Accounting and Auditing Update

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Foreword

The year gone by has witnessed various developments relating to accounting and financial reporting including those addressing effects of the pandemic (COVID-19). Despite the challenges posed by business disruptions and remote working, the expectation from the preparers of financial statements and auditors has been to continue applying existing accounting and auditing guidance and comply with all professional standards. With this objective and to provide an overview of how the accounting profession is tackling the challenges posed by COVID-19 while continuing to provide high-quality financial information to investors, recently, the American Institute of CPAs (AICPA) hosted its annual conference. In addition to financial reporting effects of COVID-19, highlights from the conference include specific observations on application of revenue, leases and credit losses standards and important auditing developments. In this edition of Accounting and Auditing Update (AAU), we aim to highlight key financial reporting matters to be considered by companies and related audit matters as discussed at the conference.

Corporate reporting is evolving to provide investors with a broader perspective on business performance. With an aim to address the reporting gap between the expectations of investors and communication by an organisation, the International Integrated Reporting Council (IIRC) issued the International Integrated Reporting <IR> Framework in December 2013. To facilitate more decision useful reporting, recently, the IIRC has issued revisions to the <IR> Framework. The revisions to the <IR> Framework focussed on simplification of the required statement of responsibility for the integrated report, improved insight into the quality and integrity of the underlying reporting process, a clearer distinction between outputs and outcomes with examples and a greater emphasis on the balanced reporting of outcomes and value preservation and erosion scenarios. Our article summarises these new developments in the <IR> Framework.

Recently, the International Auditing and Assurance Standards Board (IAASB) has issued a discussion paper to deliberate and gather perspectives from all the stakeholders about the role of the auditor in relation to fraud and going concern in an audit of financial statements. The purpose of the discussion paper is to obtain input on matters about whether the auditing standards relating to fraud and going concern reman fit-for-purpose in the current environment. Our article on the topic provides an overview of the key challenges and issues regarding the expectation gap relating to the role of an auditor, and areas where IAASB seeks responses.

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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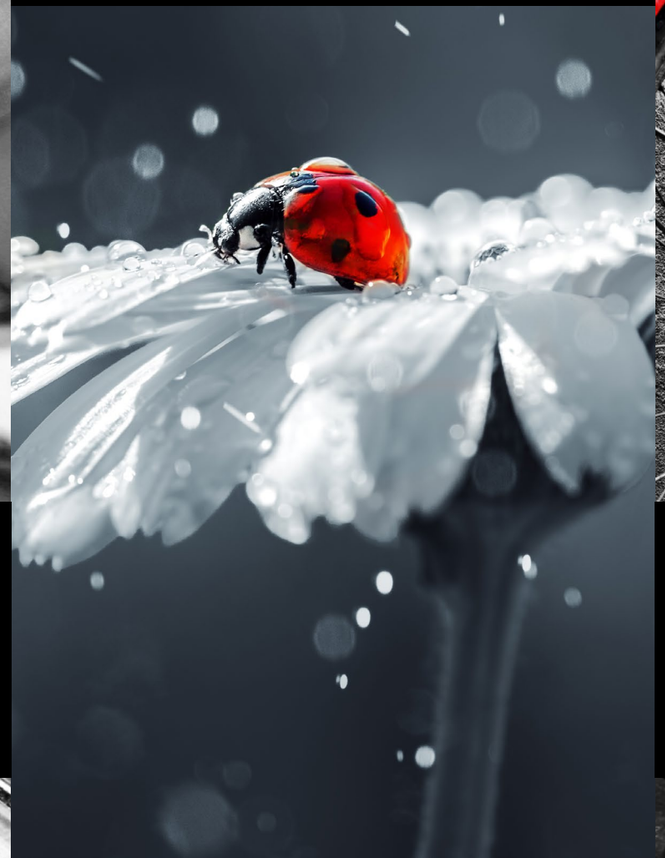

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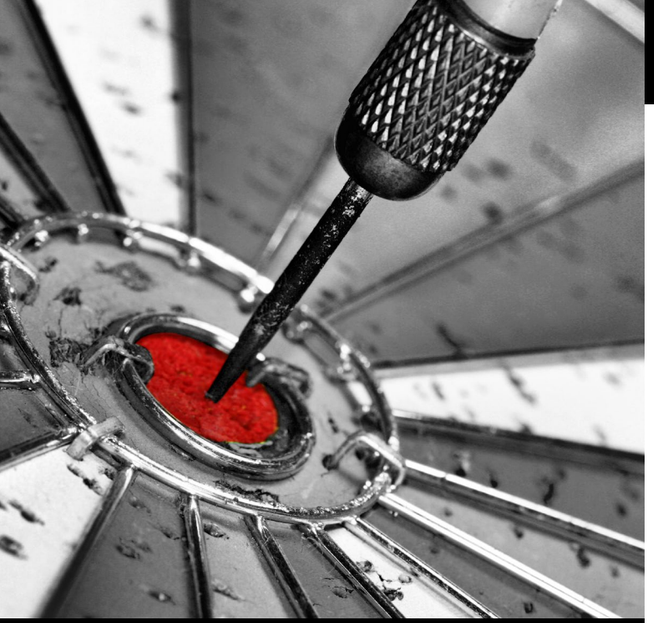
Regulatory updates



CHAPTER 1

US GAAP: SEC and PCAOB developments

This article aims to:
Provide an overview of the key financial reporting areas under US GAAP and related auditing matters that were discussed at the annual AICPA 2020 conference.

Introduction

In December 2020, the American Institute of CPAs (AICPA) hosted its annual conference on current SEC[1] and PCAOB[2] developments. An overarching theme of the conference was how the accounting profession is tackling the challenges posed by COVID-19 while continuing to provide high-quality financial information to investors. Amidst these challenges, speakers at the conference emphasised that the preparers and auditors must continue to apply the existing accounting and auditing guidance and comply with all professional standards.

In this article, we aim to highlight key financial reporting matters to be considered by companies and related audit matters as discussed at the conference.

1. US Securities and Exchange Commission (US SEC)
2. Public Company Accounting Oversight Board

Key financial reporting matters

COVID-19, along with its related economic conditions, has presented unique challenges for companies across the globe, including disruptions to supply chains, changes in financial performance, and modifications in workplaces and workforces. Speakers at the conference addressed the effects of COVID-19 on internal control over financial reporting, financial statement disclosures and non-GAAP measures and urged companies to consider the effects of COVID-19 in preparing their year-end financial statements.

- **Internal Control over Financial Reporting (ICFR):** Companies should consider the effect (or lack thereof) of the remote work environment on their business operations, processes and controls. The current environment could introduce new risks affecting internal controls, change how processes and controls are designed and operated and adversely affect the operation of existing internal controls. Companies should identify and disclose changes materially affecting an entity's ICFR in the period the change occurs.
- **Disclosures related to COVID-19:** SEC's Division of Corporate Finance (Corp Fin) staff provided some observations relating to COVID-19 disclosures and shortcomings in the disclosures, which may result in registrants receiving comments from the Corp Fin staff. Those are as follows:
  - **Lack of discussion of longer-term risks and effects:** Companies have disclosed short-term steps taken to mitigate the effects of COVID-19. However the disclosures did not contemplate the longer-term risks and effects. For instance, disclosure on short-term financing by a company with no disclosure on how the company plans to repay the borrowing.
  - **Boilerplate disclosures:** Disclosures made by the registrants are boilerplate without meaningful entity-specific considerations related to the risks and effects of the COVID-19 pandemic, and management's response to them.
  - **Information from analyst calls:** SEC observed absence of disclosures on discussions that companies have on analyst calls on the effects of COVID-19 in their periodic filing disclosures.
- **Non-GAAP measures related to COVID-19:** The Corp Fin staff encouraged companies to consider the following factors when contemplating adjustments specific to COVID-19 impacts within a non-GAAP measure:
  - Is the adjustment directly attributable to the impacts of COVID-19?
  - Is the adjustment incremental to ongoing normal operations?
  - Is the adjustment based on actual or hypothetical amounts?

Companies should take a balanced approach. If companies include adjustments for expenses related to the impacts of COVID-19, then they should also consider the need for adjustments for income related to the impacts of COVID-19, such as government grants. Further, it should be noted that whatever companies consider as incremental to normal operations now may become a normal operating expense in the future. For example, if expanded expenses related to sanitising facilities become normal and recurring, companies may need to reconsider their non-GAAP measure adjustments.

In light of these considerations, the Corp Fin staff provided some examples of potentially acceptable and unacceptable adjustments to non-GAAP measures related to COVID-19 impacts as given below:

Potentially acceptable adjustments to non-GAAP measures
• Incremental expenses to clean offices, stores, etc.
• 'Hazard pay' to compensate employees that is incremental to normal compensation
Potentially unacceptable adjustments to non-GAAP measures
• Adjustments for revenue lost due to the effects of COVID-19
• Tegmporary idle pay ('compassion pay') to compensate employees (because such pay is not incremental to normal compensation)
• Costs related to temporarily idle facilities for which the registrant continues to pay rent

Applying the most challenging accounting standards

There were many developments concerning major accounting standards over the course of the year. The FASB is in the process of conducting a post-implementation review (PIR) of the three major new standards – revenue, leases and credit losses (CECL). Some of the observations relating to the application of these standards as well as other standards discussed in the conference are as follows:

Revenue

Prevalent issues relating to the implementation of the revenue standard include application of the principal versus agent guidance and the identification of performance obligations.

- **Principal versus agent:** A fact pattern involving a registrant that produces and sells a commodity to its customers that is sourced from a related party was discussed. In this fact pattern, the registrant had the contractual right to market and sell 100 per cent of the commodity produced by a related party. The registrant determined how to source the commodity to fulfil its contracts with customers – either from its own production, from production from the related party facility, or from a third party. This raises the issue of whether the registrant was acting as a principal or an agent in selling the commodity produced by the related party.

  In such a case the registrant concluded it was an agent in this arrangement. However, the OCA staff objected to this conclusion and believed the registrant was the principal and should recognise revenue on a gross basis based on the fact that the registrant took possession and legal title of the product and transported it to the customer and had the right to redirect the product to different customers during transportation.

- **Identifying performance obligations:** A fact pattern involving the issue of whether a software license and updates to the software license represent a single performance obligation was also discussed. Revenue from software and services that are a single performance obligation result in revenue being recognised over time while revenue from a software license that is distinct would be recognised when control of the software license transfers to the customer. In this situation, the updates to the software license were critical because the software would not be able to perform its core function without the updates. Therefore, the registrant concluded that the software license and updates were highly interdependent (or interrelated), such that they significantly affect one another and there is a significant two-way dependency between the software and the related updates. As a result, based on the facts in this situation, the OCA staff did not object to the conclusion that the software license and related updates should be combined into a single performance obligation.

Further, the FASB staff highlighted a standard-setting project intended to address recognition and measurement of acquired revenue contracts with customers in connection with a business combination accounted for under FASB Accounting Standards Codification (ASC) Topic 805, *Business Combinations*, that is likely to result in the release of an exposure draft in the coming months. The project is intended to address diversity and inconsistency in practice related to recognition of acquired contract assets and liabilities and the effect of the related payment terms on the amount of revenue recognised by the acquirer.

Leases

The OCA staff addressed numerous leasing questions dealing with the scope of the leases standard, transition to the standard and accounting for lessee/lessor costs in the conference. One such fact pattern involved the abandonment of lease Right-Of-Use (ROU) assets, where the registrant expected an extended time period between the decision to abandon the ROU assets (i.e. cease use of the lease assets) and the actual abandonment.

ASC Topic 842, *Leases*, requires a lessee to recognise an impairment loss for a ROU asset under existing guidance on the impairment or disposal of long-lived assets, but the registrant concluded impairment did not exist when performing an impairment assessment of the asset group that included the ROU assets. Given its plans to abandon the ROU assets, and in the absence of any impairment, the registrant reevaluated the useful life of the ROU assets and determined they should be amortised ratably over the period between deciding to abandon the leases and the actual abandonment date. The OCA staff did not object to the registrant's conclusion.

Financial instruments

Many public companies with calendar-year ends adopted credit losses ('CECL') as of 1 January 2020. Companies that have adopted CECL in 2020 attributed successful adoption to robust planning, testing and controls throughout implementation. While implementation efforts are still ongoing, initial feedback from companies has centered around accounting for purchased financial assets with credit deterioration, creditors' accounting for troubled debt restructurings, and the inclusion of trade accounts receivable in the scope of CECL.

Consolidation

With respect to consolidation, a case wherein a registrant shared power over a variable interest entity's (VIE) significant activities with another investor was discussed. In this case, the VIE was winding down its activities and the registrant agreed to buy out the other investor under a fixed-price buy-out agreement. The OCA staff did not object to the registrant's conclusion that the fixed-price buy-out agreement did not create a de facto agency relationship with the other investor. A de facto agency relationship likely would have resulted in consolidation by the registrant under the related party guidance in ASC Topic 810, *Consolidation*.

Equity method of accounting

The evaluation of significant influence for investments in corporations, as described in ASC Topic 323, *Investments – Equity Method and Joint Ventures* requires exercise of judgement and consideration of whether certain indicators exist that provide evidence of the existence or lack of significant influence.

A fact pattern presented to OCA staff involving a registrant that held less than 20 per cent of the outstanding voting stock of an investee was highlighted. The registrant was a party to a contractual agreement with a group of other investors to vote in concert with respect to electing members to the investee's board of directors. The registrant concluded that it did not meet the requirements for applying the equity method of accounting because it did not have significant influence over the investee. However, the OCA staff objected to the registrant's conclusion because the registrant's contribution or input was necessary to guarantee the appointment of the individuals proposed by the investor group to the board of directors, the registrant shared various at-will managerial personnel with the investee pursuant to separate employment agreements and it had access to confidential information of the investee pursuant to certain informal agreements.

Consideration received from a vendor

Currently, an entity is required to account for consideration received from a vendor as a reduction of the purchase price of the goods or services acquired from the vendor unless the consideration received from the vendor is:

1. In exchange for a distinct good or service that the entity transfers to the vendor
2. A reimbursement of costs incurred by the entity to sell the vendor's products or
3. Consideration for sales incentives offered to customers by manufacturers.

A fact pattern relating to a customer's accounting for consideration received from a vendor was discussed. In the fact pattern, the registrant had previously purchased fixed assets from a vendor and had non-cancellable purchase commitments for additional fixed assets from the same vendor. After identifying a significant issue with fixed assets purchased from the vendor, the registrant and vendor developed a plan to make repairs to the purchased assets and the vendor also provided cash compensation to the registrant. The registrant asserted that the vendor made such cash payments for a variety of reasons, including retaining the registrant as a customer. Because the cash payments were not consideration for a distinct good or service that the registrant transfers to the vendor, the registrant concluded, and the OCA staff did not object, that it was appropriate to reflect the payment from the vendor as a reduction of the purchase price of the fixed assets previously acquired and the fixed assets it was firmly committed to purchase from the vendor.

Another issue relating to disclosure of cash flows arising from payments to and from the vendor was discussed. In the fact pattern, a registrant reported cash outflows to a vendor net of cash inflows arising from payments from the vendor within the 'investing activities' section of its statement of cash flows. Despite GAAP stating that, in general, information about gross amounts of cash receipts and payments is more relevant than net amounts, the registrant concluded that netting was appropriate. The registrant reached this conclusion on the basis that the amounts were large, and turnover was quick, because the registrant had contracts to purchase additional goods from the vendor in the near future for amounts in excess of the cash inflows. The registrant also asserted that because the contractual cash outflows and inflows did not have stated maturity dates, the criteria stipulating that maturities be short was not relevant to their evaluation. The OCA staff objected to registrant's conclusion to present the cash flows on a net basis.

Goodwill

The FASB plans to address lingering issues with goodwill accounting as follows:

- **New alternative for private companies and non-profits:** FASB expects to release an exposure draft by the end of 2020 that would allow eligible entities to elect to forego interim impairment testing of goodwill. Under the proposal, these entities would determine only at year-end if a triggering event has occurred during the year that would prompt them to test their goodwill for impairment. The final standard is expected to be issued by end of March 2021.
- **Amortisation:** Private companies and non-profit entities currently may elect to amortise goodwill over a period not exceeding 10 years. The FASB is debating whether to allow additional entities to amortise goodwill and what methods and amortisation periods should be allowed.

Important developments on the auditing front

COVID-19 audit challenges

Some of the auditing challenges created by the COVID-19 pandemic, and noted during the conference are as follows:

- **Obtaining audit evidence:** Since an auditor can only get digital copies of certain documents, additional audit procedures would be required to ascertain the validity of such documents.
- **Changes in ICFR:** A company may have modified its ICFR because of its working environment – or it may not have when it should have. A company may also have identified new risks due to COVID-19 that have further necessitated changes in ICFR.

Some additional challenges of auditing in the current environment include the need to conduct virtual inventory observations and changes in the way auditors interact with companies in the virtual working environment.

Despite these challenges, auditors continue to be responsible for conducting audits under PCAOB standards, as well as other regulatory and professional standards. It was also emphasised that the fundamentals of the audit have not changed, nor have the expectations of investors. The five reminders for auditors that are especially important in the current environment includes.

- Maintain due professional care and professional skepticism in completing audit work.
- Perform robust risk assessments and thoroughly understand the company's business.
- Focus on fraud procedures.
- Establish materiality levels appropriate for the circumstances.
- Consider the need for changes in the supervision of the engagement team.

Critical Audit Matters (CAM)

CAM requirements have already taken effect for audits of large accelerated filers and are effective for all other audits to which they apply for fiscal years ending on or after 15 December 2020. It was highlighted that a CAM is unlikely to be useful if it has excessive amounts of generic or standardised language. Therefore, auditors are encouraged to avoid the standardised language and view CAMs as an opportunity to show their expertise to investors.

Also, there have been a limited number of CAMs with a meaningful discussion of the impacts of climate change on the financial statements so far. It should be noted that CAMs related to matters such as climate change may become more prevalent in the future for companies whose financial statements are impacted.

New requirements for estimates and specialists

The new auditing standard for auditing accounting estimates, including fair value measurements, and the amendments to the auditing standards for the auditor's use of the work of specialists are effective for audits of fiscal years ending on or after 15 December 2020. With respect to significant estimates, auditors are required to assess management's reasonableness of the assumptions and their selection along with assessing whether the assumptions are consistent with other relevant information.

Areas of focus in 2021

PCAOB

PCAOB is expected to issue the new quality control standard in 2021.

It also plans to modify the way it selects audits to inspect in 2021 in two distinctive ways:

1. They will look at audits of companies in industries most affected by COVID-19 (e.g. transportation, retail, manufacturing, hospitality) and
2. They will increase the proportion of audits selected randomly.

Further, the impacts of COVID-19 are likely to result in PCAOB's inspection focus in 2021 in the areas of impairment of goodwill and other long-lived assets, going concern evaluations, inventory accounting and risks of fraud. For instance, estimates of fair value based on forecasted financial information and management override of ICFR when there have been staffing changes, downsizing, or other changes affecting segregation of duties.

SEC

Auditor independence

Auditor independence continues to be a focus area for the SEC staff who emphasised that it is a shared responsibility of auditors, audit committees and management. The final amendments the SEC adopted in October 2020 to its auditor independence requirements are intended to focus the compliance efforts of auditors on the relationships and services more likely to pose threats to their objectivity and impartiality. The amendments are effective from 180 days after publication in the Federal Register.

SEC enforcement

The SEC's Division of Enforcement (Enforcement) staff expressed concern that registrants might take advantage of the pandemic to hide previously existing issues by tying them to COVID-19 including heightened concerns of potential fraud risks resulting from pressures created by the pandemic.

The Enforcement staff has been using risk-based data analytics to identify potential problems in registrants' financial reporting like problematic earnings management practices, undisclosed perks given to executives, adjustments and entries tied to meeting or beating EPS estimates, mainly observed in interim financial statements not subject to audit procedures.

Changes to Regulation S-K

Regulation S-K underwent significant changes in 2020 which are part of SEC's broader objective to modernise and simplify certain disclosure requirements in a manner that reduces the costs and burdens on registrants while continuing to provide all material information to investors.

The Corp Fin staff highlighted changes related to the following items:

- Item 101, Description of business
- Item 103, Legal proceedings
- Item 105, Risk factors
- Item 301, Selected financial data
- Item 302, Supplementary financial information
- Item 303, Management's discussion & analysis (MD&A) of financial condition.

The changes to Items 101, 103 and 105 were adopted in August 2020 and are effective for all new SEC filings. The changes to Items 301, 302 and 303 will be effective 30 days after they are published in the Federal Register, and compliance will be required for fiscal years ending on or after the date 210 days after publication to the Federal Register.

Changes to Regulation S-X regarding acquired and disposed businesses

The amendments to Regulation S-X are effective from 1 January 2021. The amendments are intended to assist registrants in making more meaningful determinations of whether an acquired or disposed business is significant and to improve information that investors receive about acquisitions and dispositions of businesses. The final amendments, among other things:

- Update the significance tests by:
  - Revising the investment and income tests
  - Expanding the use of pro forma financial information in measuring significance and
  - Conforming the significance threshold and tests for a disposed business.
- Require the financial statements of the acquired business to cover no more than the two most recent fiscal years.
- Permit abbreviated financial statements for certain acquisitions of a component of an entity.
- Do not require separate acquired business financial statements once the business has been included in the registrant's post-acquisition audited annual financial statements for either nine months or a complete fiscal year, depending on significance.

Special-purpose acquisition companies (SPACs)

As SPAC related filings pertain to first time entrants into the public markets, all SPAC related filings are subject to review by the Corp Fin staff commensurate with Initial Public Offering (IPO) filings. These filing reviews are performed with the same level of rigor as applied to traditional IPOs. The Corp Fin staff offered two other reminders related specifically to SPACs.

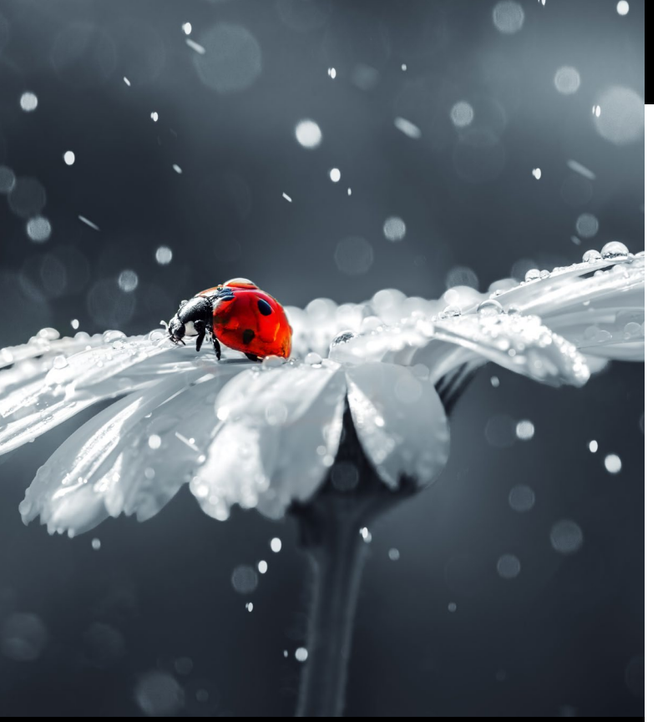
- Registrants are required to have 12 months of SEC reporting after a SPAC's transaction with an operating company to be eligible to use Form S-3.
- Target company financial statements included in a SPAC merger proxy statement or registration statement must be audited under PCAOB standards.

Disclosure considerations for incentive programs

The Corp Fin staff discussed disclosure considerations for registrants with incentive programs where a technology platform is used to connect users to suppliers. They observed these types of incentive programs are often used by registrants in the ride sharing and food delivery industries. It was highlighted that when these incentive costs are material and have been classified as a component of cost of sales or sales and marketing expense, rather than as a direct reduction of revenue, the incentives should be quantified and discussed in MD&A.

Additionally, the Corp Fin staff discussed fact patterns where a registrant has negative revenue driven by the payments to customers related to incentives that exceed the consideration received. Depending on the facts and circumstances, registrants can present the negative revenue within revenue or as sales and marketing expense. Registrants that classify material negative revenue as sales and marketing expense should quantify and discuss these amounts in MD&A.

(Source: 'SEC Issues & Trends', KPMG in the US, December 2020)



CHAPTER 2

The Integrated Reporting Framework: Revisions 2021

This article aims to:
Summarise new developments in the area of integrated reporting.
The space of corporate reporting has evolved tremendously over the years and covers a wide spectrum of topics including financial reporting, Environmental, Social and Governance (ESG) reporting and value creation for all stakeholders in the ecosystem. Regulators and standard setters across the globe recognise this growing attention towards transparent and good disclosures to meet investors' attention and expectations from the businesses.

Background

The International Integrated Reporting Council (IIRC) was formed in August 2010 with an aim to create a globally accepted framework for communication by an organisation about its value creation over time. The IIRC published the first version of its 'International Integrated Reporting <IR> Framework (<IR> Framework) in December 2013. Rather than laying down any specific detailed disclosures or measurement bases, the <IR> Framework takes a principle-based approach and establishes Guiding Principles and Content Elements that govern the overall content of an integrated report.

Over the last decade, more than 2,500 companies across 70 countries[1] have adopted the concept of integrated reporting as part of their sustainability reporting. Further, over 40 stock exchanges[1] globally make reference to the integrated reporting in their guidance. In India, the Securities and Exchange Board of India (SEBI) on 6 February 2017 had recommended the voluntary adoption of the <IR> Framework for annual reporting. Since then, more than 40 companies[2] across various sectors have adopted integrated reporting in India.

Recent developments in sustainability reporting

In its journey towards integrated reporting, the IIRC has covered several significant milestones. In September 2020, the IIRC along with four other standard setting global institutions namely the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB) and the Carbon Disclosure Project (CDP) issued a joint statement to show an intent to work together towards a comprehensive corporate reporting system. In December 2020, these five leading organisations published an illustration of how their current frameworks, standards and platforms, along with the elements set out by the Task Force on Climate-related Financial Disclosures (TCFD), can be used together to provide a 'running start' for development of global standards that enable disclosure of how sustainability matters create or erode an enterprise value.[3]

Revisions to the <IR> Framework

The primary purpose of an integrated report is to bring an improvement in the quality of information which is made available to various stakeholders in the ecosystem including investors, lenders, and public at large. The <IR> Framework lays down a set of fundamental concepts and includes guiding principles and content elements which govern preparation of an integrated report by a company. While the <IR> Framework continues to be relevant today despite various developments in the ESG and sustainability reporting space, the IIRC council endorsed for certain revisions to the existing <IR> Framework.

In January 2021, the IIRC in order to facilitate more decision useful reporting published revisions to the <IR> Framework. The revisions to the <IR> Framework focussed on a simplification of the required statement of responsibility for the integrated report, improved insight into the quality and integrity of the underlying reporting process, a clearer distinction between outputs and outcomes with examples and a greater emphasis on the balanced reporting of outcomes and value preservation and erosion scenarios.

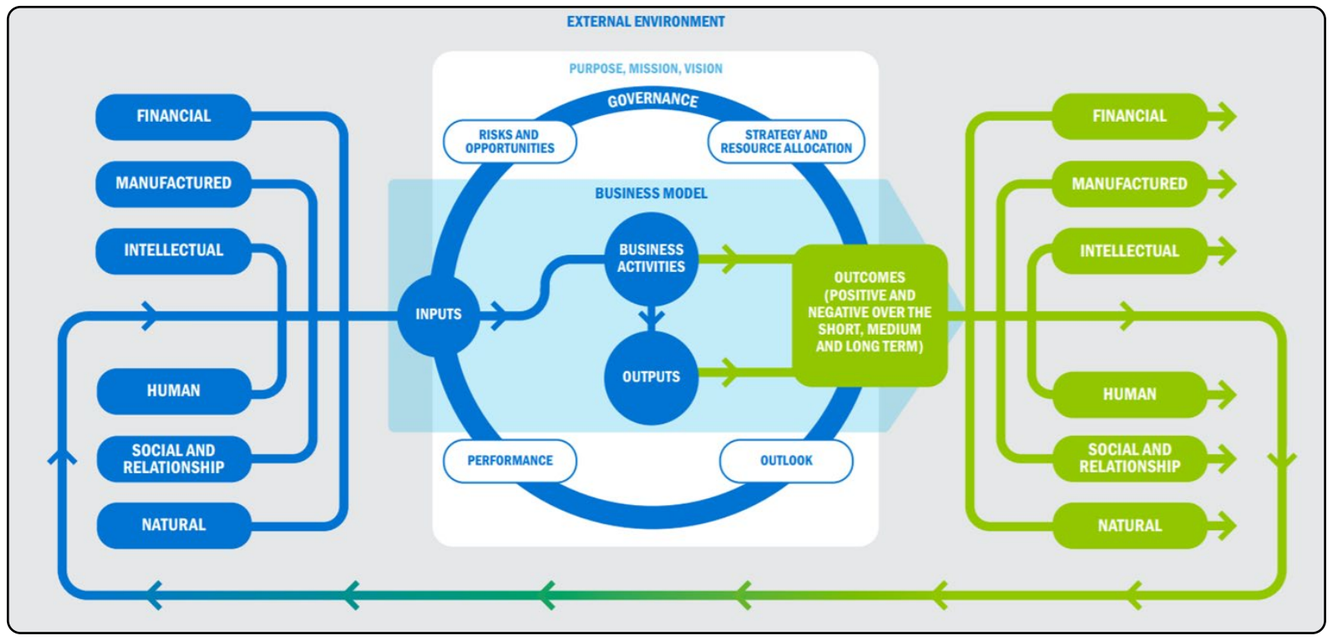
1. 'Celebrating our 10 Year Anniversary: Reflections from around the world', IIRC, 30 November 2020
2. 'Integrated reporting in India', Vrushali Gaud, IIRC, 12 September 2019
3. 'Global sustainability and integrated reporting organizations launch prototype climate-related financial disclosure standard', IIRC, 18 December 2020

Below is an overview of the key revisions made in the <IR> Framework:

- **Responsibility for an integrated report:** Under the revised <IR> Framework, an integrated report should include a statement from Those Charged With Governance (TCWG) that they acknowledge their responsibility to ensure integrity of the integrated report and that in their opinion and conclusion, the integrated report is presented in accordance with the <IR> Framework (earlier the <IR> Framework provided an option to not include such a statement). Each country may have stipulated laws and regulations defining the governance structure of the organisations, therefore, the revised framework clarifies that an organisation should consider such governance structure, the culture and legal context, size and ownership characteristics in order to access who is responsible for acknowledging this responsibility. In the revised framework, this is further explained by an example that in some jurisdictions a single board may be required whereas in others, separation of the supervisory and the executive/management functions may be prevalent in a two-tier board. In case of a two-tier board, the body responsible for overseeing the strategic direction of the company would issue the statement of responsibility.

  In jurisdictions where legal or regulatory laws preclude a company from issuing such a statement of responsibility from TCWG, this should be clearly stated in the integrated report. Further, in such cases, a company should make appropriate disclosures about the processes followed to prepare and present the integrated report. Such disclosures can include related systems, procedures and controls including key activities and responsibilities and the role of TCWG, including relevant committees.

- **Business model and value creation:** The fundamental of the <IR> Framework lies in the creation of value for the organisation itself which affects the financial returns to the providers of the financial capital and others including stakeholders and society at large. During the revision to the <IR> Framework, the IIRC recognised, that although all organisations aim to create value, the overall stock of capitals such as the financial capital, manufactured capital, human capital, intellectual capital, natural capital or social capital can also either undergo a net decrease or experience no net change. In such cases, value is eroded or preserved. Accordingly, a revision was made in the <IR> Framework to include in the integrated report how an organisation creates, preserves or erodes value over time. The IIRC believes that if companies adopt the new disclosure requirements of short term, medium term and long-term outcomes, the complete value creation story can be built. Greater emphasis on value preservation and value erosion will encourage more balanced reporting of outcomes. Consequential amendments were made in the process through which value is created, preserved or eroded as depicted in the diagram below:



Source: International <IR> Framework, January 2021

- **Clearer distinction between output and outcomes:** As illustrated in the diagram above, the <IR> Framework provides guidance on what is a business model. Section 4C of this framework defines a business model as 'an organisation's system of transforming inputs through its business activities into outputs and outcomes that aim to fulfil the organisation's strategic purposes and create value over the short, medium and long term.' Outputs are an organisation's products and services and include other outputs including any by-products and waste (e.g. emissions) which may need to be discussed and disclosed within the business model depending on the materiality. Outcomes are the internal and external consequences (positive and negative) for the capitals[4] as a result of an organisation's business activities and outputs.

The IIRC in a review of randomly selected integrated reports in 2016 observed that preparers of integrated reporting are often confused or fail to distinguish between outputs, outcomes and impacts. The IIRC acknowledged that differentiating between outputs and outcomes can be challenging and encourage organisations to decipher their business models and the impact on their activities. In the revision to the <IR> Framework in January 2021, the IIRC has included a simple example to illustrate the distinction between output and outcomes in Para 4.19 of the <IR> Framework as below:

'An automotive manufacturer produces internal combustion engine cars as its core output. Positive outcomes include increases in financial capital (through profits to the company and supply chain partners, shareholder dividends and local tax contributions) and enhanced social and relationship capital (through improved brand and reputation, underpinned by satisfied customers and a commitment to quality and innovation). Negative outcomes include adverse consequences for natural capital (through product-related fossil fuel depletion and air quality reduction) and reduced social and relationship capital (through the influence of product-related health and environmental concerns on social license to operate).'

The revised <IR> Framework encourages prepares to present outcomes in a balanced way. Where predictable, it supports an organisation's assessment of the use of and effects of the capitals with qualitative and quantitative information.

4. Stocks of value on which all organisations depend for their success as inputs to their business model, and which are increased, decreased or transformed through the organisation's business activities and outputs.

Way forward

The journey of integrated reporting which began in 2010 provided a reporting framework for companies to address the business reporting model. Over the years, much has changed including the way businesses are being conducted with globalisation, environmental concerns on the rise and growing expectations from the society on enhanced corporate reporting and accountability. Regulators and standard setters around the world have supported the vision of a comprehensive corporate reporting system to include a holistic disclosure of both financial performance as well as sustainability matters. By doing so, investors and other stakeholders such as customers, lenders, employees and society at large will be able to better understand and make investment decisions in organisations which tell the entire story of value creation, preservation and erosion of its enterprise value.

Even today, reporting requirements have evolved differently in different jurisdictions around the world. This has caused added burden and duplication of information on an organisation functioning in more than one jurisdiction. It also makes it difficult for various stakeholders such as investors to compare the performance of companies across jurisdictions.

The statement of intent issued by the five regulatory bodies i.e., the IIRC, CDSB, GRI, SASB and CDP to work towards development of a comprehensive corporate reporting system is a step in the right direction. This will enhance comparability and reliance of information sought by not only shareholders but all stakeholders in the eco-system across various jurisdictions.

Certain other prominent standard setters such as the International Accounting Standards Board (IASB) are evaluating their roles and responsibilities on setting up guidance and standards on sustainability reporting. The IASB recognises the growing and immediate demand globally towards improving transparency and comparability in sustainability. Accordingly, the IASB is looking to produce a definitive framework, including setting up a separate sustainability standards board by the end of September 2021[5]. The International Auditing and Assurance Standards Board (IAASB) in early 2019 rolled out a consultative paper to gather feedback from stakeholders in order to issue guidelines for assurance on Extended External Reporting (EER). The EER includes many different forms of non-financial reporting such as sustainability reporting, integrated reporting and other forms of ESG reporting by companies. The IAASB on its part proposes to draft a non-authoritative guidance for assurance practitioners applying International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, to EER assurance engagements[6].

Clearly, the thrust of the global standard setters is now on the non-financial reporting aspect which is an ask from the society today. Companies should keep a close watch on the areas of development in this space.

5. 'IFRS Foundation Trustees announce next steps in response to broad demand for global sustainability standards', IASB, 2 February 2021
6. IAASB consults on Extended External Reporting (EER) assurance, IAASB, 13 March 2020

CHAPTER 3

IAASB discussion paper on expectation gap

This article aims to:
Summarise the key challenges and issues regarding the expectation gap relating to the role of an auditor, and areas where IAASB seek responses.

Recently, the International Auditing and Assurance Standards Board (IAASB) has issued a discussion paper[1] to deliberate and gather perspectives from all the stakeholders about the role of the auditor in relation to fraud and going concern in an audit of financial statements. The purpose of the discussion paper is to obtain input on matters about whether the auditing standards relating to fraud and going concern reman fit-for-purpose in the current environment.

The discussion paper pointed out that in recent years there have been certain high-profile corporate failures or significant accounting restatements around the globe. This has led to erosion of trust in the financial reporting ecosystem. Therefore, corrective steps in all parts of the financial reporting ecosystem are needed to address this crisis of confidence in financial reporting.

It highlighted that many commentators continue to challenge the auditor's role in respect to fraud and going concern. The paper mentions that the concept of an audit 'expectation gap' has existed for decades and has been described in several ways. In the discussion paper, the IAASB referred to the May 2019 publication by the Association of Chartered Certified Accountants (ACCA) titled 'Closing the Expectation Gap in Audit' which describes three components of the expectation gap: the 'knowledge gap', the 'performance gap' and the 'evolution gap'.

In order to narrow down the expectation gap, all parts of the financial reporting ecosystem would have to play their role in improving external reporting in relation to fraud and going concern.

Key areas of deliberation

Following are the key areas of challenges and issues deliberated by the IAASB:

- **Corporate culture:** The current auditing standards (ISAs) emphasise the importance of a culture of honesty and ethical behaviour, reinforced by active oversight, as well as management and those charged with governance by placing a strong emphasis on fraud prevention and fraud deterrence. The discussion paper seeks inputs on the impact of corporate culture on fraudulent financial reporting and additional audit procedures that should be considered by the IAASB in this regard.
- **Forensic specialists or other relevant specialists:** The current auditing standards (ISAs) do not specifically require the use of forensic specialists. However, the use of forensic specialists on an audit engagement more broadly may help narrow the evolution gap by strengthening the procedures of the auditor with respect to fraud. Forensic specialists or other relevant specialists may help provide increased insight into the fraud risk of a company. It is important to note that a financial statement audit is broader in scope and not forensic in nature, and the effectiveness of using forensic specialists or other relevant specialists must be considered in the context of the objectives of each financial statement audit and the nature and circumstances of the specific engagement. In addition, many audit firms do not have access to these specialists in-house, and therefore, this may present scalability issues.

  Additionally, training in both forensic accounting and fraud awareness could be enhanced as part of the formal qualification and continuous learning process for financial statement auditors.

  The discussion paper seeks views on requiring the use of forensic specialists or other relevant specialists in a financial statement audit.
- **Non-material fraud:** While the auditor is not required to design and perform specific procedures with regard to misstatements that are not material, any misstatement related to fraud that has been identified may be indicative of a bigger issue. For example, evidence that an employee is not acting with integrity may also reflect broader issues in the entity's corporate culture. Furthermore, frauds that are not material that recur over long periods of time may become material (quantitatively or qualitatively) in the future.

  As the world is changing and non-material frauds are becoming more prevalent, the discussion paper explores whether more needs to be done in relation to non-material frauds identified e.g., additional audit procedures and what types of procedures.

1. Fraud and going concern in an audit of financial statements: Expectation gap published by IAASB in January 2021

- **Third party frauds:** Current auditing standards[2] contain guidance on identification and assessment of risks of material misstatement due to fraud. However, audit procedures should be designed to detect fraud that is not directly related to risks of material misstatement (e.g., cyber-attacks resulting in theft of customer information) and are rather related to reputational or operational risk. This would expand the scope of the financial audit beyond what is currently required.

  The discussion paper seeks feedback about the auditor's role in relation to third party fraud that does not result in a material misstatement of the financial statements but may have a severely negative impact on the entity (e.g., cybercrime attacks).

- **Going concern, concept of resilience and material uncertainty:** The assumption that an entity will be able to continue as a going concern is fundamental to the preparation of the financial statements. Given the number of high-profile corporate failures, some stakeholders are also looking for enhanced procedures for the auditor with regard to the entity's ability to continue as a going concern.

  Certain jurisdictions require management to report on other concepts of the company's resilience. For example, in the UK, certain entities have a responsibility to report on the entity's longer-term viability.

  Therefore, the discussion paper seeks perspectives on whether entities should be required to assess their ability to continue as a going concern for longer than 12 months, and therefore, whether auditors should be required to consider this longer time period in their assessment, beyond the current required period. If stakeholders believe a longer timeframe should be required, alignment will need to be retained between the requirements under the applicable financial reporting framework and the auditing standards for auditors to be able to adequately perform their procedures.

Next steps

The discussion paper seeks an open communication among companies, those charged with governance, investors, regulators, and others. Additionally, the synergies between auditors, standard-setters and regulators and audit oversight bodies, is critical to the effective functioning of the financial reporting ecosystem. Some matters related to the expectation gap may also need to be addressed by regulators and audit oversight bodies as appropriate, as they are in the unique position to influence auditors, and management and those charged with governance through oversight, stakeholder engagement, inspections and enforcement actions.

2. ISA 240, *The auditor's responsibility to consider fraud in an audit of financial statements*

CHAPTER 4

Regulatory updates

Revised definition of a 'small company' and 'listed company' under the Companies Act, 2013

The Ministry of Corporate Affairs (MCA) through its notifications dated 1 February 2021 and 19 February 2021 has issued the Companies (Specification of Definition Details) Amendment Rules, 2021 and the Companies (Specification of Definition Details) Second Amendment Rules, 2021. The notifications amend the definition of a 'small company' and 'listed company' under the Companies Act, 2013 (2013 Act). The revised definitions are as follows:

- **Small company (Section 2(85) read with Rule 2(1)(t)):** A small company means a company (other than a public company) which meets both the given conditions:

  a. Its paid-up share capital does not **exceed INR2 crore** (earlier INR50 lakh) or such higher amount as may be prescribed which should not be more than INR10 crore and

  b. Its turnover as per profit and loss account for the immediately preceding Financial Year (FY) does not **exceed INR20 crore** (earlier INR2 crore) or such higher amount as may be prescribed which should not be more than INR100 crore.

  (Emphasis added to highlight the changes)

- **Listed company (Section 2(52) read with Rule 2A):** Listed company means a company which has any of its securities listed on any recognised stock exchange. The amendments clarified that the following classes of companies shall not be considered as listed companies:

  a. Public companies which have not listed their equity shares on a recognised stock exchange but have listed their:

     i. Non-convertible debt securities issued on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008 or

     ii. Non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013.

  b. Private companies which have listed their non-convertible debt securities on private placement basis on a recognised stock exchange in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008

  c. Public companies which have not listed their equity shares on a recognised stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in Section 23(3) of the 2013 Act.

Effective date: The revised definitions will be effective from 1 April 2021.

(Source: MCA notification no. G.S.R. 92(E) dated 1 February 2021 and notification dated 19 February 2021)

Minimum time for acceptance in case of further issue of share capital

Currently, in accordance with the provisions of Section 62(1) of the 2013 Act, a company can increase its subscribed capital through issuing further shares to the existing shareholders by sending a letter of offer and subject to specified conditions. The conditions, *inter alia*, require that the offer should be made by a notice specifying the number of shares offered and limiting a time not less than 15 days *or such lesser number of days as may be prescribed* but not exceeding 30 days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined.

MCA through a notification dated 11 February 2021 has issued an amendment to the Companies (Share Capital and Debentures) Rules, 2014 and specified that the time period within which the offer to be made for acceptance should not be less than seven days from the date of offer.

Effective date: The amendment is effective from 1 April 2021.

(Source: MCA notification no. G.S.R. 113(E) dated 11 February 2021)

Scheme of merger between start-up companies

Currently, as per Section 233 of the 2013 Act, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly owned subsidiary company or such other class or classes of companies as may be prescribed subject to specified conditions.

MCA through a notification dated 1 February 2021 has issued amendments to the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. As per the amendments, a scheme of arrangement under Section 233 of the 2013 Act may be entered into between any of the following class of companies:

a. Two or more start-up companies[1] or

b. One or more start-up company with one or more small company.

Effective date: The amendments are effective from 1 February 2021.

(Source: MCA notification no. G.S.R. 93(E) dated 1 February 2021)

MCA notified two more sections of the Companies (Amendment) Act, 2020

Background

The MCA issued certain amendments to the 2013 Act through the Companies (Amendment) Act, 2020 (2020 Amendment Act) which received the assent of the President of India on 30 September 2020. The 2020 Amendment Act incorporates amendments suggested by the Company Law Committee (CLC) in its report. The government constituted CLC in September 2019 to review sections on offences under the 2013 Act and suggest changes to promote ease of doing business and ease of living for law-abiding corporates. MCA notified various amendments of the 2020 Amendment Act effective from 21 December 2020 and 22 January 2021. The amendments mainly relate to:

- Decriminalisation of certain compoundable offences
- Rationalisation of penalties
- Other amendments including revised definition of a listed company, periodical financial results for unlisted companies and modification of the provisions relating to Corporate Social Responsibility (CSR).

For a detailed read, please refer KPMG in India's First Notes on 'MCA notified certain provisions of the Companies (Amendment) Act, 2020' dated 13 January 2021.

New development

On 11 February 2021, MCA notified amendments relating to producer companies under the 2020 Amendment Act. The 2020 Amendment Act has inserted a new Chapter as Chapter XXIA relating to producer companies. This chapter is on similar lines to the Companies Act, 1956.

Consequent to introduction of new Chapter XXIA on 'producer companies', provision under Section 465(1) of the 2013 Act has been omitted. This section required that provisions of Part IXA of the Companies Act, 1956 would be applicable to a producer company.

Additionally, MCA has notified Producer Companies Rules, 2021.

The Rules prescribe procedures specifically for producer companies with regard to change of place of registered office from one state to another and investment of general reserves.

For a detailed read, please refer KPMG in India's First Notes on 'MCA notified the Companies (Amendment) Act, 2020' dated 17 February 2021.

(Source: MCA notifications dated 11 February 2021)

Conversion of one-person company into a public or private company

On 1 February 2021, MCA has issued certain amendments to the Companies (Incorporation) Rules, 2014. The amendments revised the eligibility criteria of a one-person company and also prescribe manner of conversion of such a company into a public or private company as follows:

- **Revised eligibility criteria of a one-person company:** As per the revised norms, only a natural person who is an Indian citizen **whether resident in India or otherwise** would be eligible to incorporate a one-person company.

  For this purpose, the term 'resident in India' means a person who has stayed in India for a period of not less than **120 days** (earlier 182 days) during the immediately preceding FY.

  (Emphasis added to highlight the change)

1. 'Start-up company' means a private company incorporated under the 2013 Act or the Companies Act, 1956 and recognised as such in accordance with notification no. G.S.R. 127 (E) dated 19 February 2019 issued by the Department for Promotion of Industry and Internal Trade.

- **Manner of conversion of a one-person company into a public or private company:** A one-person company may be converted into a private or public company (other than a company registered under Section 8 of the 2013 Act) if it fulfils the following criteria:

  a. Minimum number of members has been increased to two (in case of a private company) or seven members (in case of a public company), as the case may be

  b. Minimum number of directors has been increased to two directors (in case of a private company) or three directors (in case of a public company), as the case may be

  c. It maintains the minimum paid-up capital as per the requirements of the 2013 Act for such class of company and

  d. It ensures due compliance with the provisions of Section 18 of the 2013 Act (relating to conversion of companies already registered) for conversion.

  The one-person should alter its memorandum and articles by passing a resolution in accordance with Section 122(3) of the 2013 Act to give effect to the conversion and to make necessary changes incidental thereto. Additionally, the company should also file an application in e-Form No.INC-6 for its conversion into private or public company along with fees as provided in the Companies (Registration offices and fees) Rules, 2014 and prescribed documents including latest audited balance sheet and profit and loss account.

  Effective date: The amendments are effective from 1 April 2021.

  (Source: MCA notification dated 1 February 2021)

SEBI board meeting

The Securities and Exchange Board of India (SEBI) in its board meeting dated 17 February 2021, has, *inter alia*, approved certain changes relating to Minimum Public Offer (MPO) under the Securities Contracts (Regulation) Rules, 1957 (SCRR).

In accordance with the requirements of the SCRR, currently, issuers with post issue market capital of at least INR4,000 crore or more are required to offer to public at least 10 per cent of its post issue market capital (MPO). Further, such issuers are also required to achieve a Minimum Public Shareholding (MPS) of at least 25 per cent within three years from the date of listing.

As per the approved amendments, for issuers with post issue market capital exceeding INR1,00,000 crore, the requirement of MPO would be reduced from 10 per cent of post issue-market capital to INR10,000 crores plus five per cent of the incremental amount beyond INR1,00,000 crore. Such issuers would be required to achieve at least 10 per cent public shareholding in two years and at least 25 per cent public shareholding within five years from the date of listing.

(Source: SEBI press release no. PR No. 7/2021 dated 17 February 2021)

Revised disclosure formats under Insider Trading Regulations

Background

Regulation 7 of the SEBI (Prohibition of Insider Trading) Regulations, 2015 (Insider Trading Regulations) requires certain disclosures to be made by a listed company and designated persons.

Those, *inter alia*, includes:

- **Initial disclosures:** Every person on appointment as key managerial personnel or a director of the company or upon becoming a promoter or member of the promoter group should disclose his/her holding of securities of the company. The disclosure should made as on the date of appointment or becoming a promoter, to the company within seven days of such appointment or becoming a promoter.
- **Continual disclosures:** Every promoter, member of the promoter group, designated person and director of a company should disclose to the company the number of such securities acquired or disposed of within two trading days of such a transaction. The disclosure is required if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of INR10 lakh or such other value as may be specified.
- **Disclosures by other connected persons:** A listed company may require any other connected person or class of connected persons to make disclosures of holdings and trading in securities of the company. The disclosure would be required in such form and at such frequency as may be determined by the company in order to monitor compliance with the Insider Trading Regulations.

SEBI, though its circulars dated 11 May 2015 and 16 September 2015, had specified the formats for the said disclosures to be made under Regulation 7 of Insider Trading Regulations.

New development

On 9 February 2021, SEBI has issued revised formats for the following disclosures under Regulation 7 of the Insider Trading Regulations:

- Disclosure on becoming a key managerial personnel/director/ promoter/member of the promoter group
- Continual disclosures
- Transactions by other connected persons as identified by the company.

The revised formats are updated to incorporate the changes made to the Insider Trading Regulations pursuant to SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2019 which included reference of 'member of the promoter group' and 'designated person' in place of employee in Regulation 7 of the Insider Trading Regulations.

(Source: SEBI circular no. SEBI/HO/ISD/ISD/CIR/P/2021/19 dated 9 February 2021)

Mandatory risk-based internal audit framework for NBFCs

The Reserve Bank of India (RBI) through a notification dated 3 February 2021 has mandated Risk-Based Internal Audit (RBIA) framework for the following class of Non-Banking Financial Companies (NBFCs) and Primary (Urban) Co-operative Banks (UCBs):

a. All deposit taking NBFCs, irrespective of their size

b. All non-deposit taking NBFCs (including Core Investment Companies) with asset size of INR5,000 crore and above and

c. All UCBs with asset size of INR500 crore and above[2].

The eligible entities should implement the RBIA framework by 31 March 2022 in accordance with the guidelines on risk-based internal audit provided in the notification (Annex).

In order to ensure smooth transition from the existing system of internal audit to RBIA, the concerned NBFCs and UCBs may constitute a committee of senior executives with the responsibility of formulating a suitable action plan. The committee may address transitional and change management issues and should report progress periodically to the board and senior management.

(Source: RBI notification no. RBI/2020-21/88 dated 3 February 2021)

Capital and provisioning requirements for exposures to entities with Unhedged Foreign Currency Exposure

Background

RBI through its circular dated 3 June 2014 had issued guidelines on capital and provisioning requirements for exposures to entities with Unhedged Foreign Currency Exposure (UFCE).

The guidelines mandate that information on UFCE may be obtained by banks from entities on a quarterly basis, on self-certification basis, and preferably should be internally audited by the entity concerned. However, banks have expressed their inability in obtaining UFCE certificates from listed entities for the latest quarter due to restrictions on disclosure of such information prior to finalisation of accounts.

New development

With a view to the address the concern raised by banks, RBI has decided that in such cases, banks may use data pertaining to the immediately preceding quarter for computing capital and provisioning requirements in case of UFCE.

(Source: RBI notification no. RBI/2020-21/100 dated 17 February 2021)

RBI issued master directions for HFCs

RBI through a notification dated 17 February 2021 has issued Master Direction-NBFC-Housing Finance Company (Reserve Bank) Directions, 2021. These directions are likely to help to prevent the affairs of any Housing Finance Company (HFC) from being conducted in a manner detrimental to the interest of investors and depositors or in any manner prejudicial to the interest of such HFCs.

The directions include guidelines on asset classification and provisioning requirements for HFCs along with matters to be included in the auditor's report of HFCs.

The directions are effective from 17 February 2021. These would be applicable to every HFC registered under Section 29A of the National Housing Bank Act, 1987 and every auditor of an HFC.

(Source: RBI notification no. RBI/2020-21/73 dated 17 February 2021)

2. The UCBs with asset size less than INR500 crore, all salary earners UCBs, unit UCBs and UCBs under all inclusive directions will continue to be covered under the extant internal audit requirements as prescribed in RBI's Master Circular DCBR.CO.BPD.(PCB).MC.No. 3/12.05.001/2015-16 dated 1 July 2015.

Deferment of implementation of Net Stable Funding Ratio (NSFR)

Background

Net Stable Funding Ratio (NSFR) is one of the significant components of the Basel III reforms. It requires banks to fund their activities with sufficiently stable sources of funding over a time horizon of a year in order to mitigate the risk of future funding stress. As per the prescribed timeline, banks in India were required to maintain NSFR of 100 per cent from 1 April 2020. Related NSFR guidelines were also to be implemented from 1 April 2020.

In light of the pandemic (COVID-19), the implementation of NSFR and related guidelines were deferred up to 1 April 2021.

New development

RBI through a notification dated 5 February 2021 has further deferred the implementation of NSFR guidelines up to 1 October 2021.

(Source: RBI notification no. RBI/2020-21/95 dated 5 February 2021)

SLR holdings in HTM category

Currently, banks are permitted to exceed the limit of 25 per cent of the total investments under Held to Maturity (HTM) category. However, this is subject to the condition that the excess comprises only of Statutory Liquid Ratio (SLR) securities and total SLR securities held under HTM category is not more than 19.5 per cent of Net Demand and Time Liabilities (NDTL) as on the last Friday of the second preceding fortnight.

The RBI through a notification dated 12 October 2020 had granted banks a special dispensation of the enhanced HTM limit of 22 per cent, for SLR securities acquired between 1 September 2020 and 31 March 2021, up to 31 March 2022. The enhanced HTM limit was required to be restored in a phased manner over three quarters beginning with the quarter ending 30 June 2022.

Relaxation

The RBI through a notification dated 5 February 2021 has further extended the dispensation of enhanced HTM of 22 per cent to 31 March 2023 to include SLR securities acquired between 1 April 2021 and 31 March 2022. Accordingly, banks may exceed the specified limit of 19.5 per cent of NDTL up to 22 per cent of NDTL till 31 March 2023, provided such excess is on account of SLR securities acquired between 1 September 2020 and 31 March 2022.

The enhanced HTM limit would be restored to 19.5 percent in a phased manner, beginning from the quarter ending 30 June 2023. This means that the excess SLR securities acquired by banks during the period 1 September 2020 to 31 March 2022 would be progressively reduced from the HTM category such that the total SLR securities under the HTM category as a percentage of the NDTL does not exceed:

a. 21 per cent as on 30 June 2023

b. 20 per cent as on 30 September 2023

c. 19.5 per cent as on 31 December 2023.

As per extant instructions, banks may shift investments to/from HTM with the approval of the board of directors once a year and such shifting will normally be allowed at the beginning of the accounting year. However, in order to enable banks to shift their excess SLR securities from the HTM category to Available For Sale (AFS)/Held For Trading (HFT), it has been decided to allow such shifting of the excess securities during the quarter in which the HTM ceiling is brought down. This would be in addition to the shifting permitted at the beginning of the accounting year.

(Source: RBI notification no. RBI/2020-21/94 dated 5 February 2021)

Credit to MSME borrowers

With a view to incentivise new credit flow to the Micro, Small, and Medium Enterprise (MSME) borrowers, RBI through a notification dated 5 February 2021 has allowed scheduled commercial banks to deduct an amount equivalent to credit disbursed to 'new MSME borrowers'[3] from their NDTL for calculation of the Cash Reserve Ratio (CRR).

This exemption will be available only up to INR25 lakh per borrower disbursed up to the fortnight ending 1 October 2021, for a period of one year from the date of origination of the loan or the tenure of the loan, whichever is earlier.

Banks are required to report the exemption availed at the end of a fortnight to RBI in Annex A to Form A (Fortnightly return on CRR) under the item 'any other liabilities coming under the purview of zero prescription'.

Additionally, proper fortnightly records of credit disbursed to new MSME borrowers/CRR exemption claimed, duly certified by the Chief Financial Officer (CFO) or an equivalent level officer, must be maintained by banks for supervisory review.

(Source: RBI notification no. RBI/2020-21/92 dated 5 February 2021)

3. For the purpose of this exemption, 'new MSME borrowers' would be defined as those MSME borrowers who have not availed any credit facilities from the banking system as on 1 January 2021.

Extension of relaxation relating to marginal standing facility by banks

RBI through its notifications dated 28 September 2020 and 4 December 2020 had allowed banks to avail of funds under the Marginal Standing Facility (MSF) by dipping into the Statutory Liquidity Ratio (SLR) up to an additional one per cent of their NDTL, i.e., cumulatively up to three per cent of NDTL. This facility which was initially available up to 30 June 2020 and was later extended in phases up to 31 March 2021 to provide comfort to banks on their liquidity requirements and also to enable them to meet their Liquidity Coverage Ratio (LCR) requirements.

Relaxation

RBI through a notification dated 5 February 2021 has allowed banks to continue with the MSF relaxation for a further period of six months, i.e., up to 30 September 2021.

(Source: RBI notification no. RBI/2020-21/91 dated 5 February 2021)

ICAI publications

FAQ on LODR

Recently, the Institute of Chartered Accountants of India (ICAI) has issued guidance on applicability of the provisions of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 (LODR) in the form of Frequently Asked Questions (FAQs). The publication also incorporates guidance on recent amendments made to the LODR.

(Source: FAQs on SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015 issued by ICAI in February 2021)

Technical guide on accounting of CSR funds by third parties

Currently, a company can undertake CSR activities in the following ways:

a. CSR activities itself or

b. CSR activities through a third party being company/trust/society established under Section 8 of the 2013 Act/Non-Government Organisation (NGO).

Recently, the ICAI has issued a technical guide on accounting of CSR funds by third parties. The publication aims to provide guidance on the accounting, presentation and disclosure of CSR funds by the entities receiving the CSR contribution for implementing the CSR activities on behalf of the company i.e. the cases wherein the CSR activities are carried out by the company through third parties.

(Source: Technical Guide on Accounting of CSR Funds by Third Parties issued by ICAI in February 2021)

Handbook on certification of Form CSR-1

In accordance with the amendments to the Companies (Corporate Social Responsibility Policy) Rules, 2014 issued by MCA on 22 January 2021, every entity who intends to undertake CSR activity is required to register itself with the Central Government (CG) by filing Form CSR-1 electronically with the Registrar of Companies (ROC) with effect from 1 April 2021. Form CSR -1 should be verified digitally by a Chartered Accountant (CA) in practice, Company Secretary (CS) in practice or a cost accountant in practice.

Recently, the ICAI has issued a handbook on certification of Form CSR-1 to provide guidance on the requirements of verifying and certifying Form CSR-1.

(Source: Handbook on certification of Form CSR-1 issued by ICAI in February 2021)

Background material on BRSR

Recently ICAI has issued a background material on Business Responsibility and Sustainable Reporting (BRSR). The background material contains an overview of global trends in corporate sustainability reporting, National Guidelines on Responsible Business Conduct, 2018 (NGRBC), UN Sustainable Development Goals (SDGs), sustainable finance and assurance aspects. It also includes a comparison between Business Responsibility Reporting (BRR) disclosures and BRSR disclosures including a comparison between BRSR comprehensive and BRSR lite format of reporting proposed by the MCA committee on BRSR in its report[4].

(Source: Background Material on Business Responsibility and Sustainability Reporting issued by ICAI in February 2021)

Guidance note on accounting by e-commerce entities

The Research Committee of ICAI has revised its 'guidance note on dot-com companies' as the 'guidance note on accounting by e-commerce entities'. The old guidance note dealt with accounting treatment of various revenue and expense items peculiar to the dot-com business. However, the revised guidance note deals with accounting by e-commerce entities in respect of accounting issues relating to revenue and expense recognition.

The revised guidance note applies to companies preparing financial statements under the Companies (Accounting Standard) Rules 2006, as amended under Section 133 of the 2013 Act. It also applies to entities such as Limited Liability Partnerships (LLPs) and partnership firms.

(Source: Guidance note on accounting by e-commerce entities issued by ICAI in February 2021)

4. The MCA issued the report of the committee on 11 August 2020.

Guidance note on accrual basis of accounting (revised)

ICAI has issued a revised guidance note on accrual basis of accounting. The revised guidance note highlights the need for accrual basis of accounting, provides guidance in respect of transition from cash basis to accrual basis of accounting and also states the benefits associated with accrual system of accounting.

With the issuance of the revised guidance note, the guidance note on accrual basis of accounting issued by ICAI in 1988 stands withdrawn.

(Source: Guidance note on accrual basis of accounting issued by ICAI in February 2021)

Handbook on role of women directors

Recently, ICAI has issued a handbook on role of women directors. The publication provides insights into various role and responsibilities that are bestowed on the women directors along with highlighting the requirements under the 2013 Act and SEBI regulations. The handbook also covers important FAQs and excerpts of conversation with women independent directors to equip aspiring women directors with the holistic view in real life scenario.

(Source: Handbook on role of women directors issued by ICAI in February 2021)

Amendments to IFRS standards

On 12 February 2021, the International Accounting Standards Board (IASB) has issued narrow scope amendments to IAS 1, *Presentation of Financial Statements,* IFRS Practice Statement 2, *Making Materiality Judgements* and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

The table provides an overview of the amendments:

Standard	Overview of amendments
IAS 1	Companies are required to disclose their material accounting policy information rather than their significant accounting policies.
IAS 8	Clarification on how companies should distinguish changes in accounting policies from changes in accounting estimates. The distinction is important because changes in accounting estimates are applied prospectively only to future transactions and other future events, but changes in accounting policies are generally also applied retrospectively to past transactions and other past events.
IFRS Practice Statement 2	Provides guidance on how to apply the concept of materiality to accounting policy disclosures.

Effective date: The amendments to IAS 1 and IAS 8 will be effective for annual reporting periods beginning on or after 1 January 2023, with early application permitted.

(Source: IASB announcement dated 12 February 2021)

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

MCA notified the Companies (Amendment) Act, 2020

17 February 2021

The Ministry of Corporate Affairs (MCA) issued certain amendments to the Companies Act, 2013 (2013 Act) through the Companies (Amendment) Act, 2020 (2020 Amendment Act) which received the assent of the President of India on 30 September 2020. The 2020 Amendment Act incorporates amendments suggested by the Company Law Committee (CLC) in its report.

MCA through its notification dated 21 December 2020 notified certain sections of the 2020 Amendment Act. The notified amendments were mainly relating to decriminalisation of certain compoundable offences and rationalisation of penalties.

Recently on 22 January 2021 and 11 February 2021, MCA notified certain other sections of the 2020 Amendment Act.

This issue of the First Notes provides an overview of the recently notified sections of the 2020 Amendment Act.

Voices on Reporting (VOR) – Quarterly updates publication

On 18 January 2021, KPMG in India released the VOR - Quarterly updates publication. The publication provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Institute of Chartered Accountants of India (ICAI) and the Reserve Bank of India (RBI) that are expected to be relevant for stakeholders for the quarter ended 31 December 2020.

To access the publication, please click here.

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