Voices on Reporting

Quarterly updates

July 2019

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In this publication, we have summarised important updates relating to the quarter ending 30 June 2019 from the Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI).

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Updates relating to Ind AS

Ind AS 116, *Leases* – Transition options and considerations

The new standard on leases i.e. Ind AS 116, *Leases* is applicable for accounting periods beginning on or after 1 April 2019 and replaces Ind AS 17, *Leases*, the current standard for 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).

To ease the implementation, the new standard provides different transition options and practical expedients. Many of them can be elected independently of each other. Some of these practical expedients can even be elected on a lease-by-lease basis.

The table below summarises the key options and practical expedients for transition to Ind AS 116:

Transition options/practical expedient	Scope	Lessee or lessor
Lease definition: Option to 'grandfather' the assessment of which contracts are leases	Accounting policy choice	Lessee and lessor
Recognition exemption		
Short-term leases: Leases with a lease term of 12 months or less that do not contain a purchase option	Class of underlying asset	Lessee
Leases of low-value items: Leases for which the underlying asset is of low value when it is new (even if the effect is material in aggregate.	Lease-by-lease	Lessee

Transition options/practical expedient	Scope	Lessee or lessor
Retrospective vs modified retrospective	Accounting policy choice	Lessee
Retrospective approach: Under this approach, the lessee applies the new standard retrospectively in accordance with Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*	All leases	Lessee
Modified retrospective: Under this approach, a lessee applies the new standard from the beginning of the current period. Practical expedients under this approach: • Measurement of the right-of-use asset • Discount rates • Impairment and onerous leases • Leases with a short remaining term • Initial direct costs • Use of hindsight.	Lease-by-lease	Lessee

Source: KPMG in India's analysis read with KPMG IFRG Ltd.'s publication 'Leases transition options – What is the best option for your business? November 2018

Key considerations

Lease definition - practical expedient

- Entities should evaluate whether grandfathering their previous assessment of lease definition in the existing contracts will be beneficial considering the costs and other factors involved. This option is available to both a lessee as well as a lessor transitioning to the new standard.
- Once adopted, the practical expedient to grandfather will apply to all contracts entered before the date of initial application i.e. 1 April 2019. Ind AS 116 will apply to all contracts entered into on or after 1 April 2019.

Transition approach

- The standard provides two optional approaches to a lessee for transition i.e. retrospective or modified retrospective approach. There are several practical expedients, an entity may make use of while applying modified retrospective approach.
- A lessee will have to first choose to apply the practical expedient on lease definition and then have to decide whether to apply the retrospective or modified retrospective approach to leases.
- When an entity applies modified retrospective approach on transition, for leases previously classified as operating leases:
  - A lessee is required to use the incremental borrowing rate as at the transition date for measurement of lease liability.
  - A lessee is permitted to choose on a lease-by-lease basis, either of the following options to measure the right-of-use asset:
    - i. At its carrying amount as if the standard had been applied since the commencement date but discounted using the lessee's incremental borrowing rate at the date of initial application
    - ii. At an amount equal to lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet immediately before the date of initial application.

Lessor

A lessor is not required to make any adjustments on transition for leases except in case of sub-leases.

Key takeaway

Transition considerations: Entities will need to decide upon the transition options available under the new standard i.e. whether to apply the standard retrospectively to all leases or to use a modified retrospective approach. The extent of information required will depend on the transition approach chosen.

For a detailed reading on the requirements of Ind AS 116 transition options, please refer to Chapter 1 - Ind AS 116, Leases – Transition options of KPMG in India's publication Accounting and Auditing Update, May 2019.

Source: MCA notification dated 30 March 2019 and KPMG in India's First Notes dated 2 April 2019

Uncertainty over Income Tax Treatments – an overview

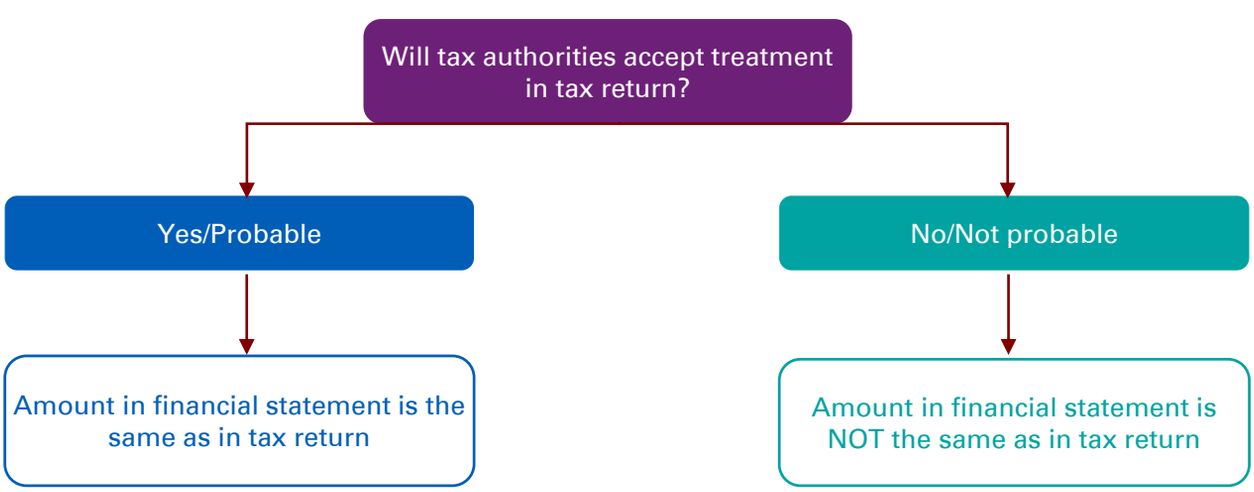
There was diversity in practice for the recognition and measurement of a tax liability or asset in the financial statements of entities. The Ministry of Corporate Affairs (MCA) added Appendix C, *Uncertainty over Income Tax Treatments* to Ind AS 12, *Income Taxes* (Appendix C) which seeks to bring clarity to the accounting for uncertainties on income tax treatments that have yet to be accepted by tax authorities, and to reflect it in the measurement of current and deferred taxes. The Appendix C is based on IFRS Interpretation Committee (IFRIC) 23, *Uncertainty over Income Tax Treatments* issued by the International Accounting Standards Board (IASB) in June 2017.

Key highlights of Appendix C

The key test

As per Appendix C, the key test is whether it is probable that the taxation authority would accept the tax treatment used or planned to be used by the entity in its income tax filings. If yes, then the amount of taxes recognised in the financial statements would be consistent with the entity's income tax filings. Otherwise, the effect of uncertainty should be estimated and reflected in the financial statements. This would require the exercise of judgement by the entity.

The below diagram explains the test:



Source: Income tax exposures - IFRIC 23 clarifies the accounting treatment, KPMG IFRG Ltd.'s publication, dated 7 June 2017

Recognition and measurement of uncertainty

The uncertainty is reflected using the measure that provides the better prediction of the resolution of the uncertainty either:

- *The most likely amount*: Being the single most likely amount in a range of possible outcomes; or
- *The expected value*: The sum of probability-weighted amounts in a range of possible outcomes.

The measurement of uncertainty is reflected in the overall measurement of tax, and separate provision is not required to be made.

Appendix C requires companies to reassess the judgements and estimates applied, and update the amounts in the financial statements, if facts and circumstances change. Some of the changes in facts and circumstances are as follows:

- Examinations or actions by tax authorities
- Changes in tax rules established by a taxation authority
- Tax authority's right to challenge a treatment expires
- Any other new facts and circumstances, including adjusting events occurring after the reporting period under Ind AS 10, *Events after the Reporting Period*, that may affect an entity's conclusion about the acceptability of tax treatments.

Accounting impact and disclosures

Depending on their current practice, entities may need to increase their tax liabilities or recognise an asset. The timing of derecognition may change.

Appendix C does not introduce any new disclosure requirements, but reinforces the need to comply with the meaningful disclosure requirement under Ind AS 1, *Presentation of Financial Statements* and the existing disclosure requirements under Ind AS 12, which include disclosure requirements of:

- Judgements made
- Assumptions and other estimates used and
- The potential impact of uncertainties that are not reflected.

Effective date and transition

Appendix C is applicable for annual periods beginning on or after 1 April 2019.

On transition, a company may apply the standard retrospectively, by restating the comparatives (i.e. period beginning 1 April 2018), if this is possible without the use of hindsight, or apply it prospectively by adjusting equity on initial application, without adjusting comparatives.

Source: MCA notification dated 30 March 2019 and KPMG in India's First Notes: MCA notified amendments to certain Ind AS dated 10 May 2019

Updates relating to the Companies Act, 2013

Requirements relating to return of deposits (Form DPT-3)

The Companies Act 2013 (2013 Act) and the Companies (Acceptance of Deposits) Rules, 2014 (Deposit Rules) prescribe the requirements relating to companies accepting the deposits. To increase transparency, the Ministry of Corporate Affairs (MCA) requires companies accepting deposits from their members or public to file two returns as follows:

- **Annual return (Rule 16)**: Every company (other than a government company) should use form DPT-3 (return of deposits) to file:

  a) A return of deposit

  b) Particulars of a transaction not considered as deposit or

  c) Both

  This return should be filed with the Registrar of Companies (ROC) on or before 30 June of every year (comprising information contained therein as on 31 March of that year duly audited by the auditor of the company).

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

Rule 16 requires that even if a company has not accepted deposits (but has receipts of money or loan of the nature which are not deposits), it should still file the annual return by 30 June 2019. In relation to this, the revised electronic form requires disclosure of 13 categories of financial transactions not considered as deposits. The coverage of these transactions is quite pervasive, as it is likely to cover many financial transactions. MCA received requests from the stakeholders seeking clarifications relating to filing of the DPT-3 form.

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

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

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

Source: MCA notification G.S.R. 341 (E) dated 30 April 2019, ICAI notification dated 25 June 2019 and KPMG in India's First Notes on MCA issued an amendment relating to one-time return of deposits and Form DPT-3 dated 8 May 2019

MCA notified amendments to NCLT Rules

Background

Section 245 of the 2013 Act deals with class action suit that can be filed by a certain number of members or depositors (or any class of members/depositors). A class action suit can be filed if members/depositors are of the opinion that management or affairs of the company are being conducted in a manner prejudicial to the interests of the company or members/ depositors. The 2013 Act lays down the various situations where class action suit could be filed.

Requisite number of members/depositors needed to file class action suit

The number of members/depositors required to file class action suits are as follows:

Type of company	Members	Depositors
Company with share capital	The number of members would be lower of (A) or (B) as follows: A. a) 100 members or b) Prescribed percentage of the total number of its members, whichever is less B. Any member(s) holding not less than prescribed percentage of the issued share capital of the company (subject to the condition that the applicant(s) has (have) paid all calls and other sums due on his/her (their) shares).	The requisite number of depositors provided would be lower of the following: A. a) 100 depositors or b) Prescribed percentage of the total number of its depositors, whichever is less, or B. Any depositor(s) to whom the company owes prescribed percentage of its total deposits.
Company without share capital	Not less than one-fifth of the total number of its members.	Same as above.

New development

On 8 May 2019, MCA has notified requisite percentage of the members/depositors who may apply for a class action suit. The percentages are as given below table:

Type of company	Members	Depositors
Company with share capital Listed company	The requisite number of members would be lower of (A) or (B) as follows: A. a) At least five per cent of the total number of its members or b)100 members, whichever is lower or B. Member(s) holding not less than two per cent of its issued share capital.	A. The requisite number of depositors would be lower of the following: a) At least five per cent of the total number of its depositors b) 100 depositors, whichever is lower or B. Depositor(s) to whom a company owes five per cent of its total deposits.
Company without share capital Unlisted company	The number of members would be lower of (A) or (B) as follows: A. a) At least five per cent of the total number of its members b) 100 members, whichever is lower or B. Member(s) holding not less than five per cent of its issued share capital.	Same as above.

Source: MCA notification G.S.R.351 (E) dated 8 May 2019 and KPMG in India's First Notes: MCA notified amendments to NCLT Rules dated 23 May 2019

Amendment to Schedule VII to the 2013 Act

Background

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

New development

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

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

E-form Active filing

On 25 February 2019, MCA amended the Companies (Incorporation) Rules, 2014 and introduced Rule 25A.

Applicability

The Rule 25A specified that every company incorporated on or before 31 December 2017 should file the particulars of the company and its registered office, in 'e-Form ACTIVE' (Active Company Tagging Identities and Verification) on or before 25 April 2019 (excluding companies under process of liquidation/ dissolution or amalgamation). MCA through its notification dated 25 April 2019 further amended Rule 25A and extended the date of filing e-Form ACTIVE by 15 June 2019.

Requirements

The attachments to 'e-From ACTIVE', *inter alia*, include the following:

- A photograph of the registered office showing name of the company
- Address of the registered office
- Photograph of office showing internal space with the presence of at least one director/key managerial personnel who will sign the form.

Consequences of non-filing e-Form ACTIVE

In case e-Form ACTIVE is not filed by the company on or before 15 June 2019, then following are the consequences:

- The compliance status for such a company would be marked as 'ACTIVE Non-compliant'
- Director Identification Number (DIN) allotted to directors of such companies would be marked as 'Director of ACTIVE non-compliant companies (Rule 12B of Companies (Appointment and Qualification of Directors) Rules, 2014)
- MCA would not accept event-based information or changes request from such companies
- Company shall be liable for action under Section 12(9) of the 2013 Act, ROC may remove the name of such company from its record.

Next steps in case of default in filing e-Form ACTIVE:

- Companies are required to file the e-Form ACTIVE along with the late filing fee of INR10,000. After form is filled, status of such companies would be marked as 'ACTIVE Compliant'.
- Directors with DIN status as 'Director of ACTIVE non-compliant company' would need to take necessary steps to ensure that all companies governed by Rule 25A in which he/she is a director file e-form ACTIVE. After all companies file 'e-Form ACTIVE', the DIN status would be restored and marked as 'Director of ACTIVE compliant company'.

Source: MCA notification G.S.R.330 (E) dated 25 April 2019 and G.S.R.368 (E) dated 16 May 2019

Updates relating to SEBI

SEBI issued procedures and formats for limited review and audit reports

Background

On 9 May 2018, the Securities and Exchange Board of India (SEBI) amended its Listing Regulations and specified that the statutory auditor (principal auditor) of the listed entities would be required to undertake a limited review of the audit of all the entities/companies whose accounts are to be consolidated with the listed entity as per Accounting Standard (AS) 21, *Consolidated Financial Statements*. This provision is applicable from 1 April 2019.

However, the term 'limited review of the audit' has been a subject of multiple interpretations as there was a lack of clarity on the level of procedures to be performed by the principal auditor in the case of a group audit. Additionally, it was unclear on how this requirement was aligned to the existing guidance for auditors included in SA 600, *Using the work of Another Auditor* and the principles set out in the *Guidance Note on Audit of Consolidated Financial Statements* (Revised 2016) issued by the Institute of Chartered Accountants of India (ICAI).

New development

The SEBI through its circular dated 29 March 2019 prescribed the procedures (to be followed by principal and component auditor) and formats for limited review report and audit report of the listed entity and its components. The revised procedures and formats would be required to be followed by the statutory auditors of listed entity and its components. These procedures are applicable from 1 April 2019.

Overview of the circular

The brief overview of the circular is as follows:

Scope: The circular is applicable to:

- All listed entities whose equity shares and convertible securities are listed on a recognised stock exchanges and their statutory auditors (principal auditors)
- All entities whose accounts are to be consolidated with the listed entity (subsidiaries, associates and joint ventures) and their statutory auditors (component auditors).

Financial reporting framework: The procedure highlighted in the circular is applicable for the audit/limited review of Consolidated Financial Statements (CFS) or consolidated financial results of the parent company. Such procedures should be in accordance with the requirements of the following financial reporting framework:

- Ind AS: Under Ind AS CFS/consolidated financial results would be prepared based on Ind AS 110, *Consolidated Financial Statements*, Ind AS 28, *Investments in Associates and Joint Ventures* and Ind AS 111, *Joint Arrangements.*
- Accounting Standards: Under Accounting Standards CFS/consolidated financial results would be prepared based on AS 21, *Consolidated Financial Statements*, AS 23, *Accounting for Investments in Associates in Consolidated Financial Statements* and AS 27, *Financial Reporting of Interests in Joint Ventures*.

Compliance with auditing framework in India: The statutory auditor (principal auditor) undertaking the audit or review of the CFS or consolidated financial results of the parent entity should ensure compliance with the following:

- SA 600, *Using the Work of Another Auditor*
- Standards on Review Engagements (SRE) i.e., SRE 2400, *Engagements to Review Financial Statements* or SRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*
- *Guidance Note on Audit of Consolidated Financial Statements* (Revised 2016) issued by ICAI.

The circular reiterates that the audit and limited review of the respective components that are being consolidated with the parent company would continue to be undertaken by the respective auditors of such components.

Procedure: The parent company management is responsible to ensure that there is coordination between principal and component auditor to comply with SA 600. The circular provides detailed procedures for principal auditor to consider while performing audit/review of the components of the listed entity. However, the procedures given in the circular should not be construed as complete.

Audit and review instructions: The circular requires principal auditor to communicate the requirements of the audit/review to the component auditor on a timely basis. The communication should set out the work to be performed, the use of that work, and the form and content of the component auditor communication with the principal auditor.

Additionally, the circular requires principal auditors to include key matters in the audit and review instructions to be considered by the component auditors.

Responsibility of the component auditor: The component auditor should provide an acknowledgement to the principal auditor for the receipt of instructions and also provide a confirmation to the principal auditor regarding compliance with the instructions received, together with the applicable audit/review report.

Revised formats for financial results: The circular provides revised formats for limited review reports and audit reports to be submitted by the statutory auditors. These formats would be applicable to listed entities including banks. Insurance companies are required to follow formats as prescribed by insurance sector regulator, Insurance Regulatory and Development Authority of India (IRDA).

The updated formats require principal auditor to assess that the audit/review of the components has been performed by the component auditor, and the principal auditor has performed the procedures as per the SEBI circular while relying on the work of the component auditor.

Key takeaways

The SEBI's circular reinforces the requirements of SA 600 and the Guidance Note on Audit of Consolidated Financial Statements. The procedure highlighted in the circular is likely to result in change in practice and enhance focus on the substance of the responsibilities for principal auditors and component auditors. The steps prescribed for principal auditor would help to obtain sufficient audit/review information and rely on the work performed by component auditors.

The robust process explained in the circular is likely to improve the overall audit quality and governance environment in India. Companies and auditors would need to consider the impact of the circular on the audit/review, and plan for any changes in the approach that may be required.

Source: SEBI circular CIR/CFD/CMD1/44/2019 dated 29 March 2019 and KPMG in India's First Notes dated 9 April 2019

SEBI revises materiality threshold for payments relating to brand or royalty

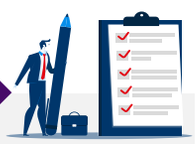
Regulation 23(1A) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) specifies that the payments made by the listed entities to related parties with respect to brand usage/royalty amounting to more than two per cent of consolidated turnover of the listed entity would be considered material. Therefore, such transactions would require shareholders' approval on a majority of minority basis i.e. none of the related parties have a right to vote to approve such resolutions. These regulations were to be made effective 1 April 2019.

Based on the representations received from the stakeholders, SEBI in its board meeting dated 27 March 2019 decided to defer the implementation of the amended regulation pertaining to royalty or brand usage payments by three months i.e. upto 30 June 2019.

New development

Recently, SEBI in its meeting dated 27 June 2019, has decided that payments made to related parties towards brand usage or royalty may be considered material if the transaction(s) exceed five per cent of the annual consolidated turnover of the listed entity during a financial year and would require approval of the shareholders, with no related party having a vote to approve such resolutions.

Key takeaways



The companies have made representation to SEBI that low materiality threshold of two per cent is likely to affect genuine transactions when the objective behind these disclosures is to help with anti-abuse of related party transactions.

The enhanced materiality threshold from two per cent to five per cent of the annual consolidated turnover will certainly bring relief to listed companies. The revised threshold is now aligned to the Kotak Committee recommendations also.

Source: SEBI press release PR No. 11/2019 dated 27 March 2019, PR No.16/2019 dated 27 June 2019 and KPMG in India's First Notes: SEBI revises materiality threshold for payments relating to brand or royalty dated 1 July 2019

SEBI approves framework for issuance of Differential Voting Rights (DVR) shares

In India, the regulatory framework does not permit issuance of Differential Voting Rights (DVR) shares that have higher or superior voting rights. Therefore, the 'Primary Market Advisory Committee' of the SEBI and a group (DVR Group) was constituted amongst the Committee members to conduct an in-depth study of the proposal of introduction of dual-class shares (as DVRs are commonly known internationally) in India.

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

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

New development

Recently, on 27 June 2019, SEBI in its board meeting approved a framework for issuance of DVR shares along with amendments to the relevant SEBI Regulations to give effect to the framework. The framework approved is in respect to issuance of shares with superior voting rights (SR shares).

The following table provides an overview of the key proposals approved:

S. No.	Caption	Approved regulation
1.	Eligibility	A company with SR shares would be permitted to undertake an Initial Public Offering (IPO) of only ordinary shares (to be listed). The IPO would be subject to fulfillment of eligibility requirements of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the following conditions: • The issuer is a tech company[01] as per the definition in Innovators Growth Platform • The SR shareholder should be a part of the promoter group whose collective net worth does not exceed INR500 crore. While determining the collective net worth, the investment of SR shareholders in the shares of the issuer company should not be considered. • The SR shares have been issued only to the promoters/founders who hold an executive position in the company. • Issue of SR shares should be authorised by a special resolution passed at a general meeting of the shareholders. • SR shares have been held for a period of at least six months prior to the filing of Red Herring Prospectus (RHP). • SR shares have voting rights in the ratio of minimum 2:1 to maximum 10:1 compared to ordinary shares.
2.	Listing and Lock-in	• SR shares would be listed on the stock exchanges after the IPO. • SR shares would remain under lock-in after the IPO until their conversion to ordinary shares. • Transfer of SR shares among promoters would not be permitted. • Creation of pledge/lien would not be permissible.

1. Tech company i.e. intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition.

S. No.	Caption	Approved regulation
3.	Rights of SR shares	• The SR shares would be treated at par with ordinary equity shares in all respects, including dividends, except in the case of voting on resolutions. • Post-listing, the total voting rights of SR shares and ordinary equity shares should not exceed 74 per cent of the total voting rights.
4.	Enhanced corporate governance	• At least half of the Board and two-third of the Committees (excluding Audit Committee) as prescribed under Listing Regulations should comprise of Independent Directors. • Audit Committee should comprise of only Independent Directors.
5.	Coat-tail provisions	Post IPO, the SR equity shares would be treated as ordinary equity shares in terms of voting rights (i.e. one SR share to have one vote) in the following circumstances: • Appointment or removal of independent directors and/or auditor • In case where promoter is willingly transferring control to another entity • Related party transactions in terms of Listing Regulations relating to SR shareholder • Voluntary winding up of the company • Changes in the company's Articles of Association or Memorandum, except any changes affecting the SR instrument • Initiation of a voluntary resolution plan under the Insolvency and Bankruptcy Code, 2016 • Utilisation of funds for purposes other than business • Substantial value transaction based on materiality threshold as prescribed under Listing Regulations • Passing of special resolution in respect of delisting or buy-back of shares and • Any other provisions notified by SEBI in this regard from time to time.
6.	Sunset clauses	SR shares should be converted into ordinary shares in following circumstances/events: • *Time based*: The SR shares shall be converted to ordinary shares on the fifth anniversary of listing. The validity can be extended once by five years through a resolution. SR shareholder would not be permitted to vote on such resolutions. • *Event based*: SR shares shall compulsorily get converted into ordinary shares on occurrence of certain events such as demise, resignation of SR shareholders, merger or acquisition where the control would be no longer with SR shareholder, etc.
7.	Fractional Rights Shares	• Issue of fractional rights shares by existing listed companies is not permitted.

Key takeaways

- The new DVR provisions would allow promoters in tech companies greater flexibility to raise capital, however, it comes with some other riders including a restriction on pledging and transferring of such shares
- SEBI has attempted to balance the concerns that minority shareholders may have on the disproportionate voting rights and power enjoyed by promoters *vis-a-vis* their shares by providing for certain restrictions and mandating conversion of DVR shares into ordinary shares.

Source: SEBI press release PR No.16/2019 dated 27 June 2019

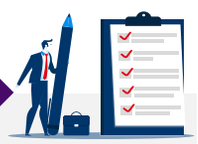
SEBI approved new directives for encumbrance shares

The SEBI in its board meeting on 27 June 2019 expanded the definition of the term 'encumbrance' and also widened disclosure norms for pledged shares. The new measures have been taken due to concerns relating to promoter/ companies raising funds from Mutual Funds/NBFCs through structured obligations, pledge of shares, non-disposal undertakings, corporate/promoter guarantees and various other complex structures.

Following are new provisions that have been approved:

- New definition includes:
  - Any restriction on the free and marketable title to shares, by whatever name called, whether executed directly or indirectly;
  - Pledge, lien, negative lien, non-disposal undertaking;
  - Any covenant, transaction, condition or arrangement in the nature of encumbrance, by whatever name called, whether executed directly or indirectly.
- Reasons for encumbrance to be disclosed: Promoters would need to separately disclose detailed reasons for encumbrance whenever their combined encumbrance along with Persons Acting in Concert (PACs) crosses 20 per cent of the total share capital in the company or half their shareholding. Further stock exchanges will have to maintain the details of such encumbrances along with the purpose on their websites.
- Declaration: Promoters would be required to declare to the audit committee and to the stock exchanges on a yearly basis, that they along with PACs, have not made any encumbrance directly or indirectly, other than already disclosed, during the financial year.

Key takeaway



The new reforms would help in tightening norms for disclosure by promoters and improving transparency in relation to pledging of shares.

Source: SEBI press release PR No.16/2019 dated 27 June 2019

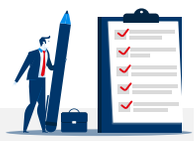
Enhanced disclosure in case of listed debt securities

The SEBI through its circular dated 27 May 2019 issued guidelines pertaining to enhanced disclosures in case of listed debt securities to tighten the disclosure norms for entities that have issued such securities.

The circular issued the following guidelines for amendments to existing regulatory framework:

- Debenture Trustees required to disclose the nature of compensation arrangement with its clients on their websites
- Debenture Trustees should display on their website the International Securities Identification Number (ISIN) wise details of interest/redemption due to the debenture holders in respect of all issues during a financial year within 5 working days of start of financial year
- Debenture Trustees should also update the status of payment ISIN-wise against such issuers not later than one day from the due date.

- Registrars to an Issue (RTA) or issuers should henceforth forward the details of debenture holders to the Debenture Trustees at the time of allotment and thereafter by the seventh working day of every next month.
- In privately placed issues, additional covenants as under, should be included as part of the issue details in the summary term sheet.



Key takeaway

The SEBI issued revised guidelines with an aim to further safeguard the interest of investors in listed debt securities and enhance transparency in the functioning and operations of the Debenture Trustees issued these guidelines.

Source: SEBI circular SEBI/ HO/ MIRSD/ DOS3/CIR/P/2019/68 dated 27 May 2019

Updates relating to RBI

Prudential framework for resolution of stressed assets

Background

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

New development

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

Overview of the Prudential Framework

Applicability

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

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

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

Early identification and reporting of stress

Lenders are required to recognise incipient stress in loan accounts, immediately on default, by classifying the accounts as Special Mention

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

Accounts (SMA) based on the number of days they are overdue. The accounts can be classified as SMA-0, SMA-1 and SMA-2.

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

Implementation of Resolution Plan

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

- **Review period:** As soon as a borrower is reported to be in default by either the SCBs, AITFIs or SFBs, the lenders are provided with 30 days review period, within which they are required to undertake a *prima facie* review of the borrower's account. During this period, lenders may decide the resolution strategy, including the nature of the RP, approach for implementation of RP, etc.
- **Inter-Creditor Agreement (ICA):** For borrowers with multiple-creditor facilities, where RP is to be implemented, all lenders concerned are mandated to enter into an ICA during the review period. The ICA, *inter alia,* prescribe the ground rules for finalisation and implementation of the RP. Decision agreed by lenders representing 75 per cent by value of total outstanding credit facilities[02] and 60 per cent of lenders by number, would be binding upon all lenders. The ICA should also protect the rights of dissenting lenders.
- **Timelines for implementation of RP and additional provisions:** The RP should be implemented within 180 days from the ***end of*** the review period. The commencement of the review period (termed as 'reference date') would depend on the aggregate exposure of the borrower, as below:

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

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

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

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

2. Fund based and non-fund based

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

The additional provisions may be reversed as under:

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

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

Prudential norms

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

- **Asset classification:** On restructuring, all accounts would be immediately downgraded as Non- Performing Assets (NPAs) (i.e. substandard to begin with), and accounts classified as NPA would be retained in the same category.
- **Upgrade of accounts:** Accounts would be upgraded only when they demonstrate satisfactory performance during the prescribed period and for certain large accounts, when they are rated as investment grade (BBB- or better) at the time of upgrade by CRAs accredited by RBI for the purpose. Specific criteria is prescribed for accounts where there has been a change in ownership. Provisions held on restructured assets may be reversed when they are upgraded to standard category.
- **Additional and interim finance:** The classification of additional and interim finance advanced under the RP would depend on the performance of the account as specified in the Prudential Framework.
- **Provisioning norms:** The accounts restructured under the Prudential Framework are required to follow the IRAC norms for provisioning. For accounts referred to IBC, the provisioning should be at least equal to the provisioning required in the normal course upon implementation of RP. The provisions in this case would be frozen for a prescribed period, subsequent to which, the IRAC norms would apply.
- **Other provisions:** The Prudential Framework provides guidelines for other provisions such as:
  - Recognition of income (on cash or accrual basis) for restructured assets
  - Asset classification and provisioning for Funded Interest Term Loans (FITL), debt and equity instruments created by conversion of principal/ unpaid interest
  - Principles for classifying sale and lease back transactions and refinancing of exposures to borrowers as 'restructuring'
  - Provides regulatory exemptions from certain provisions of RBI and SEBI.

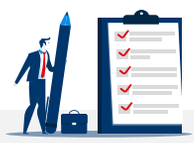
Exceptions to the Prudential Framework

The Prudential Framework would not apply in certain cases:

- Projects under implementation involving deferment of Date of Commencement of Commercial Operations (DCCO)- these would be covered under the RBI Master Circular dated 1 July 2015

4. Date of quashing of the erstwhile circular.

- Micro, Small and Medium Enterprises (MSMEs)- these would be covered under the RBI circular dated 17 March 2016
- Borrower entities in respect of which specific instructions have been issued by RBI for initiation of insolvency proceedings under IBC
- Restructuring of loans in the event of natural calamity.



Key takeaways

- The Prudential Framework brings the focus on speedy resolution of stressed assets and creation of loan loss provision against those assets.
- The aim of the Prudential Framework is to initiate a resolution process, even before a default takes place. Accordingly, the review period for review of the borrower account would start immediately when a borrower is reported to be in default by either the SCBs, AITFIs or SFBs.
- The provision of the 30 days review period would provide time to borrowers to make good a default, before any action is taken by the lenders. It also provides lenders time to review the account of the borrower and to develop an RP and strategies its implementation.
- The ICA provides for a majority decision making criteria which is a new requirement.

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

Appointment of Chief Risk Officer (CRO) for NBFCs

The RBI issued a notification on 16 May 2019 and decided that NBFCs with asset size of more than INR50 billion should appoint a CRO with specified role and responsibilities. The CRO is required to function independently so as to ensure highest standards of risk management.

Additionally, NBFCs are required to adhere to the instructions with regard to role and responsibilities of CRO which include experience, professional qualification, tenure of appointment, removal/transfer, independence, direct reporting requirement, involvement in process of identification, measurement and mitigation of risks, etc.

Source: RBI/2018-19/184, DNBR (PD) CC. No.099/03.10.001/2018-19 dated 16 May 2019

Other regulatory updates

Reporting relating to GAAR and GST in Tax Audit Report deferred till 31 March 2020

Background

The Central Board of Direct Taxes (CBDT) through its notification (no. G.S.R. 666(E)) dated 20 July 2018 amended the Income-tax Rules, 1962 with respect to the Tax Audit Report (Form 3CD). This form is required to be certified by an auditor under Section 44AB of the Income-Tax Act, 1961 (IT Act).

The amendment relates to 15 areas in the Form 3CD i.e. six are modifications in the existing clauses and nine are new clauses.

Of the nine clauses, two clauses were deferred upto 31 March 2019. Those clauses are as follows:

- *Clause 30C - Disclosure regarding General Anti-Avoidance Rules (GAAR):* This clause requires a taxpayer to report the nature and tax impact of impermissible avoidance arrangement as referred to in Section 96 of the IT Act, if any. Section 96 of the IT Act provides that an arrangement would be presumed to be impermissible if the main purpose of whole or part of the arrangement is to obtain a tax benefit.
- *Clause 44 - Break-up of total expenditure between Goods and Services Tax (GST) registered vendors and unregistered vendors*: This clause requires an assessee to report break-up of total expenditure incurred during the year between:

  i. Expenditure incurred relating to entities not registered under GST and

  ii. Expenditure incurred relating to entities registered under GST.

  Additionally, the expenditure relating to GST registered vendors is required to be further bifurcated between:

  a) Expenditure in relation to goods or services exempt from GST

  b) Expenditure towards entities registered under composition scheme and

  c) Expenditure towards other registered entities.

Keeping in view the complexity involved in reporting under the above clauses (i.e. clause 30C and clause 44) and the representations received, the CBDT through its circular (no. 6/2018) dated 17 August 2018 deferred the reporting under these clauses up to 31 March 2019.

The reporting requirement under other clauses came into effect from 20 August 2018.

New development

On 14 May 2019, CBDT through its circular (no. 9/2019) has further deferred the reporting under clause 30C and clause 44 of the Tax Audit Report till 31 March 2020.

Source: CBDT circular no. 9/2019 dated 14 May 2019

Key takeaway

CBDT received representations from many stakeholders that the requirements of these clauses are onerous and difficult to comply with. Therefore, to provide additional time to assessees, CBDT has further deferred the implementation of Clause 30C and 44 till 31 March 2020.

ICAI publications relevant for the quarter ended 30 June 2019

Publications	Overview
Ind AS: Disclosures Checklist for accounting year 2018-19 (Revised May 2019)	The checklist provides a ready reckoner of all the disclosures required by Ind AS at one place for the assistance of members and other stakeholders. It also includes disclosure requirements of new standard on revenue Ind AS 115, *Revenue from Contracts with Customers.*
Compendium of Ind AS effective 1 April 2019	ICAI has released e-version of Compendium of Ind AS. The compendium is an comprehensive up-to-date version of Ind AS which encompasses all the Ind AS issued by MCA, mandatory for accounting year beginning on or after 1 April 2019.
Frequently Asked Questions on Valuation	The publication is expected to enable stakeholders in understanding of nuisances of valuation and to have conceptual clarity on the various valuation aspects The publication is in a question and answer format and addresses issues that are being faced while undertaking valuation of securities or financial assets. It also contains a sample valuation report.
Handbook of auditing pronouncements – 2019 edition	The handbook contains the text of various engagement and quality control standards, guidance notes and statements on auditing and would be one point reference document for auditing related matters.
Handbook on GST annual return	The handbook on GST annual return contains the analysis of Form GSTR-9 (annual return to be filed by all registered taxpayers under GST) and Form GSTR-9A (annual return for composition scheme taxpayers).
Technical guide on GST audit (second edition).	The Technical Guide on GST Audit contains guidance on GST audit and provides clause by clause analysis of Form GSTR-9C.

Source: ICAI announcements dated 17 May 2019, 14 May 2019, 9 April 2019, 30 April 2019, 21 May 2019 and 31 May 2019

Expert Advisory Committee (EAC) opinions issued by ICAI during the quarter ended June 2018

Topic	Month
Provision for wage revision under Ind AS 19, *Employee Benefits*	April 2019
Presentation of deferred tax recoverable from beneficiaries (customers) accounted as 'Deferred Asset for Deferred Tax Liability' under Ind AS.	May 2019
Accounting for provision to be created for onerous contract under Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*	June 2019

Source: The Chartered Accountant - ICAI journal for the month of April 2019, May 2019 and June 2019

Glossary

2013 Act	The Companies Act, 2013
AS	Accounting Standard
SA	Standard on Auditing
AASB	Auditing and Assurance Standards Board
BoD	Board of Directors
CFS	Consolidated Financial Statements
GST	Goods and Services Tax
ICAI	The Institute of Chartered Accountants of India
IFRIC	IFRS Interpretation Committee
ICDR Regulations, 2018	SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
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
IASB	The International Accounting Standards Board
MCA	The Ministry of Corporate Affairs
ROC	Registrar of Companies
DVR	Differential Voting Rights
IPO	Initial Public Offering
DIN	Director Identification Number
CSR	Corporate Social Responsibility
CRO	Chief Risk Officer

Our publications

First Notes

SEBI revises materiality threshold for payments relating to brand or royalty

1 July 2019

Background

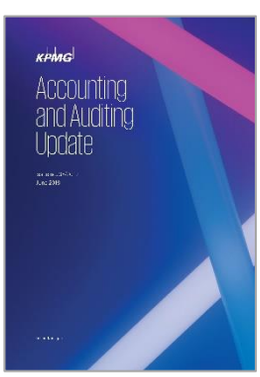
Regulation 23(1A) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) specifies that the payments made by the listed entities to related parties with respect to brand usage/royalty amounting to more than two per cent of consolidated turnover of the listed entity would be considered material. Such transactions would require shareholders' approval on a majority of minority basis.

New development

Recently, SEBI in its meeting dated 27 June 2019, has decided that payments made to related parties towards brand usage or royalty may be considered material if the transaction(s) exceed five per cent of the annual consolidated turnover of the listed entity during a financial year and would require approval of the shareholders.

This issue of First Notes provides an overview of the provision approved by SEBI.

Accounting and Auditing Update



Issue no. 35 | June 2019

In this edition of Accounting and Auditing Update (AAU) we have included an article which discusses some of these issues relating to the accounting of borrowing costs under Ind AS 23, Borrowing Costs.

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

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

Notes

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