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Voices on Reporting

Quarterly updates

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In this publication, we have summarised important updates relating to the quarter ending 30 September 2019 from the Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI), the Institute of Chartered Accountants of India (ICAI) and the Ministry of Law and Justice .

Updates relating to Ind AS

MCA clarifies 'appointed date' and 'acquisition date' in a scheme of arrangement

Requirements of the Companies Act, 2013 (2013 Act)

Currently, a company undertaking a scheme of arrangement is governed by the provisions of Section 230 and 232 of the 2013 Act. The schemes of arrangement are required to be approved by the National Company Law Tribunal (NCLT). In case a scheme filed with NCLT relates to:

a) Reconstruction of the company or merger/amalgamation between companies and

b) It involves transfer of undertaking, property or liabilities of one company to another or is proposed to be divided among and transferred to two or more companies

then, as per Section 232(6) of the 2013 Act, the scheme should indicate an appointed date from which it would be deemed to be effective. However, the term 'appointed date' has not been defined under the 2013 Act.

When NCLT approves a scheme, then the order of the NCLT is required to be filed with the Registrar of Companies (ROC) within 30 days of the receipt of certified copy of the order as per Section 232(5) of the 2013 Act.

No compromise or arrangement would be sanctioned by the NCLT unless a certificate by the company's auditor has been filed with the NCLT to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under Section 133 of the 2013 Act.

Requirements of Ind AS

As per Ind AS 103, *Business Combinations*, an acquirer needs to identify an 'acquisition date' which is the date on which it obtains control of an acquiree. Such a date is generally the closing date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree.

However, an acquirer could obtain control on a date earlier or later than the closing date (e.g. a written agreement provides that the acquirer obtains control of the acquiree on a date before closing date).

Issue under consideration

The Ministry of Corporate Affairs (MCA) received various queries on determination of 'appointed date' and 'acquisition date' such as whether it is mandatory to indicate a specific calendar date as 'appointed date' in a scheme of arrangement. Also, whether acquisition date for the purpose of Ind AS 103 would be the appointed date as referred in Section 232(6) of the 2013 Act.

Clarification issued by MCA

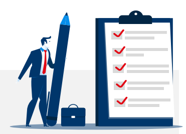
To provide clarity relating to the matter, on 21 August 2019, MCA issued a circular which provides that the provision of Section 232(6) of the 2013 Act is an enabling provision which allows the companies in the scheme to decide and agree upon an appointed date from which the scheme should come into force. Accordingly, the concerned companies can choose and state the agreed appointed date in the scheme.

MCA considered two landmark judgements[1] to clarify that an appointed date would be a specific calendar date or it could be tied to the occurrence of an event, such as grant of license by a competent authority or fulfilment of any preconditions agreed upon by the parties, or meeting any other requirement as agreed upon between the parties which are relevant to the scheme.

Accordingly, based on the above, MCA provided following clarification:

The scheme specifies a calendar date as an appointed date	The appointed date may precede the date of filing of the application for scheme of merger/amalgamation with NCLT. However, if the appointed date specified in the scheme is ante-dated beyond a year from the date of filing of the scheme, then the company is required to disclose the reasons for the chosen date in the scheme itself which should not be prejudicial to the public interest.
The appointed date is based on occurrence of an event	The scheme may identify the appointed date based on the occurrence of a trigger event which is key to the proposed scheme and agreed upon by the parties to the scheme. The event on the occurrence of which the scheme would become effective should be indicated in the scheme. In case such event-based date is a date subsequent to the date of filing the order with the ROC under Section 232(5) of the 2013 Act, then the company should file an intimation of the same with the ROC within 30 days of such scheme coming into force.
Appointed date and acquisition date	The MCA also clarified that appointed date identified in the scheme would be deemed to be the acquisition date and date of transfer of control for the purpose of conforming to accounting standards (including Ind AS 103).

Key takeaway



The MCA clarification is expected to bring uniformity in practices followed by companies in India in determining the 'appointed date' while undertaking schemes of amalgamation/merger. As per the clarification, companies would identify an appointed date which could be a specific calendar date or can also be based on occurrence of an event which is key to the proposed scheme. Further, the date specified in the scheme could also be different from the date of order of the NCLT approving the scheme.

Source: MCA circular 9/2019 dated 21 August 2019 and KPMG in India's First Notes MCA clarifies 'appointed date' and 'acquisition date' in a scheme of arrangement dated 9 September 2019

1. Marshall & Co. India Ltd. vs. ITO and Amalgamation of Equitas Housing Finance Limited and Equitas Micro Finance Limited with Equitas Finance Limited

ICAI revised FAQ on presentation of dividend and dividend distribution tax

Ind AS 12, *Income Taxes* prescribe the accounting for the income tax consequences of dividends i.e. Dividend Distribution Tax (DDT). The Companies (Indian Accounting Standards) Second Amendment Rules, 2019 amended Ind AS 12 from 1 April 2019. The amendment provides that an entity should recognise all income tax consequences of dividends (including payments on financial instruments classified as equity), consistently with the transactions that generated the distributable profits. Therefore, an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised those past transactions or events.

Further, paragraph 65A of the amended Ind AS 12 provides that when an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends. The term 'withholding tax' is neither defined in the Income-tax Act, 1961 (IT Act) nor under Ind AS.

Considering the amendment to Ind AS 12, on 17 September 2019, the Accounting Standards Board (ASB) of the ICAI revised its Frequently Asked Question (FAQ) and clarified the treatment of DDT. As per the ASB, withholding tax is only an example of tax collection mechanism envisaged by Ind AS 12. Therefore, ASB concluded that the standard does recognise possibility of other tax collection mechanisms, which have to be interpreted keeping in mind the substance and underlying intent of tax laws of the country. Accordingly, the ASB considered following two indicators to evaluate whether DDT is a portion of tax paid by company on behalf of its shareholders:

- **Dividend received with an imputed tax credit**: As per the ASB, dividend is received by the shareholders in India with an imputed tax credit i.e. it will not be charged to further tax by the taxation authorities in the hands of shareholders. Therefore, DDT is covered by situation of paragraph 65A as per ASB.
- **Receipt of net/full amount of dividend declared and 'grossing up' of DDT**: As per ASB, in India, the amount of dividend is grossed up by the company for computation of DDT and shareholders receive a net amount of the dividend after deducting tax. Thus DDT is a portion of the dividends paid to taxation authorities on behalf of its shareholders. Considering that ASB concludes that DDT in substance is payment by the company on behalf of the shareholders and thus, will be covered under paragraph 65A.

With respect to presentation of the DDT, the ASB is of the view that an entity should consider the relevant guidance in paragraph 61A of Ind AS 12. Para 61A states that 'current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss.

Accordingly, the ASB clarified that the presentation of DDT paid on dividends should be consistent with the presentation of the transaction that creates those income tax consequences, as follows:

- *Dividend charged to statement of profit and loss*: Charge DDT to the statement of profit and loss.
- *Dividend recognised in statement of changes in equity:* Recognise DDT in the statement of changes in equity.

Source: FAQ on presentation of dividend and dividend distribution tax issued by ICAI on 17 September 2019

ITFG Clarifications' Bulletin 21

The Ind AS Technical Facilitation Group (ITFG) of ICAI issued its clarifications' bulletin 21 on 17 September 2019. The bulletin clarifies on five issues relating to application of Ind AS 116, *Leases*.

The new standard on leases i.e. Ind AS 116 is applicable for accounting periods beginning on or after 1 April 2019 and replaces Ind AS 17, *Leases*. The new standard brings a significant change in the lease accounting by lessees. It eliminates the classification of leases as either finance or operating lease as required under Ind AS 17. A lessee is required to recognise a right-of-use asset along with a lease liability on its balance sheet if it has the right to control the use of an identified asset in a contract (similar to current finance lease accounting model).

The following section summarises clarifications issued by bulletin 21.

Issue 1: Determination of lease term

To determine the lease term (and therefore to determine whether a lease is a short-term lease) only the enforceable rights of the lessee to renew or extend the lease beyond the non-cancellable period should be considered. Ind AS 116 provides recognition exemption for short term leases and leases of low-value items i.e. a lessee may elect not to apply the lease accounting model in such cases.

A lease agreement would qualify as a short-term if it is for a lease term of 12 months or less at its commencement and it does not contain a purchase option. In relation to this, ITFG discussed the following situations with reference to guidance given under Ind AS 116:

- *The lease agreement provides the lessee with a right to renew or extend the lease beyond the non-cancellable period without the consent of the lessor.* In such case the period covered by the lessee's option to renew or extend is included in the lease term if the lessee is reasonably certain to exercise that option.
- *The lease agreement can be renewed or extended beyond the non-cancellable period with the consent of the lessor.* In such case, if there are no enforceable rights and obligations existing between the lessee and lessor beyond that term then there is no contract beyond the non-cancellable period.

The ITFG clarified that, where a lease agreement (including addendum, if any) which is entered for a period of 12 months or less and does not grant a renewal or extension option to the lessee, then such an agreement would qualify as a short-term lease even if there is a past practice of the lease being renewed upon expiry for a further one year at a time with the mutual consent of the lessee and the lessor. Accordingly, such lease agreements would qualify to avail the exemption of not applying the lease accounting model under Ind AS 116.

Issue 2: Accounting treatment of rent equalisation liability

The ITFG considered a situation to evaluate manner of dealing with the rent equalisation liability appearing in the balance sheet of an entity as at 31 March 2019 depending on the transition approach followed.

The ITFG discussed the situation in respect to following three scenarios:

Scenario I: Ind AS 116 is applied retrospectively

For each lease, the amount of the lease liability and the related right-of-use asset as at the beginning of the preceding period (i.e. 1 April 2018) would be determined as if Ind AS 116 had always been applied.

The difference between the right-of-use asset (together with lease equalisation liability) and lease liability would be recognised in retained earnings (or other component of equity, as appropriate).

The comparative amounts presented in the financial statements for the year ended 31 March 2020 would be restated.

If the retrospective application of Ind AS 116 has a material effect on the information in the balance sheet at the beginning of the preceding period (i.e. 1 April 2018), a third balance sheet will also need to be presented.

Scenario II: Ind AS 116 applied using modified retrospective approach

Assumption 1: The right-of-use asset is measured as if Ind AS 116 had been applied since the commencement date but discounted using the lessee's incremental borrowing rate at the date of initial application (paragraph C8(b)(i) of Ind AS 116). Following will be the accounting:

- The difference as at the date of initial application between the right to use asset (together with lease equalisation liability) and lease liability would be recognised in retained earnings (or other component of equity, as appropriate).
- Comparatives would not be restated, and a third balance sheet would not be presented at the beginning of the preceding period (i.e. 1 April 2018).

Assumption 2: The right-of-use asset is measured at an amount equal to the lease liability adjusted by the amount of any prepaid accrued lease payments relating to lease recognised in the balance sheet immediately before the date of initial application (paragraph C8(b)(ii) of Ind AS 116). Following will be the accounting:

- Consider rent equalisation liability as 'accrued lease payments' and the amount of right-of-use asset would be determined by deducting the said liability from the amount of lease liability.
- Comparatives would not be restated, and a third balance sheet would not be presented at the beginning of the preceding period (i.e. 1 April 2018).

Issue 3A: Lease consideration paid upfront at the beginning of contract

ITFG considered a situation, to determine whether a transaction would be qualified as 'lease' under Ind AS 116 when the upfront payment made by lessee accounts for almost all the present value of the payments to be made over the lease term. Additionally, the periodic lease rent is a nominal amount (e.g. INR1 per square meter per year for a piece of land).

Considering the definition under Ind AS 116, ITFG clarified that the for a contract (or a part of a contract) to qualify as a 'lease', exchange of consideration for the right-of-use of the underlying asset is essential. However, the timing or pattern of flow of such consideration is not relevant in determining whether an arrangement is a lease. If the lease deed executed between the lessor and lessee creates enforceable rights and obligations between the two parties and then such a lease deed would constitute a contract. Additionally, the contract should convey the right-of-use of the underlying asset to the lessee in exchange for upfront payment of lease premium and annual payment of lease rent (consideration).

If the above-mentioned condition is satisfied, the lease deed would qualify as a 'lease' within the meaning of Ind AS 116, notwithstanding that almost all of the consideration has been paid by the company upfront.

Issue 3B: Treatment of a lease classified as finance lease under Ind AS 17 upon transition to Ind AS 116

ITFG discussed the accounting of the lease under Ind AS 116 in the books of lessee, when lease was classified as a finance lease under Ind AS 17. Considering the guidance under Ind AS 116, ITFG clarified following:

- **Accounting of lease liability**: The requirements of Ind AS 116 relating to measurement of lease liability by a lessee at commencement date are substantially similar to requirements under Ind AS 17 for initial measurement of finance lease payable by a lessee. Therefore, the amount of lease liability immediately upon transition to Ind AS 116 would be similar regardless of whether the company applies either of the transition option available under Ind AS 116.
- **Accounting of Right-of-use asset**: The requirements of both Ind AS 116 and Ind AS 17 as to the period over which and the manner in which, the right-of-use asset (under Ind AS 116) or the asset arising from the finance lease (under Ind AS 17) should be depreciated are similar. Considering the similar requirements, ITFG clarified that the amount of right-of-use asset immediately upon transition to Ind AS 116 would be similar regardless of whether the company applies either of the transition option available under Ind AS 116.

- **Lease term**: ITFG discussed the requirements as to determination of lease term (particularly when a period covered by a renewal option should be included in lease term) and clarified that if the lease term was correctly determined by the lessee under Ind AS 17, the same assessment of lease term would continue under Ind AS 116 also.

  Further, ITFG clarified that unless the title transfer to the lessee at the end of the lease term or the lessee has a purchase option that is reasonably certain to be exercised, a leasehold land is a depreciable asset even if the lease term is very long.

Issue 4: Application of Ind AS 116 for leases acquired in a business combination by a first-time adopter of Ind AS

Entity A is a first-time adopter of Ind AS. Its date of transition is 1 April 2018 and it would apply Ind AS for the first time when it prepares its financial statements for the accounting period beginning on 1 April 2019.

In the year 2014, Entity A acquired an Indian company as its subsidiary. The acquisition qualifies as a business combination as per Ind AS 103, *Business Combinations*.

At the date of its acquisition, the acquired subsidiary was a lessee in certain operating leases which were not capitalised in the Consolidated Financial Statements (CFS) prepared by Entity A in accordance with previous GAAP (Ind AS 17).

As a first-time adopter of Ind AS, Entity A is required to apply Ind AS 101, *First-time Adoption of Indian Accounting Standards*, in preparing its first Ind AS financial statements which would include, *inter-alia*, an opening Ind AS balance sheet as at the date of transition to Ind AS.

In accordance with Ind AS 101, the general requirement is retrospective application of the standards in force at the end of an entity's first Ind AS reporting period. However, there are certain optional exemptions from, and some mandatory exceptions to, this general requirement.

Accordingly, Entity A, being a first-time adopter could apply the transitional provisions contained in Ind AS 116 only to the extent required or allowed to do so under Appendices B-D of Ind AS 101 and they are provided in next column:

Exemption from restating past business combinations

For business combinations that occurred before the date of transition, entities have the following choices:

- Restate all business combinations;
- Restate all business combinations after a particular date or
- Do not restate any of the business combinations.

Exemption from retrospective application of Ind AS 116

Ind AS 101 contains certain practical expedients in relation to Ind AS 116.

Therefore, Entity A could have taken the above choices and it would result in following scenarios:

Scenario 1: The business combination is restated

Entity A would need to account for the business combination retrospectively from the acquisition date.

Accordingly, it would be required to apply Ind AS 116 to acquired leases as if each of those leases were a new lease at the acquisition date. However, an acquirer is exempted from recognition of right-of-use assets and lease liability in the following two cases:

- Leases for which the lease term (as defined in Ind AS 116) ends within 12 months of the acquisition date or
- Leases for which the underlying asset is of low value.

Entity A would measure the lease liability in respect of a lease at the acquisition date in accordance with Ind AS 116. This would include measuring the lease liability at the present value of the lease payments that are not paid at that date. The lease payments should be discounted using the interest rate implicit in the lease, if that rate could be readily determined. If that rate cannot be readily determined, the lessee should use the lessee's incremental borrowing rate.

Further, ITFG has clarified that the incremental borrowing rate would be determined with reference to the acquisition date which represents the commencement date within the meaning of Ind AS 116 in respect of leases acquired in a business combination.

Scenario 2: The business combination is not restated

In case the business combination is not restated, the accounting treatment of the acquired leases in the first Ind AS CFS would be as follows.

- In case Entity A does not select to avail of the exemption provided by Ind AS 101 in respect of leases, it would measure the lease liability and right-of-use asset in respect of the acquired leases at the date of transition to Ind AS by applying Ind AS 116 retrospectively from the acquisition date. This implies, *inter-alia* that the lease payments would be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee's incremental borrowing rate determined with reference to the acquisition date would be used.
- In case Entity A selects to avail of the exemption provided by Ind AS 101 in respect of leases, it would measure the lease liability and right-of-use asset in respect of the acquired leases at the date of transition to Ind AS by applying paragraph D9B of Ind AS 101. This implies, *inter-alia*, that the incremental borrowing rate to be applied for measuring the lease liability would be determined with reference to the date of transition to Ind AS.

Issue 5: Treatment of foreign exchange differences relating to lease liability

The ITFG considered an issue that whether the foreign exchange differences relating to the lease liability recognised by the company are covered by the optional exemption provided by paragraph D13AA of Ind AS 101 or whether the same should be expensed off immediately as they arise.

In this regard, ITFG discussed guidance given under paragraph D13AA of Ind AS 101, that the exemption provided under Ind AS 101 is available only in respect of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Thus, the exemption is not available in respect of a lease liability recognised by a lessee because of application of Ind AS 116 as the lease liability as per Ind AS 116 was not recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Further paragraph 18 of Ind AS 101 specifically states that an "entity shall not apply the exemptions contained in Appendices C-D by analogy to other items."

Considering above, foreign exchange differences relating to the lease liability recognised by the company as per Ind AS 116 should be charged to statement of profit and loss.

Source: ICAI-ITFG clarification bulletin 21 dated 17 September 2019

Updates relating to the Companies Act, 2013

The Companies (Amendment) Act, 2019 received Presidential assent

On 31 July 2019, the Companies (Amendment) Act, 2019 (the Amendment Act) received the assent of the President of India which further amends the Companies Act, 2013 (2013 Act). The Amendment Act incorporates most of the amendments made by the Companies (Amendment) Ordinance, 2018 (ordinance) which was replaced by Companies (Amendment) Ordinance, 2019 and the Companies (Amendment) Second Ordinance, 2019 (second ordinance).

The key amendments made by the ordinance are as follows:

Topic	Key amendments
Changes in main provisions of the 2013 Act	• Power vested with the Central Government (CG) (instead of Tribunal) to approve changes to the Financial Year (FY) and alteration of articles pursuant to conversion of public companies into private companies • An additional disqualification was added that would prevent a person to be appointed as a director • Additional events added which could lead to removal of name of a company from the register of companies • Revised timeline was prescribed for registration of a charge by companies.
Changes in penal provisions	• Non-compliance with provisions relating to issue of shares at discount would amount only to a penalty, instead of imposition of fine, imprisonment or both • Furnishing false/incorrect information at the time of creating charge would be liable to action under Section 447 of the 2013 Act (i.e. fraud)

Topic	Key amendments
Changes in penal provisions (cont.)	• Penalty for frauds which involve 'an amount of INR10 lakh or more or one per cent of the turnover of the company (whichever is lower) and do not involve public interest' has been increased to INR50 lakh from INR20 lakh • Penalty for second or subsequent default under the provisions of the 2013 Act has been prescribed as an amount equal to twice the amount of penalty provided for such default under the relevant provisions of the 2013 Act • Failure to file an annual return would result in a penalty instead of a fine or imprisonment.

Source: KPMG in India's analysis, 2019 based on the amendments made by the ordinance and second ordinance

While the amendments issued through the ordinance were already effective from 2 November 2018, the new amendments brought by the Amendment Act will come into force from the date notified by CG.

Some of the key amendments made by the Amendment Act are as follows:

Constitution of NFRA (Section 132)

The MCA has notified the constitution of National Financial Reporting Authority (NFRA) with effect from 1 October 2018 to provide for matters relating to accounting and auditing standards under the 2013 Act.

Currently, the NFRA has the power to make an order for debarring the member or the firm from engaging himself/herself or itself from practice as member of the Institute of Chartered Accountants of India (ICAI) for a minimum period of six months and maximum period of 10 years, in case a professional or other misconduct is being proved with regard to any member or firm of Chartered Accountants (CAs), registered under the CA Act, 1949.

The Amendment Act now clarified that the NFRA will have the power to make order for debarring the member or the firm for the said period from:

a) Being appointed as an auditor, internal auditor, undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate or

b) Performing any valuation as provided under Section 247 of the 2013 Act. For instance:

   - Valuation of share price in case of further issue of share capital by a company
   - Valuation of shares, property and all assets for the purpose of proposed compromise or an arrangement between a company and its creditors or between a company and its members and
   - Valuation of the assets held by a company in case a winding up order has been passed or a company liquidator has been appointed by the National Company Law Tribunal (NCLT).

Investigation into affairs of a company by SFIO (Section 212)

If the Serious Fraud Investigation Office (SFIO) in its report to the CG states that a fraud has taken place in a company and due to this fraud an undue advantage or benefit, whether in the form of any asset, property, cash or in any other manner has been taken by any director, Key Managerial Personnel (KMP), other officer of the company or any other person or entity, then in such a case, the CG may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property or cash and also for holding such director, KMP, other officer or any other person liable personally without any limitation of liability.

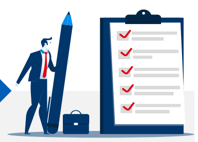
Prevention of oppression and mismanagement (Sections 241, 242 and 243)

Currently, the CG is authorised to apply directly to the Tribunal when it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to the public interest.

The Act additionally, empowers the CG to approach the Tribunal to issue an order against the persons who are connected with the conduct and management of the company as 'not fit and proper persons' for the acts committed by them and which could tantamount to mismanagement. Further, if NCLT consider such person as not a fit and proper person then such persons would not hold office of a director or any other office connected with the conduct and management of the affairs of any company for a period of five years from the date of the order. Additionally, such a person would not be entitled to any compensation for the loss or termination of office.

The above amendments have been made effective from 15 August 2019.

Key takeaway



The amendments made by the Amendment Act seek to strengthen the corporate governance norms in India. The Amendment Act incorporates most of the amendments made by the second ordinance also it includes certain other amendments.

Source: The Companies (Amendment) Act, 2019 dated 26 July 2019 and KPMG in India's First Notes: The Companies (Amendment) Act, 2019 received Presidential assent dated 16 August 2019.

MCA issued amendments relating to issue of shares with differential rights

On 16 August 2019, MCA issued the Companies (Share Capital and Debentures) Amendment Rules, 2019 and amended certain provisions relating to issue of shares and debentures by a company under the 2013 Act. The amendments have been made effective from 16 August 2019.

The key amendments are as follows:

Equity shares with differential rights

Currently, a company limited by shares can issue equity shares with differential rights as to dividend, voting or otherwise if it satisfies following conditions:

- The shares with differential rights do not exceed **26 per cent of the total post-issue paid up equity share capital** including equity shares with differential rights issued at any point of time and
- The company have a consistent track record of distributable profits for the last three years.

Amendment

The amendment rules brought the following provisions in respect to issue of equity shares with differential rights:

- For issuing equity shares with differential rights, the existing cap of 26 per cent of the total post-issue paid up equity share has been increased to **74 per cent of total voting power** including voting power in respect of equity shares with differential rights issued at any point of time.
- Omitted the condition which required companies limited by shares to have a track record of distributable profits for the last three years.

Debenture Redemption Reserve (DRR)

Currently, every company issuing redeemable debentures to create a DRR of at least 25 per cent of outstanding value of debentures for the purpose of redemption of such debentures. Further DRR is not required to be maintained for debentures issued by All India Financial Institutions (AIFIs) regulated by the Reserve Bank of India (RBI) and banking companies for both public as well as privately placed debentures.

Amendment

The amendment rules brought the following amendments relating to DRR:

- *Exemption from creation of DRR*: MCA has exempted listed companies (other than AIFIs and banking companies) and unlisted Non-Banking Financial Company (NBFC) registered with RBI and Housing Finance Companies (HFCs) registered with National Housing Bank from creation of DRR.

- *Reduction in percentage*: MCA reduced the contribution percentage of DRR from 25 to 10 per cent of the value of outstanding debentures for other unlisted companies.

Source: MCA notification no. G.S.R. 574(E) dated 16 August 2019

ICAI issues advisory on auditor's reporting under Section 197

Section 197(16) of the 2013 Act requires an auditor of a public company to state in its audit report (under Section 143(3) of the 2013 Act) whether the remuneration paid by the company to its directors is in accordance with the provisions of Section 197 or whether remuneration paid to any director is in excess of the limit laid down and give such other details as may be prescribed.

On 9 September 2019, the ICAI issued an advisory and clarified that the reporting requirement under Section 197(16) should be covered under 'Report on Other Legal and Regulatory Requirements' section of the auditor's report.

The advisory comes into force from 9 September 2019.

Source: ICAI announcement dated 9 September 2019

Updates relating to SEBI regulations

SEBI issues revised format for compliance report on corporate governance

Background

Regulation 27(2) of the Securities Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) requires every equity listed company to submit a quarterly compliance report on corporate governance (report) to the recognised stock exchange(s) within 15 days from the close of the quarter in the format specified by SEBI.

SEBI through its circular dated 24 September 2015 specified the formats for the report that should be submitted to the recognised stock exchange(s) with 15 days:

- On a quarterly basis
- At the end of Financial Year (FY) (for the whole of FY)
- At the end of six months after the end of FY. This may be submitted along with second quarters report.

Further, Regulation 17(3) of the Listing Regulations also requires the Board of Directors (BoD) of the listed company to periodically review the above reports as well as steps taken by the listed company to rectify instances of non-compliances.

New development

On 16 July 2019, SEBI through its circular issued revised formats for compliance report on corporate governance. The modifications to the formats have been made based on the recent changes made to the Listing Regulations pursuant to Kotak Committee and other amendments.

The key compliances to be additionally reported in the report are as follows:

Chairperson is related to the MD or CEO: The Listing Regulations require top 500 equity listed entities to ensure that the chairperson of the board of such listed entities should be a non-executive director and not related to the Managing Director (MD) or Chief Executive Officer (CEO). This requirement is effective from 1 April 2020.

Therefore, the revised compliance report requires every equity listed entity to disclose whether chairperson is related to MD or CEO on a quarterly basis. Entities are required to ensure compliance with the requirement from 1 April 2020, however, they are required to disclose the fact, if chairperson is related to MD or CEO, from quarter ending September 2019.

Quorum for the board meeting: Every equity listed entity is required to ensure that the quorum for every meeting of the board of directors should be one-third of its total strength or three directors, whichever is higher, including at least one independent director. The requirement has been made applicable to top 1,000 listed entities with effect from 1 April 2019.

Accordingly, the revised compliance report issued by SEBI requires compliance with the above requirement to be disclosed on a quarterly basis effective 30 September 2019 and will also form part of annual disclosures. The requirement is applicable to top 1,000 listed entities from 1 April 2019.

Disclosure on websites: Following are the disclosure requirement to be made on the website of equity listed entities:

a) Separate section for investors on the website for all information mandated under Regulation 46(2) of the Listing Regulations

b) Credit rating or revision in credit rating obtained for all outstanding instruments

c) Separate audited financial statements of each subsidiary of the listed entity in respect of a relevant financial year, uploaded at least 21 days prior to the date of the Annual General Meeting (AGM) which has been called to, *inter-alia,* consider accounts of that financial year.

The above requirements have been made effective from 1 April 2019 and should be reported at the end of FY to the stock exchanges. Additionally, listed entities are required to furnish against each item, required to be disclosed on the website, the link of the website where it has been posted/uploaded.

Sign-off of the report: As per Regulation 27(2) of the Listing Regulations, compliance report on corporate governance is required to be signed either by the compliance officer or the CEO of the listed entity. However, as per the revised format, the report can also be signed by the Chief Financial Officer (CFO) of the listed entity.

Effective date: The revised formats have been made effective from the quarter ending 30 September 2019.

Key takeaways

SEBI undertook various amendments to the Listing Regulations pursuant to Kotak Committee recommendations. The amendments aim towards better corporate governance for listed entities. SEBI through the revised compliance report incorporated consequential changes to the format of the compliance report.

Source: SEBI circular no. SEBI/HO/CFD/CMD1/CIR/P/2019/78 dated 16 July 2019 and KPMG in India's First Notes on 'SEBI issues revised format for compliance report on corporate governance by listed entities' dated 31 July 2019

Additional disclosure of reasons for encumbrance by promoter of listed companies

Background

Regulation 31(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 requires disclosure of details of shares in a target company encumbered by the promoter/persons acting in concert. The format of the disclosure has been prescribed by SEBI through circular dated 5 August 2015.

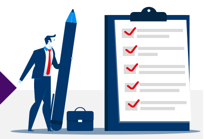
New development

SEBI through its circular dated 7 August 2019 prescribed additional disclosure requirements in relation to encumbered shares. As per the circular, promoter of every listed company is specifically required to disclose detailed reasons for encumbrance if the combined encumbrance by the promoter along with persons acting in concert with him/her equals or exceeds 50 per cent of their shareholding in the company or 20 per cent of the total share capital of the company.

The disclosure of reasons for encumbrance should be made within two working days from the creation of such encumbrance to every stock exchange (where the shares of the company are listed) and to the listed company in the format provided in Annexure - II of the circular. The disclosure is required to be made on every occasion when the extent of encumbrance increases further from the prevailing levels. The disclosure requirement is applicable from 1 October 2019.

In case the existing combined encumbrance by the promoter along with persons acting in concert with him/her is either 50 per cent or more of their shareholding in the company or 20 per cent or more of the total share capital of the company as on 30 September 2019, then the promoter is required to make the disclosure on detailed reasons for encumbrance by 4 October 2019 (in the format specified in Annexure – II of the circular).

Key takeaways



The enhanced disclosure requirement is expected to provide greater transparency regarding reasons for encumbrance, particularly when significant shareholding by a promoter along with persons acting in concert with him/her is encumbered.

Source: SEBI circular no. SEBI/HO/CFD/DCR1/CIR/P/2019/90 dated 7 August 2019

SEBI issues directions for settlement of outstanding dues prior to filing a scheme of arrangement

In order to streamline the processing of draft schemes of arrangements, SEBI on 12 September 2019 has issued directions to listed entities in relation to payment of outstanding dues to SEBI, stock exchanges and depositories. The SEBI has amended its circular (CFD/DIL3/CIR/2017/21) dated 10 March 2017 and inserted a new paragraph on 'Unpaid Dues Report'. Below are the new provisions relating to unpaid dues to SEBI, stock exchanges and depositories:

Obligations on listed entities

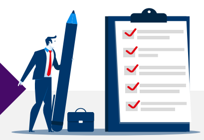
- **Payment of fines/penalties:** All listed entities should ensure that all dues to, and/or fines/penalties imposed by SEBI, stock exchanges, depositories, etc. have been paid/settled before filing the draft scheme with the designated stock exchange.
- **Unpaid dues**: In case there are unpaid dues/fines/penalties, then a listed entity, prior to obtaining observation letter from the stock exchanges on the draft scheme should submit a 'Report on the Unpaid Dues' to the stock exchanges in the prescribed manner. The circular also provides the format for Report on Unpaid Dues.

  The report on unpaid dues should be submitted by the listed entity to the stock exchange along with the draft scheme.
- **Punitive action for misstatement of facts**: Furnishing of false information or misstatement of facts will make the listed entity liable to punitive action as per the provisions of law.

Obligations on stock exchanges

The 'unpaid dues report' should be forwarded by the stock exchanges to SEBI before SEBI communicates its comments on the draft scheme of arrangement to the stock exchanges. Additionally, stock exchanges would need to communicate to SEBI the status of implementation of the provisions of this circular through a monthly development report.

Key takeaways



The recent directive of SEBI to listed entities would help clearing dues outstanding to the stock exchanges, SEBI and depositories. This move is likely to enhance SEBI's effort to streamline the processing of draft schemes of arrangements. Listed entities are required to disclose details regarding the nature of dues or fines, amounts and reasons for non-payment to SEBI and other stock exchanges. It is important for listed entities to note that any misstatement of facts will make the listed entity liable for punitive action as per applicable laws and regulations.

Source: SEBI circular SEBI/HO/CFD/DIL1/CIR/P/2019/192 dated 12 September 2019 and KPMG in India's First Notes SEBI issues directions for settlement of outstanding dues prior to filing a scheme of arrangement dated 24 September 2019

Standardised reporting of violations related to code of conduct under SEBI (Prohibition of Insider Trading) Regulations, 2015

Background

Regulation 9(1) and 9(2) of SEBI (Prohibition of Insider Trading) Regulations, 2015 requires the board of directors of every listed company and the board of directors/head(s) of the organisation of every intermediary and fiduciary to action following:

- Formulate a Code of Conduct to regulate, monitor and report trading by Designated Persons (DP) and their immediate relatives and monitor its compliance and
- Promptly inform SEBI about any violations of the Code of Conduct.

SEBI observed that the above information provided to it is either incomplete or inadequate in terms of nature of violation, designation and functional role of designated persons who have committed the violation, frequency of such violations in the past, the actions taken and reasons thereof, etc. Such information would be considered crucial for examining the reported violations and taking any further necessary action, if required.

New development

With an objective to standardise the process relating to dealing with such violations of the Code of Conduct, SEBI through circular dated 19 July 2019, mandated all listed companies, intermediaries and fiduciaries to:

a) Report such violations by the DPs and immediate relatives of DPs in the standardised format to SEBI.

b) Maintain a database of the violation of code of conduct by DPs and immediate relatives of designated persons that would entail initiation of appropriate action against them.

Standardised format issued by SEBI includes, *inter-alia*, information to be reported such as functional role of DP, details of violation observed, actions taken, reasons recorded in writing for taking actions and details of previous instances of violation, etc.

This requirement is effective from 19 July 2019.

Source: SEBI circular no. SEBI/HO/ISD/ISD/CIR/P/2019/82 dated 19 July 2019

Disclosure of cash flow statement in half-yearly results

On 9 May 2018, the SEBI issued amendments to the Listing Regulations pursuant to recommendations of the Kotak Committee on Corporate Governance. The Listing Regulations have detailed provisions for the submission of quarterly financial results by a listed entity to the stock exchanges.

The amendments to Listing Regulations provide that a listed entity is also required to submit, by way of a note, statement of cash flows as part of stand-alone and consolidated financial results for the half-year. The amendment has been made effective for half year beginning 1 April 2019.

Source: SEBI notification no. SEBI/LAD-NRO/GN/2018/10 dated 9 May 2018 and KPMG in India's publication on 'Amendments to SEBI Listing Regulations pursuant to Kotak Committee recommendations' issued in June 2018

Procedure and formats for limited review/audit report of the listed entity and those entities whose accounts are to be consolidated with the listed entity

Background

Consequent to the amendment to the Listing Regulations, on 29 March 2019, SEBI issued a circular to provide guidelines relating to group audit. The circular also contained formats of audit reports/limited review report to be issued by auditors of listed companies to give effect to the above guidelines. The circular was made effective from 1 April 2019. The circular was issued based on Standard on Auditing (SA) 700, *Forming an Opinion and Reporting on Financial Statements* issued by ICAI.

New development

ICAI has revised SA 700. Therefore, SEBI issued a circular on 19 July 2019 that aligns the format of limited review/audit report with revised SA 700.

The circular is applicable with respect to the financial results for the quarter ending 30 September 2019.

Source: SEBI circular no. CIR/CFD/CMD1/ 80 /2019 dated 19 July 2019

Other regulatory updates

The Taxation Laws (Amendment) Ordinance, 2019

Background

On 20 September 2019, the Ministry of Law and Justice issued the Taxation Laws (Amendment) Ordinance, 2019 (Ordinance, 2019) to made substantial amendments in the Income-tax Act 1961 (IT Act) and the Finance (No. 2) Act 2019 with effect from financial year 2019-20.. The important changes brought by the Ordinance, 2019 are as follows:

Tax concession for domestic companies

A new Section 115BAB has been inserted in IT Act with effect from financial year 2019-20. This Section provides an option to domestic companies to pay income-tax at the rate of 22 per cent subject to condition that they will not avail any other exemption/incentive. The effective tax rate for these companies will be 25.17 per cent inclusive of surcharge and cess. Also, such companies would not be required to pay Minimum Alternate Tax (MAT).

For companies which do not opt for the concessional tax rate and avail the tax exemptions/incentives would continue to pay tax at the pre-amended rate. However, such companies would be able to opt for the concessional tax rate after expiry of their tax holiday/exemption period. After the exercise of the option they would pay tax at the rate of 22 per cent and option once exercised cannot be subsequently withdrawn. Further, in order to provide relief to companies which continue to avail exemptions/incentives, the rate of MAT has been reduced from existing 18.5 per cent to 15 per cent from 1 April 2020 (FY2019-20).

Tax concession for new domestic manufacturing companies

A new section 115BAB has been inserted in IT Act with effect from financial year 2019-20. The new provision allows any new domestic company incorporated on or after 1 October 2019 and would commence manufacturing on or before the 31 March 2023. Such a company would have an option to pay income-tax at the rate of 15 per cent subject to certain conditions. This benefit is available to companies which do not avail any exemption/incentive. The effective tax rate for these companies would be 17.01 per cent inclusive of surcharge and cess. Also, such companies would not be required to pay MAT.

Buy back provisions

Listed companies which have already made a public announcement of buy-back before 5 July 2019, the Ordinance,

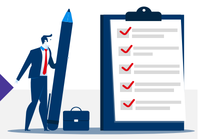
2019 provides that tax on buy-back of shares in case of such companies would not be charged. This amendment would be deemed to have been inserted with effect from 5 July 2019.

MAT

With effect from 1 April 2020 (financial year 2019-20):

- MAT rate has been reduced to 15 per cent from 18 per cent
- MAT provisions will not apply to a person who has exercised the option to avail the concessional tax rate of 22 per cent or concessional tax rate of 15 per cent to new manufacturing companies.

Key takeaway



The Ordinance, 2019 is aimed towards growth and intends to increase investment opportunities in India. It provides tax concessions to Indian companies which are expected to provide a boost to the 'Make in India' campaign of the Government since the thrust seems to be on manufacturing companies in India. The tax reduction brings India's tax structure in line with other countries and is expected to give Indian companies a level playing field internationally. Companies should on an immediate basis carry out an impact assessment of the new provisions. While the Ordinance, 2019 provides that a company needs to exercise the option whether it is using the concessional rates along with filing of the tax return.However, the decision to do so may be needed sooner for the listed entities that would be reporting financial results for the quarter ended 30 September 2019.

Source: The Taxation Laws (Amendment) Ordinance, 2019 dated 20 September 2019

The Code on Wages, 2019

The Code on Wages, 2019 (the code) received the assent of the President of India on 8 August 2019. The code regulates provisions relating to wages and bonus and matters connected therewith or incidental thereto. Accordingly, the code replaces the following acts:

- The Payment of Wages Act, 1936
- The Minimum Wages Act, 1948
- The Payment of Bonus Act, 1965 and
- The Equal Remuneration Act, 1976.

Key features of the code are as follows:

Coverage: The code will apply to all employees. The Central Government (CG) will make wage-related decisions for employments such as railways, mines, oil fields, air transport service and others. State governments will make decisions for all other employments.

Minimum wage: The code prohibits employers from paying wages less than the minimum wages. Minimum wages will be notified by the central or state governments. This will be based on time, or number of pieces produced. The minimum wages will be revised and reviewed by the central or state governments at an interval of not more than five years.

Floor wage: As per the code, the CG will fix a floor wage, taking into account living standards of workers. Further, it may set different floor wages for different geographical areas. Before fixing the floor wage, the CG may obtain the advice of the Central Advisory Board and may consult with state governments.

The minimum wages decided by the central or state governments must be higher than the floor wage. In case the existing minimum wages fixed by the central or state governments are higher than the floor wage, they cannot reduce the minimum wages.

Determination of bonus: All employees whose wages do not exceed a specific monthly amount, notified by the central or state government, will be entitled to an annual bonus. The bonus will be at least: (i) 8.33 per cent of his/her wages, or (ii) INR100, whichever is higher. Additionally, the employer will distribute a part of the gross profits amongst the employees. This will be distributed in proportion to the annual wages of an employee. An employee can receive a maximum bonus of 20 per cent of his/her annual wages.

Gender discrimination: The code prohibits gender discrimination in matters related to wages and recruitment of employees for the same work or work of similar nature. Work of similar nature is defined as work for which the skill, effort, experience, and responsibility required are the same.

Effective date: The code will come into force on such a date as the CG may, by notification in the official gazette appoint. Different dates may be appointed for different provisions of the code.

Source: The Code on Wages, 2019 issued by the Ministry of Law and Justice dated 8 August 2019

Key takeaway

Under the code on wages, the labour ministry plans to streamline the definition of wages by amalgamating four related statutes. The Code is the first in a series of four labour codes proposed in the government's labour reform initiative. The labour ministry has decided to amalgamate 44 labour laws into four codes. The Code subsumed relevant provisions of the previous laws pertaining to workers' wages, equal remuneration for men and women, its payment and bonus. The other three codes will deal with social security, industrial safety and welfare, and industrial relations.
The corporates in India should take steps to implement the new code and understand its potential business impact. Once all the provisions under the code has been notified the companies would need to make an effort to align their labor contracts and employment terms of services with the new legal requirement.

ICAI publications relevant for the quarter ended 30 June 2019

Publications	Overview
Implementation Guide to Standard on Auditing (SA) 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*	• Revised SA 720 casts a new reporting requirement on the auditors of listed entities to include a separate section on "Other Information" in their audit reports. The Standard also contains several new requirements regarding auditors' work effort on other information and is effective for audits of financial statements for periods beginning on or after 1 April 2018. • The implementation guide provides supplementary guidance relating to SA 720 (Revised) to members so that they can discharge their responsibilities in an effective manner. • The guide addresses relevant aspects envisaged in the standard through FAQs and incorporates illustrations of Auditor's Reports relating to Other Information.
Implementation Guide to SA 570 (Revised), *Going Concern*	• The Auditing and Assurance Standards Board of ICAI issued revised edition of Implementation Guide to SA 570 pursuant to revision of SA 570 which is applicable for audits of financial statements for periods beginning on or after 1 April 2017 The implementation guide provides a framework to assist in determining whether the use of going concern basis of accounting in preparation of the financial statements and the related disclosures are appropriate and in making balanced, proportionate and clear disclosures. • The guide incorporates practical case studies, illustrative examples and template for the format of auditor's report under different scenarios related to going concern.

Publications	Overview
Revised FAQs on the Insolvency and Bankruptcy Code, 2016	• Covers the developments and regulatory changes in the Code and contains questions and answers on various issues in the Code. • Incorporates all the amendments issued by Insolvency and Bankruptcy Code (Amendment) Act, 2018 and Insolvency and Bankruptcy Code (Second Amendment) Act, 2018.
Ind AS: An Overview (Revised 2019)	• Provides an overview of various aspects related to International Financial Reporting Standards (IFRS)-converged Ind AS such as road map for the applicability of Ind AS for corporates and for NBFCs, summary of all the Ind AS, etc. • Captures all the recent amendments to Ind AS notified by the MCA till March 2019 such as issuance of new leases standard (Ind AS 116, *Leases*) and other consequential amendments thereto.
Educational Material on Ind AS 8, *Accounting Policies, Changes in Accounting Estimate and Errors*	• Provides guidance in understanding the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. • Addresses relevant aspects envisaged in the standard through FAQs which are being/expected to be encountered while implementing the standard.
Compendium of Ind AS	• This edition of compendium is an upto date compilation of all the amendments incorporated in respective Ind AS including amendments effective for accounting period beginning on or after 1 April 2019.
Compendium of AS	• This edition of compendium includes all the amendments in Accounting Standard issued by MCA through Companies (Accounting Standards) Amendments Rules, 2018. Further it incorporates all the Accounting Standards applicable as on 1 July 2019.

Source: ICAI announcements dated 21 August 2019, 14 August 2019, 1 August 2019, 29 July 2019 and 17 July 2019

Expert Advisory Committee (EAC) opinions issued by ICAI during the quarter ended September 2019

Topic	Month
Computation of Effective Interest Rate on Borrowings under Ind AS 109, *Financial Instruments*	August 2019
Disclosure of Government Grants	September 2019

Source: The Chartered Accountant - ICAI journal for the month of month of August 2019 and September 2019

Glossary

2013 Act	The Companies Act, 2013
SA	Standard on Auditing
ASB	Accounting Standards Board
ITFG	Ind AS Technical Facilitation Group
BoD	Board of Directors
CFS	Consolidated Financial Statements
ICAI	The Institute of Chartered Accountants of India
Ind AS	Indian Accounting Standards
Listing Regulations	SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
MCA	The Ministry of Corporate Affairs
NBFC	Non-Banking Financial Company
SEBI	The Securities and Exchange Board of India
RBI	The Reserve Bank of India
ROC	Registrar of Companies
NCLT	National Company Law Tribunal
FAQ	Frequently Asked Question
DDT	Dividend Distribution Tax
CG	Central Government
NFRA	National Financial Reporting Authority
SFIO	Serious Fraud Investigation Office
KMP	Key Managerial Personnel
DRR	Debenture Redemption Reserve
FY	Financial Year
AGM	Annual General Meeting
IT Act	The Income-tax Act, 1961

Our publications

First Notes

SEBI revises materiality threshold for payments relating to brand or royalty

1 July 2019

Background

The Securities and Exchange Board of India (SEBI) through its circulars provides regulations to be followed for the schemes of arrangements.

New development

In order to streamline the processing of draft schemes of arrangements, SEBI on 12 September 2019 has issued directions to listed entities in relation to payment of outstanding dues to SEBI, stock exchanges and depositories. The SEBI has amended its circular dated 10 March 2017 and a new paragraph no. 11 on ' Unpaid Dues Report' has now been inserted. The circular requires all listed entities to ensure that all dues to, and/or fines/penalties imposed by SEBI, stock exchanges, depositories, etc. have been paid/settled before filing the draft scheme with the designated stock exchange.

In case there are unpaid dues/fines/penalties, then a listed entity, prior to obtaining observation letter from the stock exchanges on the draft scheme should submit a 'Report on the Unpaid Dues' to the stock exchanges in the manner prescribed.

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

Accounting and Auditing Update

Issue no. 35 | June 2019

The new standard on leases, Ind AS 116, *Leases* is now applicable for Ind AS companies from the accounting period beginning on or after 1 April 2019. In this edition of Accounting and Auditing Update (AAU), we have included an analysis of the Nifty 50 listed companies and our observations with respect to the disclosures provided by them for Ind AS 116 in the financial results for the quarter ended 30 June 2019. We have also analysed the disclosures provided in the annual reports by the Nifty 50 companies for the year ended 31 March 2019 with respect to operating lease accounting under erstwhile Ind AS 17.

Implementation of Ind AS 116 is also expected to pose many practical challenges for companies. Our article on the topic aims to discuss four key implementation issues of the standard with the help of practical examples.

Recently, the Institute of Chartered Accountants of India (ICAI) issued a Frequently Asked Question (FAQ) to address the ambiguity relating to presentation of income tax consequences. Our article provides an overview of the amendment in Ind AS 12 and the clarification provided by ICAI.

Our publication also carries a regular synopsis of some recent regulatory updates.

Notes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IN OUR SPIRIT OF UNDYING ENTHUSIASM
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