

# Audit Committee update

Quarter ended 31 December 2018



# Agenda

- London interbank offered rate(LIBOR) reforms
- MCA sets up accounting and audit regulator
- Other MCA updates
- Minimum fund raising through debt securities by large corporates
- Other SEBI updates
- Auditors responsibility on other information
- Key Audit Matters



# Moving from LIBOR to new risk-free reference rate benchmarks



- For over 30 years LIBOR has been used as risk-free reference rate in international transactions e.g., loans and mortgages, floating rate transactions, securitisation, derivatives, deposits, leasing, discounting calculations in pensions/ tax/ insurance
- Volumes at stake are enormous – 2014 estimate was USD370 trillion of notional contracts.



LIBOR is calculated daily based on rates provided by panel of banks for five currencies



Absence of active market of unsecured wholesale term borrowings and increasing reliance on expert judgement has raised concerns about long term sustainability of LIBOR as well as their vulnerability to manipulation



In July 2017, the Financial Conduct Authority (responsible for regulating LIBOR) announced that it will not compel/ persuade panel banks to make LIBOR submissions after the end of **2021**



**Alternative risk-free reference rates** (which are primarily **transaction-based and tied to overnight borrowing rates**) are being developed e.g. SOFR\*, SONIA\*\*

Significant market disruption/ adjustments expected

# Moving from LIBOR to new risk-free rates



**Companies would need to plan and prepare for alternative reference rates in case of international transactions.  
Impact of moving away from LIBOR could be far reaching**

- Certain loan/debt/mortgages agreements may require renegotiation.
- For debt agreements without stated fallback provisions, the borrower and creditor will have to negotiate an alternative index
  - Evaluation may be required whether this would need to be accounted for as a modification or extinguishment of the old agreement and issuance of the new one.
- New rate may change discount rates used in far-reaching models e.g. leases, fair valuation, impairment analysis.
- Potential impact on hedge accounting will be most relevant to hedges of interest rate risk.
- On transition, many accounting issues will arise e.g. change in hedge documentation reflecting change in transaction terms, generating data points for regression analysis using alternative risk-free rates.

Identify areas, contracts and transactions which would be impacted and plan for the transition to new risk-free rates



As envisaged under Companies Act 2013, the regulatory body, National Financial Regulatory Authority (NFRA) constituted on 1 October 2018

## Key powers and duties

- Recommend accounting and auditing standards to Central Government after seeking recommendations from ICAI.
- Monitor and enforce compliance with accounting and auditing standards and oversee the quality of accounting and audit of prescribed classes of companies
  - May review financial statements of companies in prescribed classes/working papers of their auditors. Has power to seek information/ explanations
  - May publish findings on website/send a separate report to Central Government.
- Undertake investigation of professional/other misconduct and impose penalties in case of prescribed classes of companies.
- Constitution of NFRA
  - One chairperson
  - Three full time members
  - Nine part time members [including representatives of MCA, C&AG, RBI, SEBI, ICAI (3)].



## NFRA will cover following classes of companies/ body corporates:

- Companies listed in India/ outside India.
- Unlisted public companies having:
  - Paid-up capital not less than INR500 crores or
  - Annual turnover not less than INR1,000 crores or
  - Aggregate outstanding loans, debentures and deposits of not less than INR500 crores as on the 31 March of immediately preceding financial year.
- Insurance/ Banking/ Electricity companies/ companies governed by any special act as per specified section of the Act.
- Overseas subsidiary/ associate of a company/ body corporate covered above which has income/ net-worth > 20 per cent of the consolidated income/ net-worth of such a company.
- On a reference made by the Central Government in public interest.



# MCA sets up accounting and audit regulator

(3/3)



- Company/body corporate meeting listed/capital/turnover/aggregate loan, debenture, deposit criterion will continue to be governed by NFRA for a period of three years after it ceases to meet the relevant criterion.
- Annual return: auditor of a covered company to file a return before 30th April every year in the prescribed form (not yet prescribed).
- Overseas body corporate which is subsidiary/associate of a covered company and which qualifies the criterion of exceeding 20 per cent of consolidated net worth/consolidated income has to inform NFRA, the details of its auditors within prescribed timelines
  - first time filing within 30 days of the commencement of the rules i.e., 14 November, 2018
  - subsequently, by following specified body corporates within 15 days of auditor appointment:
    - existing body corporates covered subsequently in 20 per cent threshold
    - new body corporates.



# Companies Act, 2013 sees yet another round of amendments



The Companies (Amendment) Ordinance, 2018 came into force on 2 November 2018. The main impact of the amendments is that penalties as laid down in the Act have been rationalised. It also promotes ease of doing business and better corporate compliance

## Key amendments

- Exceeding the limit on the number of directorships included as an additional disqualification for appointment as a director.
- Reintroduction of conditions for commencement of business or exercise of borrowing powers for a company incorporated after the commencement of the amendment:
  - Declaration by director to ROC confirming payment of value of shares by the subscribers to the memorandum within 180 days
    - If declaration not filed and ROC has reasons to believe that no business or operations are being carried on by the company, process of removal of the company can be initiated
  - Filing of verification of its registered office with ROC.
- Rationalisation of penalties
  - In many cases, punishment by imprisonment replaced by penalty (and made compoundable)
  - Higher penalty for repeated defaults.

Bill to replace the ordinance passed by the Lok Sabha in January 2019 – awaits consideration of the Rajya Sabha.

# Further changes in Companies Act, 2013 mooted (1/3)



**In addition to the Ordinance/Companies Amendment Bill 2018, MCA has mooted further changes in the Companies Act, 2013 and invited public comments. Salient proposals are as follows:**

## **Independent Directors (IDs)**

- Limit on pecuniary relationship with the company/ holding/ subsidiary/ associate/ their promoters/ directors increased to 25 per cent (earlier 10 per cent) of total annual income of the ID during the two immediately preceding years or the current year, with a sub-limit of 10 per cent for professional fees
  - Remuneration received and expenses incurred for participation in the Board and other meetings to be excluded unless otherwise provided.
- Introduction of requirement of assessment by prescribed body/ institute for qualification as an ID, unless exempted by the Central Government.
- In addition to declaration for meeting the criteria of independence filed with the company, ID to file a Return with the ROC with prescribed particulars of independence.
- Resignation of ID:
  - ID required to forward a copy of resignation along with detailed reasons to ROC within 7 days of giving notice; resignation to take effect from 30th day from the date of receipt of notice by the company or such later date as may be specified in the notice
  - Other directors may forward a copy of resignation along with detailed reasons to ROC within 30 days of giving notice.
- Requirement of special resolution and reasonable opportunity of being heard required for removal of any ID (at present, applicable only for IDs in their second term).



- Companies incorporated for less than three years to compute amount to be spent on CSR based on average profits since incorporation.
- Unspent CSR amount to be transferred within 30 days from the end of a financial year to a separate bank account in a scheduled bank
  - Such amount to be spent by the company as per its CSR Policy within a period of three financial years from the date of such a transfer.
- Central Government may give general or special directions to ensure compliance with CSR provisions.



At present section 135(5) merely requires that where a company fails to spend the CSR amount, its board of directors has to specify reasons for not spending the amount in its report. The proposal regarding provisions for spending unspent CSR amount introduces mandatory spending of CSR amount.

# Proposal to empower the Government to make an application to NCLT against certain individuals

(3/3)



- Apart from power to apply to NCLT when affairs of a company are being conducted in a manner prejudicial to public interest, it is proposed that:
  - Central Government should also have the power to make an application to NCLT against certain individual/s in situations of fraud, misfeasance, persistent negligence or default, business of company not managed by such person in accordance with sound business principles or otherwise for fraudulent or unlawful purpose or in manner prejudicial to public interest etc.
- NCLT would then determine whether respondent is a fit and proper person to be director or to hold any other office of any company and would be able to debar the person from the management of any company for five years.



# Minimum fund raising through debt securities by large corporates



**Applicable from 1 April 2019 (entities following April-March as financial year)/ 1 January 2020 (entities following the calendar year)**

- **Large corporates** to raise not less than 25 per cent of its **incremental borrowings** during the financial year by way of issuance of debt securities
  - Aimed at giving impetus to debt securities market and reducing dependence of large corporates on clean loans from Banks/Institutions.
- Requirement will apply subsequent to the financial year in which the listed entity is identified as a Large Corporate.
- Norms to apply as follows:
  - *For FY 2020 and 2021:* on an annual basis; shortfall to be explained to the stock exchange in prescribed manner
  - *For FY 2022:* over a contiguous block of two years; shortfall will attract monetary penalty of 0.2 per cent of the amount of shortfall.

(Does this not indirectly mean that companies with high credit rating have more onerous responsibility and would be penalised)
- Prescribed disclosures to be made to the stock exchange; such disclosures also part of audited annual financial results.

## **Large corporates**

Listed entity (other than scheduled commercial bank) which on the last day of FY has

- Listed equity/ debt/ non-convertible redeemable preference shares
- Outstanding long term borrowing of  $\geq$  INR100 crores computed in the prescribed manner, and
- Credit rating of 'AA and above' determined in the specified manner.

## **Outstanding long term borrowing/ Incremental borrowing (during a financial year)**

Any borrowing of original maturity of more than one year (whether for refinancing/ repayment of existing debt or otherwise); excludes ECB and inter-corporate borrowings between a parent and subsidiary(ies).

# Revised LODR tightens re-classification of shareholding status



Classification of shareholders of listed entities into promoter shareholders or public is significant since special considerations and restrictions apply to promoters – Reclassification required where earlier promoters no longer control day to day management and have low shareholding e.g., after an open offer.



- Stock exchange to permit change in status only on receipt of application by listed company
  - Earlier the concerned shareholder could also apply directly
  - Only compliant listed entities eligible to apply.
- Specific responsibility of the board and shareholders to consider reclassification
  - Request along with recommendations of the Board to be approved by shareholders.
- Re-classification only if promoters/ their related persons
  - hold not more than 10 per cent of voting rights
  - not exercise control directly/indirectly
    - not act as a KMP in the listed entity
  - not represented on the Board (including as nominee director).
    - not be 'wilful defaulter' or 'fugitive economic offender'
- Condition of equity holding to be considered as a 'listed entity with no promoter' (earlier 'professionally managed') revised from not more than 1 per cent to not more than 10 per cent.
- Receipt of request, Board consideration of request, submission of application to exchange and its decision - to be disclosed to the exchange as soon as reasonably possible and not later than 24 hours from the event.



Disclosures regarding price risks and hedging risks regarding commodities including:

- risk management policy
- gross exposure throughout the year
- exposure to each commodity (where material) including amount/quantity/percentage hedged through derivatives
- commodity risk faced during the year and how is it managed.

Disclosures with respect to Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 – number of complaints filed, disposed of and pending.

- Ind AS 107 requires certain disclosures relating to commodity risks in the financial statements.
- SA 720 (Revised) requires auditor to report inconsistencies between the financial statements and 'other information' in documents containing audited financial statements.

# Disclosures by equity listed entities regarding the reasons for a delay in the submission of results



Equity listed entities are now required to disclose the detailed reasons for delay in submission of financial results to the stock exchange within

- one working day of the due date
- one working day of the decision to delay the submission of results if such a decision was taken prior to the due date.

*Disclosure will enable the investors to be aware of the reasons of delays which may have an impact on their*

## **A quick recap:**

- Quarterly and annual financial results are to be submitted by listed entities to stock exchanges within 45/60 days from the end of the quarter/financial year.
- Listing Regulations and SEBI circulars provide for procedures non submission/ delay in submission of financial results by equity listed entities
  - These include levy of penalties, freezing of promoter shareholding.

# SEBI Board decision- Facilitating listing of high technology start-ups



## Innovators Growth Platform (IGP) - for start-ups

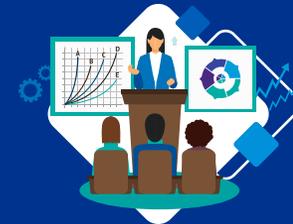
- Issuers eligible for listing on IGP:
  - Companies that are deeply entrenched in the use of technology, IT, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value.
- 25 per cent of pre-issue capital for atleast a period of two years should have been held by specified persons (with not more than 10 per cent by accredited investors).
- Minimum application size and minimum trading lot to be INR2 lakhs and in multiples of INR2 lakhs thereof.
- Minimum net offer to the public to be as per minimum public shareholding norms and minimum offer size to be INR10 crores.
- No minimum reservation of allocation to specific category of investors; minimum allottees to be 50.
- Option to trade under regular category after one year of listing subject to necessary compliance.

# Direct listing of Indian companies on foreign bourses and vice versa (1/2)



- Existing Indian legal framework does not permit direct listing of equity shares of Indian companies outside India and companies incorporated outside India on Indian stock exchanges
  - SEBI constituted an Expert Committee to suggest a framework for such listing
  - At present Indian companies can access foreign markets through ADR/GDR framework. Foreign companies can access Indian capital markets through IDR framework.
- The recommendations of the committee on suitable framework facilitating direct listing would need to be considered and implemented by Indian and foreign authorities expeditiously since there is strong economic rationale for such a listing.





## Listing of equity shares of Indian companies on foreign exchanges

- Direct listing of Indian companies may be allowed only on specified stock exchanges in Permissible Jurisdictions (those which satisfy the suggested criteria).
- Company to follow the listing framework of the concerned Permissible Jurisdiction (in addition to the relevant Indian laws).
- Enabling amendments/ clarifications will be required in Indian laws e.g. Companies Act, SEBI Regulations, FEMA, KYC.
- Department of Revenue to provide clarity on tax challenges e.g. tax on issuance and transfer of shares, applicability of sec 56.
- Relevant accounting standards of the country of listing to be applicable (in addition to preparation of financial statements as per Ind AS).

## Listing of equity shares of companies incorporated outside India on Indian exchanges

- Company should have been incorporated only in Permissible Jurisdictions.
- Enabling amendments/ clarifications will be required in Indian laws e.g. Companies Act, SEBI Regulations, FEMA.
- Department of Revenue will need to provide clarity on tax related challenges e.g. determination of fair market value, exclusion from place of effective management(POEM) provisions.
- Financial statements to be prepared as per Ind AS/ IFRS/ US GAAP/ local GAAP of such company.  
In case of use of GAAP other than Ind AS, the company must provide:
  - Summary of difference with Ind AS
  - Quantitative reconciliation with Ind AS if CFS has been prepared as per local GAAP of such a company.

# Consistency between financial statements and other financial/ non-financial information in the annual report



- Management/Board should ensure that financial or non-financial information given in Annual Report (other than financial statements and auditor's report) is in consonance with the information in financial statements and auditor's report.
- To ensure the above the auditor is also required to read and consider the other information - financial or non financial - to identify inconsistencies with financial statements and auditors' report.
- Standard on Auditing (SA 720) has been strengthened and from audits of financial statements for periods beginning on or after 1 April 2018, auditor should
  - consider whether there is a material inconsistency between the other information and the financial statements; and
  - consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit and
  - respond/report in his/hers audit report appropriately.
- The reporting on the auditor's work relating to other information to be as below:
  - The auditor's report will include a separate Other Information section when the auditor has obtained at least some of the other information as of the date of the auditor's report of unlisted corporate entities
  - For audits of financial statements of listed entities, Other Information section will be included even if the auditor expects to obtain the entire other information after the date of the auditor's report.
- Reading/considering 'other information' as above does not mean that auditor has audited the same i.e. the other information does not qualify as being 'audited'.

# Responding to material inconsistencies when discovered after the date of auditor's report



The standard requires the auditor to take appropriate action to seek to have the uncorrected misstatement brought to the attention of users when he/she obtains knowledge of inconsistencies after the date of his/her audit report

- Appropriate actions, if permitted by law, that the auditor may take to have uncorrected material misstatements brought to attention of users include:
  - Providing a new or amended auditor's report including a modified section and requesting management to provide this report to users for whom the auditor's report is prepared
    - Auditor may also review the steps taken by management to provide the new/amended auditor's report to such users
  - Bringing the material misstatement to the attention of the appointing authority
  - Communicating with the regulator where required by applicable law or regulation
  - Considering the implications for engagement continuance.
- Auditor may also consider it appropriate to seek legal advice about the auditor's legal rights and obligations.



In view of the implications it would be better if other information is available by the time audit report is issued.

# Communicating Key Audit Matters (KAM) in Independent Auditor's Report

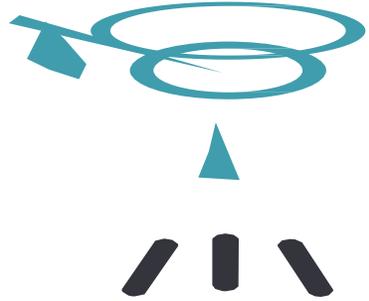


- For audits of financial statements of listed entities for period beginning 1 April 2018, statutory audit report to contain separate section on matters which were of most significance in the audit.
- Applicable to audits of complete sets of general purpose financial statements of
  - listed entities and
  - circumstances when the auditor otherwise decides to communicate KAM in the auditor's report.
- No change in the scope of audit.

## Criteria for determining key audit matters



# Objective of reporting key audit matters



## Purpose of communication about key audit matters

- Helps users in understanding the entity and areas of most significant audit attention including management judgment, estimations, uncertainties, lack of vital controls, fraud etc.
- Enhances the communicative value of the auditor's report.
- Provides greater transparency about the audit.

Does not result in a modified audit report. Modified opinion to be expressed by an auditor when required by the circumstances.

## Communication of key audit matters is not a qualification/reservation/modification. Nor it is substitute for :

- Disclosures in the financial statements.
- Reporting in accordance with SA 570, Going Concern – when material uncertainty exists casting doubt on ability to continue as going concern.

# Examples of areas from which key audit matters could emerge



Number of key audit matters to be included in auditor's report may be affected by-

- Size and complexity of the entity
- Nature of entity's business and environment
- Facts and circumstances of audit engagement

# Questions and answers



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