Editorial
The Central Board of Direct Taxes (CBDT) has published amendment rules in relation to Form 3CD on 20 July 2018. These amendment rules have made substantial changes to Form 3CD and have added new clauses as well as revised certain existing clauses. The new clauses relate to General Anti-Avoidance Rules (GAAR), thin capitalisation, Country-by-Country reporting, Goods and Services Tax (GST), etc. On 17 August 2018, CBDT deferred application of clauses relating to GAAR and GST due to certain implementation challenges.

Recently, on 22 August 2018, the Institute of Chartered Accountants of India (ICAI) released the ‘Implementation Guide on the amendments made to Form 3CD’. This implementation guide provides detailed guidance and is expected to help taxpayers and tax auditors to implement required disclosures. In this issue of Accounting and Auditing Update (AAU), we summarise key changes and implementation challenges with regard to GAAR and GST due to certain implementation challenges.

Under Ind AS 115, Revenue from Contracts with Customers, when an entity satisfies a performance obligation but does not have an unconditional right to consideration, an entity should recognise a contract asset. The standard setters have made a distinction between a contract asset and a receivable because doing so provides users of financial statements with relevant information about the risks associated with an entity’s rights in a contract. That is because although both would be subject to credit risk, a contract asset is also subject to other risks, for example, performance risk. Additionally, while presenting financial statements under Ind AS, an entity needs to classify its assets into financial or non-financial assets category. Our article on this topic highlights the considerations to be assessed while classifying contract assets as financial or non-financial assets in the balance sheet.

Financial institutions may adjust contractual terms of loans advanced to borrowers for various purposes. Under Ind AS 109, Financial Instruments, when there is a change in the terms of financial assets due to renegotiation or modification of the contractual cash flows of a financial asset then the financial institution needs to assess whether such a financial asset needs to be derecognised. We have explained the factors to be considered for determining when modification of financial assets would lead to derecognition and the accounting for the same with the help of an illustration.

Entities may have an investment from a private equity or venture capital investors. Under Ind AS, whenever a new investor invests in an existing entity, it is a trigger to evaluate whether control of the entity has changed hands from its previous owners to new investors. One of the criteria to be evaluated for demonstrating control is the nature of rights with the new shareholders. In many situations, a private equity investor may take a minority stake but the contractual rights attached to that stake may impact the ability of the previous owners to demonstrate control over the entity. Our article on funding by private equity investor describes key considerations that should be assessed for the rights granted to a private equity or venture capital investor for evaluating if there is a change in control.

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

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

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax audit – the rugged road ahead</td>
<td>01</td>
</tr>
<tr>
<td>Classification of assets under Ind AS 115 in the balance sheet</td>
<td>05</td>
</tr>
<tr>
<td>Derecognition analysis for modification of financial assets</td>
<td>09</td>
</tr>
<tr>
<td>Funding by private equity investor - How does it impact consolidation of your business</td>
<td>13</td>
</tr>
<tr>
<td>Regulatory updates</td>
<td>17</td>
</tr>
</tbody>
</table>
This article aims to:
- Discuss key changes to Form 3CD.

The tax audit requirement in Form 3CD which was initially introduced in April 1985 with the object of identifying the differential tax treatments of expenses as compared to the audited financial statements, has morphed into a detailed disclosure of tax position taken by the assessee.

The latest amendment to Form 3CD was made by the Central Board of Direct Taxes (CBDT) vide Notification no. 33/2018 dated 20 July 2018 (8th Amendment) Rules, 2018 (Amendment Rules). The Amendment Rules have made substantial changes casting an onerous responsibility on both the tax auditor and the taxpayer to furnish cumbersome additional details covering a wide spectrum of tax aspects.

The latest amendment provides for 15 changes in the Form 3CD. The amendments include six modifications in the existing clauses and have inserted nine new clauses which require reporting in relation to recent changes and developments under the Income-tax Act, 1961 (IT Act) such as General Anti-Avoidance Rules (GAAR), thin capitalisation, Country-by-Country reporting, Goods and Services Tax (GST), etc.

The disclosures have new qualitative requirements posing a greater deal of subjectivity and onus of interpretation of tax law. The modified Form 3CD is applicable from 20 August 2018 and hence, would apply to all Form 3CD uploaded on or after 20 August 2018.

Additionally, on 22 August 2018, the Institute of Chartered Accountants of India (ICAI) released the ‘Implementation Guide on the amendments made to Form 3CD’. This implementation guide provides detailed guidance and is expected to help tax payers and tax auditors to implement required disclosures.
This article summarises key changes made by the Amendment Rules.

A. Newly inserted clauses

- Clause 44: Break up of total expenditure between GST registered vendors and unregistered vendors

The Government of India has been working on data analytics projects to tackle the mismatch in income earning and spending pattern of the taxpayers. Financial year 2017-18 was the first year of GST roll out and with the new requirement on GST disclosure, the government possibly intends to make use of the data analytics methodologies to match the data available with various divisions of the Ministry of Finance.

Clause 44 requires a break-up of total expenditure incurred during the year between expenditure incurred relating to entities not registered under GST and expenditure incurred relating to entities registered under GST. Additionally, the expenditure relating to GST registered vendors is required to be further bifurcated between expenditure in relation to exempt supply, expenditure towards entities registered under composition scheme and other registered entities.

Since the above required data may not be readily available with the taxpayer, it may require substantial time and effort on the part of a taxpayer to collate the relevant data. In addition to the data collection issue, there are many unanswered questions in relation to reporting under clause 44 such as

- Whether the details are required to be furnished vendor-wise, expense-wise, or in total
- Whether expenses such as salaries or rates and taxes which are not liable to GST are required to be reported.

Additionally, it is unclear whether capital expenditure (as it will not form part of the statement of profit and loss) on which GST has been paid should also be disclosed in Form 3CD.

Keeping in view the complexity involved and the representations made, the government has deferred the reporting under this clause till 31 March 2019.

- Clause 30B: Thin capitalisation norm

The Finance Act, 2017 introduced thin capitalisation rules under Section 94B of the IT Act to counter cross border shifting of profits through excessive interest payments by adopting Organisation for Economic Co-operation and Development (OECD) recommendation under Action Plan 4 of the Base Erosion and Profit Shifting (BEPS) principles. Section 94B restricts deduction of interest paid to non-resident Associated Enterprise (AE) including interest on loans guaranteed by them to 30 per cent of ‘Earnings before Interest, Taxes and Depreciation’ (EBITDA).

The disclosure in Form 3CD requires the tax auditor to furnish the working of interest disallowable under Section 94B. However, since its introduction, the section has been plagued by many issues such as whether EBITDA refers to book profits or tax profits, which payments would form part of interest, whether the section is applicable to interest capitalised, etc. These open issues are likely to increase the onus on the taxpayer to critically evaluate all interest transactions for inclusion in the Form 3CD.

With regard to EBITDA, the ICAI implementation guide clarifies that the figures as per the final audited stand-alone accounts of the company should be considered, and not the figures as adjusted for the income tax computation after various allowances and disallowances.

Additionally, regarding computing interest payments, the implementation guide clarifies that only interest and expenditure of similar nature which is deductible while computing income under the head ‘Profits and Gains of Business or Profession’ should be considered and not interest deductible under any other head of income or interest which is otherwise not deductible.
• **Clause 29B: Reporting of gifts as per Section 56(2)(x) of the IT Act**

This clause requires a taxpayer to report the amount taxable as ‘Income from Other sources’ under Section 56(2)(x) of the IT Act on account of receipt of any sum of money, immovable property, or specified movable property without or inadequate consideration paid. Though the clause requires mere disclosure of the nature and amount of such income, however, there has been prolonged debate around the applicability of this section to various transactions such as Transferrable Development Rights (TDRs), lease, cash subsidy, buy back of shares, etc. Further, the taxpayer may face a challenge in determining the amount taxable under this section in cases where there is a difference in consideration due to commercial reasons such as purchase of distressed assets and assets subject to encumbrance/contingent liability.

• **Clause 30A: Primary adjustments under Section 92CE(1) of the IT Act**

The Finance Act, 2017 introduced a new Section 92CE, which requires the taxpayer to make secondary adjustment to remove the imbalance between cash account and actual profit pursuant to primary adjustments made as per Section 92CE(1) of the IT Act. This adjustment is likely to reflect that the actual allocation of profit between the taxpayer and its associated enterprise is consistent with the transfer price charged. Further, the section provides for the repatriation of excess money to India within 90 days and computation of imputed interest where such sum is not so repatriated. The amendment requires the taxpayer to disclose the nature and amount of primary adjustments and imputed interest in case of non-repatriation. It is not clear whether these provisions are also applicable to the Minimum Alternate Tax (MAT) computation and to the recognition of secondary adjustment in the books of account.

• **Clause 36A: Disclosure relating to deemed dividend**

This clause requires reporting of date and amount of receipt of any income by the taxpayer which is taxable as deemed dividend under Section 2(22)(e) of the IT Act. Though the disclosure requirement appears to be straightforward, however, there could be a practical challenge associated with the said disclosure since the amount of deemed dividend would have to be reckoned with reference to the financial statements of the payer entity which would not be available with the recipient taxpayer and its tax auditor. Further, there are contrary judicial precedents on the issue of what constitutes deemed dividend which add to the challenge.

• **Clause 43: Country-by-Country reporting (CbC)**

The CbC reporting requirement was introduced by the Finance Act, 2016 in line with the recommendations contained in Article 13 of the OECD BEPS Action Plan requiring preparation of three-tiered transfer pricing documentation. This clause requires Indian parent entity or Indian constituent entity (with Indian parent or foreign parent) to disclose certain details, if furnishing of CbC is applicable to such international group as per Section 286(2) of the IT Act. Apart from the above, certain other new clauses have been added in the Form 3CD to reflect disclosure in relation to forfeiture of advance under Section 56(2)(ix), cash receipts exceeding INR2 lakh under Section 269ST of the IT Act and specified financial transaction and reportable account in Form 61, 61A and 61B filed by the taxpayer.
B. Amendments made in the existing clauses

- **Clause 34(b): Disclosure in relation to TDS¹/TCS² returns.**

  Presently, Form 3CD requires details of TDS/TCS returns which have not been filed within the due date. However, the amendment requires the taxpayer to furnish details of all TDS/TCS returns filed during the year irrespective of whether they were filed within time or on a belated basis.

  Organisations may revise their TDS/TCS returns to reflect changes in previously filed returns. In the absence of any clarity presently, the taxpayer would need to take a position as to whether only the details of original return are required to be furnished or whether details of all revised returns are also required to be given. Further, the amendment also requires details of all transactions which are required to be reported in the returns but not furnished in TDS/TCS returns. This requirement again poses a question for the taxpayer to determine whether the disclosure is to be given only in respect of those transactions on which TDS has been deducted but not reported in TDS statements or all transactions on which TDS has not been deducted either erroneously or the basis of some favourable tax position.

  In this regard, the ICAI implementation guide mentions that in the situations where there is a failure to report the transaction in the statement of tax collected or deducted at the tax auditor would have to report the same. This area could lead of a lot deliberation between the taxpayer and the auditor.

- **Minor amendments have been made to the following existing clauses of Form 3CD:**
  - Details of GST registration undertaken by the taxpayer
  - Investment allowance under Section 32AD and deemed profits thereon
  - Amount remaining unpaid to railways disallowable under Section 43B
  - Clarificatory amendments in the clause dealing with Section 269T on repayment of loans and deposits.

As can be seen from the above changes, conformity with the new Form 3CD format will require extensive data collation by the taxpayer and settlement of interpretational issues with the tax auditor. With the changes being notified in July end, CBDT has not given much time to the taxpayer to comply with such cumbersome requirements. Practically, companies may not have all the data fields available with them to provide the relevant details to the tax auditor for him/her to express his/her opinion. Recognising the hardship on the taxpayer and the tax auditor, the ICAI had made a representation to the CBDT to defer the applicability of the new Form 3CD till next assessment year. Representations have been made by various other chambers as well as corporate entities.

Keeping in view the representations and the possible hardship, CBDT vide Circular No 6/2018 dated 17 August 2018, has deferred the reporting requirement relating to GAAR and GST till 31 March 2019. However, the reporting requirement under the other clauses has come into force from 20 August 2018, as initially planned. Since no relief has been granted by the CBDT in relation to other clauses, the taxpayers would have to start compiling the necessary information to complete the disclosure requirement under the new Form 3CD.
This article aims to:
- Highlight the considerations to classify assets as financial or non-financial assets in the balance sheet.

**Classification of assets under Ind AS 115 in the balance sheet**

**Background**

The Indian generally accepted accounting principles (Indian GAAP) require companies to disclose and segregate in its balance sheet, financial and non-financial assets and liabilities. Accordingly, contract assets arising on revenue contracts were classified as financial assets in the previous year (years until 31 March 2018).

Ind AS 115, *Revenues from Contracts with Customers* (Ind AS 115) is the new revenue recognition standard and is applicable to companies in India for accounting periods beginning on or after 1 April 2018.

Ind AS 115 now specifically defines a ‘contract asset’ and elaborates the presentation and accounting of the such assets. It distinguishes a contract asset from a ‘receivable’ and provides specific definitions of these terms. These terms were not defined in the standards previously under Indian GAAP.

Another important point to note is that Ind AS 115 interacts with Ind AS 109, *Financial Instruments* with regard to the accounting for financial instruments arising due to rights and obligations from revenue contracts with customers. While Ind AS 109 applies to the accounting of receivables but for contract assets only impairment requirements of Ind AS 109 are applicable.
Companies in the information technology/information technology enabled services’ sector would need to assess whether the contract assets or receivables covered by Ind AS 115 are financial or non-financial in nature. This determination is an area requiring consideration which is likely to lead to a change in practice from erstwhile Indian GAAP.

In this article we aim to analyse the factors to assess the classification of contract asset into financial assets or non-financial asset.

**Nature of the revenue contracts**

For companies in the information technology/information technology enabled services sector, revenue contracts are generally categorised into three types i.e. time and material contract, maintenance contracts under fixed time frame and fixed price application development contracts.

**Time and material contracts**

Generally, revenue from time and material contracts are accounted on an output basis measured by efforts expended. Additionally, companies may raise invoices either on a monthly or quarterly basis and which can be on a date other than the month-end or quarter-end date. Where an invoice has been raised in a time and material contract, the entity has an unconditional right to the consideration and hence, the contract asset becomes a trade receivable (under the purview of Ind AS 109) and thereby, would be disclosed as a financial asset.

However, in many situations an invoice is raised one or two weeks post the month end and is not conditional on execution of the remaining performance obligation. For example, services for the month of March are billed in the month of April. In such cases at the month end, the rendered services have been consumed by the customer and only the act of billing has been deferred, resulting in an asset. This asset is likely to meet the definition of a receivable as there is an unconditional right to receive cash for services rendered until month-end and only the passage of time is required before payment becomes due can be presented.

In our experience, the companies in this sector may require prior approval of customers before raising the invoice. An entity would need to assess whether such approvals are administrative in nature and therefore, do not impact the classification of receivable within financial assets. However, in the situations where approvals for raising an invoice are not administrative in nature then an entity may not be able to classify the asset as a receivable within financial asset.

**Maintenance contracts**

Revenues from fixed price maintenance contracts are generally straight-lined over the underlying period of the contract.

In these contracts, the accounting treatment is expected to be the same as that of time and material contracts i.e. the resulting asset becomes a receivable within the financial asset category.

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Ind AS 115 defines contract asset and receivable as follows:

*Contract assets are defined as an entity’s right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditional on something other than the passage of time (for example, the entity’s future performance). An entity shall assess a contract asset for impairment in accordance with Ind AS 109. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of Ind AS 109.*

*A receivable is an entity’s right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. An entity shall account for a receivable in accordance with Ind AS 109. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Ind AS 109 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss).*
**Fixed price application development contract**

In fixed price application development contracts, an entity’s performance creates or enhances an asset (e.g. an application tool) that the customer controls, as the asset is created or enhanced. In this case, revenue would be recognised over time using the method that depicts its performance i.e. the pattern of transfer of control of the service to the customer. Generally, in this sector efforts or costs are used to determine the stage of completion. Revenue is recognised based on an entity’s efforts or costs toward satisfying a performance obligation, relative to the total expected efforts or costs to the satisfaction of that performance obligation (percentage of completion of method). In relation to fixed price application development contracts, invoices are raised upon achievement of key milestones defined in the contract.

At a month-end, even though the services have been rendered and billable upon termination for convenience, the asset will not to meet the definition of a receivable as the payment is not unconditional. In these cases, in order to raise an invoice an entity needs to perform future service which is necessary to achieve the billing milestone or an act of termination has to be exercised by the customer. Therefore, the entity’s right to consideration is not unconditional at the month-end.

The contract asset that arises is not within the scope of Ind AS 109 and has to be classified as non-financial. However, such asset is subject to impairment testing as per the requirements of Ind AS 109).

For example:

Company A enters into a contract to develop a payroll application system suite for company B. The activities to be undertaken include (i) system testing; (ii) system integration testing (iii) system readiness testing and (iv) user acceptance testing.

Billing milestones are structured based on the achievement of the key activities detailed in the contract. Using the percentage of completion method, the company recognises its revenues by measuring the efforts expended till date as a proportion of the total efforts required to be expended for project completion.

At the month end, the company A has not yet completed the first stage of systems testing. As the right to invoice for services rendered is conditional on future performance and achievement of the first milestone (i.e. this is a condition that is other than the passage of time), therefore, the related contract asset would be classified as a non-financial asset.

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**Diagrammatic representation of classification of contract asset**

1. Did the entity transfer a good or provide service in advance of receiving consideration?
   - Yes
     - Is the consideration based on something other than the passage of time?
       - No
         - Generally time and material and fixed price maintenance contracts fall under this category
       - Yes
         - If yes, then classified as a contract assets under the non-financial asset category

2. If no, then classified as a receivable within the financial asset category
Consider this

- Companies would need to assess when the right to consideration becomes unconditional for an asset to be classified as a receivable after considering facts and circumstances of such contact and thereby be able to classify those as financial assets.
- Contact asset is non-financial asset.
- Companies need to distinguish between current and non-current portions of their contract assets.
- Similar accounting may apply to other sectors as well. Therefore, companies should evaluate classification of assets under Ind AS 115 in the balance sheet.

Transition impact

Many technology companies have previously classified their entire unbilled revenues (i.e. contract assets) as financial assets since there was no specific guidance under previous Indian GAAP.

In the first year of applying Ind AS 115, an entity has two transition options:

1. It can apply the standard retrospectively to each comparative period presented (full retrospective method, with restatement of comparatives and third balance sheet where opening balances are affected). Under this option, the comparative balance sheet is required to be reclassified.

2. It can apply the standard retrospectively by recognising the cumulative effect of initially applying the standard at the date of initial application in retained earnings (this is a simplified transition method where restatement of comparatives and third balance sheet is not required). Under this option, only the current year classifications would be required to be in accordance with Ind AS 115.
Derecognition analysis for modification of financial assets

This article aims to:
- Demonstrate the matters to be assessed when evaluating derecognition of modified financial assets.

Financial institutions may adjust contractual terms of loans advanced to borrowers for various purposes. This can be done as an initiative to preserve the relationship with the borrower, by reducing interest rates on improvement of their credit ratings, or as part of a restructuring arrangement of distressed assets, which would allow the borrower sufficient capacity to service the debt either entirely or partially (this is often referred to as ‘forbearance’). In either case, financial institutions need to assess the accounting for such transactions.

Under Indian Generally Accepted Accounting Principles (IGAAP), a change in terms of the loan would generally not warrant substantial accounting implications, however, under Indian Accounting Standards (Ind AS), such change in terms may result in a modification of the loan or derecognition of the financial asset.

Ind AS 109, Financial Instruments, states that in some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to derecognition, and as an example, it refers to a ‘substantial modification’ of a distressed asset that would result in derecognition. However, what is considered as ‘substantial’ is not specified therein. Thus it is imperative to perform both a quantitative and qualitative evaluation of whether the modification is ‘substantial’. Further, if an entity plans to modify a financial asset in a way that would result in forgiveness of part of the existing contractual cash flows, then it should consider whether a portion of the asset should be written off before evaluating the accounting for such modification.

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1. In this article, change in terms of loan refers to change in interest rates, extension of moratorium period, amending covenants, etc. However, it does not include conversion of loans into equity or other forms of debt.
In this article, we aim to illustrate the factors to be considered when determining when a modification of financial assets would lead to derecognition, and the accounting for the same.

**Example: Modification of loans advanced by bank M**

The corporate banking group of bank M (the bank) had advanced an eight year loan of INR100 million at 12 per cent per annum to company D. On 1 April 2019, company D had repaid three instalments of INR10 million each, however, it failed to pay the interest due on 31 March 2019, citing significant financial difficulties. Company D accordingly requested bank M to restructure the terms of the loan. On the basis of bank M’s evaluation of the loan, it did not expect to recover INR10.5 million of the total outstanding loan and interest amount.

After receiving appropriate internal approvals, on 15 May 2019, bank M altered the terms of the debt agreement, by increasing the term of the loan to 10 years, and reducing the outstanding loan amount to INR60 million, the original and revised terms of the loan are below.

As per the policy of bank M, a modification of loan which is less than or equal to 10 per cent of the original loan amount will not be considered as ‘substantial’ from the perspective of derecognition of the loan.

As per the policy of the company, all modification fees charged to the customer and costs incurred should be amortised over the period of the loan.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Original loan</th>
<th>Revised terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of loan</td>
<td>INR100,000,000</td>
<td>INR60,000,000</td>
</tr>
<tr>
<td>Interest</td>
<td>12 per cent per annum</td>
<td>8 per cent per annum for initial four years (paid during moratorium period), post which it will be 14 per cent per annum</td>
</tr>
<tr>
<td>Period</td>
<td>8 years</td>
<td>10 years</td>
</tr>
<tr>
<td>Repayment terms</td>
<td>INR10 million for first 3 years, and INR14 million thereafter</td>
<td>Moratorium period of four years, post which loan will be repaid at INR10 million per annum.</td>
</tr>
<tr>
<td>Effective Interest Rate (EIR)</td>
<td>11.7 per cent per annum</td>
<td>NA</td>
</tr>
<tr>
<td>Gross carrying amount of loan on date of modification</td>
<td>INR70.5 million</td>
<td>NA</td>
</tr>
<tr>
<td>Expected Credit Loss (ECL) on 1 April 2019</td>
<td>INR10.5 million</td>
<td>INR2.5 million</td>
</tr>
<tr>
<td>Modification fees</td>
<td>NA</td>
<td>INR1.2 million</td>
</tr>
</tbody>
</table>

**Accounting issue**

Bank M needs to assess whether the modification in the terms of the loan agreement would result in derecognition of the original loan in accordance with Ind AS 109. Further, where specified rights to cash flows are given up under a modification, can these be derecognised before assessing the remainder of the financial asset for derecognition.

**Accounting guidance**

While assessing the derecognition of a modified financial asset, entities should evaluate whether the contractual cash flows of the original financial asset and the modified asset are substantially different. In the absence of any prescribed guidelines within Ind AS 109, entities need to develop their own policies and methods while performing the quantitative and qualitative evaluation of such modifications. In doing so they may, but are not required to, analogise to the guidance on the derecognition of financial liabilities.

Figure 1 (on the next page) illustrates the evaluation performed by bank M when assessing the derecognition on modification of loan advanced to company D.
**Analysis**

**Write-off a part of the loan**

Prior to assessing the derecognition of the modified financial assets, bank M is required to faithfully represent the present value of the current contractual cash flows. This will be done by writing off a portion of the gross carrying amount of the loan that the bank has no reasonable expectation of receiving. In the current example, bank M had assessed that INR10.5 million would not be recoverable from company D. Accordingly, bank M should write off that portion of the loan in accordance with Ind AS 109. Thus, the gross carrying amount of the loan that would faithfully represent the current contractual cash flows is INR60 million.

Since the write-off would be adjusted against the existing ECL provision of INR10.5 million, it would not have an impact on the statement of profit and loss.

**Derecognition analysis**

As per the policy of the company, a modification in the terms of the loan which result in contractual cash flows that deviate up to 10 per cent of the original loan amount, would not result in derecognition of the loan. Accordingly, bank M should compare the net present value of the revised contractual cash flows, including the fees received, discounted at the original EIR of the loan (INR56.7 million) with the present value of the remaining contractual cash flows (INR60 million) to perform a quantitative evaluation of the modification. Since the difference between the two comes to 5.4 per cent, which is less than the threshold defined by the company, bank M will not derecognise the loan.

From a qualitative evaluation, bank M does not observe any significant changes in the terms of the loan that are not already reflected in the quantitative evaluation. Hence, there are no factors that require a derecognition of the financial asset.

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2. Revised after write off of INR10.5 million.
**Accounting for modification of loan**

For modifications that do not result in derecognition, the gross carrying amount of the asset is recalculated by discounting the modified contractual cash flows (including the fees received) using the original effective interest rate (INR 56.7 million). The difference between this recalculated amount and the existing gross carrying amount (INR60 million) is recognised in the profit or loss as a modification loss (i.e. INR3.3 million in this example).

In accordance with the policy of the company, the modification fees charged of INR1.2 million will adjust the gross carrying amount of the modified financial asset and be amortised over the remaining term of the modified financial asset.

Bank M should recognise the ECL (assuming it is INR2.5 million) on the modified loan on the date of modification in the statement of profit and loss.

**Consider this**

- There is no guidance in Ind AS 109 on the line item in the statement of profit and loss in which gains or losses on the modification of financial assets should be presented. A modification gain or loss may not necessarily relate to impairment, because not all modifications are performed for credit risk reasons. Accordingly, an entity should exercise judgement to determine an appropriate presentation for the gain or loss.

- Modification of financial assets may result in the modified cash flows not meeting the SPPI criterion even though the original cash flows did so, or vice versa. A question then arises whether this change in the assessment of the SPPI criterion is a qualitative factor to consider in determining whether the modification of the financial asset is substantial. Ind AS 109 does not require reassessment of the SPPI criterion following initial recognition of a financial asset and does not require or allow an entity to reclassify financial assets based on a reassessment of the SPPI criterion after initial recognition. However, the fact that a financial asset would be classified on a different basis if the SPPI criterion were reassessed may be a relevant factor to consider when performing the derecognition assessment. Therefore, entities should choose accounting policies and apply them consistently.

- Ind AS 109 specifies that costs or fees incurred by the lender as part of the modification should adjust the gross carrying amount of the modified financial asset and be amortised over the remaining term of the modified asset. However, it is not clear regarding the treatment of fees charged by the lender. In this example, bank M has opted to account for the fees charged to the borrower in the same way as it would treat the fees incurred on modification. Alternatively, entities may opt to treat these fees differently as:
  - A part of modification gain or loss, or
  - Adjust the gross carrying amount only for the fees received that have been charged by the lender to recover costs or fees incurred.

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3. Criterion that the cash flows of the instrument are solely in the nature of principal and interest on the principal outstanding.
Funding by private equity investor - How does it impact consolidation of your business

This article aims to:
- Describe the key considerations to be assessed for the rights granted to a private equity or venture capital investor.

Over the years, many companies and promoters have obtained growth capital from Private Equity (PE)/Venture Capital (VC) investors. In many of these instances, the promoters transfer the underlying business in a separate investee company and the PE investors pick up a minority stake in the business by infusing the required capital in such investee company. The majority stake is owned by the promoters. In order to ensure that the capital is efficiently deployed and to better their return, such PE investors often obtain certain rights in the underlying investee companies. These arrangements have given rise to an important accounting consideration on the ability of the promoter/majority shareholder to consolidate such investee company as its subsidiary. In this article, we have covered some of the practical implications of such arrangements. These nuances will require careful evaluation and consideration by stakeholders at the time of the transaction, since consolidation of the investee company as a subsidiary may have a significant impact on the reported financial results of the promoter, particularly if the promoter is listed or has bank covenants linked to consolidated financial results.
Under the Ind AS framework, the parent company can consolidate the investee only if it has ‘control’ over the investee. It is important to understand the term ‘control’. Under Ind AS 110, Consolidated Financial Statements, an investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Further, power is explained as ‘existing rights that give the current ability to direct the relevant activities’ and relevant activities are activities of the investee that significantly affect the investee’s returns. Thus, in order to demonstrate control under Ind AS, the parent will need to have the ability to direct all the activities of the investee which are likely to impact the returns from the investee.

The aforesaid definition is unlike what is stated under AS 21, Consolidated Financial Statements in Indian GAAP. However, where Indian GAAP takes a narrow view and assumes that holding a majority of the voting interest of an entity automatically results in controlling the entity, Ind AS requires a more detailed evaluation.

One of the criteria to be evaluated for demonstrating control is the nature of rights with other shareholders. This becomes an important aspect when evaluating arrangements with PEs, as explained above. Though PEs generally have a minority stake, the contractual rights that they get as a part of the shareholders’ agreement may impact the ability of the promoter (who is the majority shareholder) to demonstrate control under Ind AS and thereby not be able to consolidate the financial results of the investee company as a subsidiary.

Ind AS differentiates between substantive rights and protective rights of the investors. Substantive rights exercisable by minority investors (PE) can prevent promoter/majority shareholder from controlling the investee to which those rights relate. Such substantive rights do not require the minority investors to have the ability to initiate decisions. As long as the rights are not merely ‘protective’, substantive rights held by minority investors (PE) may prevent the promoter from controlling the investee even if the rights give the holders only the current ability to approve or block decisions that relate to the relevant activities.

Common examples of such substantive rights are:

- Approval from minority shareholders for selecting, terminating, and setting the compensation of management responsible for implementing the investee’s policies and procedures.
- Approval from minority shareholders for establishing, operating and capital decisions of the investee, including budgets, in the ordinary course of business.

Illustration 1

Two companies A and B come together to form a company X in which company A holds 75 per cent with three directors on the board of company X and company B holds 25 per cent with two directors on the board. By virtue of majority holding, company A consolidates company X as a subsidiary under Indian GAAP. The shareholders’ agreement between A and B states that for certain decisions, a unanimous approval of the board of directors is required. These decisions include approving the annual and semi-annual budgets of the company and selection and appointment of senior management personnel. In such a case, under Ind AS, company A may not control company X, instead it may share joint control over it along with company B. Hence, if company A does not control company X as a subsidiary then it should evaluate Ind AS 111, Joint Arrangements and account for it as a joint venture arrangement (i.e. an equity method investee).

The aforesaid arrangements are common in the PE sector, where the PE does often obtain such affirmative rights in order to seek involvement in business and better their return.

As against substantive rights, protective rights are related to fundamental changes in the activities of a company, or are rights that apply only in exceptional circumstances. Therefore, protective rights do not give the holder power or prevent other parties from having power and therefore, control over a company. Few examples of protective rights are as follows:

- Amendments to a company’s constitution
- The liquidation of the entity or commencement of bankruptcy proceedings
- Share issues or repurchases
- The sale of a significant portion of the entity’s operating assets.
- Related party transactions.
Illustration 2
Continuing with illustration 1, if the decisions requiring unanimous approvals related only to change in capital structure, liquidation of business, etc., then company A would deem to have control over company X given its majority shareholding, majority on the board and no substantive rights available with company B (the minority investor).

Further in situations where minority investor has substantive rights, it is also important to evaluate the deadlock provisions before reaching the conclusion on consolidation.

Depending on the deadlock provisions, the consolidation conclusion may vary, as explained below:

1. If the deadlock provision leads to arbitration and the resolution is dependent on the arbitrator’s decision, the presence of substantive rights with PE will restrict the promoter from consolidation of the investee as a subsidiary, since the promoter will lack power to direct relevant activities.

2. If, in case of deadlock, the promoter has a final decision, then the promoter can still consolidate, since the PE then cannot effectively restrict the promoter from directing the relevant activities of the investee.

3. If in case of a deadlock the promoter has the ability to buy the stake of the PE at fair value (call option), the promoter may still be able to consolidate the investee. This is because the promoter does have the potential to direct the relevant activities of the investee by exercising the call option. Ind AS requires assessment of potential voting rights as well in determining control.

Illustration 3
Continuing with the example in Illustration 1, if in case of a deadlock in the board on matters requiring unanimous approval, company A had an option to buy company B’s stake in X, then company A could consolidate X as its subsidiary.

Consider this
- Consolidation under Ind AS is based on the concept of who controls the investee. The analysis of control may lead to a different conclusion under Ind AS when compared with Indian GAAP. Companies preparing financial statements under Ind AS should carefully analyse the implications of substantive rights and how those rights affect their ability to consolidate downstream entities. In our experience, the assessment of control and more importantly, determination of who exercises power over the relevant activities of the investee involves a detailed reading of the shareholders’ agreements, rights of each investor and sound judgement by the management. Moreover, ‘control’ is an ever changing phenomenon and therefore, assessment of control has to be performed on a continuous basis. The implications of this analysis and the related conclusions could have a significant effect on an investor’s ability to consolidate the financial statements of the investee.
MCA issued amendments to the Companies Act, 2013 and corresponding rules

Recently, the Ministry of Corporate Affairs (MCA) notified certain provisions of the Companies (Amendment) Act, 2017 (Amendment Act, 2017) to amend following sections of the Companies Act, 2013 (2013 Act). Additionally, MCA notified certain amendments to the corresponding rules to the 2013 Act.

- **Incorporation of a company (Section 7):** Currently, under the 2013 Act, while making an application for registration of a company, certain documents and information are required to be filed with the Registrar of Companies (ROC) within whose jurisdiction the registered office of a company is proposed to be situated. These documents, *inter alia*, include a declaration (earlier ‘an affidavit’ was required) from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles, affirming the following:
  - He/she is not convicted of any offence in connection with the promotion, formation or management of any company, or that he/she has not been found guilty of any fraud or misfeasance or of any breach of duty to any company under the 2013 Act or any previous company law during the preceding five years and
  - All the documents filed with the ROC for registration of the company contain information that is correct and complete and true to the best of his/her knowledge and belief.

Rule 15 of the Companies (Incorporation) Rules, 2014 has also been amended to incorporate these new requirements.

The amendments are effective from 27 July 2018.

- **Registered office of a company (Section 12):** A company is required to establish its registered office within 30 days of its incorporation and at all times thereafter (earlier ‘on and from the fifteenth day of its incorporation’ was mentioned).

Additionally, a notice of every change of the situation of the registered office (after the date of incorporation of the company) is required to be given to the ROC within 30 days of the change (earlier notice was required within 15 days of the change). The amended section is effective from 27 July 2018.

- **Financial statements, board’s report, etc. (Section 134):** Currently under 2013 Act, Section 134 requires the Chief Executive Officer (CEO) to sign the financial statements only if he/she is a director of the company. Whereas the Chief Financial Officer (CFO) and the Company Secretary (CS) of a company are mandatorily required to sign the financial statements.

In this regard, the Amendments Act, 2017 now mandates a CEO too to sign the financial statements regardless of whether he/she is a director in the company.

Further, the Amendment Act, 2017 clarifies that the disclosures made in the financial statements are to be referred in the board’s report in order to avoid duplications. These amendments are effective from 31 July 2018.

- **Private placement (Section 42):** The Amendment Act, 2017 substituted Section 42 of the 2013 Act relating to issue of shares on the basis of private placement with a new section. As per the revised norms, a private placement should be made only to a select group of persons who have been identified by the board of directors (i.e. identified persons). The number of identified persons should not exceed 200 in a financial year. Further, more than one issue of securities can be made to each class of identified persons.

Related amendments are incorporated under the Companies (Prospectus and Allotment of Securities) Rules, 2014 (Allotment Rules).

The following are the key provisions of the newly inserted Section 42 and Allotment Rules:
  - Private placement to be made to only identified persons
  - Limit on number of people to whom offer is to be made
  - Offer has to be previously approved by the shareholders of the company by passing a special resolution
  - Requirement to issue a private placement offer cum application letter as per revised Form PAS-4
  - The private placement offer and application form would not carry any right of renunciation
  - No media/public advertisement to inform the public at large about issue through private placement
  - Keep the application money received in a separate bank account in a scheduled bank
  - Maintain record of bank account in which payment for subscription has been received
  - Allotment of securities within 60 days from the date of receipt of the application money for such securities
  - Return of allotment has to be filed with the ROC in Form PAS-3 within 15 days of allotment
  - Fresh offer cannot be made till completion of earlier allotments
  - Penal provisions prescribed.

The amendments are effective from 7 August 2018.
Companies (Accounts) Amendment Rules, 2018:
The MCA through its notification dated 31 July 2018 has issued the Companies (Accounts) Amendment Rules, 2018 to amend Rule 5 of the Companies (Accounts) Rules, 2014 which deals with the provisions relating to matters to be included in the board’s report.

As per the amendments, the board’s report of every company (except one person company or small company) should also include the following:

- A disclosure, as to whether maintenance of cost records as specified by the central government (under Section 148(1) of the 2013 Act), is required by the company and accordingly, such accounts and records are made and maintained.
- A statement that the company has complied with the provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013.

Additionally, a new sub-rule, Rule 8A has been added which specifies the matters to be included in the board’s report of a one person company and a small company.

The amended rules are effective from 31 July 2018.

Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2018: The MCA through its notification dated 21 August 2018 amended the Companies (Appointment and Qualification of Directors) Rules, 2014. As per the amendment, every individual who has already been allotted a Director Identification Number (DIN) as at 31 March 2018, would be required to submit e-form DIR-3 KYC on or before 15 September 2018 (earlier the period was till 31 August 2018). Also, revised Form DIR-3 KYC has been issued. These amendments will come into force from the date of their publication in the official gazette.

Companies (Registration Offices and Fees) Fourth Amendment Rules, 2018: The MCA on 21 August 2018 amended the Companies (Registration Offices and Fees) Rules, 2014. As per the amendment, in case of delay in e-filing of Form DIR-3 KYC, for the current financial year (2018-2019), no fee would be chargeable to directors till 15 September 2018 and fee of INR5,000 would be payable on or after the 16 September 2018 (earlier, no fee was chargeable till 31 August 2018 and fee of INR5,000 was payable on or after the 1 September 2018). These amendments are effective from 23 August 2018.

SEBI issued a consultative paper on revision of provisions relating to reclassification of promoters

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

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

The Kotak Committee on Corporate Governance in its report to SEBI provided certain recommendations which were aimed towards rationalising the existing norms pertaining to professionally managed entities and to introduce a new requirement which could enable one of the multiple promoters to get reclassified as a public shareholder. However, as several concerns were raised on the recommendations, SEBI decided to revamp the existing provisions governing reclassification of promoters/classification of entities as professionally managed.

Accordingly, on 24 July 2018, SEBI issued a consultative paper and proposed revision to the existing provisions of Regulation 31A of the Listing Regulations (consultative paper).

The key revisions proposed are as follows:

- Simplification of conditions for reclassification: Currently, Regulation 31A of the Listing Regulations specifies certain conditions for reclassification of promoters of a listed entity as public shareholders in different scenarios. The consultative paper proposes that a single set of conditions should be applicable to all situations of reclassification of promoters as public shareholders.
- Uniform process to be followed for reclassification of promoters as public shareholders: Currently, the process to be followed for reclassification of promoters as public shareholders varies on a case to case basis and shareholders’ approval is required in certain specified cases only. The SEBI has proposed a uniform process containing clear stages to be followed by a listed entity and the promoters for all cases of promoter reclassification.

**Listed entities with no promoters:** Currently, Regulation 31A of the Listing Regulations specifies conditions to be complied by a listed entity to be classified as ‘professionally managed’. It has been proposed to replace the term ‘professionally managed’ with a new term ‘listed entities having no promoter’ as the new term is considered more appropriate. A listed entity would be considered as ‘the listed entities with no promoter’ if the entity does not have any promoter due to reclassification or otherwise.

Further, a listed entity with no promoter would also be required to comply with the proposed set of conditions.

**Disclosure of material events:** The SEBI has also proposed for disclosure of certain events by a listed entity to the stock exchanges as material events not later than 24-hours from the occurrence of such event.

**Applicability of reclassification provisions in case of transfer of shares by way of transmission/succession/inheritance/gift:** The SEBI has proposed to include certain clarifications in case of transfer of shares by way of transmission/succession/inheritance/gift.

The consultative paper was open for comments until 16 August 2018.

For detailed information on consultative paper refer KPMG in India’s First Notes dated 17 August 2018.

(Source: SEBI’s consultative paper on revision of provisions relating to reclassification of promoters dated 24 July 2018)

**SEBI proposes new framework for delisting of equity shares**

The SEBI Delisting of Equity Shares Regulations, 2009 (Delisting Regulations) lay down policies relating to the delisting process. The Delisting Regulations provide provisions for voluntary and compulsory delisting. Currently, in voluntary delisting an issuer/promoter has to first take the approval of shareholders, then an in-principle approval of the stock exchange followed by reserve book building process to discover the price. Additionally, the promoter may choose to pay a price equal to or more than the discovered price to the shareholders who had tendered their shares in the reserve book building process. Delisting is regarded as successful if promoter shareholding reaches 90 per cent pursuant to reserve book building at the discovered price which is acceptable to the promoter.

Several concerns have been raised by the stakeholders regarding implementation of the reverse book building process. To address the concerns raised, SEBI on 26 July 2018 issued the discussion paper on Delisting of Equity Shares-Review of ‘Reverse Book Building Process’ proposing changes in valuation of shares under the same.

The discussion paper proposes that the promoter would be allowed to make a counter offer to the shareholders of the class and if the counter offer is lucrative to the shareholders, the delisting should be treated as successful. Further, the counter offer should not be less than the book value and it should be accepted by such number of public shareholders where the promoter’s shareholding reaches 90 per cent.

(Source: SEBI’s Discussion paper on Delisting of Equity Shares-Review of ‘Reverse Book Building Process’ dated 26 July 2018)

**SEBI clarifies the applicability of amendment relating to transfer of securities**

The SEBI through its notification dated 8 June 2018 amended Regulation 40 of the Listing Regulations which deals with transfer, transmission, or transposition of securities. According to the amendment, in order to process the requests for transfer of listed securities, the securities should be mandatorily required to be held in the dematerialised form with a depository with effect from 5 December 2018. Consequent to the amendment, SEBI has received concerns from the stakeholders regarding the applicability of the amendment.

With an aim to resolve the concerns, SEBI on 10 August 2018 through its press release clarified the following:

- The amendment does not prohibit the investor from holding the shares in physical form, investor has the option of holding shares in physical form even after 5 December 2018.
- The amendment is not applicable for transmission i.e. transfer of title of shares by way of inheritance/succession) and transposition cases.
- Any investor who is desirous of transferring shares (which are held in physical form) after 5 December 2018 can do so only after the shares are dematerialised.

(Source: SEBI notification SEBI/LAD-NRO/GN/2018/24 dated 8 June 2018 and press release PR No.: 3344//22001188 dated 10 August 2018)
SEBI issued a report of the Committee on Fair Market Conduct

In August 2017, SEBI formed a committee on Fair Market Conduct under the Chairmanship of Shri T.K. Viswanathan to review the existing legal framework to deal with market abuse and to ensure fair market conduct in the securities market. The committee was also assigned the responsibility to review the surveillance, investigation and enforcement mechanisms being undertaken by SEBI to make them effective in protecting market integrity and the interest of investors from market abuse. The committee has submitted its report to SEBI on 8 August 2018. The report includes recommendation to amend the SEBI Act, 1992, SEBI (Prohibition of Insider Trading) Regulations, 2015 and the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003.

The report of the committee is divided under four parts:


ii. The second part deals with insider trading and suggestions relating to SEBI (Prohibition of Insider Trading) Regulations, 2015.

iii. The third part deals with recommendations related to the code of conduct for market intermediaries, listed companies and other fiduciaries.

iv. The fourth part deals with regulatory measures to enhance surveillance, investigation and enforcement. Additionally, it includes suggestions to changes in the SEBI Act or the other relevant Regulations.

The report of the committee was open for comments until 27 August 2018.

(Source: Report submitted by the Committee on Fair Market Conduct issued by SEBI dated 9 August 2018)

The ICAI has issued an education material on Ind AS 115

The new revenue standard Ind AS 115, *Revenue from Contracts with Customers* is effective for accounting periods beginning on or after 1 April 2018. The core principle of Ind AS 115 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard establishes principles that an entity should apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

Recently, the Institute of Chartered Accountants of India (ICAI) issued educational material on Ind AS 115. The educational material contains a summary of Ind AS 115 that highlights the key requirements of the standard and the Frequently Asked Questions (FAQs) covers the issues, which are expected to be encountered frequently while implementing the new standard. The education material also contains a section to explain differences under Ind AS 115 from IFRS 15, *Revenue from Contracts with Customers* and from AS 7 *Construction Contracts* and AS 9 *Revenue Recognition*.

(Source: Education Material on Ind AS 115 issued by ICAI, August 2018 edition)
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.

IFRS Notes

Ind AS Transition Facilitation Group (ITFG) issues Clarifications Bulletin 15

18 April 2018
The Ind AS Transition Facilitation Group (ITFG) in its meeting considered certain issues received from the members of the Institute of Chartered Accountants of India (ICAI), and issued its Clarifications’ Bulletin 15 on 5 April 2018 to provide clarifications on 10 application issues relating to Indian Accounting Standards (Ind AS).

This issue of IFRS Notes provides an overview of the clarifications issued by ITFG through its Bulletin 15.

First Notes

SEBI issues a consultative paper on revision of provisions relating to reclassification of promoters

17 August 2018
Currently, Regulation 31A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) permits reclassification of promoters of listed entities as public shareholders in different scenarios, subject to the specified conditions.

The Kotak Committee on Corporate Governance in its report to SEBI (Kotak Committee) provided certain recommendations which were aimed towards rationalising the existing norms pertaining to professionally managed entities and to introduce a new requirement which could enable one of multiple promoters to get reclassified as a public shareholder. However, as several concerns were raised on the recommendations, SEBI decided to revamp the existing provisions governing reclassification of promoters/classification of entities as professionally managed.

Accordingly, on 24 July 2018, SEBI issued a consultative paper and proposed revision to the existing provisions governing reclassification of promoters/classification of entities as professionally managed.

This issue of First Notes provides an overview of the revisions made to the provisions relating to reclassification of promoters.

Voices on Reporting

Special session: Webinar on Ind AS 115 - Sector Series 3

Continuing with the series of special sessions on Ind AS 115, in recent session of Voices on Reporting webinar on 30 August 2018, we discussed the key implementation issues of Ind AS 115 to be considered by entities in the automotive sector (i.e. automotive suppliers). Some of the key implementation areas are as follows:

- Dealer incentives
- Warranties
- Repurchase agreements
- Principal versus agent evaluation, etc.

The audio recording and presentation can be accessed at KPMG in India website.

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