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Editorial

Recently, the Government of India (GOI) introduced a slew of unprecedented measures through amendments to the Income-tax Act, 1961 (IT Act) and the Finance (No.2) Act, 2019. The amendments relate to concessional tax rates for specified domestic companies and new manufacturing companies subject to fulfillment of specified conditions. The decision as to whether a company should shift to the new concessional tax regime, and the timing thereof, would be based on a detailed impact analysis of the tax effect under the existing tax regime (with deductions/incentives) versus tax effect under the new concessional tax regime (without deduction/incentives). In this issue of Accounting and Auditing Update (AAU), our article on the topic provides an overview of the recent tax changes along with its impact on key sectors in India.

An entity with joint control of, or significant influence over an investee is required to account for its investment in an associate or a joint venture using the equity method as per Ind AS 28, *Investments in Associates and Joint Ventures* except when that investment qualifies for an exemption under Ind AS. While applying equity method, an investor would need to account for cross holding. However, Ind AS is silent on the accounting for cross holding structures. Education material on Ind AS 28 issued by the Institute of Chartered Accountants of India (ICAI) provides guidance on these kinds of structures. Our article on the topic discusses the accounting of a cross holding structure with the help of a case study.

Recently, the International Auditing and Assurance Standards Board (IAASB) has issued revised International Standard on Auditing (ISA) 315, *Identifying and Assessing the Risks of Material Misstatement*. ISA 315 (revised) is applicable for audits of financial statements of all entities for periods beginning on or after 15 December 2021. The revised standard addresses the concerns relating to current ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* by significantly enhancing the auditor's considerations in relation to an entity's use of Information Technology (IT) and its impact on the audit. The revised standard also requires an auditor to obtain an understanding of the entity's control environment and how this forms a foundation for the rest of the entity's system of internal control. Our article aims to summarise the key changes introduced by revised ISA 315 with respect to identification and assessment of material misstatement in the financial statements.

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

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

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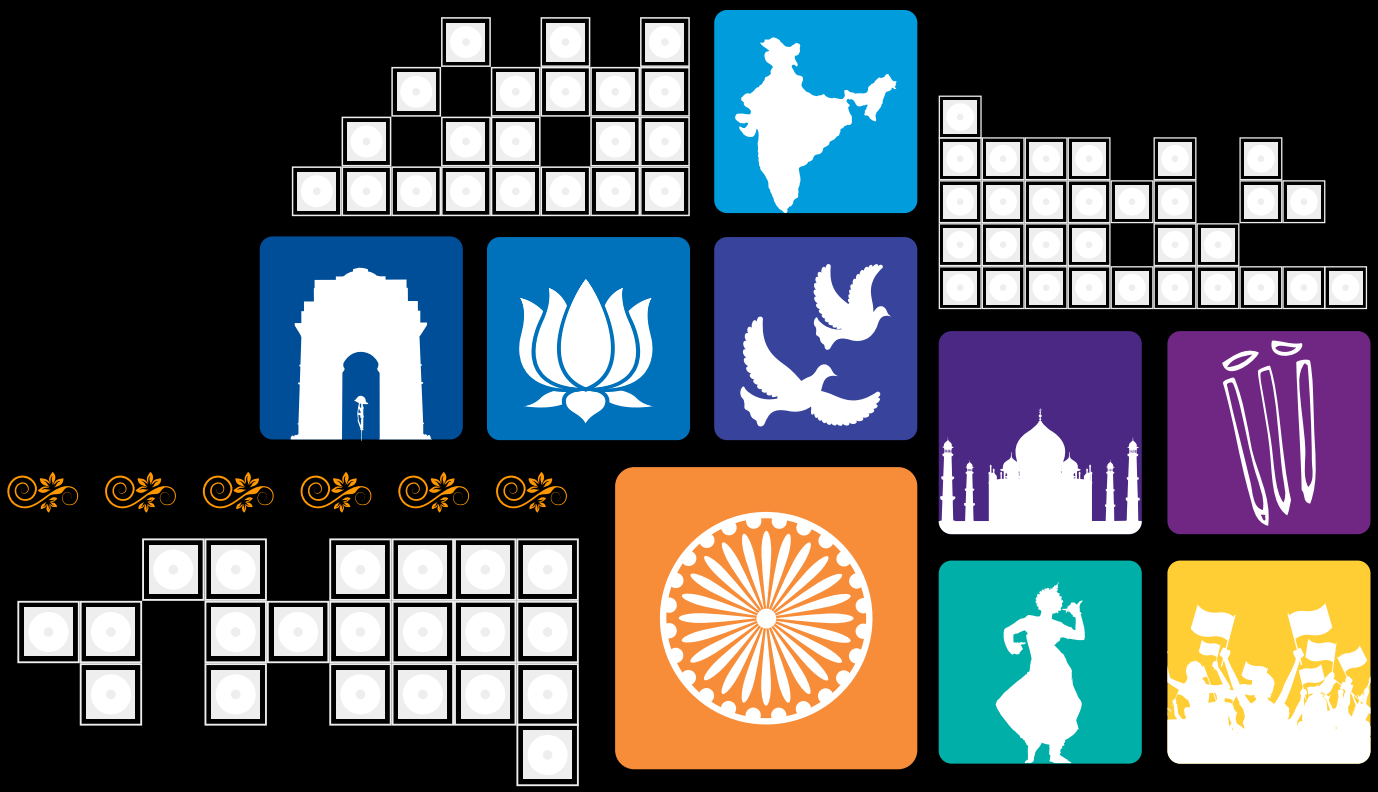


Chapter 1

Recent changes in tax laws: Impact on key sectors

This article aims to:

Summarise the recent changes in tax laws for corporates along with its impact on certain sectors of the economy.

Introduction

With an objective to boost foreign investments and revive the spirit of the Indian economy amidst the continuing economic slowdown, the Government of India (GOI) introduced a slew of unprecedented measures through the Taxation Laws (Amendment) tax ordinance, 2019 (tax ordinance). The amendments of the tax ordinance have been incorporated into the Income-tax Act, 1961(IT Act) and the Finance (No.2) Act, 2019[1].

The key amendments relate to the following aspects:

- Tax concession for domestic companies
- Tax concession for new domestic manufacturing companies
- Reduction in Minimum Alternate Tax (MAT) rate and
- Buy-back of shares by listed companies.

In addition to the changes made by the tax ordinance, the Tax Act has introduced additional amendments to the IT Act and the Finance (No.2) Act, 2019.

In this article, we aim to provide an overview of the recent tax changes along with its impact on key sectors.

1. Recently, the GOI introduced the Taxation Laws (Amendment) Bill, 2019 (Tax Bill) to replace the tax ordinance. The Tax Bill received the assent of the President of India on 11 December 2019. Consequently, the Taxation Laws (Amendment) Act, 2019 (Tax Act) came into effect from 20 September 2019 i.e. from the date of issue of the tax ordinance.

Overview of the amendments

Tax concession for domestic companies

A new Section 115BAA has been inserted in the IT Act with effect from Financial Year (FY) 2019-20. Section 115BAA allows every domestic company an option to pay income-tax at the rate of 22 per cent (effective tax rate is 25.17 per cent including surcharge and cess) subject to certain specified conditions.

Key conditions to avail concessional tax rate under Section 115BAA of the IT Act

- The company will not avail any of the specified deductions/incentives under the IT Act.

  These specified deductions/incentives relate to newly established units in Special Economic Zones (SEZs), additional depreciation on new plant or machinery acquired or installed after the specified date, investment in new plant and machinery in notified backward areas in certain states, tea, coffee, rubber development account, site restoration fund, expenditure on scientific research, expenditure for specified business, agricultural extension project, skill development project or specified provisions of Chapter VI-A under the heading 'deductions in respect of certain incomes' other than the provisions of Section 80JJAA under the IT Act.

- The total income of the company should be computed in the following manner:

  a. Without set-off of any loss carried forward or depreciation[2] from any earlier Assessment Year (AY), if such loss or depreciation is attributable to any of the specified deductions.

  b. Without set-off of any loss or allowance for unabsorbed depreciation deemed so under Section 72A of the IT Act, if such loss or depreciation is attributable to any of the above-mentioned deductions.

  c. By claiming the depreciation under Section 32 of the IT Act, other than additional depreciation on new plant or machinery acquired or installed after 31 March 2005, determined in such manner as may be prescribed[3].

- Where there is a depreciation allowance in respect of a block of assets which has not been utilised prior to the AY beginning on 1 April 2020, then the corresponding adjustment should be made to the written down value of such block of assets as on 1 April 2019 in the prescribed manner.

Failure to comply with conditions

- In case a company fails to satisfy the conditions specified under Section 115BAA in any Previous Year (PY), then the option (to pay tax at the concessional rate of 22 per cent) would become invalid in respect of the AY relevant to that PY and subsequent AYs.
- When there is a failure to comply with conditions, other provisions of the IT Act would apply, as if the option had not been exercised for the AY relevant to that PY and subsequent AYs.

Effective date

- The concessional tax rate option has to be exercised by the company in the prescribed manner on or before the due date for furnishing the returns of income for any PY relevant to AY commencing on or after 1 April 2020.
- Concessional tax rate option once exercised would apply to that and subsequent AYs and it cannot be subsequently withdrawn for the same or any other AY.

MAT provisions not applicable

Companies which avail the exemption under Section 115BAA of the IT Act are not required to pay Minimum Alternate Tax (MAT). Also, such companies will not be entitled to their previous MAT credit balances.

2. The loss or depreciation should be deemed to have already given full effect to and no further deduction for such loss or depreciation should be allowed for any subsequent year.

3. Refer Rule 5 and Appendix I to the Income-tax Rules, 1962.

In case of a company with a unit[4] in the International Financial Services Centre (IFSC)[5] has exercised the concessional tax rate option, then the conditions provided in the provisions should be modified to the extent that the deduction under Section 80 LA of the IT Act would be available to such a unit subject to fulfillment of the conditions.

Further, where concessional tax rate option exercised by a company under Section 115BAB (15 per cent) of the IT Act becomes invalid due to violation of certain prescribed conditions[6],then it may exercise option under Section 115BAA (22 per cent).

Tax concession for new domestic manufacturing companies

A new section 115BAB has been inserted in the IT Act with effect from FY2019-20. As per Section 115BAB, any domestic company which has been incorporated on or after 1 October 2019 and commences manufacturing or production of an article or thing on or before 31 March 2023 can choose to pay income tax at the rate of 15 per cent (effective tax rate is 17.16 per cent including surcharge and cess) subject to certain specified conditions.

Business of manufacture - Specific exclusions

The business of manufacture or production of any article or thing referred in Section 115BAB would not include business of:

a. Development of computer software in any form or in any media

b. Mining

c. Conversion of marble blocks or similar items into slabs

d. Bottling of gas into cylinder

e. Printing of books or production of cinematograph film or

f. Any other business as may be notified by the Central Government (CG) in this behalf.

Key conditions to avail concessional tax rate under Section 115BAB of the IT Act

- The company will not claim any of the specified exemption/incentive under the IT Act (same as those specified in Section 115BAA) and should commence manufacturing/production on or before 31 March 2023.
- The company is not formed by splitting up or reconstruction of a business already in existence. It does not use any plant or machinery previously used for any purpose. Also, it does not use any building previously used as hotel/convention center in respect of which deduction under Section 80-ID of the IT Act has been allowed.
- The company is not engaged in any business other than that of manufacturing or production any article or thing and research in relation to, or distribution of, such article or thing manufactured/produced by it.
- The total income of the company should be computed in a similar manner as prescribed for Section 115BAA of the IT Act[7].

4. The term 'unit' should have the same meaning as assigned to it under Section 2(zc) of the Special Economic Zones Act, 2005

5. As provided in Section 80LA(1A) of the IT Act.

6. Conditions in relation to use of old plant/machinery and building and condition that the company will not be engaged in any business other than manufacturing or production of an article or thing

7. It is to be noted that the provision allowing adjustment of unutilised depreciation allowance is not available under Section 115BAB

Failure to comply with conditions

- In case a company fails to satisfy the conditions specified under Section 115BAB in any PY, then the concessional tax rates option (to pay tax at the reduced rate of 15 per cent) would become invalid in respect of AY relevant to that PY and subsequent AYs.
- In such a case, other provisions of the IT Act would apply, as if the option had not been exercised for the AY relevant to that PY and subsequent AYs.

However, as mentioned in context of Section 115BAA, where the concessional tax rate option exercised under Section 115BAB (15 per cent) of the IT Act becomes invalid due to violation of certain prescribed conditions, then a company may exercise option under Section 115BAA (22 per cent).

Other amendments

- Where the total income of the company, includes any income, which has neither been derived from nor is incidental to manufacturing or production of an article or thing and in respect of which no specific rate of tax has been provided separately, such an income should be taxed at the concessional tax rate of 22 per cent. Further, no deduction or allowance in respect of any expenditure or allowance would be allowed in computing such income.
- The income-tax payable in respect of the income of the company deemed not at an arm's length as prescribed under Section 115BAB (including transfer pricing provisions), would be computed at the tax rate of 30 per cent.
- The income-tax payable on short-term capital gains derived from transfer of a capital asset on which no depreciation is allowable under the IT Act would be computed at the concessional tax rate of 22 per cent.
- In case of an amalgamation, the concessional tax rate option under Section 115BAB would remain valid in case of the amalgamated company if the specified conditions continue to be satisfied by such a company.

MAT provisions not applicable

Companies which avail the concessional tax rate under Section 115BAB of the IT Act are not required to pay MAT.

If any difficulty arises in fulfilment of conditions, the Central Board of Direct Taxes (CBDT) may with the approval of the CG issue guidelines for the purpose of removing the difficulty and to promote manufacturing or production of article or thing using new plant and machinery. Further, guidelines issued by the CBDT would be laid before each house of parliament and would be binding on the company and the income-tax authorities.

Companies that continue to avail tax exemptions

A company which does not opt for the concessional tax rates and avails the tax exemption/incentive should continue to pay tax at the pre-amended rate (25 or 30 per cent as the case may be)[8]. However, such companies can opt to pay tax at the concessional rate of 22 per cent after the tax holiday/exemption period is over. The option once exercised cannot be subsequently withdrawn.

The rate of MAT for companies which continue to avail exemptions/incentives has also been reduced from 18.5 per cent to 15 per cent.

Minimum Alternate Tax (MAT)

With effect from 1 April 2020 (FY2019-20), following amendments have been made with respect to MAT and MAT credit:

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

Buy-back of shares by listed companies

Listed companies which have already made a public announcement of buy-back of shares before 5 July 2019 are not required to pay tax on buy-back of shares.

Impact on key sectors

Typically, the decision as to whether a company should shift to the new concessional tax regime, and the timing thereof, would be based on a detailed impact analysis of the tax effect under the existing tax regime (with deductions/incentives) versus tax effect under the new concessional tax regime (without deduction/incentives). This would include factoring the quantum and duration of existing tax incentives, business projections for forthcoming years, quantum and status of loss carry forwards and MAT credits, etc.

The companies that opt for concessional tax rate would need to assess the impact on the financial statements of FY2019-20 as there would be a change in provision for tax. Additionally, the Effective Tax Rate (ETR) as calculated as per Ind AS 12, *Income Taxes* would also change.

The carrying amount of deferred tax assets and liabilities would change if a company opts for concessional tax rates as provided in the IT Act and would impact statement of profit and loss. Companies following Ind AS may carry large deferred tax balances, for example, certain deferred tax assets and liabilities are recognised at the time of a business combination, on transition to Ind AS and adoption of new Ind AS standards. Due to change in tax law, there would be remeasurement of deferred tax balances and generally the impact would be accounted through statement of profit and loss. In certain cases, remeasurement impact may relate to items previously recognised in Other Comprehensive Income (OCI) or directly in equity and this impact may be recognised in OCI or equity. The entities should evaluate the principles of Ind AS 12 carefully while recognising the impact due to remeasurement of deferred tax assets and liabilities.

Additionally, cash flows of the companies opting for reduced tax rates would be impacted and such companies should consider this impact while analysing impairment assessment of non-financial assets.

In some case, the impact may be easy to calculate. In other cases, in applying the new provisions of the IT Act, a company will make its best estimate and may revise that estimate in future periods as a result of new or better information, clarifications of the application of tax laws and/or more experience. Management's intention is relevant to determine which tax rates would apply to measure current tax and deferred tax balances. In all cases, the financial statements should include appropriate disclosures under Ind AS 12, including relevant information about major sources of estimation uncertainty in applying the new provisions of the IT Act.

8. Domestic companies with a total turnover or gross receipt (in PY2017-18) of less than INR400 crore are required to pay corporate tax at the rate of 25 per cent of the total income and domestic companies with a total turnover or gross receipt of INR400 crore or more are required to pay corporate tax at the rate of 30 per cent of the total income.

The impact of the new provisions on key sectors is highlighted in the section below.

Power sector

The Indian power sector is a regulated sector and is a beneficiary of various tax incentives largely due to its capital-intensive nature and inherent public service. The power companies in India have enjoyed profit-linked tax holidays (Section 80-IA) and accelerated depreciation (Section 32) under the IT Act.

Companies in power sector, where the vintage of their operations in India is 5 to 8 years, have significant unutilised MAT credits due to Section 80-IA tax holiday period. The decision to avail concessional tax rates would be based on the benefit analysis of specified deductions/incentives versus the concessional tax rates. However, in our experience, companies may opt for concessional tax rate given the benefits of time value of money on account of lower tax payments. Also, utilisation of MAT will take a long time and until then companies will have to pay taxes at higher rates.

Further, the amendment wherein companies would be able to adjust the written down value of the block of fixed assets for tax purposes in cases where depreciation allowance in respect of such block of asset has not been given effect to has been a welcome relief to companies in this sector.

The Tax Act has not specifically excluded the business of power generation out of business of manufacturing for the purpose of lower tax rate of 15 per cent. Unless specifically excluded, power generation should fall within the purview of manufacturing for the purpose of Section 115BAB of the IT Act.[9] In the past also, companies in the power sector have been availing tax benefits available for manufacturing companies, for instance, investment allowance under Section 32AC of the IT Act. Accordingly, power companies incorporated after 1 October 2019 and planning to commence operation prior to 31 March 2023, can avail the benefit under Section 115BAB of the IT Act.

Pharmaceutical sector

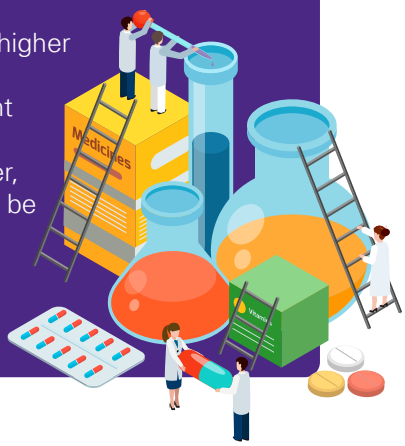
Currently pharmaceutical sector enjoys various benefits/deductions, for example:

- Weighted deduction of expenditure (revenue and capital) on scientific research
- Profit from business eligible under Chapter VI-A claims under the Heading C
- Section 10AA in respect of units in SEZ.

Considering various deductions/benefits available, their current ETR is lower which leads them to pay tax under MAT provisions. Post amendments due to the tax ordinance, several companies in the sector may not be inclined to forgo their past MAT credit entitlement. However, given the reduction in the MAT rate from 18 per cent to 15 per cent (ETR), we expect that companies covered by the MAT provisions may see an accelerated utilisation of MAT credit on account of increase in the difference between the MAT rate and normal tax rate.

Companies may evaluate to opt out of old tax regime, once all the benefits are utilised or cease to flow to such companies, since option to opt for concessional tax rate once exercised cannot be withdrawn. Also the companies need to forecast time period until which they shall continue under old tax regime. Accordingly, once they move to concessional tax regime, the carrying amount of deferred tax assets and liabilities would change.

The companies where ETR is higher than the concessional tax rate and that do not have significant MAT credit may opt for the concessional tax rate. However, we expect this assessment to be based on quantification of the benefits expected.



9. There are judicial decisions to support that power generation qualifies as manufacture/production of goods.

Healthcare sector

Hospitals

In our experience, many of the large hospitals in India are not likely to opt for concessional tax rates for FY2019-20, even though these hospitals are not in SEZ/tax holiday period, as current ETR is lower than the concessional tax rate. The current ETR is lower because these hospitals generally have huge accumulated losses and large MAT credit balances. Further, many hospital chains are currently in expansion phase and the losses are expected to continue in near future.

Medium-size hospitals with turnover/gross receipts less than INR400 crore are currently taxed at 25 per cent (exclusive of surcharge and cess). Such hospitals may opt concessional tax rates upon evaluation of benefits on a case-to-case basis.

Diagnostic centers

Many of the diagnostic centers in India are generally making profits. Therefore, upon election of concessional tax rates, their ETR will reduce resulting in a lower current tax. The impact of the same can be envisaged in the results of certain listed companies for the period ended 30 September 2019 wherein they have elected the concessional tax rate and taken the impact in the said quarter.

Medical equipment companies

Many of the medical equipment companies in India are profitable and have an ETR higher than the concessional tax rate. Hence, their ETR will reduce resulting in lower current tax charge, upon election of concessional tax rates.

Medical equipment manufacturing companies would need to evaluate the benefits of Section 115BAB on a case-by-case basis

Building, Construction and Real Estate (BCRE) sector

Large companies in real estate sector would need to evaluate the impact of adoption of concessional tax rates and may plan to avail the corporate tax rate reduction after utilisation of existing MAT credit and brought forward business losses.

However, real estate companies with gross receipts/ turnover less than INR400 crore are currently paying income taxes at the rate of 25 per cent (exclusive of surcharge and cess). Therefore, they are unlikely to be additionally benefited by opting for the concessional tax rates.

Real estate companies have a significant gestation period unlike other sectors, wherein during the construction phase certain companies may incur book losses and may not pay taxes under the MAT provisions of the IT Act. Companies are likely to have brought forward losses, and therefore, future tax liability is expected to be lower than the concessional rate of tax.

Many real estate companies (in the commercial real estate sector with leasing model) also avail the benefit of deductions of SEZ, IT parks, etc. These companies enjoy tax holiday period for 10 years (though pay MAT and avail MAT credit). Based on the tax holiday period and the projections of the taxable profits and utilisation of MAT credit, such companies would need to determine the timing of transition to the concessional rate of tax.

In our experience, many of the companies in this sector may not want to forgo MAT credit asset, since it would be a cash loss to the company. Further based on the quantum of the carry forward losses and the construction phase of the project, combined with the market outlook, companies might elect to continue with existing tax regime, resulting in liability payable under MAT rules (which is lower than the concessional tax rate).

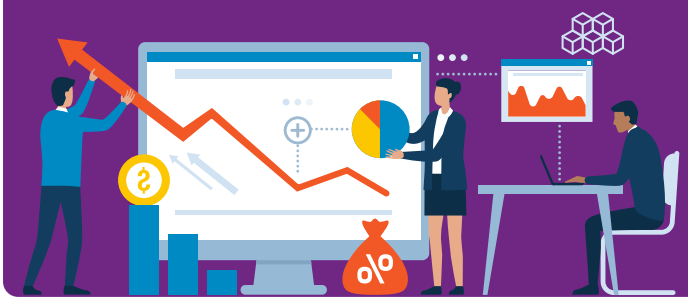
Financial services sector

Banks/NBFCs (including HFCs)

In our experience, many of the banks and Non-Banking Financial Companies (NBFCs) (including Housing Finance Companies (HFCs)) are likely to opt for the concessional tax rates as they will benefit from a lower tax charge in comparison to their current ETR.

Banks and NBFCs, in general, have higher loan loss provisions in the books of account (in accordance with the Reserve Bank of India (RBI) norms and/or Ind AS provisioning requirements, as applicable) as compared to tax books (where provisions are deductible on the basis of actual write-offs) resulting in future tax-deductible timing differences on loan loss provisions.

The resultant Deferred Tax Asset (DTA) (relating to loan loss provision) on the balance sheet will get remeasured at the reduced rate resulting in a charge to the statement of profit and loss in FY2019-20.



Further upon election of new tax rates, banks with offshore banking units will lose benefit of deduction under Section 80LA[10] of the IT Act.

Insurance companies

Life insurance companies are unlikely to opt for the concessional tax rates as their current ETR is lower than the concessional tax rate offered. While the general insurance companies would need to evaluate the concessional tax rates in comparison to the specified deductions/incentives availed.

Mutual funds

There will be no impact of the recent tax amendments on the mutual funds as the income generated by mutual funds are exempt from tax.

Venture Capital Funds (VCFs) and Alternate Investment Funds (AIFs)

Funds are generally registered as trusts. Hence, the concessional tax rate benefit does not apply to them.

Other companies

Impact on other companies in financial services sector (i.e. asset management, advisory and broking companies) will depend on evaluation of benefits provided by the tax concessions on a case-by-case basis.

Technology sector

In our experience, many of the large companies in the technology sector have not availed concessional tax rate for the FY2019-20 as their ETR is currently lower than the concessional tax rates of 22 per cent. This is largely due to tax exemptions under Section 10AA[11] of the IT Act for revenue from SEZs.

They may evaluate to avail the benefit of the concessional tax rate after two to three years from now when the SEZ benefits would not be available.

For companies that have not availed the concessional tax rate, a scenario could arise where the revised MAT rate (17.47 per cent) increases the quantum of MAT assets that can be adjusted against future tax liability, since the gap between the current tax and MAT has now increased. Companies may be able to recognise previously unrecognised MAT assets, which due to their inability to utilise MAT credit had not been recognised.

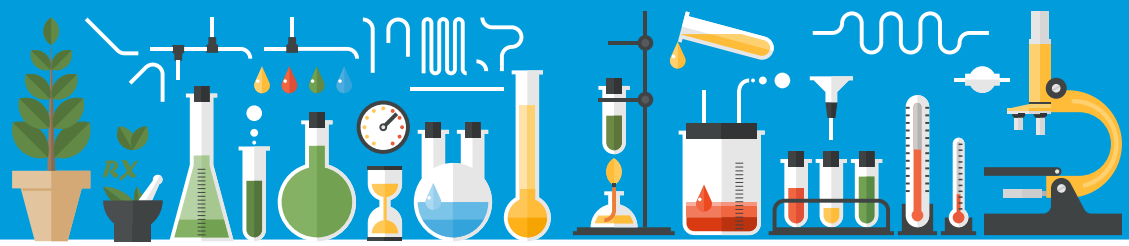
10. Available to a bank incorporated by/under the laws of the country outside India with an offshore banking unit in SEZ or to a unit of an IFSC.

11. The tax exemption varies from 100 per cent of profits for the first five years of operations to 50 per cent for the next five, and 50 per cent for a further five years where the profits are credited and utilised for investment in the prescribed manner

Chemical sector

Currently, companies operating in chemical sector enjoy certain tax breaks under the IT Act. These, *inter alia*, include deduction under Section 10AA, Section 35(2AB) and Section 80-IA.

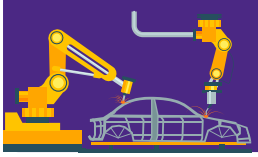
In our experience, companies have considered the impact of the above tax benefits and the availability of unutilised MAT credit and brought forward losses before deciding on moving into the new tax regime and many companies have concluded that deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc. are not significant enough for these companies to continue with the old tax regime, and are opting for the new concessional rate.



Automotive, telecom and Transport, Leisure and Sports (TL&S) sector

With respect to the adoption of the concessional tax rate by the companies in the automotive, telecom and TL&S sector, there is a mixed reaction. This is mainly on account of the tax holiday benefit and carry forward of MAT.

While assessing the options under the IT Act, companies are required to evaluate the potential loss of MAT and tax benefits such as deductions under Section 80-IA, Section 80-IB and Section 35D.



Chapter 2

Accounting treatment for cross holding associates

This article aims to:

Discuss the accounting treatment for cross holding structures under Ind AS.

Introduction

Ind AS 28, *Investments in Associates and Joint Ventures* prescribes the accounting for investments in associates[1] and requirements for the application of equity method when accounting for investment in associates. Further, under Ind AS 28 an entity is presumed to have significant influence when an entity holds, directly or indirectly (e.g. through subsidiaries), 20 per cent or more of the voting power of the investee.

Accounting of an associate through equity method

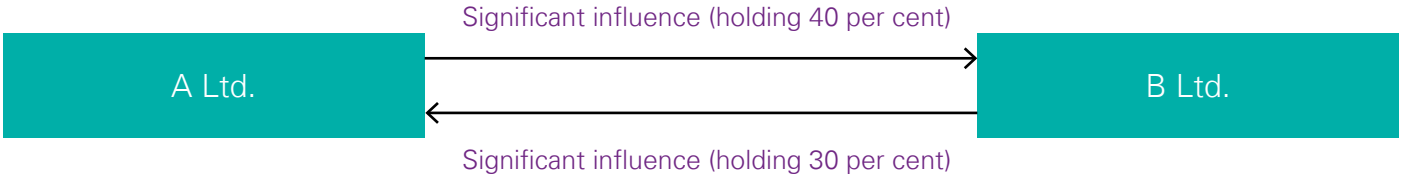
An entity with joint control of, or significant influence over an investee should account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for an exemption under Ind AS. Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

1. Associate is an entity over which the investor has significant influence.

Cross holding

Two entities may have an ownership interest in each other that results in mutual significant influence or joint control. For example, an entity could be an investor in an associate and that investee or associate could be an investor in the entity and have significant influence over it. The situation is termed as cross holding structures.

Following illustration explains the structure.



Impact of cross holding while applying equity method

Application of equity method is complicated by cross holding structures as there is a reciprocal relationship. Further, Ind AS 28 also does not provide any specific guidance on application of equity method in such a scenario.

The Institute of Chartered Accountants of India (ICAI) issued an educational material on Ind AS 28, which provides a summary of the standard in the form of key requirements and Frequently Asked Questions (FAQs) covering certain issues expected to be encountered frequently while implementing the standard. The educational material also discusses the accounting of associates in case of cross holding structures. It discusses that Ind AS 28 provides that when an associate or joint venture has subsidiaries/associates/ joint ventures, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate's/ joint venture's financial statements (including the associate's/joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies.

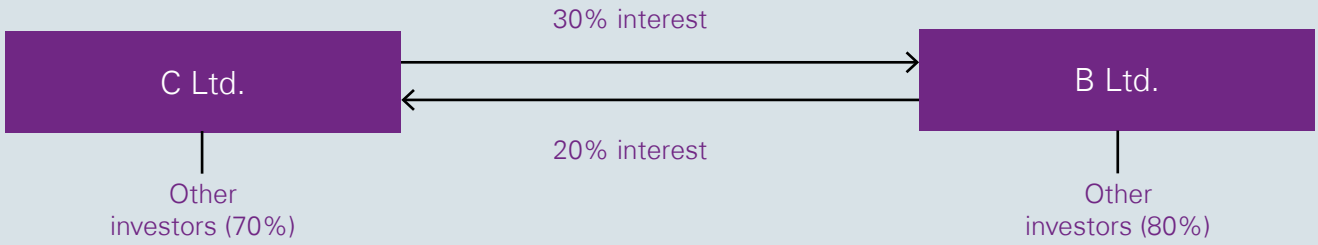
However, the cross holding structures or reciprocal interest would lead to double counting of profits. Since in case of cross holding, the comprehensive income of investor includes investor's share of post-acquisition comprehensive income of investee or associate, and the comprehensive income of investee or associate includes investee's share of post-acquisition comprehensive income of investor.

According to the educational material, in the case of reciprocal holdings, it would be appropriate to simply account for interest i.e. in investor's financial statements where the share of investor in an associate would be calculated ignoring the reciprocal interest held by associate.

The following illustration discusses the accounting of the cross holding structures using simple interest approach.

Illustration: Exclusion of cross holding interest

Company C owns 30 per cent of company B, and B owns 20 per cent of C. Each company has significant influence over the other and therefore, applies the equity method.



Other details are as follows:

	C Ltd.	B Ltd.
Trading profit (before reciprocal share)	100,000	60,000
Number of shares	20,000	10,000

Accounting issue: How would entity C Ltd. and B Ltd. account for cross holdings?

In the instant case, C's profit is dependent on B's profit and vice versa. C's profit = INR100,000 + 30 per cent of B's profit and similarly B's profit = INR60,000 + 20 per cent of C's profit. The same would apparently be leading to double counting of profit.

Therefore, considering the net approach discussed above, the profit for the period is calculated by adopting an approach of simple accounting for interest in associate i.e. ignoring the reciprocal interest held by the associate.

Profit of C Ltd. = 100,000 + 30% of 60,000 = INR118,000

Profit of B Ltd. = 60,000 + 20% of 100,000 = INR80,000

Calculation of Earnings Per Share (EPS)

For the purpose of calculating the EPS, the profits related to the reciprocal interests should be ignored. Therefore, the number of shares should also be adjusted to eliminate the reciprocal holdings to calculate EPS.

C Ltd. has effectively acquired 6 per cent of its own shares (30% x 20%), and B Ltd. has acquired 6 per cent of its own shares (20% x 30%). These shares should be treated as being equivalent to treasury shares and ignored for the purpose of the EPS calculation.

	C Ltd.	B Ltd.
Total number of shares	20,000	10,000
Number of shares after elimination	18,800 20000*(100%-6%)	9,400 10,000*(100%-6%)
Profits	INR118,000	INR80,000
EPS	INR6.28 (118,000/18,800)	INR8.5 (80,000/9,400)

Conclusion

The company should exercise significant judgement and consider all the facts and circumstances while determining the interest in another associate. The simple interest approach discussed in educational material is in line with the consolidation principles prescribed under Ind AS 110 which provides that the income arising on investment held by a subsidiary in a parent should be eliminated in consolidated financial statements.

Internationally, under IFRS, cross holding accounting is based on effective ownership interest approach. Under the effective ownership approach, an investor determines its share of comprehensive income of an investee on the basis of the investor's effective interest in the investee. The effect of the reciprocal interests is incorporated into the investee's financial statements through the investee's own equity accounting - i.e. the investee's comprehensive income would already include the equity pick-up for its own equity interest in the investor.

Chapter 3

ISA 315 (Revised) - Key requirements

This article aims to:

Provide an overview of the key changes introduced by the revised ISA 315.

The International Auditing and Assurance Standards Board (IAASB) has issued revised International Standard on Auditing (ISA) 315, *Identifying and Assessing the Risks of Material Misstatement* in December 2019. This ISA will be effective for audits of financial statements of all entities for periods beginning on or after 15 December 2021. The ISA has been revised to respond to challenges and issues with the current ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* by making changes for clarity and consistent application.

With the changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent and entities and their governance structures becoming more complex, there was an urgent need to have a robust and comprehensive risk identification and assessment mechanism. Also, the current standards on auditing did not address the potential benefits and implications of using automated tools and techniques by the entities at large in the current times.

Therefore, the revised standard addresses these issues by significantly enhancing the auditor's considerations in relation to an entity's use of Information Technology (IT) and its impact on the audit. It also clarifies the auditor's understanding of the entity's control environment and how this forms a foundation for the rest of the entity's system of internal control.

In this article, we aim to summarise the key changes introduced by revised ISA 315 with respect to identification and assessment of material misstatement in the financial statements.

Overview of revised ISA 315

Understanding system of internal control

The IAASB is of an opinion that understanding an entity's system of internal control is integral to the auditor's identification and assessment of the risks of material misstatement. Therefore, the term *internal control,* as it is used in extant ISA 315, has been revised to the entity's *system of internal controls.* The definition has been extended to reflect that the entity's system of internal control comprises of following five components:

a. Control environment

b. Entity's risk assessment process

c. Entity's process to monitor the system of internal control

d. Information system and communication and

e. Control activities.

Therefore, understanding all components to the extent implemented by an entity is vital to understand the entity's system of internal control relevant to financial reporting. Financial reporting system is relevant to the preparation of the financial statements in accordance with the requirements of the applicable financial reporting framework.

An important management responsibility is to establish and maintain an entity's system of internal control on an ongoing basis. Management's process to monitor the system of internal control could include considering whether controls are operating as intended and they are modified appropriately for changes in conditions.

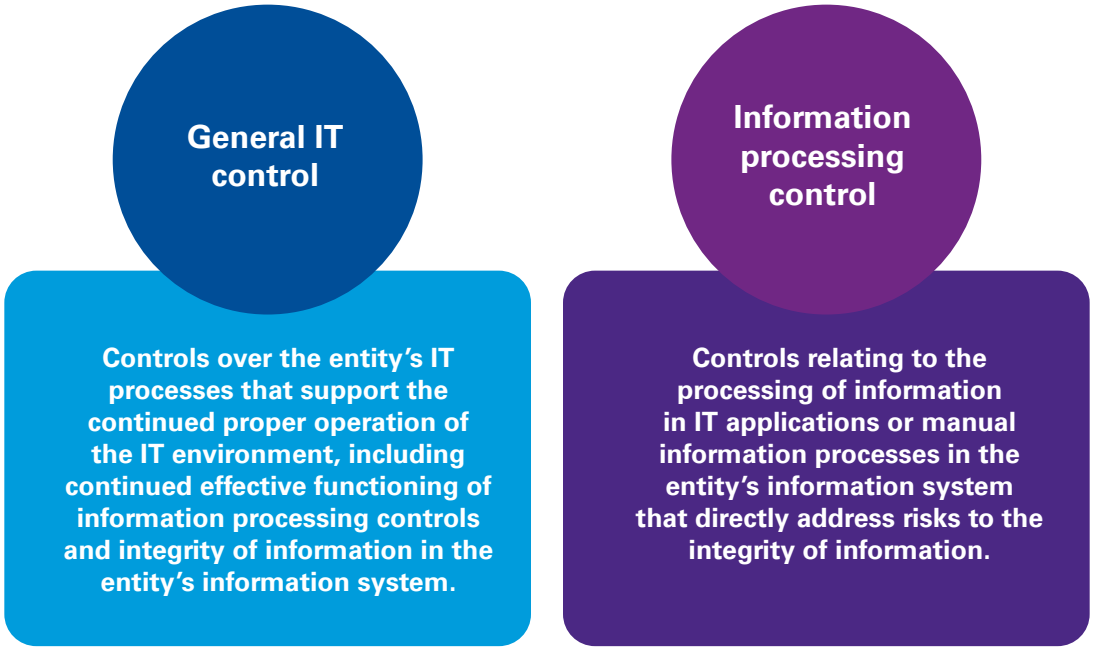
The entity's process to monitor the system of internal control may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies.

The auditor, on the other hand, would evaluate the Design of each control relevant to the audit and determine whether it has been Implemented (D&I). Based on the D&I, it may plan to test the operating effectiveness of these controls.

Entity's use of Information Technology (IT)

In current times, there are significant changes in economic, technological and regulatory aspects of the markets and environment in which entities and audit firms operate. Additionally, there is a continuing evolution of entities' use of IT. The standard recognises that there could be risks of material misstatement from the entity's use of IT such as, risks to the integrity of information in the entity's information system due to ineffective design or operation of controls in the entity's IT processes.

Therefore, there is a need for more robust understanding of the entity's control environment including its IT controls. Accordingly, the standard introduces new definition of 'general IT controls' and 'information processing controls' which are explained in the figure below:



The auditor's understanding of the IT environment may focus on identifying, and understanding the nature and number of, the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing, or storing those transactions or information.

The increasing use of automated tools and techniques by auditors when performing risk assessment procedures necessitated changes in the standard to recognise usage of such tools and techniques explicitly. Accordingly, the standard allows an auditor to use automated techniques to obtain direct access to or a digital download from the databases in the entity's information system that store accounting transactions. Analysis of complete or large sets of transactions through application of automated tools or techniques may result in the identification of variations from the normal or expected processing procedures or such transactions which may result in the identification of risk of material misstatement.

Risk assessment procedures

Risks of material misstatement could include both those due to error and those due to fraud. The standard requires that risk assessment procedures should be performed to obtain audit evidence to support identification and assessment of the risks of material misstatement in an unbiased manner. Audit evidence from risk assessment procedures comprise both information that supports and corroborates management's assertions and any information that contradicts such assertions. This may involve obtaining evidence from multiple sources within and outside entity. The sources of information for risk assessment may include:

a. Interactions with the management, those charged with governance and other key entity personnel such as internal auditors

b. Certain external parties such as regulators whether obtained directly or indirectly

c. Publicly available information about the entity, for instance, press releases issued by entity, analysts' reports or information about trading activity.

The risk assessment procedures should be performed to obtain an understanding of the entity's organisational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT, applicable financial reporting framework and entity's accounting policies and reasons for changes thereto.

The standard also introduces the requirement of 'stand-back' once the risk assessment procedures have been performed. It requires an auditor to reconsider whether all significant classes of transactions, account balances and disclosures have been identified once the initial risk identification and assessment has been completed. For material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, the auditor shall evaluate whether the auditor's determination remains appropriate.

Documentation

The revised standard strengthened the documentation requirements relating to the exercise of professional skepticism by an auditor. For instance, when the audit evidence obtained from risk assessment procedures includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgements made in evaluating whether the audit evidence provides an appropriate basis for the auditor's identification and assessment of the risks of material misstatement.

Way forward

The entities should take note of the requirements envisaged by the revised standard, in particular, developing a robust control environment with a focus on IT and related application processing controls.

Chapter 4

Regulatory updates

IRDAI defers implementation of Ind AS in the insurance sector

Background

Indian Accounting Standards (Ind AS) was initially applicable to companies in the insurance sector from accounting periods beginning from 1 April 2018. The Insurance Regulatory and Development Authority of India (IRDAI) through its circular dated 28 June 2017, deferred the implementation of Ind AS by two years i.e. up to 31 March 2020. However, such companies were required to submit proforma Ind AS financial statements on a quarterly basis in the prescribed format to IRDAI.

New development

The IRDAI through its circular dated 21 January 2020, has further deferred the implementation of Ind AS in the insurance sector until finalisation of International Financial Reporting Standard (IFRS) 17, *Insurance Contracts* by the International Accounting Standards Board (IASB). Also, the requirement to submit proforma Ind AS financial statements by insurance companies on a quarterly basis to IRDAI has been withdrawn.

Also read KPMG in India's First Notes on 'IRDAI defers the effective date for implementation of Ind AS in the insurance sector till further notice' dated 24 January 2020.

(Source: IRDAI circular no. IRDAI/F&A/CIR/ACTS/023/01/2020 dated 21 January 2020)

SEBI defers the timeline for separation of the roles of non-executive chairperson and MD/CEO by two years

Background

Section 203 of the Companies Act, 2013 (2013 Act) provides that an individual should not be appointed/ reappointed as the chairperson of a company, as well as its Managing Director (MD) or Chief Executive officer (CEO), unless allowed by articles of a company or such a company does not undertake multiple businesses.

Regulation 17(1B) of the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) specifies that the chairperson of the board of top 500[1] equity listed entities would be a non-executive director and not be related to the MD or CEO in accordance with the definition of 'relative' as per the 2013 Act. This requirement would not be applicable to listed entities that do not have any identifiable promoters as per the shareholding patterns filed with stock exchanges. This regulation was to be made effective from 1 April 2020.

New development

SEBI through its notification dated 10 January 2020, deferred the implementation of the above mentioned provision relating to separation of the roles of non-executive chairperson and MD/CEO by two years i.e. 1 April 2022.

Also refer to KPMG in India's First Notes on 'SEBI defers the timeline for separation of the roles of non-executive chairperson and MD/CEO by two years' dated 17 January 2020.

(Source: SEBI notification no. SEBI/ LAD-NRO/GN/2020/02 dated 10 January 2020)

SEBI streamlines right issue process

SEBI through its notification dated 26 December 2019 issued amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations) relating to rights issue.

On 22 January 2020, SEBI issued a circular which prescribes detailed procedures to be followed by companies while making rights issue (in its Annexure I).

Key features of the revised process are as follows:

- **Introduction of dematerialised Right Entitlements (REs):** The REs would be credited to the demat account of the eligible shareholders in dematerialised form.
- **Trading of dematerialised REs on stock exchange platform:** The REs should be traded on secondary market platform of stock exchanges with T+2 rolling settlement similar to the equity shares. The trading would begin from the opening of the issue and would be closed at least four days before the closure of the rights issue.
- **Newspaper advertisement:** Regulation 84 of the ICDR Regulations requires the issuer to publish an advertisement in newspapers confirming completion of dispatch of the letter of offer and composite application forms. The amendment now requires an issuer to publish this advertisement at least two days before the date of opening of the issue instead of current requirement of three days. Additionally, now an issuer would give an intimation to the stock exchange(s) for dissemination on their websites.
- **Payment:** Application for a rights issue would be made only through Applications Supported by Blocked Amount (ASBA) facility. Also, withdrawal of an application is not allowed after the issue closing date.

(Source: SEBI circular no. SEBI/HO/CFD/DIL2/CIR/P/2020/13 dated 22 January 2020)

SEBI issues a format on statement of deviation/variation of end use of issue proceeds of NCDs or NCRPs

Background

Regulation 52 of the Listing Regulations requires listed entities to submit to the stock exchange(s) on a half-yearly basis, a statement of deviation or variation in the use of proceeds of issue from Non-Convertible Debt securities (NCDs) or Non-Convertible Redeemable Preference Shares (NCRPs). However, the Listing Regulations do not prescribe any format for statement of deviation for listed entities which have listed NCDs or NCRPs on the stock exchange(s).

New development

In order to address this concern, SEBI through its circular dated 17 January 2020 issued a format for statement of deviation in the issue proceeds from NCDs or NCRPs.

1. The top 500 entities would be determined on the basis of market capitalisation, as at the end of the immediate previous FY

The key features of the circular are as follows:

- **Applicability:** The format is applicable to every listed entity which has raised funds through issue of NCDs or NCRPs.
- **Frequency of disclosures:** Disclose the statement of deviation on a half-yearly basis within 45 days of end of half-year until funds are fully utilised or the purpose for which these proceeds were raised has been achieved.
- **Role of the audit committee:** The statement of deviation should be reviewed by the audit committee and after such review, the comments of the audit committee along with the report should be disclosed/ submitted to the stock exchange as part of the format. In cases where the listed entity is not required to form an audit committee under the provisions of the Listing Regulations or the 2013 Act, then such a report should be reviewed by the board of directors.

Effective date: The first such submission should be made by the listed entities for the half-year ending 31 March 2020, subsequent submissions would be on half-yearly basis.

(Source: SEBI circular No. SEBI/HO/DDHS/08/2020 dated 17 January 2020)

Non-compliance with certain provisions of the Listing Regulations

Background

Regulation 98 of the Listing Regulations, provides that when an entity or any other person thereof contravenes any of the provisions of the Listing Regulations, then in addition to liability under the securities laws, he/she would be liable for the following actions:

a. Imposition of fines

b. Suspension of trading

c. Freezing of promoter/promoter group holding of designated securities, as may be applicable, in coordination with depositories

d. Any other action as may be specified by SEBI.

SEBI through its circular dated 3 May 2018 prescribed a uniform approach to be followed by stock exchange(s) while imposing fines for non-compliances with certain provisions of the Listing Regulations and also provided a standard operating procedure for suspension and revocation of trading of specified securities.

New development

Pursuant to the amendments to the Listing Regulations and to further streamline the standard operating procedure for dealing with non-compliances, on 22 January 2020, SEBI issued a new circular which supersedes the circular dated 3 May 2018.

As part of the actions to be taken by stock exchange(s), stock exchange(s) are required to review the compliance status of the listed entities and issue notices to the non-compliant listed entities within 30 days from the due date of submission of information.

Non-compliant listed entity is required to ensure that the subject matter of non-compliance which has been identified and indicated by the stock exchange(s) and any subsequent action taken by the stock exchange(s) in this regard should be placed before the board of directors of the entity in its next meeting. Comments made by the board of directors should be informed to the recognised stock exchange(s) for dissemination.

The requirements of the circular are applicable from compliance periods ending on or after 31 March 2020.

(Source: SEBI circular no. SEBI/HO/CFD/CMD/CIR/P/2020/12 dated 22 January 2020)

Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2020

The Ministry of Corporate Affairs (MCA) through its notification dated 3 January 2020 amended the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 (Managerial Personnel Rules). The amendments relate to the following:

- **Appointment of a Company Secretary (CS):** Currently, Rule 8A of the Managerial Personnel Rules requires **a company (other than a company covered under Rule 8 of the Managerial Personnel Rules) with a paid-up share capital of INR5 crore or more** to appoint a whole-time CS.

  Amendment

  The amendments require **every private company** with a paid-up share capital of **INR10 crore or more** to appoint a whole-time CS.

  (Emphasis added to highlight the change)

- **Secretarial audit report:** Currently, Section 204(1) of the 2013 Act read with Rule 9 of the Managerial Personnel Rules requires every listed company and a public company with a paid-up share capital of INR50

crore or more, or turnover of INR250 crore or more, to annex a secretarial audit report with its board's report in Form No. MR.3.

Amendment

In addition to the above, the amendment to the Managerial Personnel Rules requires every company with outstanding loans or borrowings from banks or public financial institutions of INR100 crore or more to submit a secretarial audit report with its board's report.

An explanation to Rule 9 of the Managerial Personnel Rules has been inserted to clarify that for the purpose of determining the above thresholds, the paid-up share capital, turnover or outstanding loans or borrowings, existing on the last date of latest audited financial statement should be considered.

Effective date: The amendments are applicable from Financial Year (FY) commencing on or after 1 April 2020.

(Source: MCA Notification No. G.S.R 13 (E) dated 3 January 2020)

Educational material on Ind AS 116, *Leases*

The new standard on leases, Ind AS 116 has been made applicable to companies following Ind AS framework from 1 April 2019. Recently, the Institute of Chartered Accountants of India (ICAI) has issued an educational material on Ind AS 116. The publication aims to provide guidance on implementation of the requirements of the standard with the help of examples. It also covers major differences between Ind AS 116, IFRS 16, *Leases* and Accounting Standard (AS) 19, *Leases.*

(Source: Educational material on Ind AS 116 issued by ICAI in January 2020)

IASB clarifies requirements for classifying liabilities as current or non-current

On 23 January 2020, the International Accounting Standards Board (IASB) issued narrow-scope amendments to International Accounting Standard (IAS) 1, *Presentation of Financial Statements* to clarify how to classify debt and other liabilities as current or non-current.

The amendments aim to promote consistency in applying the requirements by helping companies determine whether, in the statement of financial position, debt and other liabilities with an uncertain settlement date should be classified as current (due or potentially due to be settled within one year) or non-current. The amendments clarify that the classification of liabilities as current or non-current should be based on rights that are in existence at the end of the reporting period. Further, the classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability.

The amendments clarify, not change, existing requirements, and so are not expected to affect companies' financial statements significantly. However, they could result in companies reclassifying some liabilities from current to non-current, and vice versa; this could affect a company's loan covenants.

The amendments are effective for annual reporting periods beginning on or after 1 January 2022 and are to be applied retrospectively. Earlier application is permitted.

(Source: IASB announcement dated 23 January 2020)

Notes

KPMG in India's IFRS institute

Visit KPMG in India's IFRS institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

First Notes

IRDAI defers the effective date for implementation of Ind AS in the insurance sector till further notice

24 January 2020

Background

Indian Accounting Standards (Ind AS) was initially applicable to companies in the insurance sector from accounting periods beginning from 1 April 2018. The Insurance Regulatory and Development Authority of India (IRDAI) through its circular dated 28 June 2017, deferred the implementation of Ind AS up by two years i.e. up to 31 March 2020. However, such companies were required to submit proforma Ind AS financial statements on a quarterly basis in the prescribed format to IRDAI.

New development

The IRDAI through its circular dated 21 January 2020, has further deferred the implementation of Ind AS in the insurance sector until finalisation of International Financial Reporting Standard (IFRS) 17, *Insurance Contracts* by the International Accounting Standards Board (IASB). Also, the requirement to submit proforma Ind AS financial statements by insurance companies on a quarterly basis to IRDAI has been withdrawn.

This issue of First Notes provides an overview of the circular issued by IRDAI.

Voices on Reporting

KPMG in India is pleased to present Voices on Reporting (VOR) - a series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 09 January 2020, KPMG in India organised a VOR webinar to discuss key financial reporting and regulatory matters that are expected to be relevant for stakeholders for the quarter ended 31 December 2019.

Please visit KPMG in India's website to access the audio recording and presentation.

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