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Editorial

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Currently, an entity is required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a 'qualifying asset' as part of the cost of that asset as per Indian Accounting Standard (Ind AS) 23, *Borrowing Costs*. Determination of borrowing costs eligible for capitalisation and inclusion of specific borrowings as part of general borrowings once the qualifying asset is ready for its intended use has been a matter of debate and interpretation. In this edition of Accounting and Auditing Update (AAU), we have included an article which discusses some of these issues relating to the accounting of borrowing costs.

In order to sustain in the rapidly growing economy, companies are required to raise capital. Raising equity on a periodic basis may lead to dilution of founder/promoter stake, which can be effectively addressed through use of Differential Voting Rights (DVRs) (prevalent internationally) as a mode of capital raising. The current regulatory regime does not allow issue of shares with higher or superior voting rights. However, subject to certain conditions, it is possible to issue shares with inferior (less than one vote per share) voting rights. The Securities and Exchange Board of India (SEBI) has constituted a group to conduct an in-depth study of the proposal of introduction of shares with DVRs in the Indian scenario. Our article provides an overview of the proposals of the group in its report for the issuance of DVR shares by companies in India.

As is the case each month, we have also included a regular round-up of some recent regulatory updates including Prudential Framework for Resolution of Stressed Assets issued by the Reserve Bank of India. The circular provides directions for early recognition, reporting and time bound resolution of stressed assets.

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

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Table of contents

Borrowing costs: Key issues

01

Shares with differential voting rights: SEBI's consultation paper

05

Regulatory updates

11

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Borrowing costs: Key issues

This article aims to:

- Discuss key issues with respect to accounting of borrowing costs under Ind AS.

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Introduction

Currently, Indian Accounting Standard (Ind AS) 23, *Borrowing Costs* governs the principles relating to accounting of borrowing costs. As per the standard, an entity is required to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a 'qualifying asset'[01] as part of the cost of that asset.

The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. In certain cases, determination of such directly attributable costs is difficult and requires exercise of judgement. For instance, financing activity of an entity is coordinated centrally or a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group.

Capitalisation of borrowing costs would commence when an entity meets all of the following conditions:

a. Expenditure for the asset is being incurred

b. Borrowing costs are being incurred and

c. Activities that are necessary to prepare the asset for its intended use or sale are in progress.

Capitalisation of borrowing costs is suspended during the period in which active development of a qualifying asset itself is suspended and altogether ceased when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

The guidance in Ind AS 23 is largely similar to the guidance prescribed under International Accounting Standard (IAS) 23, *Borrowing Costs* issued by the International Accounting Standard Board (IASB). Ind AS 23 additionally, provides guidance on how the adjustment on account of foreign exchange differences is to be determined which is not present in IAS 23.

In this article, we aim to highlight certain key areas relating to borrowing costs.

Issue 1: Qualifying asset is ready for intended use - specific borrowing considered as general borrowing

As per the standard, to the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity is required to determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to all borrowings of the entity that are outstanding during the period, excluding borrowings made specifically for the purpose of qualifying asset.

There has been a debate in the past as to whether borrowings made specifically for the purpose of a qualifying asset can be considered as part of general borrowings once the qualifying asset is ready for its intended use. In the absence of any guidance, there has been diversity in practice in such cases.

In this regard, the Expert Advisory Committee (EAC) (the committee) of the Institute of Chartered Accountants of India (ICAI) in a given case study[02] (based on Accounting Standard (AS) 16, *Borrowing Costs*) highlighted that while determining which borrowings should be considered for application of the capitalisation rate to be applied to general borrowings, an entity should exclude those borrowings which were borrowed for a specific purpose unless there is an evidence that the same were used for the capital expenditure on qualifying assets.

Therefore, under AS, even if an asset is ready for its intended use, specific borrowings in relation to a qualifying asset that would be outstanding were not considered as part of general borrowings.

On the other hand, as per US Generally Accepted Accounting Principles (GAAP), money is considered to be fungible and therefore, attributing an expenditure to a particular source of funds is considered impracticable since the funds from various sources get pooled together. Even where such attribution is practicable, the resultant identification could be arbitrary. For instance, a payment for a qualifying asset made from a bank account wherein funds raised from equity alone have been placed may as well could have been made from a different bank account.

The International Financial Reporting Standards (IFRS) also carries the same analogy as that of US GAAP, however, it was not clearly mentioned that specific borrowing should be considered as part of general borrowings, once the qualifying asset is available for intended use.

Recently, as part of the annual improvements to IFRS, on 12 December 2017, the IASB amended IAS 23 and clarified that while computing the capitalisation rate for funds borrowed generally, an entity should exclude borrowing costs applicable to borrowings made specifically for obtaining a qualifying asset, only until the asset is ready for its intended use or sale.

01. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

02. EAC opinion no. 29 dated 27 January 2004.

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Borrowing costs related to specific borrowings that remain outstanding after the related qualifying asset is ready for intended use or for sale would subsequently be considered as part of the general borrowing costs of the entity.

The standard also clarifies that an entity includes funds borrowed specifically to obtain an asset other than a qualifying asset as part of general borrowings.

Similar amendment has been made in Ind AS 23 which is applicable to borrowing costs incurred on or after the beginning of the annual reporting period beginning on or after 1 April 2019.

Issue 2: Eligible amount of borrowing costs for the purpose of capitalisation

The IFRS Interpretations Committee (IFRIC) (the committee) of IASB in its update issued in September 2018 considered a case where an entity incurs expenditure on the qualifying asset both before and after it incurs borrowing costs on the general borrowings.

As per the facts of the case, the entity did not incur any borrowings at the start of the construction of the qualifying asset. However, during the course of construction, the entity borrowed funds generally and used them to finance the construction of the qualifying asset. The issue under consideration was whether the entity is allowed to use the expenditure on the qualifying asset incurred before obtaining general borrowings while determining the amount of borrowing costs eligible for capitalisation.

Based on the guidance given in IAS 23, the IASB in this case, concluded that an entity would not begin capitalising borrowing costs until it incurs borrowing costs.

Once the entity incurs borrowing costs and therefore, satisfies all the three conditions given in the standard for capitalisation (i.e. incurs expenditure on the asset and borrowing costs and undertakes activities that are necessary to prepare the asset for its intended use or sale) then it is required to apply the standard to determine the expenditures on the qualifying asset to which it applies the capitalisation rate.

The committee observed while determining the expenditure on qualifying asset to which an entity applies capitalisation rate, it should not disregard expenditure on the qualifying asset incurred before it obtains the general borrowings.

Issue 3: Application of capitalisation rate for assets acquired under business combination

Another area of concern relates to treatment of borrowing costs (eligible for capitalisation) acquired as part of a business combination in the separate and the Consolidated Financial Statements (CFS) of an entity.

With a view to provide some guidance in the area, the Ind AS Technical Facilitation Group (ITFG) of ICAI in its bulletin 19 (issue 4) dated 10 May 2019 considered a situation where a company (ABC Ltd.) has a Capital Work in Progress (CWIP) of INR100,000 which meets the definition of a 'qualifying asset' as per Ind AS 23 and capitalised corresponding borrowing cost using capitalisation rate for general borrowings.

The issue relates to what would be the accounting treatment of borrowing cost in case:

- PQR Ltd., an independent entity, acquires ABC Ltd. and merges it into itself.
- PQR Ltd. acquires 100 per cent shares and control of ABC Ltd. but ABC Ltd. remains a separate legal entity consolidated by PQR Ltd.

ITFG provided following guidance in the above mentioned situations:

Situation 1: Where ABC Ltd. is merged into PQR Ltd. and merger meets the definition of a 'business combination' as per Ind AS 103, *Business Combination*, the CWIP would appear as an asset in the separate and consequently, in the CFS of PQR Ltd. At the time of merger, PQR Ltd. needs to make a fresh, independent assessment to evaluate whether CWIP meets the definition of a qualifying asset from its perspective.

In the given case, PQR Ltd. made an independent assessment and asserted that the CWIP still meets the definition of a qualifying asset and attributed an amount of INR120,000 as a consideration towards purchase of the CWIP as part of the purchase price.

The value of CWIP and timing of incurrence of the aforesaid expenditure should be determined from the perspective of PQR Ltd. and not from the perspective of ABC Ltd. For instance, if PQR Ltd. acquires ABC Ltd. and pays cash consideration on 1 July 20XX, then, for determining the amount of borrowing costs to be capitalised, the expenditure of INR120,000 would be considered to have been incurred by PQR Ltd. on 1 July 20XX.

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Consequently in separate and CFS of PQR Ltd., INR120,000 would represent the expenditure incurred by PQR Ltd. on the CWIP and for purposes of applying the requirements of Ind AS 23 relating to capitalisation of borrowing costs.

Situation 2: Instead of a merger, in case PQR Ltd. acquires 100 per cent shares and consequently control of ABC Ltd. which continues to remain in existence, PQR Ltd.'s CFS would include the CWIP as an asset but not in its separate financial statements. For the purpose of CFS, the determination of whether an asset meets the definition of a 'qualifying asset' and the amount of expenditure incurred thereon would be made from the perspective of the group rather than from the perspective of the subsidiary which owns or holds the CWIP.

In the issue under consideration, the group has incurred an expenditure of INR120,000 to acquire the CWIP from a party outside the group. For the purpose of applying the requirements of Ind AS 23 relating to capitalisation of borrowing costs at the group level, it is determined that the CWIP meets the definition of a 'qualifying asset' from the group's perspective and the amount of expenditure on the CWIP would be considered to be INR120,000.

Accordingly, the separate financial statements of PQR Ltd. would include the investment in ABC Ltd. rather than individual assets and liabilities of ABC Ltd. As this investment is a financial asset, borrowing costs cannot be capitalised as part of carrying amount as per the requirements of Ind AS 23 which specifically provides that financial assets are not qualifying assets.

Consider this...

- An entity would not begin capitalising borrowing costs until it incurs borrowing costs.
- Capitalisation of borrowing costs will commence when an entity meets all the given conditions:
  a. It incurs expenditure for the asset
  b. It incurs borrowing costs and
  c. It undertakes activities that are necessary to prepare the asset for its intended use or sale.

  Once all the above conditions are met, the entity has to apply the standard to determine the expenditures on the qualifying asset to which it applies the capitalisation rate.
- An entity would be required to exclude borrowing costs applicable to borrowings made specifically for obtaining a qualifying asset, only until the asset is ready for its intended use or sale.

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Shares with differential voting rights: SEBI's consultation paper

This article aims to:

- To provide an overview of the proposals on fractional voting rights and superior voting rights.

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The debate on shares with Differential Voting Rights (DVRs) has received increasing attention globally. Recent issuances of shares by some unicorns and other companies in the US and elsewhere have invited mixed reviews. On the positive side, such shares allow promoters to retain control of their businesses to ensure that they can steer them towards growth and profitability without diluting their decision making rights. At the same time they get access to equity and an exit route in case they are publicly listed. DVR shares have also been criticised by some as alienating the rights of minority shareholders and allowing promoters a free run without adequate safeguards. Like any other fund raising instrument the pros and cons of such shares must be carefully evaluated.

Closer to home, India has also seen a number of high profile startups and new age companies experience rapid growth which in turn requires large amounts of capital raising on a regular basis to drive that growth.

Raising equity on a periodic basis leads to dilution of the founder/promoter's stake, which can be effectively addressed through use of DVRs as a mode of capital raising. This is especially relevant for such new age companies where the promoters continued involvement may be key to sustained growth and the firm's ability to attract capital.

DVR shares can be broadly classified into two categories:

a. Issue of shares with superior voting rights to founders and/or

b. Issue of shares with lower or fractional voting rights to raise funds from private/public investors.

One way to let Indian entrepreneurs have some autonomous space for managing and growing their business without the suppliers of their capital over-supervising them and offering advice they cannot refuse is to allow them to issue shares with differential voting rights to the founders/promoters. DVR shares have rights disproportionate to their economic ownership.

Currently in India, the regulatory regime does not permit issuance of DVR shares with higher or superior voting rights. However, subject to certain conditions, it is possible to issue shares with inferior (less than one vote per share) voting rights. DVR shares with lower voting rights may be of some interest to small shareholders as dividend yield and capital appreciation probably rank higher than voting rights in their investment decisions.

The matter was deliberated in the 'Primary Market Advisory Committee' of the Securities and Exchange Board of India (SEBI) and a group (DVR Group) was constituted amongst the Committee members to conduct an in-depth study of the proposal of introduction of dual-class shares (as DVRs are commonly known internationally) in India.

Consultation paper

Based on the report submitted by the DVR Group (the Report), SEBI issued a Consultation Paper for issuance of shares with DVRs in March 2019. The Report proposes to structure the regulation of DVR issuance under two broad heads as below:

- Issuance of shares with fractional voting rights (FR shares) by companies whose equity shares are already listed on stock exchanges, and
- Issuance of shares with superior voting rights (SR shares) by companies with equity shares not hitherto listed but proposed to be offered to the public.

This article provides an overview of the regulations proposed in the Report for issuance of DVR shares by companies in India.

Key overview of proposed regulations

Conditions precedent

The Report sets out two preconditions for a company to be entitled to issue DVR shares as below:

- Issue of DVR shares must have been authorised in the articles of association of the company, and
- The issue of DVR shares should be authorised by a special resolution passed at a general meeting of the shareholders (for companies already listed, by way of e-voting in accordance with the Companies Act, 2013) with notice of specific matters, including but not limited to, size of issuance, ratio of the difference in the voting rights, rights as to differential dividends, if any, sunset clause, 'coat tail provisions', etc., as made applicable by SEBI regulations to be notified in this regard.

Companies whose equity shares are already listed

First issue of FR shares

A company whose equity shares are already listed and traded on a recognised stock exchange for at least one year would be permitted to issue FR shares by way of any of the following:

- Rights issue
- Bonus issue pro rata to all equity shareholders
- Follow-on Public Offer (FPO) of FR shares.

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In case of rights issue and bonus issue, FR shares would be provided to all existing shareholders. In the case of FPO, a right would be provided to all existing shareholders to subscribe to the FR shares, along with third parties.

Subsequent issues of FR shares once FR shares are already listed

Some key proposals given in the Report for subsequent issues of FR shares when a company has already listed FR shares are given in the table below:

Sr. no.	Caption	Proposed regulation
1.	**Rights issue or bonus issue**	A company that has already listed FR shares would be eligible to transact a rights issue or a bonus issue of FR shares of the same class of FR shares to all shareholders on a pari-passu basis.
2.	**Qualified Institutions Placement (QIP) or preferential issue**	A company whose FR shares are listed for at least one year, would be eligible to undertake a preferential issue or a QIP of FR shares of the same class.
3.	**Face value of FR shares**	The face value of a company's FR shares would be the same as that of its ordinary equity shares.
4.	**Number of FR shares**	The number of FR shares would be subject to the provisions of the Companies Act, 2013 and the Rules framed thereunder.
5.	**Pricing**	The pricing would be in accordance with regulatory considerations applicable to mode of issuance of FR shares.
6.	**Voting and other rights on FR shares**	• The FR shares should not exceed a ratio of 1:10, i.e. one vote as applicable to one ordinary equity share, would be voting entitlement on 10 FR shares • The ratio can be in full numbers from 1:2 to 1:10 • At any point in time, the company can only have one class of FR shares.
7.	**Dividends**	• Company may pay FR shares a higher dividend as compared to ordinary equity shares and the same should be mentioned in terms of offering. • If no dividend is declared by a company for any year to ordinary equity shares, the same shall apply to FR shares also.
8.	**Listing**	FR shares would be listed and traded on all stock exchanges similar to how ordinary equity shares are traded with a separate identifier from them.
9.	**Minimum public shareholding**	The company should comply with the minimum public shareholding requirements for each class of equity shares (both equity and FR shares) as per provisions of the Securities Contracts (Regulation) Rules, 1957 (SCRR).
10.	**Conversion**	The FR shares can be converted into ordinary equity shares only in cases of schemes of arrangement.

Companies whose equity shares are proposed to be listed

First issue of SR shares

SR shares can be issued only to the promoters of a company by an unlisted company. An unlisted company where the promoters hold SR shares would be permitted to undertake an Initial Public Offer (IPO) of only ordinary equity shares provided the SR shares are held by the promoters for more than one year prior to filing of the draft offer document with SEBI.

Subsequent issue of SR shares

A company would not be permitted to issue SR shares to any person, including to the promoters, in any manner whatsoever, including by way of rights issue or bonus issue, once its ordinary equity shares have been listed.

Subsequent issue of FR shares

A company whose SR shares and ordinary equity shares are already listed would be permitted to issue FR shares as per the terms of the applicable provisions for issue of FR shares by listed companies.

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Some key proposals given in the Report for issue of SR shares are given in the table below:

Sr. no.	Caption	Proposed regulation
1.	**Number of SR shares**	A company would be permitted to issue any number of SR shares of the same class prior to an IPO subject to the provisions of the Companies Act, 2013.
2.	**Face value of SR shares**	The face value of a company's SR shares would be the same as that of its ordinary equity shares.
3.	**Voting and other rights on SR shares**	• The SR shares would be treated at par with ordinary equity shares in all respects except in the case of voting on resolutions (see coat-tail provisions for exceptions) • These shares would be maximum ratio of 10:1, i.e. 10 votes for every SR share held • Ratio can be in whole numbers from 2:1 to 10:1 • A ratio once adopted by a company would remain valid for any subsequent issuances of SR shares • Any rights or bonus issue by the company post-listing would be offered only as ordinary equity shares • On certain matters to be notified by regulations, the SR shares would be treated as having only one vote. The initial list of the same is set out in the 'coat-tail' provisions.
4.	**Coat-tail provisions**	Post IPO, the SR shares would be treated as ordinary equity shares in terms of voting rights (i.e. one SR share one vote) in the following circumstances: • Provisions relating to appointment or removal of independent directors and/or auditor • In case there is a change in control of the company • Any contract or agreement of the company with any person holding the SR Shares, in excess of the materiality threshold prescribed under SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 • Voluntary winding up of the company • Any material changes in the company's Article of Association or Memorandum such as undertaking variation in the voting rights of the shareholders, changing the principal objects of the company • Initiation of a voluntary resolution plan under the Insolvency and Bankruptcy Code, 2016 • Extension of the validity of the SR shares post completion of five years from date of listing of ordinary equity shares • Any other provisions notified by SEBI in this regard from time to time.
5.	**Dividends**	Same dividend and other rights as ordinary equity shares, except for superior voting rights.
6.	**Lock-in of SR shares**	All SR shares would remain under a perpetual lock-in after the IPO.
7.	**Initial disclosure**	• Company to disclose in the offer document the names of all holders of SR shares, with complete details of all the special rights provided to them • No change in the terms of the SR shares, which are favourable to the SR shareholders would be permitted post IPO, other than sunset clause.
8.	**Listing**	• SR shares would be listed on the main board platform of the recognised stock exchanges • SR shares cannot be traded except upon conversion into ordinary equity shares.
9.	**Minimum public shareholding**	• The company should comply with the minimum public shareholding requirements for the ordinary equity shares as per provisions of the SCRR. • Post-listing, the voting rights with the promoters through the SR shares and ordinary equity shares should not exceed 75 per cent of the total voting rights.

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Sr. no.	Caption	Proposed regulation
10.	**Pledge of SR shares**	Creation of any encumbrance over SR shares including pledge, lien, negative lien, non-disposal undertaking, etc. would not be permissible. In other words, no third-party interest may be created over the SR shares and any instrument purporting to do so would be *void ab initio*.
11.	**Sunset clause/ conversion of SR shares**	• SR shares to be converted into ordinary equity shares on the fifth anniversary of the listing of the ordinary shares of the company. Validity of the SR shares may be extended by another five years by taking specific approvals in the manner prescribed in the Report. • Promoters may carry out an accelerated conversion of their SR shares into ordinary equity shares at any time prior to the fifth anniversary or such extended period • Compulsory conversion to ordinary equity shares will take place in case of merger or acquisition of the company/sale of SR shares by the identified promoter/in case of death of the promoter • Transfer of SR shares between promoters or persons of the promoter group is not permitted.

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Key takeaways

DVRs or dual class shares give the holders more voting and dividend power than ordinary equity shares. Such shares help promoters retain decision-making powers by retaining shares with superior voting rights or by issuing shares with lower or fractional voting rights. While this allows promoters greater flexibility in raising capital, it comes with some other riders including a restriction on pledging such shares and only being able to issue one class of DVR shares.

In India, issuance of shares with differential voting or dividend rights has been around since 2000 and only few listed companies have issued shares with differential voting/dividend rights. The market performance of DVR shares vis-a-vis normal shares has been fairly mixed so far. These proposals are a welcome move as they allow India's new age companies to also evaluate DVR shares as a fund raising alternative mirroring global trends.

SEBI has attempted to balance the concerns of minority shareholders may have on the disproportionate voting rights and power enjoyed by promoters vis-a-vis their shares by providing for certain restrictions and mandating conversion of DVR shares into ordinary shares. Some of the key conditions introduced in the consultation paper issued by SEBI are as follows:

- SR shares should be converted into ordinary equity shares on the fifth anniversary of the listing of the ordinary shares of the company
- The validity of SR shares can be extended for another five years through approval by a special resolution
- The maximum votes a SR share can get is 10:1
- Barring transfer of SR shares between promoters or persons of the promoter group.

In case DVRs are introduced in India, SEBI would need to make the relevant changes in several other laws, e.g.:

- SEBI (Issue of Capital and Disclosure Requirements) Regulations: This would allow promoters to hold SR shares post the listing of companies' ordinary equity shares
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SEBI Takeover Code): The amendment should clarify that any increase beyond the threshold of entitlement to voting rights would not trigger an open offer obligation.

Additionally, the Ministry of Corporate Affairs (MCA) would need to amend the Companies (Share Capital and Debenture) Rules, 2014 so that DVRs can be issued by an unlisted company without profitability track record.

In addition SEBI should also evaluate enhanced corporate governance norms for companies that issue such shares. These may include setting lower thresholds of paid-up share capital for owners of ordinary shares to convene general meetings, require a larger proportion of independent directors on the Board and other relevant committees vis-a-vis companies that only have ordinary shares.

Conclusion

In the past decade, India has seen a boom in new age companies, especially in the technology space. One of the key issues faced by founders is to raise funds for growth without diluting control. SEBI's attempt to address this concern, by improving access to the Indian capital markets through a regulated DVR regime, is timely. However, its success rate would depend on the market's acceptance of such instruments along with changes required to be made to other laws to operationalise these instruments.

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Regulatory updates

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IASB issued exposure draft for amendments to IFRS as a part of its annual improvement process

The International Accounting Standards Board (IASB) issued amendments to International Financial Reporting Standard (IFRS) as part of its annual improvement process. Annual improvements are part of IASB's process for maintaining IFRS and contain interpretations that are minor or narrow in scope. Amendments made as a part of annual improvement process either clarify the wording in an IFRS or correct relatively minor oversights or conflicts between existing requirements of IFRS.

IASB on 21 May 2019 issued exposure drafts to propose amendments included in this year's annual improvements consultation document to IFRS.

Annual improvements to IFRS (2018-2020)

Standard	Proposed amendment
IFRS 1, *First-time adoption of International Financial Reporting Standards*	Currently IFRS 1 provides a subsidiary that becomes a first-time adopter of IFRS later than its parent with an exemption relating to the measurement of its assets and liabilities. The exemption in paragraph D16(a) applies only to assets and liabilities of the subsidiary and not to components of equity. Accordingly, a subsidiary that becomes a first-time adopter later than its parent would apply paragraphs D12–D13 of IFRS 1 to cumulative translation differences at its date of transition to IFRS. By applying these paragraphs, the subsidiary might be required to keep two parallel sets of accounting records for cumulative translation differences based on different dates of transition to IFRSs. The Board received a request to extend the exemption in paragraph D16(a) to cumulative translation differences reported by a subsidiary that becomes a first-time adopter later than its parent. The Board proposes to require a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences using the amounts reported by the parent, based on the parent's date of transition to IFRS. This proposed amendment would also apply to an associate or joint venture that elects to apply paragraph D16(a) of IFRS 1.
IFRS 9, *Financial Instruments*	This amendment proposes to clarify the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability in determining whether to derecognise a financial liability. The clarification proposes a borrower to include only those fees paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf (for '10 per cent' test for derecognition of financial liabilities).
IFRS 16, *Leases*	The IASB was informed about the potential for confusion in applying IFRS 16 because of how Illustrative Example 13 accompanying IFRS 16 illustrates the requirements for lease incentives. In particular, it is unclear why, in Illustrative Example 13 based on the limited facts provided, the lessee does not consider the reimbursement relating to leasehold improvements to be a lease incentive as defined in IFRS 16. The IASB developed Illustrative Example 13 to illustrate requirements in IFRS 16 for initial and subsequent measurement of a right-of-use asset and lease liability. The inclusion in the example of payments from the lessor to the lessee (in relation to both real estate commission and leasehold improvements) was intended to illustrate when such payments meet the definition of lease incentives and when they do not. Illustrative Example 13 concludes that the lessee does not account for payments relating to leasehold improvements as a lease incentive but applies other relevant Standards. The explanation provided - 'because costs incurred on leasehold improvements by lessee are not included within the cost of the right-of-use asset'- implies that these payments are not associated with the lease. However, to be sufficiently precise, Illustrative Example 13 should have stated more clearly that these payments did not meet the definition of lease incentives in IFRS 16 (that is, the payments were not associated with the lease and were not the reimbursement or assumption by the lessor of costs of the lessee because, for example, the payments reimbursed the lessee for improvements made to the lessor's asset).

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Standard	Proposed amendment
IFRS 16, *Leases* (cont.)	Because illustrative examples do not provide mandatory requirements, the requirements in IFRS 16 would prevail in case of any confusion or apparent conflict. Nonetheless, the IASB proposes to amend Illustrative Example 13 to remove the potential for confusion from this example.
IAS 41, *Agriculture*	The IASB proposes to remove the requirement in paragraph 22 of IAS 41 for entities to exclude cash flows for taxation when measuring fair value applying IAS 41.

The last date for comments on the exposure drafts issued by IASB is 20 August 2019.

(Source: Exposure Draft ED/2019/2 dated 21 May 2019 - Annual Improvements to IFRS Standards 2018-2020)

Directors of company required to file 'e-form Active'

Background

On 25 February 2019, the Ministry of Corporate Affairs (MCA) amended the Companies (Incorporation) Rules, 2014 and introduced Rule 25A. Rule 25A (as amended) specified that every company incorporated on or before the 31 December 2017 should file the particulars of the company and its registered office, in 'e-Form ACTIVE' (Active Company Tagging Identities and Verification) on or before 15 June 2019 (excluding companies under process of liquidation/dissolution or amalgamated). The attachments to 'e-From ACTIVE', *inter alia,* include a photograph of the registered office showing name of the company, address of the registered office, photograph of inside office along with at least one director/key managerial personnel who would sign the form, etc.

Failure to file 'e-Form ACTIVE' by 15 June 2019 by a company would be marked as 'ACTIVE-non-complaint'. Also, a company can file 'e-Form ACTIVE' on or after 16 June 2019 on payment of a fee of INR10,000 and company would be marked as 'ACTIVE-Complaint'.

New development

The MCA amended the Companies (Appointment and Qualification of Directors) Rules, 2014 and introduced Rule 12B on 16 May 2019. Rule 12B specifies that failure by the company to comply with Rule 25A (as above) would make the Director Identification Number (DIN) allotted to its existing directors marked as 'Director of ACTIVE non-compliant company'.

Directors with DIN status as 'Director of ACTIVE non-compliant company' would need to take necessary steps to ensure that all companies governed by Rule 25A in which he/she is a director file e-form ACTIVE. After all companies in which he/she is a director file 'e-Form ACTIVE', the DIN status would be restored and marked as 'Director of ACTIVE compliant company'.

(Source: MCA notification G.S.R.368 (E) dated 16 May 2019)

MCA issued National Financial Reporting Authority (Meeting for Transaction of Business) Rules, 2019

Background

The Companies Act, 2013 (2013 Act) provides regulatory framework for composition and constitution of National Financial Reporting Authority (NFRA). Section 132 of the 2013 Act provides that NFRA would be responsible for recommending accounting and auditing standards and oversight of the work of auditors and audit firms. The NFRA also has the power to levy monetary penalties or order debarment from practice on the auditors and audit firms.

On 13 November 2018, MCA has notified the NFRA Rules 2018. These rules empower NFRA to monitor and enforce compliance with both accounting and auditing standards, oversee the quality of service or undertake investigation of the auditors of the specified entities. These rules lay down functions and duties of NFRA and entities covered.

New development

The MCA through its notification dated 22 May 2019 issued the NFRA (Meeting for Transaction of Business) Rules, 2019. These Rules prescribe key definitions such as chairperson, secretary, part time member, etc. and procedures for transaction of business in NFRA meeting. These procedures, *inter alia,* include location, day, date, timing, leave of absence, meeting through video conferencing, quorum, minutes of the meeting, disclosure of interest, etc. It also enlists power to regulate procedures in certain circumstances and effect of any irregularities of procedure.

The Rules came into force on the date of publication in the official gazette i.e. 22 May 2019.

(Source: MCA notification G.S.R.377 (E) dated 22 May 2019)

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Amendment to Schedule VII to the Companies Act, 2013

Background

Section 135(3) of the 2013 Act requires Corporate Social Responsibility (CSR) Committee to formulate and recommend to the Board CSR policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII of the 2013 Act.

New development

The MCA through its notification dated 30 May 2019 inserted another CSR permissible activity as clause 'XII' to Schedule VII of the 2013 Act. The activity relates to 'disaster management, including relief, rehabilitation and reconstruction activities'.

(Source: MCA notification G.S.R.390 (E) dated 30 May 2019)

Prudential framework for resolution of stressed assets

Background

To harmonise and simplify the generic framework for resolving loan assets under stress, on 12 February 2018, the Reserve Bank of India (RBI) had introduced a Revised Framework for resolution of such stressed assets. This circular, *inter alia,* prescribed rules for recognising one-day defaults by large corporates and called for insolvency action under the Insolvency and Bankruptcy Code, 2016 (IBC) as a remedy. In April 2019, the Supreme Court declared the circular ultra vires and it was struck down.

New development

On 7 June 2019, RBI issued the Prudential Framework for Resolution of Stressed Assets (Prudential Framework), which comes into force with immediate effect. This has been issued to provide directions for early recognition, reporting and time bound resolution of stressed assets. With the introduction of the Prudential Framework, all the earlier schemes and guidelines issued by RBI in this respect[01] have been repealed.

Overview of the Prudential Framework

Applicability

The Prudential Framework is applicable to the following entities (collectively called 'lenders'):

- Scheduled Commercial Banks (SCBs) (excluding Regional Rural Banks)
- All India Term Financial Institutions (AITFIs)
- Small Finance Banks (SFBs), and
- Systemically Important Non-Deposit taking Non-Banking Financial Companies (NBFCs) and Deposit taking NBFCs (together termed as 'NBFCs').

The circular deals with various aspects related to early identification and reporting of stressed assets and timely implementation of a resolution plan.

Early identification and reporting of stress

Lenders are required to recognise incipient stress in loan accounts, immediately on default, by classifying the accounts as Special Mention Accounts (SMA) based on the number of days they are overdue. The accounts can be classified as SMA-0, SMA-1 and SMA-2.

Additionally, all credit information, SMA classification and defaults with regard to borrowers having an aggregate exposure (fund based and non-fund based) of INR5 crore or above should be reported to the Central Repository of Information on Large Credits (CRILC) through weekly and monthly reports.

Implementation of Resolution Plan

All lenders are required to put in place Board-approved policies for resolution of stressed assets, which include the timelines for resolution. The Resolution Plan (RP) may include any action, plan, and reorganisation such as regularisation of accounts, assignment, and change in ownership, restructuring or any other planned action, which should be clearly documented.

- **Review period:** As soon as a borrower is reported to be in default by either the SCBs, AITFIs or SFBs, the lenders are provided with 30 days review period, within which they are required to undertake a *prima facie* review of the borrower's account. During this period, lenders may decide the resolution strategy, including the nature of the RP, approach for implementation of RP, etc.

- **Inter-Creditor Agreement (ICA):** For borrowers with multiple-creditor facilities, where RP is to be implemented, all lenders concerned are mandated to enter into an ICA during the review period. The ICA, *inter alia,* prescribe the ground rules for finalisation and implementation of the RP. Decision agreed by lenders representing 75 per cent by value of total outstanding credit facilities[02] and 60 per cent of lenders by number, would be binding upon all lenders. The ICA should also protect the rights of dissenting lenders.

01. These include the framework for revitalising distressed assets, corporate debt restructuring scheme, flexible structuring of existing long-term project loans, Strategic Debt Restructuring (SDR) scheme, change in ownership outside SDR and the Scheme for Sustainable Structuring of Stressed Assets (S4A). These schemes have been withdrawn with immediate effect. Additionally, the Joint Lenders' Forum (JLF) which was a mandatory institutional mechanism for resolution of stressed accounts also stands discontinued.
02. Fund based and non-fund based

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- **Timelines for implementation of RP and additional provisions:** The RP should be implemented within 180 days from the ***end of*** the review period. The commencement of the review period (termed as 'reference date') would depend on the aggregate exposure of the borrower, as below:

Aggregate exposure of the borrower to SCBs, AITFIs and SFBs	Reference date
INR2,000 crore and above	• 7 June 2019 (if borrower is in default on that date), or • The date of first default after 7 June 2019
INR1,500 crore and above, but less than INR2,000 crore	• 1 January 2020 (if borrower is in default on that date), or • The date of first default after 1 January 2020
Less than INR1,500 crore	Not declared yet

Certain RPs involving restructuring/change in ownership would require Independent Credit Evaluation (ICE) of residual debt by specifically authorised Credit Rating Agencies (CRA) to be considered for implementation. For accounts with aggregate exposure of INR100 crore and above, one ICE is required and for accounts with aggregate exposure of INR500 crore and above, two ICEs are required. The credit opinion in all ICE(s) obtained (even if more than those prescribed) should be RP4 or better.

A delay in implementation of the RP would result in additional provisions over and above the total provisions held or required to be made as per the IRAC norms[03]. These are as below:

Timeline for implementation of RP	Additional provisions as a % of total outstanding
180 days from end of RP	20%
365 days from the **commencement** of RP	15% (i.e. total additional provision of 35% (20+15))

The additional provisions may be reversed as under:

- *When RP includes regularisation of account:* If the borrower is not in default for a period of six months from the date of clearing of overdue amounts with ***all lenders***
- RP includes restructuring/change in ownership ***outside IBC*** upon implementation of RP
- RP includes restructuring/change in ownership ***under IBC*** in the following cases:
  - Half of the additional provision is reversed on filing of insolvency application
  - Remaining additional provision is reversed on admission of the borrower into the insolvency resolution process under IBC
- RP includes assignment or recovery: On completion of assignment/recovery.

- **Provision as on 2 April 2019:** The Prudential Framework specifies that the provisions maintained as on 2 April 2019[04] in respect of any borrower should not be reversed, unless the reversal is required by the IRAC norms or on account of recovery or resolution following the instruction of the Prudential Framework.
- **RBI's direction for insolvency proceedings:** RBI may from time to time issue specific instructions for initiation of insolvency proceedings under IBC. The provisions of the Prudential Framework would not apply in those cases.

Prudential norms

The Prudential Framework prescribes the norms that all restructurings/change in ownership (whether under or outside IBC) would be subject to:

- **Asset classification:** On restructuring, all accounts would be immediately downgraded as Non-Performing Assets (NPAs) (i.e. substandard to begin with), and accounts classified as NPA would be retained in the same category.
- **Upgrade of accounts:** Accounts would be upgraded only when they demonstrate satisfactory performance during the prescribed period and for certain large accounts, when they are rated as investment grade (BBB- or better) at the time of upgrade by CRAs accredited by RBI for the purpose. Specific criteria is prescribed for accounts where there has been a change in ownership. Provisions held on restructured assets may be reversed when they are upgraded to standard category.
- **Additional and interim finance:** The classification of additional and interim finance advanced under the RP would depend on the performance of the account as specified in the Prudential Framework.
- **Provisioning norms:** The accounts restructured under the Prudential Framework are required to follow the IRAC norms for provisioning. For accounts referred to IBC, the provisioning should be at least equal to the provisioning required in the normal course upon implementation of RP. The provisions in this case would be frozen for a prescribed period, subsequent to which, the IRAC norms would apply.

03. RBI's Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances dated 1 July 2015.

04. Date of quashing of the erstwhile circular.

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- **Other provisions:** The Prudential Framework provides guidelines for other provisions such as:
  - Recognition of income (on cash or accrual basis) for restructured assets
  - Asset classification and provisioning for Funded Interest Term Loans (FITL), debt and equity instruments created by conversion of principal/ unpaid interest
  - Principles for classifying sale and lease back transactions and refinancing of exposures to borrowers as 'restructuring'
  - Provides regulatory exemptions from certain provisions of RBI and the Securities and Exchange Board of India (SEBI).

Exceptions to the Prudential Framework

The Prudential Framework would not apply in certain cases:

- Projects under implementation involving deferment of Date of Commencement of Commercial Operations (DCCO)- these would be covered under the RBI Master Circular dated 1 July 2015
- Micro, Small and Medium Enterprises (MSMEs)- these would be covered under the RBI circular dated 17 March 2016
- Borrower entities in respect of which specific instructions have been issued by RBI for initiation of insolvency proceedings under IBC
- Restructuring of loans in the event of natural calamity.

(Source: RBI notification no. RBI/2018-19/203 dated 7 June 2019)

MCA issued Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2019- Reconciliation of Share Capital Audit Report

The MCA through its notification dated 22 May 2019 issued Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2019 to amend the Companies (Prospectus and Allotment of Securities) Rules 2014. The amended rule requires that every unlisted public company should submit Form PAS-6 to the Registrar with requisite fees which, *inter alia,* include detailed classification of the capital of the company held in dematerialised and physical form. The form is referred as 'Reconciliation of Share Capital Audit Report'. Form PAS-6 shall be filed within 60 days from each half year end (September and March) duly certified by a chartered accountant/company secretary in practice.

The information to be furnished while filing the form shall be for the half year ended 30 September and 31 March in every financial year for each International Securities Identification Number (ISIN) separately.

The rule shall come into force with effect from 30 September 2019 subject to publication in the Official Gazette.

(Source: MCA notification G.S.R.376 (E) dated 22 May 2019)

Clarification on auditor's certificate on return of deposits (Form DPT-3)

The Companies (Acceptance of Deposits) Rules, 2014 (Deposit Rules) prescribes the requirements relating to companies accepting the deposits. The MCA with an aim to increase transparency on the part of companies accepting deposits from its members or public mandated filing of following returns:

- **Annual return (Rule 16):** Every company (other than a government company) should use form DPT-3 (return of deposits) to file:
  a. A return of deposit
  b. Particulars of a transaction not considered as deposit or
  c. Both

  This return should be filed with the Registrar of Companies (ROC) on or before 30 June of every year (comprising information contained therein as on 31 March of that year duly audited by the auditor of the company).
- **One-time return (Rule 16A):** A one-time return is required to be filed by every company (other than a government company) with respect to the receipt of money or loan outstanding from 1 April 2014 till 31 March 2019 but not considered as deposits. The return should be filed with the ROC by 29 June 2019 (i.e. within 90 days from 31 March 2019) along with specified fees.

These returns require companies to provide detailed information regarding 13 categories of financial transactions, therefore MCA received requests from the stakeholders seeking clarifications relating to filing of the DPT-3 form.

In this regard, the MCA vide its letter to ICAI (dated 24 June 2019) has clarified as under:

- The auditor's certificate is mandatory only in case when return of deposits is to be filed
- For filing particulars of transactions not considered as deposits as on 31 March of that year need not be from the duly audited financial statements.

Also in order to provide guidance to auditors on the format of the certificate, the Auditing and Assurance Standards Board (AASB) of ICAI has issued Illustrative Auditor's Certificate on Return of Deposits.

(Source: ICAI announcement dated 25 June 2019)

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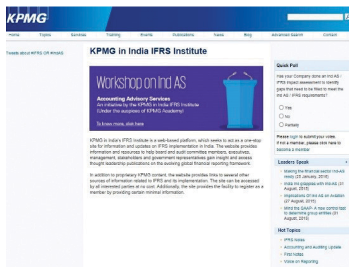

KPMG in India's IFRS institute

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 proposes changes in the rights issue process

12 June 2019

The Companies Act, 2013 and the Securities Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements (ICDR)) Regulations, 2018 lay down general conditions and procedure for rights issue. Every listed issuer is required to comply with the requisite conditions before making rights issue within the stipulated timelines.

SEBI on 21 May 2019 issued a discussion paper on Review of Rights Issue Process to explore ways to make the rights issue process more efficient. Currently, the listed issuer requires 55 to 58 days for undertaking rights issue process through the fast track route. In this regard, SEBI proposed to reduce the timelines both in the pre issue opening phase and after issue closure such that the issuer and shareholders benefit from process efficiencies.

The discussion paper issued by SEBI evaluates means to reduce time between the announcement of terms of the issue and issue closing which would help in reducing price risks.

This issue of First Notes provides an overview of the proposals made by SEBI.

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 22 May 2019, KPMG in India organised a special session of VOR webinar to discuss significant impact areas of Ind AS 116, *Leases* on life sciences sector.

Also we discussed other important updates e.g. Appendix C, *Uncertainty over Income Tax Treatments* of Ind AS 12, *Income Taxes*. The new guidance seeks to bring clarity to the accounting for income tax treatments that are yet to be accepted by tax authorities. The appendix is effective for accounting periods beginning on or after 1 April 2019.

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