a period shorter than a financial year. Ind AS 34, *Interim Financial Reporting*, does not specify which entities must publish an interim financial report. Ind AS 34 is applicable if an entity, using Ind AS in its annual financial statements, publishes an interim financial report that asserts compliance with Ind AS. The standard prescribes the minimum content of an interim financial report and prescribes the principles for recognition and measurement in complete or condensed financial statements for an interim period. The minimum content is a set of condensed financial statements for the current period and comparative prior period information, i.e. statement of balance sheet, statement of profit and loss, statement of cash flows, statement of changes in equity, and selected explanatory notes.

The same accounting policies are applied in the interim report as in the most recent annual financial statements, and specified disclosures are required in case of change in an accounting policy. Assets and liabilities are recognised and measured for interim reporting on the basis of information available on a year-to-date basis. While measurements in both annual financial statements and interim financial reports are often based on reasonable estimates, however, preparation of interim financial reports may require relatively a greater use of estimation methods in comparison with annual reporting. With an aim to

provide guidance on key principles under Ind AS 34, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) has formulated an educational material, in July 2022, on Ind AS 34 which provides guidance by way of Frequently Asked Questions (FAQs). In this edition of Accounting and Auditing Update (AAU), we discuss the key principles and guidance provided by ICAI in the education material.

The Companies Act, 2013 (2013 Act) requires auditors of the specified class of companies to include a statement in their reports on specific matters as prescribed in the Companies (Auditors' Report) Order (CARO). In 2020, the Ministry of Corporate Affairs (MCA) revised CARO (CARO 2020) which is applicable to a wide range of companies for the financial years commencing on or after 1 April 2021. Consequently, ICAI issued a guidance note on CARO 2020 (guidance note) which provides guidance on application of the CARO 2020. The MCA also amended the Schedule III to the 2013 Act to incorporate amendments relating to presentation and disclosures in the financial statements which are also applicable from 1 April 2021. With an aim to update the guidance on CARO 2020, ICAI issued a revised the Guidance note on CARO 2020 (Revised Edition 2022). The amendments incorporate the disclosure requirements of the Schedule III amended by the MCA and include other regulatory updates. Our article on the topic aims to provide an overview of the changes made

in the Revised Guidance note on CARO 2020.

There have been various regulatory developments in India and internationally during this month. Recently, MCA mandated availability of books of accounts and maintenance of backups of such accounts on a server physically located in India and on a daily basis. Further, the Securities and Exchange Board of India (SEBI) has issued amendments to certain regulations to incorporate provisions relating to creation of Social Stock Exchange (SSE) and the Sustainability Reporting Standards Board (SRSB) of the ICAI has released an exposure draft on the Compendium of Social Audit Standards (SAS). Our regulatory updates *articles* cover these and other important regulatory developments in India and internationally.

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



**Sai Venkateshwaran**  
Partner - Assurance  
KPMG in India



**Ruchi Rastogi**  
Partner - Assurance  
KPMG in India



CHAPTER 1

# Interim financial reporting

**This article aims to:**

Summarise the guidance provided in the education material issued by the Institute of Chartered Accountants of India (ICAI) on Ind AS 34, *Interim Financial Reporting*

Ind AS 34, *Interim Financial Reporting*, prescribes the minimum content of an interim financial report and prescribes the principles for recognition and measurement in complete or condensed financial statements for an interim period.

The Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) has formulated an educational material on Ind AS 34, which seeks to provide guidance by way of Frequently Asked Questions (FAQs) to explain the principles enunciated in the standard. The educational material provides guidance to stakeholders on the content of an interim financial report, application of the recognition and measurement principles to an interim financial report and various other aspects related to such report.

The subsequent section discusses some of the key issues highlighted in the FAQs.

### **Applicability and disclosure of compliance with Ind AS**

Ind AS 34 does not mandate which entity is required to publish interim financial reports. This standard is applicable if an entity either voluntarily elects or is required to publish an interim financial report in accordance with the Indian Accounting Standards (Ind AS). Accordingly, if an entity's interim financial report states that it complies

with the Ind AS, then all the requirements of Ind AS 34 must be complied with in its interim financial statements.

If an entity's interim financial report is in compliance with this standard, that fact shall be disclosed. An interim financial report shall not be considered to comply with Ind AS unless it complies with all of the requirements of this Ind AS. Therefore, an entity shall comply with accounting, recognition, measurement and disclosure requirements as specified under Ind AS 34 while preparing interim financial statements.

### **Complete or condensed set of financial statements**

The standard prescribes minimum components for preparation of interim financial report both, for complete set of financial statements and for a set of condensed financial statements. An entity can elect to prepare a complete set of financial statements (as described in Ind AS 1, *Presentation of Financial Statements*) in its interim financial report or condensed interim financial statements. The standard lays down a single recognition and measurement principle that applies to both, 'complete set' and 'condensed set' of the interim financial statements.

The minimum components to be disclosed in a condensed interim financial statements are as follows:

- i. a condensed balance sheet
- ii. a condensed statement of profit and loss
- iii. a condensed statement of changes in equity
- iv. a condensed statement of cash flows and
- v. selected explanatory notes.

The objective of permitting an entity to present a condensed set of financial statement, is to provide an update on the latest complete set of annual financial statements. Accordingly, it shall focus on new activities, events and circumstances and shall not duplicate information that has been reported previously.

The condensed financial statements shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this standard. Additional line items or notes shall be included if their omission would make the condensed interim financial statements misleading. Thus, for instance, it would be inappropriate to present a three-line condensed statement of cash flows showing only a total of operating, investing and financing cash flow activities as information about

cash flows helps users to understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about the financial performance. Therefore, an entity shall present all the information that is relevant in understanding an entity's ability to generate cash flows and the entity's needs to utilise those cash flows in its condensed financial statements.

The goal is to ensure that an interim financial report includes all information that is considered to be relevant in understanding an entity's financial position and performance during the interim period.



## Materiality

While determining the recognition, measurement, classification, or disclosure of an item for interim financial reporting purposes, materiality shall be assessed in relation to the interim period financial data. In making assessments of materiality, it is pertinent to note that, the interim measurements may rely on estimates to a greater extent than measurements of the annual financial data.

While arriving at the materiality judgements on its interim financial report, an entity shall consider the following factors:

- a. The entity should assess whether the information in the interim financial report is material in relation to the interim period financial data and not annual data.
- b. The entity shall apply the materiality factors on the basis of both the current interim period data and also, whenever there is more than one interim period (e.g. in the case of quarterly reporting), the data for the current financial year-to-date.
- c. The entity may consider whether to provide in the interim financial report information that is expected to be material to the annual financial statements. However, information that is expected to be material to the annual financial statements need not be provided in the interim financial report if it is not material to the interim financial report.

## Significant events and transactions and other disclosures

The interim report should be prepared in a manner that it contains all the information, explanation of events and transactions that are relevant to understand the changes in financial position and performance of the entity during the interim period. As the users of an entity's interim financial report will have access to the most recent annual financial report of that entity, it is unnecessary to present in the notes to an interim financial report relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report. Paragraph 15B of Ind AS 34 provides an illustrative list of events and transactions for which disclosures would be required if they are significant.

Furthermore, paragraph 16A of Ind AS 34 provides a list of information which needs to be included in the interim financial report.

## Accounting policies

An entity shall apply the same accounting policies in its interim financial statements as those applied in its annual financial statements.

The frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results. Therefore, measurements for interim reporting purposes shall be made on a year-to-date basis.

As per Ind AS 34, a change in an accounting policy, other than one for which the transition is specified by a new Ind AS, should be reflected by:

- a. Restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of any prior financial years that will be restated in the annual financial statements in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Error*; or
- b. When it is impracticable to determine the cumulative effect at the beginning of the financial year of applying a new accounting policy to all prior periods, adjusting the financial statements of prior interim periods of the current financial year, and comparable interim periods of prior financial years to apply the new accounting policy prospectively from the earliest date practicable.

Presentation in case of change in the accounting policy:

### a. Complete interim financial statements:

Where the entity has opted to provide a complete set of interim financial statements (as described in Ind AS 1), such an entity shall present a third balance sheet i.e. balance sheet at the beginning of the comparative period when it applies a change in accounting policy retrospectively in accordance with paragraph 40A-40D of Ind AS 1.

**b. Condensed interim financial statements:** As per the minimum components of a condensed financial statements, an entity is not required to include a third balance sheet when it applies an accounting policy retrospectively. Therefore, an entity may voluntarily elect to present a third balance sheet. Where a third balance sheet has not been presented and the change in accounting policy has to be applied retrospectively, the same shall be adjusted in the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

## Estimates

The use of estimates is inherent in the financial reporting process be it annual or interim financial reports. However, the preparation of interim financial reports may require relatively a greater use of estimation methods in comparison with annual reporting. The measurement procedures to be followed in an interim financial report shall be designed to ensure that the resulting information is reliable and that all material financial information that is relevant to an understanding of the financial position or performance of the entity is appropriately disclosed.

### Disclosure in annual financial statements

If an estimate has changed significantly during the final interim period of the year and the same has not been reported as separate interim financial report since it is not published for that final interim period, the entity is required to disclose the following in the notes in the annual financial statements for that year:

- a. nature of estimate and
- b. amount of change in estimate made in an interim period

### Recognition of assets and liabilities and their related inflows and outflows

The tests of future economic benefits that applies for recognition of an asset at the end of a financial year shall also be applied for interim financial reporting. A cost that does not meet the definition of an asset at the end of an interim period shall not be deferred in the balance sheet with the hope that the conditions will be met in future by the year-end. Similarly, a liability at the end of an interim reporting period must represent an existing obligation as at that date, in the same manner as it is recognised at the end of an annual reporting period. If the inflows or outflows with respect to revenue and expense, have already taken place, then the related revenue and expense are recognised in the balance sheet, otherwise they are not recognised. Thus, a mere intention or necessity to incur expenditure related

to an event which is to take place in future is not sufficient to give rise to an obligation which meets the recognition criteria.

For example, an employer's contributions to government-sponsored insurance funds are assessed on an annual basis. During Q1 and Q2 larger amounts of payments for this contribution were made, while during the Q3 minor payments were made (since contribution is made up to a certain maximum level of earnings per employee and hence, for higher income employees, the maximum income reaches before year end). Therefore, the employer should work out an average effective contribution rate and account for the same accordingly in its interim financials.

### Reversal of impairment loss of goodwill

As stated in the above mentioned sections, as per Ind AS 34, an entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements.

As per Ind AS 36, *Impairment of Assets*, an entity is required to assess goodwill for impairment at the end of each reporting period, and, if required, to recognise an impairment loss at that date. Further, paragraph 124 of Ind AS 36 states an impairment loss recognised for goodwill shall not be reversed in a subsequent period.

Therefore, basis the above guidance stated by Ind

AS 34 and Ind AS 36, an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill. With regard to reversal of impairment of intangible assets (other than goodwill), the impairment loss can be reversed if other requirements of Ind AS 36 are met.

### Recognition of income tax expense

As stated in the aforementioned sections, an entity shall apply the same accounting recognition and measurement principles in its interim financial statements as are applied in its annual financial statements. As per Ind AS 34, income tax expense (income tax expense is the aggregate amount of current tax and deferred tax) shall be recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes. Therefore, in case of any change in tax rates enacted or substantively enacted in an interim period, amounts accrued for income tax expense in one interim period should be adjusted in a subsequent interim period of that financial year.



The estimated average annual effective income tax rate is required to be re-estimated on a year-to-date basis at the end of each interim reporting period. In arriving at the interim period income tax expense, jurisdiction-wise Profit Before Tax (PBT), income categories taxed at different rates need to be considered. Thus, to the extent practicable, a separate estimated average annual effective income tax rate shall be determined for each tax jurisdiction and shall be applied individually to the interim period pre-tax income of each jurisdiction. Further, if different tax rates apply to different categories of income viz. capital gain, income from profits and gains from business or profession etc. then to the extent practicable, a separate rate shall be applied to each individual category of pre-tax income.

The education material discusses various scenarios with the help of case studies under the topic of income tax to explain above mentioned principles. Some of the situation discussed are:

1. Estimating tax rate that applies to the annual estimated income
2. Change in enacted tax rate during the financial year
3. Estimating tax expense in case of profit in the first quarter but loss in the subsequent quarters
4. Calculation of estimated average annual effective income tax rate in case of differential tax slab rates
5. Carry forward of Unused (unabsorbed) tax losses
6. Different tax rates for different categories of the estimated annual accounting income
7. Impact of depreciation on income tax expense.

## Conclusion

The education material on Ind AS 34 issued by ICAI covers number of practical scenarios. However, companies while preparing interim financial reports should consider both Ind AS 34 and education material to understand the impact of the guidance under Ind AS.





CHAPTER 2

# ICAI issued revised guidance note on CARO 2020

**This article aims to:**

Provide an overview of the revised guidance provided by ICAI in the guidance note on CARO (Revised 2022).

## Introduction

The Companies Act, 2013 (2013 Act) requires auditors of the specified class of companies to include a statement in their reports on specific matters as prescribed in the Companies (Auditors' Report) Order (CARO). In 2020, the Ministry of Corporate Affairs (MCA) revised CARO (CARO 2020) which is applicable to a wide range of companies for the financial years commencing on or after 1 April 2021. Consequently, the Institute of Chartered Accountants of India (ICAI) has issued a guidance note on CARO 2020 (guidance note) which provides guidance on application of the CARO 2020.

Further, to align the auditor's reporting requirements with the disclosures provided by the companies, on 24 March 2021, the MCA has issued a slew of amendments to the Schedule III to the 2013 Act<sup>1</sup>. The amendments are effective from 1 April 2021.

The ICAI on 1 July 2022 issued a revised the Guidance note on CARO 2020 (Revised Edition 2022). The amendments incorporate the disclosure requirements of the Schedule III amended by MCA on 24 March 2021 and include other regulatory updates.

1. Schedule III to the 2013 Act provides general instructions for presentation of financial statements of a company under both AS and Ind AS.

## Overview of the revised guidance

The following section discusses some of the key guidance under revised guidance note.

**Applicability:** CARO 2020 is applicable to all companies except certain class of private companies.

CARO 2020 provides applicability provisions for certain private companies including Non-Banking Financial Companies (NBFCs). The applicability provisions contain threshold limits relating to paid-up capital and reserves and surplus of a company.

The amended Schedule III to the 2013 Act categorises reserves and surplus under following categories:

- Capital reserve
- Securities premium
- Other reserves (specify nature)
- Retained earnings.

Considering the amendments under the Schedule III, the revised guidance note changed the definition of reserves and surplus for applicability of CARO to NBFCs (following Division III of the Schedule III).

Additionally, one of the applicability criteria of CARO 2020 is to consider the total income. The revised guidance provides that total income should be considered instead of total revenue

while determining the applicability of CARO 2020. Accordingly, total income would include revenue from operations and other income as per the Schedule III.

### Clause 3(i)(a): Details of tangible and intangible assets – Maintenance of records

CARO 2020 requires an auditor to report whether a company is maintaining proper records and those records show full particulars, including quantitative details and situation of the property, plant and equipment.

The MCA through its notification dated 24 March 2021 had introduced a concept of audit trails by inserting proviso to Rule 3(1) of the Companies (Accounts) Rules, 2014. The amended rule provides that for the financial year commencing on or after the 1 April 2023, every company which uses an accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.

The revised guidance note has now included the reference of this requirement for the auditor to consider for reporting under the clause.

### Clause 3(i)(c): Details of tangible and intangible assets - Title deeds not held in name of the company

The guidance note provides that in case a company under the lease agreement obtains Right of Use (ROU) assets which are covered under Ind AS 116, *Leases* then the same should also be considered by the auditor for reporting under the clause relating to tangible and intangible assets.

Additionally, guidance note now includes a reference of the Schedule III disclosure relating to details of title deeds of immovable properties. In this case while reporting on this clause, an auditor is required to review the disclosure provided as per the Schedule III for tangible and intangible assets.

### Clause 3(ii)(b): Physical inventory verification and working capital sanction - Sanctioned working capital limits exceeding INR5 crore

This clause in CARO 2020 requires an auditor to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of INR5 crore, in aggregate, from banks or financial institutions on the basis of security of current assets. However, disclosure requirements under the Schedule III to the 2013 Act are not limited to working capital limits but cover all borrowings. Further, a monetary threshold has not been prescribed under the Schedule III to the 2013 Act.

The guidance note now clarifies that an auditor should review the Schedule III disclosures as well before making a comment under this clause.

#### **Clause 3(iii)(c): Schedule of repayment of principal and interests for loans granted**

CARO 2020 requires an auditor to report, in respect of loans and advances in the nature of loans, upon the stipulation of schedule of repayment of principal and payment of interest and on regularity of their repayments i.e., the principal and interest should normally be paid whenever they fall due.

The guidance note provided a format for an auditor to report under this clause. The revised guidance note has modified the reporting format and added an additional column for actual date of payment. Now the revised reporting format is as below:

Name of the Entity	Amount	Due date	<b>Date of payment</b>	Extent of delay	Remarks, if any
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*(Emphasis added to highlight the change)*

#### **Clause 3(iii)(e): Renewal of loans/fresh loans to settle overdues of existing loans**

CARO 2020 requires an auditor to report in respect of a loan or an advance in the nature of a loan granted which has fallen due during the year and has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties i.e., identification of instances of 'evergreening'<sup>2</sup> of loans/advances in the nature of loans.

The guidance note provides a format for an auditor to report under this clause. The revised guidance note has modified this format and added an additional column for gross amount of loans/advances in nature of loan granted during the year to those parties where the overdue amount was settled by renewal or extension or fresh loan. The revised format is as below:

Name of the parties	Aggregate amount of loans or advances in the nature of loans granted during the year	<b>Aggregate overdue amount settled by renewal or extension or by fresh loans granted to same parties</b>	Percentage of the aggregate to the total loans or advances in the nature of loans granted during the year
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*(Emphasis added to highlight the change)*

2. The term 'evergreening' is not defined in the 2013 Act. However, in general parlance it implies an attempt to mask loan default by giving new loans to help delinquent borrowers to repay/adjust principal or pay interest on old loans.

This amendment requires an auditor to report party-wise information of the loans renewed during the year. Also, the party-wise percentage is to be provided for loans renewed during the year. Earlier the requirement was to compute a percentage of loans renewed against the total loans and advances granted during the year.

#### **Clause 3(iii)(f): Loans granted to promoters and related parties**

CARO 2020 requires disclosure of gross amount of loans or advances in the nature of loans which are either repayable on demand or do not specify any terms or period of repayment. If a company has granted such loans, then specific disclosures would need to be provided for an aggregate amount of loans granted to promoters and related parties as defined under relevant provisions of the 2013 Act.

The amended Schedule III requires specific disclosure in case of loans and advances given to promoters, directors, Key Managerial Personnel (KMP) and other related parties. The revised guidance note now provides that an auditor should review such disclosures before making comment under this clause. However, it should be noted that the Schedule III disclosures include loans and advances given to promoters, directors, KMP and other related parties, whereas in CARO 2020 includes loans and advances given to all related parties and parties other than related parties.

#### **Clause 3(iv): Compliance with requirements of Section 185 and 186 of the 2013 Act**

CARO 2020 requires an auditor to report whether a company has complied with the provisions of Section 185 and 186 of the 2013 Act in respect of loans, investments, guarantees, and security provided in connection with loans. The revised guidance emphasises that while reporting under this clause, an auditor should verify not only on the loans and advances made by the company but also the guarantees given, security provided or acquisition of securities by the company.

#### **Clause 3(ix)(c): Application of term loans**

CARO 2020 requires an auditor to report whether term loans were applied for the purpose for which these loans were obtained. If not, then an auditor is also required to report the amount of loan so diverted and the purpose for which it is used. However, the Schedule III to the 2013 Act requires the management to provide disclosures in the financial statements where borrowings from banks and financial institutions were not used for the specific purpose for which it was taken at the balance sheet date and disclose details of where they have been used in the financial statements of the company itself.

The revised guidance note highlights that CARO 2020 requires auditors to report on the term loans from any party, whereas disclosures under the Schedule III are not limited to term loans but cover all borrowings from banks and financial institutions.

Therefore, the revised guidance note requires an auditor to review disclosures of the Schedule III as well before reporting under this clause.

**Clause 3(ix)(f): Funds raised on pledge of securities held in subsidiaries, joint ventures or associates**

Under CARO 2020, an auditor is required to report whether a company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies. In case the answer is affirmative, it requires an auditor to:

- Give details of such loans and
- Report if the company has defaulted in repayment of such loans raised.

The revised guidance note requires an auditor to mention nature of security and its amount (as per the carrying value in the financial statements) and reference to the relevant note in the financial statements should also be provided by the auditor.

**Clause 3(xvi)(b): Companies registered with RBI**

CARO 2020 requires an auditor to report on whether a company has conducted any non-banking financial or housing finance activities without a valid Certificate of Registration (CoR) from the Reserve Bank of India (RBI) as per the RBI Act. Also, RBI through its circular 'Review

of regulatory framework for Housing Finance Companies (HFCs)' dated 22 October 2020 has provided definition of housing finance companies. The revised guidance note requires an auditor to consider this definition while reporting under this clause.

The definition provided by the RBI is as follows:

'HFC' shall mean a company incorporated under the 2013 Act that fulfils the following conditions:

- I. 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). Housing finance for this purpose shall mean providing finance as stated in clauses (a) to (k) of para below.
- II. 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 as stated in clauses (a) to (c) of para below.

'Housing Finance' shall mean financing, for purchase/construction/reconstruction/renovation/repairs of residential dwelling units, which includes:

- a. Loans to individuals or group of individuals including co-operative societies for construction/purchase of new dwelling units
- b. Loans to individuals or group of individuals for purchase of old dwelling units

- c. Loans to individuals or group of individuals for purchasing old/new dwelling units by mortgaging existing dwelling units
- d. Loans to individuals for purchase of plots for construction of residential dwelling units provided a declaration is obtained from the borrower that he intends to construct a house on the plot within a period of three years from the date of availing of the loan
- e. Loans to individuals or group of individuals for renovation/reconstruction of existing dwelling units
- f. Lending to public agencies including state housing boards for construction of residential dwelling units
- g. Loans to corporates/Government agencies for employee housing
- h. Loans for construction of educational, health, social, cultural or other institutions/centres, which are part of housing projects, and which are necessary for the development of settlements or townships
- i. Loans for construction meant for the conditions in slum areas, for which may be extended directly to the slum dwellers

- on the guarantee of the Central Government, or indirectly to them through the State Governments
- j. Loans given for slum improvement schemes to be implemented by Slum Clearance Boards and other
- k. Public agencies
- l. Lending to builders for construction of residential dwelling units.



**Clause 3(xix): Material uncertainty**

CARO 2020 requires an auditor to comment on whether the auditor is of the opinion that no material uncertainty exists as on the date of the audit report about the company's capability of meeting its liabilities existing at the date of balance sheet as and when they fall due within a period of one year from the balance sheet date. The guidance note (previous edition) provided that an auditor should form an opinion on the basis of the following:

- Financial ratios
- Ageing and expected dates of realisation of financial assets and payment of financial liabilities
- Other information accompanying the financial statements, for example, the director's report
- Auditor's knowledge of the board of directors and management plans.

In the absence of disclosure of financial ratios in the financial statements, the guidance note (previous edition) required an auditor to refer to liquidity ratios to report under this clause. However, now the amended Schedule III requires disclosure of certain ratios in the financial statements. Considering the amendment, the revised guidance requires an auditor to review financial ratios as disclosed in the financial statements as part of the Schedule III requirements instead of liquidity ratios.

**Clauses amended due to the Schedule III amendments**

The revised guidance note has amended reporting guidance for following clauses to include disclosure requirements of the Schedule III to the 2013 Act. Also, the revised guidance note requires an auditor to consider the disclosure under the Schedule III relating to following clauses:

- *Clause 3(i)(e), Benami property:* Details of benami property held in terms of amount, beneficiaries, reference in the balance sheet, details of proceedings against the company along with status/nature, etc.
- *Clause 3(viii), Unrecorded income:* Provide details of unrecorded or undisclosed income in terms of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income in the tax assessment.
- *Clause 3(ix)(b), Wilful defaulter:* Disclosure in case when a company is a declared wilful defaulter by any bank or financial institution.
- *Clause 3(xx), Unspent Corporate Social Responsibility (CSR) amount:* Where a company covered under Section 135 of the 2013 Act, the Schedule III requires disclosures such as amount required to be spent, expenditure incurred, shortfall, previous year

shortfall, reasons for shortfall, nature of CSR activities, etc. CARO 2020 also requires an auditor to report whether the company has transferred unspent amount in respect of other than ongoing projects to specified fund and relating to an ongoing project to the specified bank accounts.

**Conclusion**

The introduction of CARO 2020 and amendments to the Schedule III presentation and disclosure requirements are aimed at enabling the higher level of corporate governance and additional information with the regulators.

The revised guidance note suggests auditors should read CARO 2020 in conjunction with the corresponding amendments to the Schedule III in order to understand the presentation and disclosure requirements set forth therein and to carry out the audit procedures in accordance with those requirements.

CHAPTER 3

# Regulatory updates



## Updates relating to social stock exchange

The Finance Minister, in her budget speech for FY 2019-20 had proposed to initiate steps towards creating a Social Stock Exchange (SSE), under the regulatory ambit of the Securities and Exchange Board of India (SEBI).

Accordingly, SEBI constituted a Working Group (WG) and Technical Group (TG) in September 2019 and 2020, respectively to provide recommendations relating to establishment of the SSE and to provide guidance on the matters relating to the scope of work, eligibility criteria and regulation of social auditors. This was followed by a release of regulatory framework for SSE by SEBI in February 2022. Based on the recommendations of the WG and the TG, and from the stakeholders, SEBI through its notification dated 25 July 2022, issued amendments to SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) to insert a new chapter X-A on the SSE.

Corresponding amendments have been made to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and SEBI (Alternative Investment Funds) Regulations, 2012.

## Key points relating to SSE

- **Social Enterprise:** A social enterprise (i.e either a Not for Profit Organisation (NPO) or a for profit social enterprise that meets the eligibility criteria specified in the new chapter X-A) shall be eligible to raise funds from an SSE provided such a social enterprise engages in a social activity that is listed by the regulator (there are 16 broad categories). An SSE would be a separate segment of a recognised stock exchange having nationwide trading terminals permitted to register NPO and/or list the securities issued by an NPO in accordance with provisions of these regulations.
- **Applicability:** The provisions of the chapter X-A are applicable to:
  - a. NPO seeking to only get registered with an SSE
  - b. NPO seeking to get registered and raise funds through an SSE
  - c. For profit social enterprise seeking to be identified as an SE.
- **Eligibility conditions for being identified as a social enterprise:** In order to be recognised as a social enterprise, an NPO or for profit social enterprise would need to establish social intent as their primary goals by demonstrating their focus towards the eligible social objectives and satisfy the prescribed conditions.

The notification also prescribes the manner and procedures in which funds can be raised by a social enterprise and the ineligibility with respect to the same.

## Social audit standards

With regard to the aforementioned amendments to the SEBI ICDR Regulations, the Sustainability Reporting Standards Board (SRSB) of the Institute of Chartered Accounts of India (ICAI), on 5 August 2022, has released an Exposure Draft (ED) on the Compendium of Social Audit Standards (SAS). The following aspects are covered in the ED:

- i. Draft preface:** As per the ED, the SAS shall be mandatorily applied whenever an independent social audit of a social enterprise is carried out. The SASs may also have application, as appropriate, to other related functions of social auditors.
- ii. Draft framework:** The framework in the ED defines and describes the elements and objectives of a social audit performed by an social auditor. It also provides a frame of reference for:
  - a. Social auditors when performing social audits i.e., social impact assessment of a project/programme executed by the social enterprises.
  - b. The responsible party, the engaging party, if any, and other stakeholders who are the intended users of a social audit report.



**iii. Draft SASs on 16 thematic areas:** The SASs contain essential procedures and related guidance/criteria for the performance of each of the area-specific social audit engagements based on the 16 categories of social activities as specified by SEBI. The respective SASs may be referred for the area specific social indicators. The list of the draft SAS are as follows:

- **SAS 100:** Eradicating hunger, poverty, malnutrition and inequality
- **SAS 200:** Promoting health care (including mental health) and sanitation; and making available safe drinking water
- **SAS 300:** Promoting education, employability and livelihoods
- **SAS 400:** Promoting gender equality, empowerment of Women and LGBTQIA+ communities
- **SAS 500:** Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation
- **SAS 600:** Protection of national heritage, art and culture
- **SAS 700:** Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports

- **SAS 800:** Supporting incubators of social enterprises
- **SAS 900:** Supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building
- **SAS 1000:** Promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector
- **SAS 1100:** Slum area development, affordable housing, and other interventions to build sustainable and resilient cities
- **SAS 1200:** Disaster management, including relief, rehabilitation and reconstruction activities
- **SAS 1300:** Promotion of financial inclusion
- **SAS 1400:** Facilitating access to land and property assets for disadvantaged communities
- **SAS 1500:** Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection
- **SAS 1600:** Promoting welfare of migrants and displaced persons.

The last date to provide comments was upto 29 August 2022.

*(Source: SEBI notification no. SEBI/LAD-NRO/GN/2022/90 dated 5 July 2022 and Exposure Draft of Compendium of Social Audit Standards issue by ICAI on 5 August 2022)*

### SEBI amended the definition of an 'associate' under mutual fund regulations

SEBI (Mutual Funds) Regulations, 1996 are regulations that govern mutual funds and provide the rules to buy and sell of mutual funds in India.

The regulations define an 'associate' as a person:

- i. Who directly or indirectly, by himself, or in combination with relatives, exercises control over the asset management company or the trustee (or the sponsor), as the case may be, or
- ii. In respect of whom the asset management company or the trustee (or the sponsor), directly or indirectly, by itself, or in combination with other persons exercises a control, or
- iii. Whose director (except an independent director), officer or employee is a director, officer or employee of the asset management company;

On 3 August 2022, SEBI amended the definition of an 'associate' to include a proviso to the definition. As per the amendment the definition of an associate would not be applicable to such sponsors, which invest in various companies on behalf of the beneficiaries of insurance policies or such other schemes as may be specified by SEBI from time to time.

This amendment is applicable from 3 September 2022.

Consequent to the above amendment, SEBI has issued a circular on 25 August 2022, to provide that the Asset Management Companies (AMCs) investing in securities of entities are excluded from the revised definition of 'associate'. Additionally, such AMCs are required to provide the scheme wise disclosure of investments including International Securities Identification Numbers (ISIN) wise value of investment and value as percentage of Assets Under Management (AUM) of scheme. The specified disclosure should be made on the websites of respective AMCs and on the website of Association of Mutual Funds in India (AMFI) within one month from the close of each quarter.

*(Source: SEBI notification SEBI/LAD-NRO/GN/2022/92 dated 3 August 2022 and SEBI circular SEBI/HO/IMD/DOF2/P/CIR/2022/111 dated 25 August 2022)*





## Amendment in the Companies (Accounts) Rules, 2014 relating to availability of books of account and other relevant books and papers

The Ministry of Corporate Affairs (MCA) through its notification dated 5 August 2022 has amended the certain provisions of Rule 3 of the Companies (Accounts) Rules, 2014 relating to availability of books of account and other relevant books and papers maintained in electronic mode. The amendments are as follows:

- Rule 3(1) relating to maintaining the books of account and other relevant books and papers in electronic mode has been amended. The amended provision provides that such books of account and other relevant books and papers should be accessible in India, **at all times**.
- Rule 3(5) of the Accounts Rules provides that there should be a proper system for storage, retrieval, display or printout of the electronic records. The provision relating to maintenance of backups has been amended. The amendment provides that the back-up of the books of account and other books and papers of the company maintained in an electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India **on a daily basis** earlier it was required to be maintained on periodic basis.

- Rule 3(6) relating disclosure in case of service provider has been amended. The amendments requires an additional disclosure by the company to the Registrar of Companies (ROC) the name and address of the person in control of the books of account and other books and papers in India, where the service provider is located outside India.

Therefore, the revised requirements to be disclosed to the ROC on an annual basis at the time of filing of financial statement are:

- a. the name of the service provider
- b. the internet protocol address of service provider
- c. the location of the service provider (wherever applicable)
- d. where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider

### e. details of where the service provider is located outside India, the name and address of the person in control of the books of account and other books and papers in India.

*(Emphasis added to highlight the changes)*

*(Source: MCA notification G.S.R. 624(E), Companies (Accounts) Fourth Amendment Rules, 2022 dated 5 August 2022)*

## ICAI released revised Guidance Note on Tax Audit for AY 2022-23

Section 44AB of the Income-tax Act, 1961 (IT Act) contains provisions pertaining to the tax audit. A tax audit is an examination of a taxpayer's books of account and other relevant records. Basis the examination, an audit report in Form No. 3CA/3CB and particulars in Form No. 3CD is required to be issued by the practicing chartered accountants.

The Direct Tax Committee of the ICAI has issued a revised Guidance Note on Tax Audit under Section 44AB of the IT Act. This guidance note is for the audits to be conducted for Assessment Year (AY) 2022-23. The guidance note is revised to incorporate changes in provisions of law and new clauses included in the particulars to be furnished in the Form No. 3CD since the last edition. The revised guidance note incorporates all the changes in the desired clauses which have taken place due to amendments to the IT Act, 1961 as well as judicial pronouncements, circulars etc.

*(Source: Revised Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961 issued by ICAI dated 19 August 2022)*

## Reporting going concern matters in the auditor's report

The Going Concern Task Force of the International Auditing and Assurance Standards Board (IAASB) has issued a Frequently Asked Questions (FAQs) publication in August 2022 to address some of the common questions involving the use of and the interrelationship of material uncertainty related to going concern and Key Audit Matters (KAM) sections, and Emphasis of Matter paragraphs (EOM), in the auditor's report prepared in accordance with International Standards on Auditing (ISAs).

Key considerations addressed in the publication include:

- i. Purpose, applicability and inter-relationship of the material uncertainty related to going concern, KAM and EOM in the auditor's report
- ii. Implications of material uncertainty related to going concern, KAM and EOM on the auditor's opinion and the auditor's report
- iii. Situations where no material uncertainty related to going concern exists, can going concern matters be communicated as a KAM or EOM in the auditor's report.

*(Source: FAQs issued by IAASB on 1 August 2022)*

## Implementation guide released for identifying and assessing the risk of material misstatements in an audit of financial statements

In December 2019, IAASB has issued the revised ISA 315, *Identifying and Assessing the Risks of Material Misstatement* to include a robust and consistent risk identification and assessment. The revised standard is effective for periods beginning on or after 15 December 2021.

In light of the revised standard and considering that it became applicable, on 27 July 2022, IAASB released the First-Time Implementation Guide for ISA 315 (Revised 2019) which highlights and focusses on the substantial changes made in revised standard.

The objective of this First-Time Implementation Guide is to help understand and apply the changes in ISA 315 (Revised 2019). Additionally, IAASB highlighted that the contents of this publication do not amend or override ISA 315 (Revised 2019).

*(Source – IAASB Press Release/News Alert dated 27 July 2022)*

## IAASB proposes narrow scope amendments to operationalise changes to the IESBA code that enhance transparency about independence

In April 2022, the International Ethics Standards Board for Accountants (IESBA) approved the revisions to the definition of a listed entity and a public interest entity to the International Code of Ethics for Professional Accountants (including International Independence Standards) (the Code). The revisions include an expanded definition of a 'Public interest Entity (PIE)' in the Code by specifying a broader list of public interest entity categories, including a new category a 'publicly traded entity' to replace the category 'listed entity'.

The revisions also introduce a transparency requirement for firms to publicly disclose the application of independence requirements for PIEs where they have done so. The aforementioned pronouncement would be applicable for audits of financial statements for periods beginning on or after 15 December 2024.

Considering the updates from IESBA, in July 2022, the International Auditing and Assurance Standards Board (IAASB) proposed narrow scope amendments to ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, and ISA 260 (Revised), *Communication with Those Charged with Governance* to support

the operationalisation of IESBA's transparency requirement.

### Key proposals include:

- i. **Statement of independence:** The IAASB has proposed two possible approaches in ISA 700 (Revised) relating to auditor's statement on independence:
  - a. A conditional requirement that applies only when the relevant ethical requirements require public disclosure that differential independence requirements for audits of financial statements of certain entities were applied. If the condition is met, then the auditor is required to indicate in the auditor's report that the relevant ethical requirements for independence for those entities were applied, or
  - b. A non-conditional requirement that would apply in all circumstances when differential independence requirements for audits of financial statements of certain entities were applied, even if the relevant ethical requirements do not require the auditor to publicly disclose that such differential independence requirements were applied.
- ii. **Communication with Those Charged with Governance:** A new application material has been proposed to ISA 260 (Revised) in line with the proposed requirements for ISA 700 (Revised).

iii. **Amendment to ISRE 2400:** Paragraph 86(j) of ISRE 2400 (Revised) *Engagements to Review Historical Financial Statements*, requires a practitioner's report to include a reference to the practitioner's obligation under this ISRE to comply with relevant ethical requirements. The practitioner is not required to provide a statement similar to the requirement in paragraph 28(c) of ISA 700 (Revised), which requires an auditor to identify the jurisdiction of origin of the relevant ethical requirements or refer to the IESBA Code. IAASB is seeking stakeholder views to whether to amend ISRE 2400 in a manner which is consistent with proposed amendments to ISA 700 (Revised) wherein a conditional requirement could be introduced in ISRE 2400 (Revised), together with application material and illustrations as necessary.

iv. **Proposed effective date:** The effective date for application of the proposed amendments to ISA 700 (Revised) and ISA 260 (Revised) has been proposed to be applicable for audits of financial statements for periods beginning on or after 15 December 2024 in line with the effective date for application of revisions made to IESBA Code.

The period to provide comments on the exposure draft is upto 4 October 2022.

*(Source: IAASB announcement dated 6 July 2022)*

## First Notes



## MCA issues narrow scope amendments to Indian Accounting Standards

5 May 2022

In view of the recent amendments to IFRS, and in order to keep the Ind AS converged with IFRS1, the Ministry of Corporate Affairs (MCA) issued certain amendments to Ind AS vide a notification dated 23 March 2022 (2022 amendments). These amendments have been issued in the areas mentioned below:

- Ind AS 16, *Property, Plant and Equipment* - Accounting for proceeds before intended use
- Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* - Determining costs to fulfil a contract
- Ind AS 103, *Business Combinations* - Reference to the Conceptual Framework for Financial Reporting
- Annual improvements to Ind AS (2021)
  - Ind AS 101, *First-time adoption of Indian Accounting Standards*
  - Ind AS 109, *Financial Instruments*
  - Ind AS 41, *Agriculture*

This issue of First Notes provides an overview of the 2022 amendments.



On 21 July 2022, KPMG in India released its VOR - Quarterly updates publication. The publication provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Institute of Chartered Accountants of India (ICAI) and the Reserve Bank of India (RBI) for the quarter ended 30 June 2022.

To access the publication, please click [here](#).

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

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## Introducing



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