



Accounting and Auditing Update

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Foreword

The Company Law Committee (the committee) was formed on 18 September 2019 to recommend changes to foster improved corporate governance and promote ease of doing business and ease of living to law abiding corporates. The committee submitted its third report to the central government on 21 March 2022 and proposed various amendments to the existing provisions of the Companies Act, 2013. The objective of the proposals is to strengthen existing company law framework and an effort to address practical challenges being faced by the companies. The proposals relate to many areas e.g. amendments relating to directors' appointment, tenure and disqualification, audit framework, aligning of provisions of the Companies Act, 2013 with the SEBI Listing Regulations, expedite corporate processes, improve compliance requirements, and remove ambiguities from existing provisions

of the Companies Act, 2013. In this edition of Accounting and Auditing Update (AAU), our article summarises the key proposals of the committee.

Our second article focusses on calculation of deferred taxes in relation to compound financial instruments. Ind AS 32, *Financial Instruments: Presentation* and Ind AS 109, *Financial Instruments* provide guidance on determination of components of financial liability and equity within a compound financial instrument. Further, Ind AS 12, *Income Taxes* prescribes accounting for income taxes. It follows a balance sheet approach to determine the amount of deferred taxes. One of the important steps in determination of deferred tax liability or deferred tax asset is the identification of a tax base and accounting base of the assets and liabilities on a company's balance sheet. The tax base of an asset or a liability is the

amount attributed to that asset or liability for tax purposes. Determination of tax base of the balance sheet items may not be straight forward, and it could involve complex computation in some situations e.g. where tax consequences depend upon how carrying amounts are recovered or settled, items with multiple tax consequences or compound financial instruments. In this article, we have highlighted this complexity with the help of two examples i.e. compulsorily convertible debentures and optionally convertible debentures.

As is the case each month, we also cover 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

Company Law Committee report - Key proposals

This article aims to:

Discuss key proposals in the committee's report



On 18 September 2019, the Ministry of Corporate Affairs (MCA) formed a Company Law Committee (the committee) to recommend changes to foster improved corporate governance and promote ease of doing business and ease of living to law abiding corporates.

The committee submitted its third report to the central government on 21 March 2022 and suggested changes to facilitate and promote greater ease of doing business in India. The report proposed various amendments to the provisions of the Companies Act, 2013 (2013 Act), the Limited Liability Partnership Act, 2008 (LLP Act) and the Rules made thereunder.

The recommendations relate to following key captions:



Overview of the recommendations

The following section discusses the key recommendations:

1. Revising provision relating to directors' appointment, retirement, etc.

A. Proposals relating to Independent

Directors (IDs): Section 149 of the 2013 Act provides that an ID may hold office for a term not exceeding five consecutive years but would be eligible for re-appointment if the company passes a special resolution and such an appointment is disclosed in the Board's reports. Further, an ID should not be permitted to hold an office beyond two consecutive terms and will be eligible for re-appointment only after the expiry of the requisite cooling-off period of three years. The committee has issued following clarifications relating to an ID's tenure:

- The total tenure of an ID should not exceed the prescribed period of five years for a single term or 10 years for two consecutive terms, as the case may be, under any circumstances.
- The tenure of ID should be inclusive of any tenure held as an additional director. Therefore, the period during which the ID functioned as an additional director before regularisation should be included while computing the total tenure of ID.

- The tenure should be capped at a period of five years for a single term and period of ten years where the re-appointment of an ID is made after expiry of first term, irrespective of any resignation made before the expiry of the term of appointment. No individual can be appointed for more than two successive terms by any company under any circumstances.

- Section 149 of the 2013 Act provides that a person who is an employee, a proprietor or a partner of a legal or consulting firm, transacting with the company, could be appointed as an ID in such a company provided that such a transaction amounted to less than 10 per cent of the gross turnover of that firm. However, Section 149(11) further provides that during the three-year cooling-off period, the ID of a company should not be appointed in or associated with the company in any other capacity directly or indirectly.

The committee has recommended that Section 149(11) should be amended to allow the relevant legal or consulting firm to render the services as per the threshold limit provided under Section 149 of the 2013 Act. Further, the threshold limit of 10 per cent under Section 149 should be reduced to five per cent.

B. Revising provisions on disqualification and vacation of director's office

Section 164 and Section 167 of the 2013 Act lay down provisions relating to the disqualification and vacation of director's office, respectively. Section 164 identifies certain specific circumstances wherein a person shall not be eligible for appointment as a director of a company. The committee made following recommendations in relation to disqualification and vacation of a director's office:

- **Vacation of director's office as a result of disqualification under Section 164(2):** Section 167(1)(a) explicitly provides that vacancy shall arise if the director incurs any of the disqualifications specified in Section 164. In this regard, committee recommended that the vacation of office of directorship under Section 167(1)(a) should be limited only to disqualifications due to personal incapacity as per Section 164(1) and not on account of defaults made by a company under Section 164(2). However, the proposed amendment would be applicable prospectively and any vacation of office of directorship that has already arisen under Section 164(2)¹ would not be affected.
- **Relaxation relating to disqualification of new directors:** Proviso to Section 164(2) provides that after a company makes a default, any newly appointed director is exempt from disqualification for a period of six months from the date of appointment,

to make good of the company's default. The committee proposes to extend the mentioned relaxation to two years instead of six months under Section 164(2).

- **Safeguarding rights of nominee directors:** Based on representations received from the Securities and Exchange Board of India (SEBI), the committee recommended that a new proviso be inserted in Section 164(2) of the 2013 Act to provide that the disqualification should not apply to the nominee directors appointed pursuant to nomination by the debenture trustees registered with SEBI.

C. Cooling off period for directors and auditors

- **Cooling off period before auditors become directors:** Section 149(6)(e)(ii) prohibits a person from being appointed as an ID of a company if he/she or any of his/her relative(s) has been an employee, proprietor or partner of a firm of auditors or company secretaries or cost auditors in such a company or group of companies, in any of the three financial years preceding the year in which employment is to take place.

However, the 2013 Act does not contain any provision prohibiting an auditor from becoming a Non-Executive Director (NED), Managing Director (MD) or Whole-Time Director (WTD) in the same company or group of companies. Therefore, the committee recommends that there should

be a mandatory one-year cooling-off period, from the date of cessation of office, after which an auditor of a company may be permitted to hold a position of a director in the same company or group of companies. In case an audit firm structured as a partnership/LLP, such a restriction should only operate concerning the partner that audited the company.

- **Cooling off period before an ID becomes managerial personnel:** Section 149(6)(e)(i) provides that a person shall not be appointed as an ID of a company if such a person currently holds or used to hold the position as a Key Managerial Personnel (KMP) or an employee in the same company or group of companies during any of the three financial years immediately preceding the financial year in which employment is to take place.

Currently, the 2013 Act does not restrict appointment of an ID as a managerial person, i.e., an MD, a WTD or a manager, in the same company or group of companies after ceasing to be an ID of such company. Therefore, the committee recommends a mandatory one-year cooling-off period, from the date of cessation of office, after which an ID may be permitted to hold the position of an MD, a WTD, or a manager in the same company or group of companies.

1. Section 164(2) deals with the disqualification of directors on account of lapses made by a company in filing its annual returns and financial statements or default in repayment of deposits or debentures.

D. Clarifying resignation procedure of certain KMPs

Section 168 of the 2013 Act provides provisions relating to the resignation of directors. Section 168(1) allows a director to resign from their office by providing a notice to a company in writing. The 2013 Act empowers directors to directly file their resignation with the Registrar of Companies (ROC) since there is no requirement that a company should formally accept a director's resignation for it to become effective.

The committee recommended that the initial obligation to notify the ROC should be on the company about resignations tendered by KMPs, whose appointment intimation was filed with the ROC. In cases where the company fails to intimate the ROC within 30 days, the KMPs should be allowed to file their resignations directly with the ROC. The date on which resignation KMPs should come into effect should be harmonised with provision relating to resignation by directors.



2. Committees of board

Setting up Risk Management Committee

(RMC): Section 134(3)(n) of the 2013 Act requires a board's report to contain a statement indicating the development and implementation of a risk management policy for the company, including the identification of risks that may pose a threat to the existence of a company. Additionally, Section 177(4)(vii) places an obligation on an audit committee to evaluate a company's internal financial controls and risk management systems. Further, Part II of Schedule IV requires IDs to bring an independent judgement to the board deliberations relating to risk management systems.

However, currently the 2013 Act does not contain any provisions relating to the formation of a RMC. Therefore, the committee has recommended to include new provisions in the 2013 Act, for constitution of a RMC for such class of companies, as central government may prescribe.

3. Reviewing and strengthening the audit framework

A. Amendments relating to NFRA

Section 132 of the 2013 Act, empowers the central government to constitute the National Financial Reporting Authority (NFRA) for matters relating to accounting and auditing standards for companies. The committee deliberated upon the autonomy of NFRA and its powers under

the 2013 Act and recommended the following:

- **Empower NFRA to take appropriate action:** The NFRA should be empowered to take an appropriate action against individuals or a firm in case of non-compliance with the provisions under the 2013 Act in addition to its existing powers to take action against 'professional or other misconduct'. Further, it has been proposed to make specific provisions to enable NFRA to act in case its orders are neither complied with nor any appeal is made against such an order to National Company Law Appellate Tribunal (NCLAT).
- **Constitution of a NFRA fund:** The committee proposes amendments be made to the 2013 Act for the constitution of a NFRA Fund. The fund is expected to provide financial autonomy to NFRA and the amount in fund would be used to meet the expenses. Currently, NFRA receives its funding entirely from the central government.
- **Enabling NFRA to make regulations and granting supervisory powers to the NFRA chairperson:** The NFRA should be enabled to make regulations for specific matters such as
 - Form and manner of filing information with NFRA,

- Place, timing, and procedure to be followed for NFRA meetings.

Additionally, chairperson of NFRA should be provided with the powers of general superintendence and direction within NFRA.



B. Reviewing and strengthening the audit framework and introducing mechanisms to ensure the independence of auditors

Sections 139 to 148 of the 2013 Act and the Companies (Audit and Auditors) Rules, 2014, govern the manner in which companies are audited under the 2013 Act. This includes provisions for auditors' appointment, removal and resignation, and eligibility of the auditors. The committee deliberated the mechanisms to strengthen audits under the 2013 Act and recommended following:

- **Non-audit services:** Section 144 of the 2013 Act provides an exhaustive list of services that an auditor is prohibited from rendering. The committee has recommended to enable the central government to prescribe a differential list of prohibitions on availing non-audit services or total prohibition on availing non-audit services for such class or classes of companies where public interest is inherent.
- **Punishment under Section 143:** It is recommended that Section 147 of the 2013 Act be amended to cover penal consequences for contravention of Section 143 regarding sub-sections other than sub-section (12).
- **Obligations of resigning auditor:** Section 140(2) of the 2013 Act states that the auditor who has resigned from a company is

required to file a statement in a prescribed form within a period of 30 days to the company and the ROC from the date of resignation. The statement must indicate the 'reasons for resignation' and any 'other facts relevant with regard to resignation'.

The committee recommended that an explicit obligation of a resigning auditor should also be introduced to make detailed disclosures before resignation and specific disclosure of reasons of such resignation such as non-cooperation from the company, fraud, severe non-compliance, or diversion of funds. However, if an auditor fails to make such disclosures in the resignation statement, then suitable action would be taken against such an auditor. Additionally, the auditor should be mandated to provide assurance about the company's accounts and independence of his/her decision to resign.

- **Mandatory joint audit for certain companies:** The 2013 Act should enable the central government to mandate joint audits for such class or classes of companies as it may deem necessary.
- **Auditor of holding company to comment on the true and fair view of each subsidiary company:** Section 143(1) provides an auditor of a holding company with a right of access to the records of all its subsidiaries and associate companies in so far as it relates to the consolidation

of its financial statements with that of its subsidiaries and associate companies. However, there is no statutory obligation or liability on the auditor of the holding company to verify and confirm on the fairness and truthfulness of accounts of subsidiary companies.

Therefore, the committee recommends to make suitable amendments in the provisions of the 2013 Act to ensure that an auditor of a holding company has been given assurance about the fairness of audit of each subsidiary company by respective auditors. In addition, the auditor of the holding company may be empowered to independently verify the accounts or part of accounts of any subsidiary company.

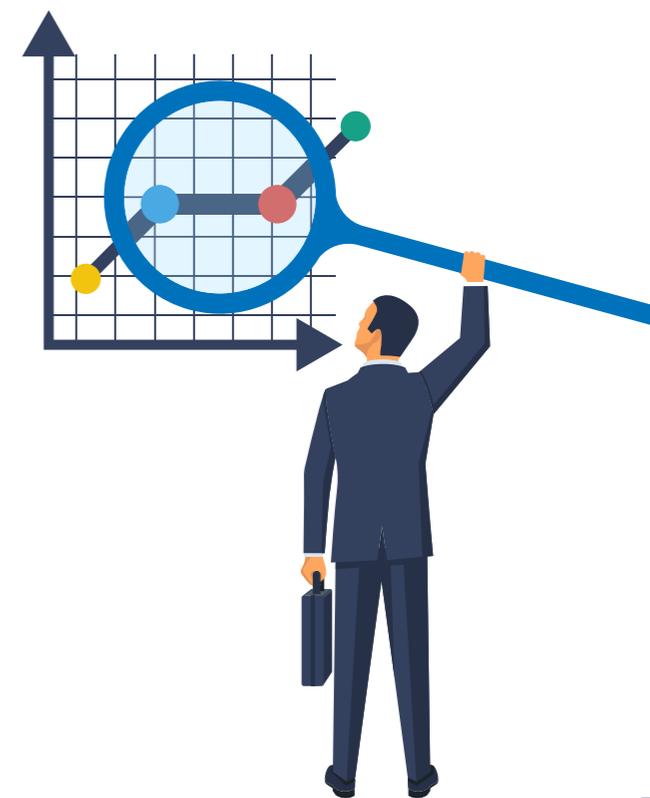
- **Forensic audit:** The 2013 Act should enable the central government to prescribe detailed rules relating to forensic audit through subordinate legislation.

C. Standardising qualification by auditors

Section 143(3)(f) and section 143(3)(h) of the 2013 Act require an auditor to provide observations and comments on financial statements of a company and to provide qualifications, reservations or any adverse remarks in relation to the maintenance of accounts of the company. However, currently auditors are not required to provide information on the impact of a qualification or an adverse

remark on the economic health or functioning of the company.

Therefore, the committee has recommended an enabling provision under the 2013 Act to allow the central government to introduce a format for auditors to provide the impact of every qualification or adverse remark on the company's financial statements for circulation to the Board of a company before circulating to the shareholders of the company.



4. Changes in other matters

- **Allowing companies to realign their financial year in line with the 2013 Act requirements where they cease to be associated with a foreign entity**

Section 2(41) of the 2013 Act provides that a company which is a holding company, or a subsidiary or an associate of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, may be allowed to follow such different financial year upon making an application to the central government.

Currently, the 2013 Act does not contain any provision that allows such a company or a body corporate to revert to the financial year required to be followed under the provisions of the 2013 Act. Therefore, the committee recommended that such companies, which cease to be associated with a foreign entity, should be allowed to file a fresh application with the central government in a prescribed form to allow them to revert to the financial year followed under the 2013 Act.

- **Allowing companies to hold general meetings in virtual, physical or hybrid modes**

The committee recommended that the 2013 Act should be amended to enable companies to hold general meetings, i.e.,

Annual General Meetings (AGMs) and Extraordinary General Meetings (EGMs) physically, virtually, and in hybrid mode. Further, it is proposed where the EGM is to be conducted entirely in electronic mode, then the notice period for those meetings should be reduced to such a period as may be prescribed by the central government.

- **Facilitating communication in an electronic form**

Section 20 of the 2013 Act prescribes the mode by which documents can be served on a company, its officers or the ROC. The committee recommends amendment to Section 20 to introduce an overriding provision enabling the central government to prescribe rules for class or classes of companies mandatorily required to serve certain documents in an electronic mode only.

However, if a member requests a company to provide physical documents also, then the company should deliver physical documents as an investor friendly measure to such members. Also, companies should be allowed to stipulate a fee for requesting such documents at any general meeting.

- **Maintaining statutory registers through an electronic form**

The 2013 Act and rules thereunder require companies to maintain records in the form

of registers. In this regard, the committee recommends that Section 120 should be amended to mandatorily require certain class or classes of companies to maintain their registers on an electronic platform in the manner laid down by the central government. For this purpose, the central government may set up an electronic facility. However, the central government may direct the company to share the information held on such statutory registers pursuant to certain enforcement-related functions.

- **Clarifying provision on buy back of securities – inclusion of free reserves**

The committee has proposed that free reserves are to be included in the calculation of buy-back of equity shares even though the term has not been specifically stated in the provisions. Further, it is recommended that only shares on which the shareholders have exercised the stock option should be allowed to buy-back.

- **Issuance and holding of fractional shares, Restricted Stock Units (RSUs) and Stock Appreciation Rights (SARs)**

A fractional share refers to a portion of a share less than one share unit. Fractional shares may arise as a consequence of corporate actions like mergers, issue of bonuses, or rights issues. Currently, the 2013 Act prohibits the holding of fractional shares.

The committee recommended to enable issuance, holding, transfer of fractional shares, in a dematerialised form, for prescribed class or classes of companies in consultation with SEBI (for listed companies), as may be required. Further, RSUs and SARs should be recognised under the 2013 Act, and their issuance should be sufficiently encumbered.

- **Easing the requirement of raising capital in distressed companies**

Currently, Section 53 of the 2013 Act prohibits a company to issue shares at a discount. The committee recommended distressed companies should be allowed to issue shares at a discount, notwithstanding the prohibition under Section 53. For this purpose, distressed companies may be categorised as such a class or classes of companies that have cash losses (other than those arising out of depreciation or revaluation) for previous three consecutive years or more and fulfil such terms and conditions and issue shares at a discount in such a manner as prescribed by the central government.



- **Recognising Special Purpose Acquisition Companies (SPAC) and allowing such companies, which are incorporated in India, to list on permitted exchanges**

A SPAC is a type of a company that does not have an operating business and has been formed with a specific objective of acquiring a target company. This allows a shell company to issue an Initial Public Offering (IPO) without any commercial activity. After listing, the SPAC merges with or acquires a company, i.e., the target, thereby allowing the target company to benefit from such listing without going through the formalities of an IPO.

The committee has recommended introducing an enabling provision to recognise SPACs under the 2013 Act and allow listing of a SPAC incorporated in India on domestic and global exchanges. The committee further recommended to relax the requirement to carry out businesses before being struck off and provide exit options to the dissenting shareholders of a SPAC if they disagree with the choice of the target company identified to be laid down in the 2013 Act.

- **Amendments relating to Investor Education and Protection Fund (IEPF)**

- Section 124(5) provides that any money transferred to the Unpaid Dividend Account of a company that remains unpaid or

unclaimed for seven years from the date of such transfer shall be transferred to the IEPF along with interest accrued, if any. Currently, the provisions do not cover the unclaimed dividend, not yet transferred to the unpaid dividend account, in respect of shares which have already been transferred to IEPF. Therefore, the committee recommends that any dividend which has not been paid or claimed in respect of shares transferred by the company to the IEPF fund shall also be transferred to the IEPF fund at the time of transfer of shares irrespective of the year they pertain to.

- The committee proposes to include 'redemption amount towards unpaid or unclaimed preference shares' in the list of purposes for which the fund must be utilised.
- The committee has proposed to include the money that remains unclaimed for seven years or more in respect of shares/securities that have either been bought back or cancelled should be allowed to be transferred to IEPF account.

- **Drafting and clarificatory changes to remove the inconsistency in various provisions within the 2013 Act**

- **Amendment in Section 136(1) relating to shorter notice for AGM and other general meetings:** Section 136 of the 2013 Act provides a company's members with

the right to get copies of audited financial statements for all general meetings. The proviso to Section 136(1) provides that copies of audited financial statements may be sent to members in a shorter time than the prescribed 21 days before the date of the meeting, . However, it does not distinguish between AGMs and other general meetings. The committee recommends providing separate schemes when sending copies of audited financial statements for AGMs and any other general meetings.

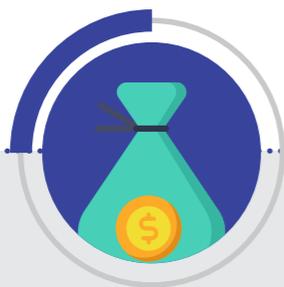
- **Penalty in relation to Section 188 (i.e. related party transactions) to be included as a ground for disqualification:** Section 164(1)(g) disqualifies a director who has been convicted of an offence dealing with related party transactions under Section 188. The committee recommended that penalty under Section 188 should be included as a ground for disqualification under Section 164(1)(g).
- **Allowing Wholly Owned Subsidiary (WOS) to be the only member of the subsidiary:** Section 187 of the 2013 Act provides that a company's investments shall be held in its own name. However, the proviso to Section 187(1) provides an exception in the case of shares held by nominees of holding company in the subsidiary company. The committee proposed that such an exception to be provided in the case of joint ventures also.

Additionally, holding company should be allowed to be the only member in its WOS. Similar relaxations should also be permitted in the case of a WOS in which the entire shareholding is held by the holding company along with one or more of its WOSs.



5. Reviewing provisions relating to mergers and amalgamations

Section 232(3)(b) provides that a transferee company is not permitted to hold any shares in its own name or in the name of trust whether on its behalf or on behalf of any of its subsidiary or associate company and any such shares would be cancelled or extinguished. Following are the recommendations relating to mergers and amalgamations:



- **Treasury shares:** The committee recommends that company holding treasury stock would be required to report to the central government through a declaration in a prescribed form. Additionally, such a company should dispose of treasury stock within a period of three years. In case, the company fails to dispose of the treasury shares, then such shares would stand cancelled and share capital of the company would be reduced in prescribed manner and penal action can be initiated against such a company.



- **Fast-track merger:** The committee recommended to permit fast-track mergers between a holding company and its subsidiary company or companies other than wholly owned subsidiaries if such companies are not listed and meet prescribed conditions. The committee recommended twin test for fast-track mergers. A twin test requiring approval by
 - i. Majority of persons present and voting at the meeting accounting for 75 per cent, in value, of the shareholding of persons present and voting; and
 - ii. Representing more than 50 per cent, in value, of the total number of shares of the company, should be mandated for approval of fast-track mergers under Section 233 of the 2013 Act.



- **Constitution of benches of the NCLT:** The committee recommends including a provision under Section 419² to enable a competent authority to constitute the benches of the National Company Law Tribunal (NCLT) that may deal with matters of economic importance such as mergers, amalgamations, corporate restructuring and specialised IBC cases involving public interest.

Next steps

The recent committee's report has proposed various important amendments to the existing provisions of the 2013 Act. The objective of the proposals is to strengthen existing company law framework and an effort to address practical challenges being faced by the companies. The corporates in India should look out for further developments in this area.



2. Section 419 requires constitution of the Benches of the NCLT and vests the power with the central government to constitute such number of Benches of the NCLT as may be specified by it by way of notification.

Chapter 2

Deferred taxes - compound financial instruments

This article aims to:

Explain with examples calculation of
deferred taxes for compound financial
instruments



Ind AS 12, *Income Taxes* is the standard that prescribes accounting for income taxes. It follows a balance sheet approach to determine the amount of deferred taxes.

Deferred tax is the amount of income tax payable (recoverable) in future periods as a result of past transactions or events.

The objective of Ind AS 12 notes that it is inherent in the recognition of an asset or a liability that the entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, then the entity recognises a deferred tax liability (deferred tax asset), with certain limited exceptions.

To measure deferred tax liability or deferred tax asset, an entity needs to identify a tax base and accounting base of its assets and liabilities on its balance sheet. The tax base of an asset or a liability is the amount attributed to that asset or liability for tax purposes.

Determination of tax base of the balance sheet items may not be straight forward and it could involve complex computation in some situations e.g. where tax consequences depends upon how carrying amounts are recovered or settled, items with multiple tax consequences, or compound financial instruments.

Compound financial instrument

An instrument may contain both a financial liability (e.g. an obligation to make interest and/or scheduled principal payments) and an equity component (e.g. a conversion feature in a convertible bond). Such an instrument is a compound instrument.

An entity that issues a compound instrument applies split accounting and classifies the liability and equity components of the instrument separately as a financial liability and equity.

To allocate the initial carrying amount of a compound instrument to the underlying financial liability and equity components, an entity would need to first determine the fair value of the liability component. This includes any embedded derivatives - whether or not they have to be accounted for separately. The fair value of the liability component is determined with reference to the fair value of a similar stand-alone debt instrument (including any embedded non-equity derivatives) that does not have an associated equity component. The amount allocated to the equity component is the residual amount after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.

Compound financial instruments include many types of financial instruments and most common ones are 'compulsorily convertible debentures' and 'optionally convertible debentures'.

Temporary difference

A temporary difference is the difference between the tax base of an asset or liability and its carrying amount in the financial statements. Such a temporary difference will result in taxable or deductible amounts in future periods when the carrying amount is recovered or settled.

When analysing compound financial instruments, if there is a temporary difference between the carrying amount of a financial liability component and its tax base on initial recognition, then an entity would need to recognise the corresponding deferred tax.

Ind AS 109, *Financial Instruments* requires on initial recognition a financial asset or financial liability is measured at fair value plus or minus directly attributable transaction costs, unless the instrument is classified as at fair value through profit or loss or is a trade receivable that does not have a significant financing component.

Normally, the fair value on initial recognition is the transaction price. However, on initial recognition of a compound financial instrument, Ind AS 32, *Financial Instruments: Presentation* requires an issuer to split compound financial instruments

(as mentioned above) into a financial liability and an equity component. Because of these requirements, the carrying amount of the financial liability component may not equal its par or nominal value.

Further, as per paragraph 23 of the Ind AS 12, in some jurisdictions, the tax base of the liability component on initial recognition is equal to the initial carrying amount of the sum of the liability and equity components. The resulting taxable temporary difference arises from the initial recognition of the equity component separately from the liability component. Therefore, the initial recognition exemption¹ does not apply. Consequently, an entity recognises the resulting deferred tax liability and the deferred tax is charged directly to the carrying amount of the equity component. Subsequent changes in the deferred tax liability are recognised in profit or loss as deferred tax expense (income).

1. As per Ind AS 12 deferred tax is not recognised for certain temporary differences that arise on the initial recognition of assets and liabilities.

Example 1 – Compulsorily convertible debentures

Company A issued compulsorily convertible debentures of INR1,000 to a third party investor and would be paying non-discretionary interest at 10 per cent in cash for 5 years. The debenture is mandatorily convertible into fixed number of equity shares at the end of 5 years. This instrument is a compound financial instrument and would need to be separated at inception between financial liability (interest strip) and an equity component (as a residual).

The following is the break-up of the compulsorily convertible debentures (before calculation of deferred tax:

Components	Amount (INR)
Liability (present value of INR500)	379
Equity	621
Interest cash outflows over the life of compulsorily convertible debenture, which will be tax-deductible when paid	500

(Source: KPMG in India's analysis, 2022)

As the instrument is compulsorily convertible into equity shares, nothing will be repaid on maturity. The cash outflow will be relating to interest component to the holders of this instrument. Therefore, the cash flow accounts both for the repayment of principal and for the interest on the liability recognised by company A. All of these cash flows are deductible for tax purposes in A's tax jurisdiction, where tax rate is 30 per cent.

The tax base of the liability component of the compulsorily convertible debenture would be zero. This is the difference between the carrying amount of the liability component (i.e. INR379), and all repayments deductible for tax purposes (i.e. INR500, which actually exceeds the carrying amount of INR379). INRIN379). This will result in deductible temporary difference of INR379 from initial recognition of the mandatorily convertible debenture. This difference will result in a deferred tax asset of INR 114 (379*30 per cent) which would be recognised subject to recoverability in equity².

Balance sheet item	Accounting base	Tax base	Deductible temporary difference	Deferred tax asset @30 per cent
Liability	379	0	379	114

(Source: KPMG in India's analysis, 2022)

2. In this case specific requirements on compound financial instruments override the initial recognition exemption.

Company A would recognise following accounting entry at the time of initial recognition of compulsorily convertible debenture:

	Debit (INR)	Credit (INR)
Bank	1,000	
Deferred tax asset	114	
Liability		379
Equity (balancing figure)		735

(Source: KPMG in India's analysis, 2022)



Example 2 – Optionally convertible debentures

Company B issued optionally convertible debentures for proceeds of INR1,000 to a third party investor and would be paying non-discretionary interest at 10 per cent in cash. The term of the debentures is 5 years. They are convertible at the option of the holder into fixed number of equity shares at the end of 5 years. If not converted, they would be redeemed for INR 1,000 at the end of 5 years. This instrument is a compound financial instrument and would need to be separated at inception between financial liability and an equity component (as a residual).

The following is the break-up of the optionally convertible debentures (before calculation of deferred tax):

Components	Amount (INR)
Liability (present value of INR1,500)	832
Equity	168

(Source: KPMG in India’s analysis, 2022)

The tax base of the liability component of the optionally convertible debenture would be INR1,000. This will result in taxable temporary difference of INR168 from initial recognition of the optionally convertible debenture. This difference will result in a deferred tax liability of INR 50 (168*30 per cent) which would be recognised in equity.

Balance sheet item	Accounting base	Tax base	Taxable temporary difference	Deferred tax liability @30 per cent
Liability	832	1,000	168	50

(Source: KPMG in India’s analysis, 2022)

Company A would recognise following accounting entry at the time of initial recognition of compulsorily convertible debenture:

	Debit	Credit
Bank	1,000	
Deferred tax liability		50
Liability		832
Equity (balancing figure)		118

(Source: KPMG in India’s analysis, 2022)

Key consideration

Accounting for deferred taxes for compound financial instruments is a complex topic as it requires separation of components into financial liability and equity. Further, application of Ind AS 12 requires careful analysis to determine the tax base and accounting base of the liability component. This article shares only two examples to showcase the complexity in this area.

The types and features of compound financial instruments could vary and would require a detailed analysis for splitting the equity and financial liability components and corresponding tax base e.g. additional complexities may arise in relation to the accounting for deferred taxes on a convertible debenture issued by a subsidiary to an external party to the group and its accounting impact on the consolidated financial statements.



Chapter 3

Regulatory updates



MCA and SEBI relaxation for conduct of AGMs and EGMs

Recently, the Ministry of Corporate Affairs (MCA) provided relaxations in respect of the following:

- **Conduct of AGMs** – Companies whose Annual General Meetings (AGMs) are due in the year 2022 have been allowed to conduct their AGMs through Video Conferencing (VC) and Other Audio-Visual Means (OAVM) on or before 31 December 2022 (earlier was allowed up to 30 June 2022). Additionally, companies are required to comply with the requirements mentioned in the circular dated 5 May 2020 which provides relaxation such as sending physical copies of financial statements to the members only through email, etc.

It has been further clarified that the circular should not be construed as conferring any further extension of time for holding AGMs by the companies under the Companies Act, 2013 (the 2013 Act). Companies which have not adhered to the relevant timelines would remain subject to legal action under the 2013 Act.

Further considering the above relaxations provided by MCA, the Securities and Exchange Board of India (SEBI) has also provided relaxation upto 31 December 2022, from the requirement of sending hard copy of annual report containing salient features of all the documents prescribed under Section 136 of the 2013 Act to the shareholders. Further, the

notice of AGM published by an advertisement in terms of Regulation 47 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations), should contain a link to the annual report, so as to enable shareholders to have access to the full annual report.

It is however emphasised that in terms of Regulation 36 (1)(c), listed entities are required to send hard copy of full annual report to those shareholders who request for the same.

(Source: MCA general circular no. 02/2022 dated 5 May 2022 and SEBI SEBI/HO/CFD/CMD 2/CIR/P/2022/62 dated 13 May 2022)

- **Conduct of EGMs** – Companies can conduct their Extraordinary General Meetings (EGMs) through VC/OAVM or transact items through postal ballot upto 31 December 2022 (earlier was allowed upto 30 June 2022). This will be in accordance with the framework provided in the circulars dated 8 April 2020, 13 April 2020, 15 June 2020, 28 September 2020, 31 December 2020, 23 June 2021 and 8 December 2021.

(Source: MCA general circular no. 03/2022 dated 5 May 2022)

MCA has issued amendments to certain Rules under the 2013 Act

The Companies (Registration of Charges) Amendment Rules, 2022

Section 77 of the 2013 Act and Rule 3 of the Companies (Registration of Charges) Rules,

2014 require entities to register the creation or modification of charges with payment of specified fees with the Registrar of Companies (RoC) within 30 days from the date of creation or modification of charge.

On 27 April 2022, MCA issued amendment to the Companies (Registration of Charges) Rules, 2014, inserting a new sub-rule Rule 3(5), which provides that Rule 3 would not apply to any charge required to be created or modified by a banking company under Section 77 in favour of the Reserve Bank of India (RBI) when any loan or advance has been made to it under Section 17 of the RBI Act, 1934.

(Source: MCA notification Companies (Registration of Charges) Amendment Rules, 2022 dated 27 April 2022)

The Companies (Prospectus and Allotment of Securities) Amendment Rules, 2022

Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 provides the procedure and restrictions applicable to a company that makes an offer or an invitation to subscribe to securities through issue of a private placement offer letter. The Rule additionally provides that an entity would not make an offer to subscribe to securities through private placement unless the proposal has been previously approved by shareholders through a special resolution.

On 5 May 2022, MCA issued the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2022 inserting a new proviso under Rule 14, which provides that no offer or

invitation of any securities should be made to a body corporate incorporated in, or a national of, a country which shares a land border with India, unless such body corporate or the national have obtained Government approval under Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and have attached the same with the private placement offer cum application letter.

Additionally on 20 May 2022, MCA issued a revised Form INC-9. The INC-9 form provides a format in which a declaration is to be filed by subscribers and directors to send a notice about the company to establish that they have not been convicted of any offence and not been found guilty of any fraud or misfeasance.

The key change in the form INC-9 is an additional declaration by subscribers and first directors that they have obtained government's approval under the Foreign Exchange Management (Non-debt instruments) Rules, 2019 prior to subscription of shares.

As per Rule 15 of the Companies (Incorporation) Rules, 2014, a declaration should be submitted by each of the subscribers to the memorandum and each of the first directors named in the articles of association in Form No. INC-9.

(Source: MCA notification G.S.R 338 (E), Companies (Prospectus and Allotment of Securities) Amendment Rules, 2022 dated 5 May 2022 and MCA Companies (Incorporation) Second Amendment Rules, 2022 dated 20 May 2022)

Constitution of advisory committee on Environmental, Social and Governance (ESG) matters

The SEBI has constituted a committee for advising on ESG related matters in the securities market which include:

- Preparers of sustainability reports
- Users of sustainability reports (mutual funds, asset managers and insurance companies)
- ESG rating providers, proxy advisors and credit rating agencies
- Others – technical experts, assurance providers.

The terms of reference of the committee include the following:

- Enhancements in Business Responsibility and Sustainability Report (BRSR)
- ESG ratings
- ESG investing.

(Source: SEBI circular PR No. 15/2022)

Revision in fee structure of privately placed Infrastructure Investment Trust (InvIT)

Schedule II of the SEBI (Infrastructure Investment Trust (InvIT)) Regulations, 2014 deals with application fees to be paid at the time of filing of offer document/placement memorandum with SEBI.

On 4 May 2022, SEBI issued the SEBI (InvIT) (Amendment) Regulations, 2022 which amended the filing fees for privately placed InvIT in order to bring it at par with the filing fees paid by publicly offered InvIT.

As per the amendment privately placed InvIT shall pay non-refundable filing fees of:

- 0.1 per cent in case of initial offer and
- 0.05 per cent in case of rights issue.

The percentages are determined based on the total issue size including green shoe option, if any, at the time of filing of draft placement memorandum or letter of offer, as applicable.

(Source: SEBI (Infrastructure Investment Trusts) (Amendment) Regulations, 2022. dated 4 May 2022)

SEBI has reduced timelines for listing of units of REITs and InvITs

As a part of the continuing endeavour to streamline the process of public issue of units of Real Estate Investment Trusts (REITs) and units of InvIT, SEBI through its circulars dated 28 April 2022, reduced the time taken for allotment and listing of units of REITs and InvITs after the closure of issue to six working days as against the present requirement of closure within 12 working days. The provisions of the circular would be applicable to the public issue of units of REITs and InvITs which opens on or after 1 June 2022.

SEBI has reduced the timeline with an aim to protect the interests of investors and promote the development of the securities markets.

(Source: SEBI circular No SEBI/HO/DDHS_Div3/P/ CIR/2022/54 and 55 dated 28 April 2022)

SEBI has issued a consultation paper for pre-filing of offer document in case of IPO

SEBI on 11 May 2022 has issued a Consultation Paper (CP) on Pre-filing of Offer Document in case of Initial Public Offerings (IPO).

As per requirements under the SEBI regulations, an entity desirous of coming out with an IPO is required to undergo certain steps with SEBI such as filing of the Draft Offer Document (DRHP) with SEBI containing therein all relevant disclosures as mandated in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations). The CP highlights that generally, the above process requires at least 30 to 70 days after filing of DRHP (based on various factors) before an issuer company can access capital markets. Further, an issuer company may choose to not pursue its IPO after undergoing the above process.

As initiating an IPO is a long process and to expedite it, the Primary Market Advisory Committee (PMAC) of SEBI deliberated the matter and favorably considered to permit 'pre-filed' document with SEBI to ease the requirements.

Therefore, SEBI through its CP has proposed to add a 'pre-filing' of offer document requirement with SEBI and stock exchanges without making it available for public for an initial scrutiny period only. The document should contain all disclosures as required currently under the SEBI ICDR Regulations.

Issuer would be required to make a public announcement stating that it has done pre-filing of offer document with SEBI and stock exchanges. The issuer company shall state that pre-filing of offer document need not necessarily mean that the issuer shall undertake IPO.

The issuer and lead managers would also be required to submit an undertaking that it should not undertake marketing/advertising campaign which refers to its intended IPO or showcases any key performance indicators through any means to public including social media.

The period to provide comments on this consultation paper is upto 6 June 2022.

(Source: SEBI Consultation Paper on Pre-filing of Offer Document in case of Initial Public Offerings dated 11 May 2022)



Guidelines for compensation of Key Managerial Personnel (KMP) and senior management in NBFCs

Background

On 22 October 2021, RBI issued a revised regulatory framework for Non-Banking Financial Companies (NBFCs) – Scale Based Regulation (SBR). As per the said regulatory framework, NBFCs were required to put in place a Board approved compensation policy that included the following:

- Constitution of a Remuneration Committee
- Principles for fixed/variable pay structures, and
- Malus/clawback provisions.

In addition, NBFCs should outline the role of various committees, including Nomination and Remuneration Committee (NRC).

New development

- Subsequently, on 29 April 2022, RBI has issued guidelines on compensation of KMP and senior management in NBFCs which intend to provide broad guidance to NBFCs and their NRCs in formulating their compensation policy. While formulating the compensation policy, all the statutory mandates and the rules and directions issued under the guidelines need to be complied with.
- These guidelines will be applicable for fixing the compensation policy of KMPs and members of senior management of all NBFCs under SBR

framework, except those categorised under 'Base Layer' and government owned NBFCs. The guidelines come into effect from 1 April 2023.

(Source: RBI circular no RBI/2022-23/36 dated 29 April 2022)

ICAI issued Implementation Guide on Reporting under Rule 11(e) and Rule 11(f) of the Companies (Audit and Auditors) Rules, 2014

The MCA through its notification dated 24 March 2021 amended the Rule 11 of the Companies (Audit and Auditors) Rules, 2014. The amendments inserted new Rule 11(e) and Rule 11(f) which deals with reporting on lending or receiving of funds on behalf of ultimate beneficiary and reporting on the payment/declaration of dividend respectively.

Considering these new requirements, the Auditing and Assurance Standards Board (AASB) of the Institute of the Chartered Accountants of India (ICAI) issued an implementation guide for providing guidance to the members on these new reporting requirements so that the members can discharge their responsibilities in an effective manner.

The implementation guide contains detailed guidance on various aspects of reporting under Rule 11(e) and Rule 11(f) such as analysis of Rules, management's responsibilities in respect of disclosures in financial statements under Schedule III to the 2013 Act, various audit procedures to be performed, reporting considerations, illustrative formats of confirmation letters, illustrative

formats of management representations. The implementation guide will enable auditors of companies to comply with the reporting requirements under these Rules effectively.

(Source: ICAI notification dated 26 April 2022)

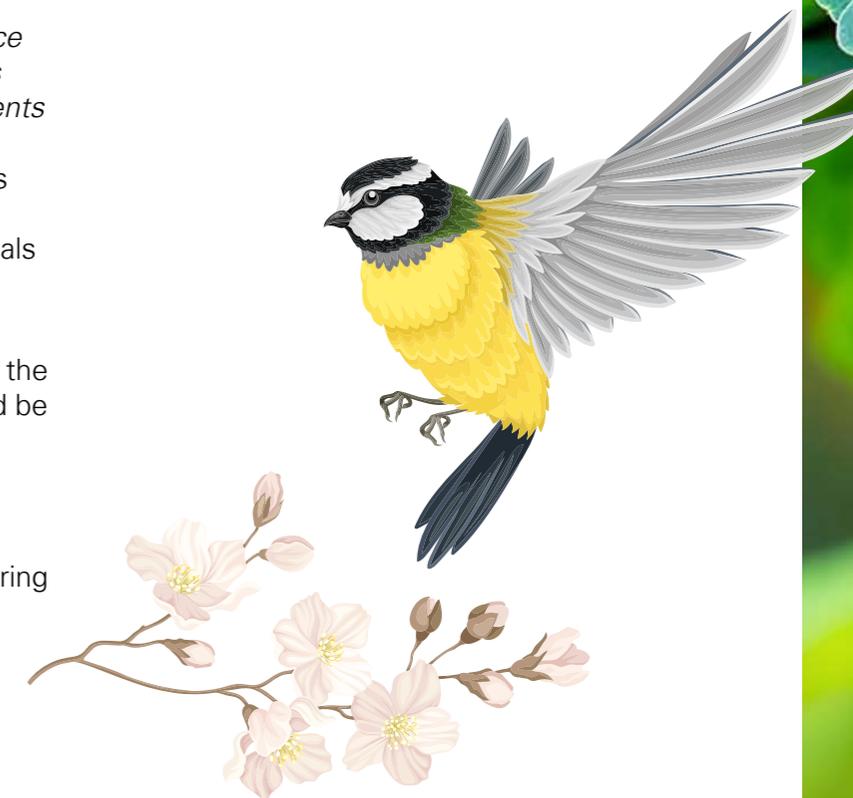
ICAI announced effective date of SAE 3410

In February 2021, ICAI issued Standard on Assurance Engagements (SAE) 3410, *Assurance Engagements on Greenhouse Gas Statements* equivalent to ISAE 3410, *Assurance Engagements on Greenhouse Gas Statements* issued by the International Auditing and Assurance Standards Board (IAASB) of International Federation of Accountants (IFAC). The standard SAE 3410 deals with assurance engagements to report on an entity's greenhouse gas (GHG) statement.

Recently, on 2 May 2022, ICAI announced that the effective date of application of SAE 3410 would be as follows:

- Voluntary basis for assurance reports covering periods ending on 31 March 2023
- Mandatory basis for assurance reports covering periods ending on or after 31 March 2024

(Source: ICAI notification dated 2 May 2022)



IAASB issued new fact sheet to address engagement team definition

In December 2020, the International Auditing and Assurance Standards Board (IAASB) as part of quality management project, clarified and updated the definition of engagement team under ISA 220 (Revised), *Quality Management for an Audit of Financial Statements* to improve quality management at the firm and engagement level.

The revised definition is as follows:

'All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, excluding an auditor's external expert and internal auditors who provide direct assistance on an engagement'. The revised definition is applicable for all engagements for the periods beginning on or after 15 December 2022.

Recently, with an aim to help users to adapt to the clarified and updated definition of 'engagement team', the IAASB has released a new fact sheet. The new fact sheet addresses the clarified definition and its possible impacts, including recognition that engagement teams may be organised in a variety of ways, including across different locations or by the activity they are performing. The fact sheet also includes a diagram that walks users through who specifically is included and excluded. This new engagement team

definition applies to the International Standards on Auditing and International Standards on Quality Management.

(Source: IASB Fact Sheet Definition of Engagement Team, April 2022)

IAASB issues` new non-authoritative guidance on fraud in an audit of financial statements

The IAASB on 5 May 2022 released non-authoritative guidance, *The Fraud Lens – Interactions Between ISA 240 and Other ISAs*. The guidance illustrates the relationship and linkages between ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, and other ISAs when planning and performing an audit engagement and reporting thereon.

As IAASB recently approved a project proposal to revise ISA 240 to enhance or clarify an auditor's responsibilities on fraud in an audit of financial statements, the non-authoritative guidance illustrates how extant ISA 240 is to be applied in conjunction with the full suite of ISAs. As part of the project, additional non-authoritative guidance may be developed to further support the implementation and application of the proposed revised standard, once developed.

(Source: IAASB non-authoritative guidance, May 2022)



First Notes

MCA issues narrow scope amendments to Indian Accounting Standards

5 May 2022



In view of the recent amendments to IFRS, and in order to keep the Ind AS converged with IFRS1, the Ministry of Corporate Affairs (MCA) issued certain amendments to Ind AS2 vide a notification dated 23 March 2022 (2022 amendments). These amendments have been issued in the areas mentioned below:

- Ind AS 16, *Property, Plant and Equipment - Accounting for proceeds before intended use*
- Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* - Determining costs to fulfil a contract
- Ind AS 103, *Business Combinations - Reference to the Conceptual Framework for Financial Reporting*
- Annual improvements to Ind AS (2021)
 - Ind AS 101, *First-time adoption of Indian Accounting Standards*
 - Ind AS 109, *Financial Instruments*
 - Ind AS 41, *Agriculture*

This issue of First notes provides an overview of the these amendments.



On 28 April 2022, KPMG in India released its VOR - Annual 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) for the year ended 31 March 2022.

To access the publication, please [click here](#)

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