ACCOUNTING AND AUDITING UPDATE

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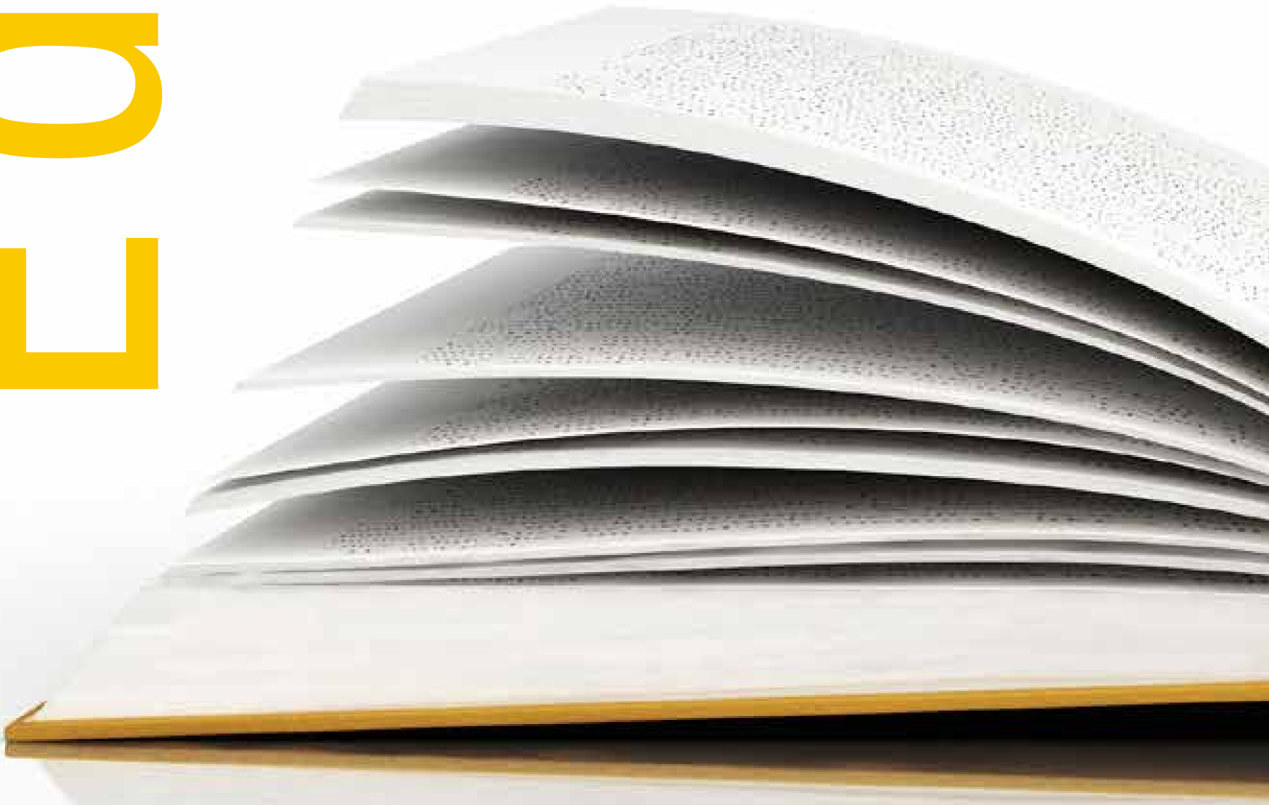
KPMG

cutting through complexity

Editorial



It appears that the general mood in the economy has changed. People seem more positive; markets have run up considerably, and sectors that were once overlooked and ignored are now back into focus. This month we look at the microfinance sector and its distinct story of a turnaround, continuing challenges and opportunities. We expect that the level of activity in this sector will grow considerably given the government's and Reserve Bank of India's emphasis on financial inclusion.

Reporting on internal financial controls under the Companies Act, 2013 is one of the more significant changes and responsibilities cast on companies and auditors. This month, we examine some of the critical aspects of these requirements and provide some thoughts on how one could approach and what one should be mindful of in this context. We also provide some additional perspectives on related party transactions in this issue of the Accounting and Auditing Update.

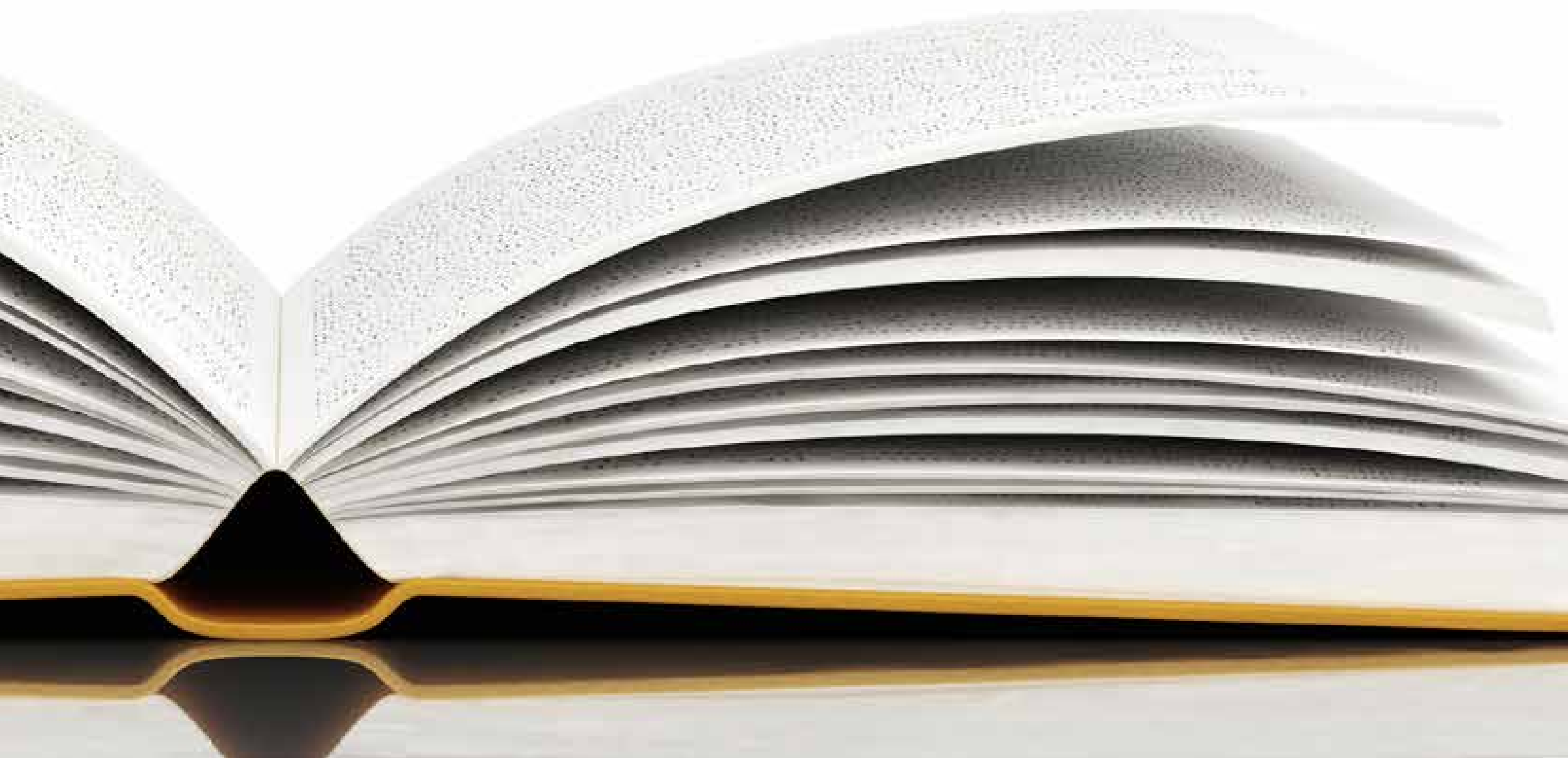
The life of an auditor is full of excitement these days and the most recent changes to the tax audit reports and clauses therein bring about some subtle but possibly far reaching changes in scope. Many professionals and companies are struggling with these changes that almost slipped by unnoticed and we cast our spotlight on them in this month's issue.

We also cover a number of regulatory and reporting updates this month as well as an examination of some of the key accounting and reporting issues associated with the foreign direct investment regulations in retail cash and carry sector.

As I sign off for this month, I would like to remind you that in case you have any suggestions or inputs on topics we cover, we would be delighted to hear from you. Best wishes for the festive season!

Jamil Khatri

Deputy Head of Audit, KPMG in India
Global Head of Accounting Advisory Services



Microfinance institutions

background and challenges

This article aims to

- Describe the Indian microfinance sector, its turnaround, growth and regulatory environment
- Highlight the challenges that the microfinance sector faces.

Microfinance in its essence means providing financial services to low-income people. Microfinance institutions (MFI) and other financial service providers have been working to develop products and delivery methods to meet the diverse financial needs of low-income people.

In India, the government has been working on various initiatives to bring financial assistance to the people in low income strata. Over the period, the sector has expanded its reach. Microfinance service providers include apex institutions like National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) and Rashtriya MahilaKosh (RMK). At the grassroots level we have commercial Banks, Regional Rural Banks and cooperatives to provide microfinance services. Several public and private commercial banks, registered and unregistered non-banking financial companies (NBFCs), societies, trusts and non-governmental organisations (NGOs) are also providing microfinance by using their branch network and through different microfinance delivery models.

On an overall basis, MFIs now have presence in 27 states and Union Territories. Tamil Nadu, Karnataka, Maharashtra, Gujarat, Madhya Pradesh, Uttar Pradesh, Rajasthan, Bihar, and Uttarakhand now has more than 10 MFIs operating, signifying pan India outreach of the industry.

Modes of delivery of microfinance[1]

Microfinance Institutions (MFIs) around the world follow a variety of different methodologies. The following are major methodologies employed by MFIs to deliver financial services to low income families:

- Self Help Groups (SHGs) - In this case, the members of SHGs pool their small savings regularly at a prefixed amount on daily or weekly basis and SHGs provide loans to members for a fixed period. SHGs are essentially a formal and voluntary association of 15 to 20 people formed to attain common objectives.
- Individual Banking Programmes (IBPs) – In IBPs there is a provision by microfinance institutions for lending to individual clients though they may sometimes be organised into joint liability groups, credit and saving cooperatives. This model is increasingly popular through cooperatives.
- Grameen Model - Grameen Model was pioneered by Dr. Mohammed Yunus of Grameen Bank of Bangladesh. In Grameen Model, the groups are formed voluntarily consisting of five borrowers each. The lending is made first to two, then to the next two, and then to the fifth. While the loans are made to the individuals, all in the group are held responsible for loan repayment. According to the rules, if one member ever defaults, all in the group are denied subsequent loans.
- Joint Liability Groups (JLGs) – In this case, the borrowers make a group among themselves and the microfinance institutions give loan to that group usually four to ten in number. JLG is an informal group of individuals coming together for the purpose of availing of bank loan either singly or through the group mechanism against mutual guarantee in order to engage in similar type of economic activities.

Among all methodologies, SHGs model was popular in India but there has been a shift towards the JLG model which requires lesser number of members and the shared guarantee works as an alternative check.

As the MFI industry in India matured and outreach increased, the shift from SHG linked lending to bulk loans to MFIs by the banks created a keen interest in the sector from global investors in addition to banks. This accelerated the growth of commercial MFIs.

The fast pace of growth in the MFIs primarily driven by an unprecedented expansion in operations led to an imbalance in the social objective and financial management objective as `profit maximisation' and scalability was given more importance. Such growth always brought into question the ability to build processes to keep pace with the growth and it was not long before certain practices such as over/multiple lending, aggressive collection mechanisms, weak monitoring and lack of adequate governance systems were challenged.

Andhra Pradesh crisis[2]

Over the period, Andhra Pradesh had the highest concentration of microfinance operations with 17.31 million SHG members and 6.24 million MFI clients. This high penetration of both SHGs and MFIs also led to stiff competition for the client outreach between the state and private financial providers resulting in wider conflict of interest. This period also witnessed a series of suicide incidents attributed to the alleged abusive practices of MFIs such as charging high interest rates, adopting coercive collection practices, and lending aggressively beyond the repayment capacity of the borrowers rather than helping the poor get out of poverty. Allegedly, as a result, certain rural people were driven to suicides unable to bear the coercion unleashed by their recovery agents.This was a volatile period with poor business practices and a political involvement creating a very destabilising environment for the MFI business in the country.

To arrest the growth of MFIs and to stem the alleged abusive practices adopted by the MFIs, the state government promulgated an ordinance on 16 October 2010. In December 2010, the ordinance was enacted into 'The Andhra Pradesh Microfinance Institutions (Regulation of Money lending) Act, 2010'. One of the key steps the ordinance had proposed was setting up of fast-track courts in every district for MFI-related issues.

As an immediate fallout, as of January, 2011, the MFI repayment rates fell from 99 per cent right before the issuance of the ordinance to less than 20 per cent. The stringent regulations set by the state government (such as monthly repayments, all MFI branches to be registered with the government, no door to door collection of repayments, etc.) coupled with active encouragement by the local politicians led to the fall in repayment levels.

This, along with other reasons, led to what is commonly termed as 'the AP crisis'. The crisis undermined the growth and indeed the very existence of commercialised microfinance institutions. The crisis had an impact not only in the state of AP but also throughout India with many MFIs facing issues raising funds, expanding operations, etc.

Steps taken to bring growth back to the sector

The Reserve Bank of India (RBI) Governor, Y.V.Reddy (2007) gave a simple definition of financial inclusion as "ensuring bank account to all families that want it". He said it would be the first step towards reaching the goal of bank credit as a human right as advocated by Nobel laureate Professor Mohammed Yunus.

Following steps have been taken to bring the growth back to the microfinance sector:

- In October 2010, the Malegam sub-committee was set up to monitor the functioning of MFIs in the country, leading to recognition of MFIs as a separate category, NBFC-MFIs.
- The Microfinance Bill was introduced in 2012, followed by its several versions of drafts
- RBI's MFI Directions 2012 to regulate MFIs.

These changes at the macro level have been targeted to result in a revival of the MFI sector via flow of private equity capital and credit enhancement offered by banks/ financial institutions in the microfinance sector.

The intent of these initiatives has been to ensure that the right balance between the pursuit of social objective and interest of shareholders is maintained through responsible financing.

1. Status of Microfinance in India - A review by Padmalockan Mahanta, Gitanjali Panda and Sreekumar, November 2012
2. Andhra Pradesh MFI Crisis and its impact on clients 2012 issued by Centre of Microfinance and MicroSave

Malegam committee report on the microfinance sector

The microfinance industry had come under the scanner when the Andhra Pradesh government passed an ordinance calling the borrowers to stop paying their loans, making it illegal for the micro lenders to ask for weekly repayments and also required them to get a no objection from the local authorities before providing for a second loan to a borrower, bringing a jolting halt to the industry in India and exposing the inherent problems in the sector.

In October 2010, the RBI had set-up a sub-committee under the chairmanship of Shri Y.H Malegam, to address the several issues concerning the microfinance sector. The RBI released the report of recommendations by the sub-committee on 19 January 2011. The sub-committee was to review the scope and objectives of regulations governing MFIs with regard to interest rates, lending and recovery practices, applicability of existing money lending legislations, need for grievance redressal machinery, and other issues concerning the sector.

The sub-committee recommended creation of a separate category of NBFCs, NBFC-MFIs, providing short-term, and unsecured loans to the low income borrowers for income generating activities. The sub-committee also recommended various parameters relating to individual ceiling for borrowers to borrow loans, how much portion of the loans should be income-generating, minimum net worth of the NBFC-MFI, etc.

Additionally, the sub-committee also recommended guidelines relating to the moratorium period between disbursement of loan and commencement of recovery, formation of credit information bureau to avoid multiple lending and over borrowing by borrowers, a customer protection code to be prepared and adopted, grievance redressal procedures and establishment of ombudsmen, MFIs to charge insurance premium, interest charges and loan processing fees, disclosures to be made in the financial statements of MFIs with regard to the outstanding loan pools, etc.

The sub-committee also suggested that entities be governed by an Act.

RBI directions

In the RBI Monetary Policy Statement 2011-12, it was announced that the broad framework of regulations recommended by the Malegam Committee had been accepted by the RBI and accordingly, a separate category of NBFCs viz. Non Banking Financial Company-Microfinance Institution (NBFC-MFI) was formed and separate directions were issued vide Notification DNBS.PD.No.234 CGM(US)2011 dated 2 December 2011 containing the regulatory framework for NBFC-MFIs.

According to the guidelines, an NBFC which does not qualify as an NBFC-MFI is not allowed to extend loans to the microfinance sector, which in aggregate exceeds 10 per cent of its total assets. The guidelines also defined regulatory framework with capital adequacy norms, asset classification and provisioning norms, pricing regulations, corporate governance norms, practice codes, prescription of fair practices in lending prescribed, etc.

The RBI guidelines also encourage all NBFC-MFIs to become member of at least one industry association/Self-Regulatory Organisation (SRO) which is recognised by the RBI; they will also have to comply with the Code of Conduct prescribed by the SRO. While membership with an SRO was not made mandatory, the RBI mentioned that the membership of NBFC-MFIs in the industry association/SRO will be seen by the trade, borrowers and lenders as a mark of confidence, and removal from membership will be seen as having an adverse impact on the reputation of such removed NBFC-MFIs.

In a press release dated 26 November, 2013, the RBI invited applications from interested parties for seeking recognition as SRO wherein it specified the criteria and obligations for such SROs. The SRO holding recognition from the RBI will have to adhere to a set of functions and responsibilities, such as formulating and administering a Code of Conduct recognised by the RBI, having a grievance and dispute redressal mechanism for the clients of NBFC-MFIs, ensuring borrower protection and education, monitoring compliance by NBFC-MFIs with the regulatory framework put in place by the RBI, surveillance of the microfinance sector, training and awareness programmes for the members, SHGs, etc., and submission of its financials, including Annual Report, to the RBI.

In June 2014, the Microfinance Institutions Network (MFIN) was recognised as the first SRO in the financial services sector by the RBI.

Mircofinance bill

The Ministry of Finance (Department of Financial Services) vide its order dated 10 March 2011 constituted a committee to recommend the draft of a new Microfinance Institutions (Development and Regulation) Bill. This committee had members from the Department of Financial Services, Reserve Bank of India (RBI), Indian Banks Association (IBA), National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), the State Governments (Bihar and Tamil Nadu) and State Level Bankers' Committee, Andhra Pradesh. The MFIs were represented by Microfinance Institutions Network (MFIN) and Sa-Dhan.

India's Microfinance Bill has been re-drafted many a times over the last three to four years and many new recommendations have been incorporated since the Bill was first mooted in June 2011.

In February 2014, a Parliamentary Panel had rejected the Bill and asked the incumbent government to bring forth a fresh legislation before Parliament post wider consultations.

Consequently, the sector remains susceptible to local legislative and socio-political issues. It is argued that implementation of a new law at the national level, protecting the MFIs from dual regulations, would further enable long term stability and orderly development.

The tide has turned but challenges still exist

Asset quality structurally strengthened, but susceptibility to socially sensitive factors remains

While the regulatory environment has improved, MFIs continue to be exposed to inherent risks in the business model. Given that their borrowers belong to the low income segments, customers are more prone to default; additionally, the fact that microfinance loans are unsecured limits potential for recovery in the event of default. Moreover, with MFI operations concentrated in specific geographies, geographic concentration risks persist e.g. these risks include natural disasters, social unrests, or political upheavals.

The credit bureau checks enable MFIs to assess the extent of total leverage of prospective customers, and their track record. Active use of credit bureaus, restrict instances of multiple lending and over-indebtedness of the borrowers, and seems to have structurally strengthened the asset quality for the sector. Additionally, MFIN has prescribed a code of conduct that provides guidelines for MFI operations, and greater uniformity in their functioning. Leaving aside the AP crisis and a few district-specific issues, the MFIs have maintained healthy asset quality as reflected in 30 days past due of below one per cent for the sector over the years[3].

Integration of advanced technology to monitor the performance of collection centres, and stronger borrower discipline in repayments have also contributed to the robust performance of microfinance loans.

Margins are regulated

RBI's guidelines on pricing of credit require the large MFIs to operate at a margin cap of 10 per cent (applicable for NBFC-MFIs from 1 April 2014). MFIs would need to scale-up in operations and bring about an improvement in operating efficiency.

The increasing use of mobile technology for collections and the bank account based disbursement of funds (courtesy initiatives like the *Jan dhan* scheme announced recently by the Government of India) is expected to further bring down the operation costs.

Loan collectability is always a task

The MFIs are expected to maintain strong collection performance over the medium term. However, the Government of Andhra Pradesh's ordinance for MFIs demonstrated the vulnerability of MFIs to regulatory and legislative risks. It triggered a chain of events that adversely impacted the business models of the Andhra Pradesh based MFIs by impairing their growth, asset quality, profitability, and solvency. Since the business of these institutions involves lending to the poor and economically weaker sections of the society it will remain exposed to local level socially sensitive factors, including charging high interest rates, and, consequently, to the risk of tighter regulations and legislation. Implementation of a new law at the national level protecting the MFIs from dual regulations, could further enable long-term stability and orderly development.

Other industry matters – operational

- **Role of IT systems:** Usually MFIs operate in a decentralised environment wherein the disbursement and collections are managed locally at the branch level. It requires robust IT systems with adequate review mechanism to capture correct data of disbursements/repayments in the customer account.
- **Role of robust internal audit systems and procedures and credit bureau in the MFIs:** Many of the requirements of MFI directions such as total indebtedness, membership of SHG/JLG, borrowing sources, and so on can be complied with the help of information available at credit bureaus. The credit bureau maintains details of borrowers who had taken loan from any MFI in India. The data maintained with these bureau agencies are updated by sharing loan book data by MFIs periodically.

Conclusion and way forward for MFIs

Conventional wisdom has it that access to microfinance services can enable the poor to smoothen their consumption, manage their risks better, build their assets, develop their microenterprises, enhance their income earning capacity, and enjoy an improved quality of life. The primary clientele of MFIs consist, almost by definition, of those who face severe barriers to access financial products from conventional financial institutions. These barriers comprise mainly high operational costs and risk factors.

Notwithstanding the challenges at hand, the sector's turnaround underscores its relevance and that of the microfinance industry to the financial inclusion goals of India. Even after AP crisis, the steps taken by the RBI are helping flourishing the MFI sector. The sector is set to report buoyant growth over the medium term and there has been improvement in the flow of debt funding and equity capital to this sector as it is attracting private equity and foreign investment[4]. The government's focus on financial inclusion is only likely to further boost this sector's fortunes.

3. Micrometer MFIN issue 10 Q1-FY-14-15 6 August 2014
4. CRISIL India's 25 Leading MFIs June 2014

Mandatory reporting on internal financial controls

Corporate commitment to self-governance

This article aims to

- Highlight the requirements of the Companies Act, 2013 in relation to internal financial controls
- Summerise the steps companies in India should take to comply with the requirements of internal financial controls.

The Companies Act, 2013 (2013 Act) offers organisations an opportunity to re-evaluate the strength of their internal control components, specifically risk assessment, monitoring, and information and communications in order to determine if they are keeping pace with the business environment and emerging risks. The potential benefits that these new requirements afford include enhanced governance, extended coverage/ applicability beyond financial reporting to other forms of reporting, operations, and compliance (for example, sustainability reporting), improved risk assessment and anti-fraud practices, and enhanced adaptability to change.

The 2013 Act requires the director's report for listed companies, including public companies with paid up capital of INR250 million or more, and statutory auditor's report for all companies to comment on whether the company has adequate internal financial controls system in place and operating effectiveness of such controls. For this purpose, the term 'internal financial controls' means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to the company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

There continues to be some ambiguity on whether the ambit of internal financial control for public companies with paid-up capital of under INR250 million, is limited to internal controls over financial reporting or to a wider ambit of internal financial controls that extend beyond financial reporting. There is currently a lack of congruence in the guidance containing the 2013 Act and its rules around this area. It is therefore possible, that all companies may need to lay down internal financial controls covering its operations, reporting (financial and non-financial) and compliance responsibilities; and not just over financial reporting. If this interpretation is the one that Ministry of Corporate Affairs/the Institute of Chartered Accountants of India (ICAI) eventually settles on, the 2013 Act would have significantly expanded applicability of internal financial controls to cover all aspects of operations of a company.

The Institute of Chartered Accountants of India (ICAI) is in the process of issuing guidance to statutory auditors on the audit of internal financial controls. This guidance considers the requirements of the COSO[1] Framework, which is one of the commonly used frameworks globally by entities in developing and evaluating their internal control systems.

1. Published by the Committee of Sponsoring Organisations of the Treadway Commission

The Companies Act, 2013: Mandating a robust control framework, supported by evolutionary governance principles

Corporate governance provides the structure through which an organisation sets and pursues its objectives, while reflecting the context of the social, regulatory and market environment. At the same time, corporate governance is a mechanism for monitoring the actions, policies and decisions of the company. There is a general need for clear oversight structures, defining of roles and responsibilities, effective management information, and transparent decision making. Thus, having a management oversight and internal control framework that fits the company's strategy, operations and culture can make governance effective and efficient because it avoids inconsistencies, overlaps, and gaps among governance mechanisms. Such a framework would improve clarity, because

- a well-conceived governance operating model provides the Board an ability to clearly define the roles, responsibilities, accountabilities, information flows
- guidelines that people need in order to achieve strategic goals, along with a clear line of sight into the management's decision-making and risk management processes.

Having evaluated their business needs and capabilities, business leaders would be expected to embed internal controls monitoring into their operations, reporting and compliance processes, as opposed to financial reporting only. Organisations are expected to shift from point in time testing to ongoing testing embedded within the business processes.

Stakeholder groups should consider their role in the assessment and transition with respect to the new internal control requirements prescribed by the regulations

As businesses evaluate the impact of the 2013 Act on their internal control structure, stakeholder groups should consider their role in the assessment and transition with respect to their roles and responsibilities for internal control. It is important that the three lines of defence - (a) management and senior management (b) risk, compliance and other policy setting groups and (c) internal audit - fully comprehend the implications of the updated framework. Prior to implementation, the management should obtain an understanding of the required components, principles, and points of focus. Once there is an understanding, a detailed assessment should be completed to identify gaps between existing control structures and anticipated changes as a result of the 2013 Act. Functional risk, compliance and policy-setting groups can play a critical role in assisting management with their understanding and assessment, and work toward remediating gaps in control design as the transition evolves. In addition, these groups would be expected to make their own assessment and evaluate the need to update policies, guidance and tools to reflect the principles and points of focus. They should also work with the management to communicate to 'internal audit and the Board/audit committee' the results of their assessment and transition plans for remediating the identified weaknesses.

In summary, the involvement of all three lines of defence and stakeholder groups is a prerequisite to successfully transition to the new legislation and helping the organisation achieve a system of internal controls that is effective in a dynamic business environment.

Road to self-governance: challenges while preparing for the transition

While the new corporate law has increased the disclosure requirements to bring in more transparency in corporate reporting and self-governance, there are many areas which require further deliberation, introspection and review. The prompt implementation of the new requirements reinforces the commitment to enforce the new legislation and towards raising the bar on governance. However, at the same time it may be aspirational in expecting that all Indian companies will be able to adopt the plethora of changes with little time to plan and prepare. There are implementation challenges, including the planning, execution and reporting issues, arising from the requirements relating to internal financial controls under the 2013 Act. Expected compliance during the financial year beginning 1 April 2014 itself is a subject matter of discussion among the corporates and the regulators at the moment. Some of the implementation challenges we expect in the coming quarters, as Indian corporates put themselves together to prepare for this transition are listed below:

- Planning a new internal control structure that addresses the revised language of the reporting objective to cover internal and external financial and non-financial reporting:
  - Quantifying cost benefit for management, Board of Directors/audit committee for undertaking extensive review and documentation for the new framework required
  - Defining oversight structure and responsibility matrix for the new framework.
- Controls such as financial, people related, supply chain, etc. are critical attributes of management. Thus, being too prescriptive in this respect may appear very intrusive for the management

- Difficulty in updating, maintaining and testing on a continuous/ periodic basis:
  - Whether the documented system of internal controls has kept pace with significant changes in the organisation, operations, technology and governance needs
  - Whether the control structure creates the flexibility needed to manage increased globalisation, an increasing complex regulatory environment and rapidly changing technology and its impacts on all stakeholders.
- Fully optimising monitoring controls, including data analytics, within its control structure to better monitor the effectiveness of process-level controls and identify process-level changes. This would entail designing the monitoring controls in a way that is precise enough to manage the specific risks within an organisational unit or function.
- Integrate compliance needs within the new framework to lower costs and create a more transparent compliance process.
- Ensuring that the organisation's and internal audit's risk assessments incorporate risk tolerance, velocity and persistence. Reviewing the current methodology to actively assess whether controls are adapting to changing risk profiles or changing objectives.
- Reviewing whether the transition plan appropriately accounts for people, process and technology resources that will be needed for the transition.
- There are limited assertions made on certain internal controls aspects in the CARO report (Statement of Companies (Auditor's Report) Order). Whether the intent of the new requirements is to achieve compliance with the same level of rigour, breadth and depth as has been done for CARO reporting in the past.
- Whether to expand the work and procedures involved in compliance and monitoring beyond the existing level.
- Lack of guidance on how to comply with the new requirement that imposes responsibility on auditors to report on the adequate internal financial controls system in place, and the operating effectiveness of such controls.

The Guidance Note to be issued by the ICAI to provide guidance to the statutory auditors is in the process of finalisation. Once finalised, corporates would need to review and align their existing structures to desired state.

Hence, what is required is a clear and concise 'call for action' to adopt a transition plan in order to remediate identified gaps. .The table below lists down some of the key actions points that the companies are expected to work on to implement this change:

Assess and evaluate 'tone at the top'

- Review management's philosophy and operating style to promote effective internal financial controls
- Check whether sound integrity and ethical values, particularly of top management, are developed and understood
- Ensure that the Board or audit committee understands and exercises oversight responsibility over financial reporting and internal control
- Ensure presence of defined policies and procedures aligned to the company's philosophy

Develop an internal control framework

- Internal control framework based on COSO 2013 – entity level and operations control; holistic coverage of operational, financial and fraud risks designed in accordance with the COSO/COBIT frameworks
- Mapping of various operating processes/sub-process and activities at an organisation level; clearly defined workflows in line with current operating practices
- Conduct a qualitative assessment of existing documents to meet current business operations
- Identify gaps in the availability/ adequacy of existing documentation compared to the requirements of the COSO framework
- Updated process documents covering various components of the COSO framework
- Defined roles and responsibilities to ensure compliance to the monitoring and reporting requirements of the COSO framework

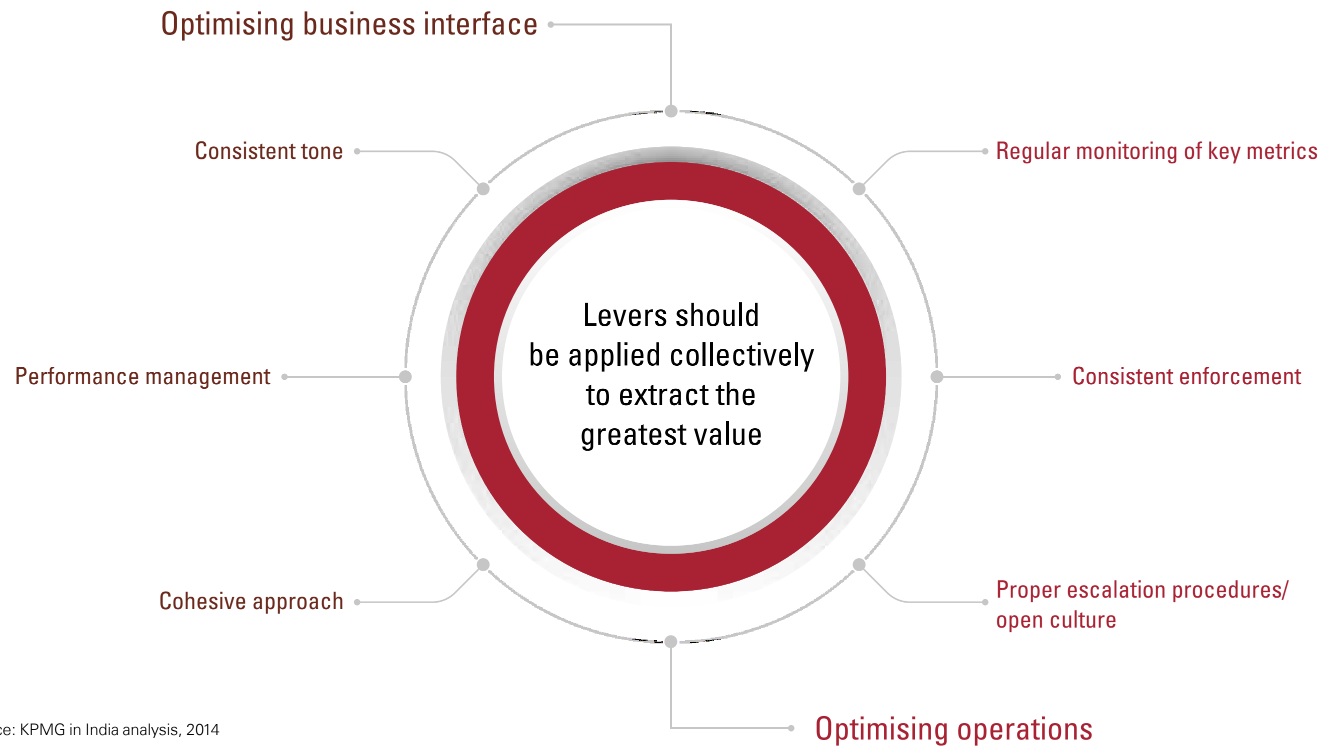
Develop a combined assurance plan

- Develop a combined assurance plan for risk management and continuous monitoring through self-assessment
- Create a repository of risk and controls to ensure identification and coverage across all financial and operating risks (i.e. strategic, operational, reputational, financial and fraud risks)
- Evaluate, document and prioritise risks across the organisation/ business segments
- Create a reporting, monitoring and escalation framework to provide the desired level of assurance to the senior management
- Holistic risk assessment across various assertions defined under the COSO framework

Test the operating effectiveness of internal financial controls

- Assess the operating efficiencies of the process design and operating controls
- Assess the effectiveness of the internal control system and identify gaps at a design and operating effectiveness level
- Comprehensive management assurance implemented through self-assessment programmes
- Continuous control monitoring and assurance through data analytics/ control dashboards
- Assist with the management's assessment of the design of controls over business operations
- Enable evaluation of operating effectiveness and deviation identification

New internal financial controls framework: six levers that would help extract additional value and achieve a consistent governance framework



Source: KPMG in India analysis, 2014

We do not expect that implementation and management this change would be a simple task, yet it is important to achieve full benefits from this new framework and sustain regulatory compliance and optimal Governance. Organisations should consider that this would be a collaborative process and a concerted effort is needed to manage this change. Below we list down six levers or dimensions that need to be in tandem while implementing this change and no single dimension can be the sole focus at any one time.

Consistent tone: Employees should look for consistent tone at the top, from the board and senior management, but also get a sense for how messages are transmitted and reflected on the front lines, the 'tone at the bottom'.

Metrics that are regularly monitored: Culture is difficult to measure, but a combination of discrete metrics, such as the number of risk limits that are broken, and the cause, especially without prior approval; the number of problems identified in internal audit reports; the manner in which they are addressed; the pre-existing level of awareness of the problems (was the management surprised by the findings, or were they already working on corrective action), etc. can help build a mosaic of the culture in an organisation.

Proper escalation processes and an open culture: The degree to which issues are voluntarily self-reported and whether information is filtered as it is elevated up through the organisation can provide a sense for how open the culture is.

Consistent enforcement: The manner in which the company handles employees who have seriously violated company policies, and equally important, the manner in which unintentional mistakes are reported and handled, and how control issues or adherence to ethical standards are incorporated into the ongoing people performance, evaluation, and compensation systems, can yield insight into whether values are enforced.

Performance management: The management should link achievement of the organisation's internal control objectives to individual performance objectives. Each person within the organisation should be held accountable for the achievement of assigned internal control objectives. A system of internal control, including financial and non-financial performance indicators, can help to provide reasonable assurance that organisations deliver the outputs expected.

Cohesive approach: Internal controls can only work effectively when they, together with the risks they are supposed to address, are clearly understood by everyone involved. Therefore, controls should not be documented and communicated in isolation, but integrated through formal and informal channels across all elements of the management system in which they are intended to operate.

Recent amendments in the tax audit form

This article aims to

- Highlight the significant amendments in the Form No. 3CD
- Summarise the guidance provided by the Guidance Note on tax audit issued by the ICAI.

The Central Board of Direct Taxes (CBDT) has amended the Form No. 3CD of the Income tax Rules, 1962 (the Rules) vide Income-tax (7th amendment) Rules, 2014. The new Form No. 3CD includes certain new clauses and also amends few existing clauses. With these changes in Form No. 3CD, the responsibilities of the auditor as well as assessee to report detailed information under the new/amended clauses have increased significantly. Pursuant to the changes in Form No. 3CD, the Institute of Chartered Accountants of India (ICAI) has issued updated Guidance Note on Tax Audit (Guidance Note) under section 44AB of the Income-tax Act, 1961 (IT Act).

The objective of this article is to understand the significant amendments introduced in Form No. 3CD, the reporting responsibilities of the auditor and assessee to furnish information under the new/amended clauses and guidance available as per the updated Guidance Note issued by the ICAI to comply with the new reporting requirements.

Analysis of significant new and amended clauses of the Form No. 3CD

I. New clause 4 requires the auditor to report whether the assessee is liable to pay indirect taxes like excise duty, service tax, sales tax, customs duty, etc. If yes, the registration number or any other identification number allotted for the same is required to be furnished.

   This new clause requires the auditor to assess if the business or profession carried on by the assessee is subject to the provisions of indirect taxes. If yes, details of the registration number/ identification number allotted are required to be furnished. Information is restricted not only to excise duty, service tax, customs duty, but is also required to be furnished for each indirect tax applicable to the assessee. The term 'Indirect taxes' has not been defined anywhere in the Income tax Act, 1961 and therefore, it appears that it covers each type of Indirect tax applicable to the assessee.

   The Guidance Note has clarified that an auditor could rely upon the assessee to provide the list of indirect taxes applicable to the assessee and furnish the required details under this clause. In case, the auditor prima facie is of the opinion that any of the indirect taxes laws applicable on the business or profession of the assessee, but if the assessee is not registered under the said law, the tax auditor would report the same appropriately in the tax audit report.

II. As per new clause 8, the auditor is required to indicate the relevant clause of section 44AB under which the audit has been conducted.

The assessee is required to get his accounts audited under either of the following four clauses of section 44AB of the IT Act:

a. If total sales, turnover or gross receipts, as the case may be, in business exceed or exceeds INR10 million in any previous year

b. If gross receipts in profession exceed INR2.5 million in any previous year

c. If the assessee claims that actual profits/gains are lower than profits/ gains deemed under section 44AE or section 44BB or section 44BBB, or

d. If the assessee claims that actual profits and gains are lower than the profits and gains deemed under section 44AD.

The relevant clause of section 44AB under which tax audit is performed needs to be disclosed in the Form No. 3CD.

III. The clause 11(b) has been amended to specify the address at which the books of account are kept. If the books of account are not kept at one location, then the addresses of locations along with the details of books of account maintained at each location is required to be furnished.

In case, where the books of account are maintained and generated through a computer system, the Guidance Note clarifies that the auditor should obtain from the assessee the details of address of the place where the server is located or the principal place of business/head office or registered office by whatever name called, and mention the same accordingly in clause 11(b).

IV. Clause 11(c) relates to the list of books of account examined . This clause has been amended to include the nature of relevant documents examined by the tax auditor.

During the course of audit, the auditor examines various documents including bills, voucher, receipts, bank statements, challans for deposit of statutory dues, etc. Various documents examined by the auditor are now required to be specified under this clause.

V. Clause 17 relating to the transfer of land, building or both, under section 43CA/50C of the IT Act has been incorporated in the Form No. 3CD which provides as below:

"Where any land, building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or section 50C, details of property, consideration received or accrued and value adopted or assessed or assessable needs to be disclosed."

This new clause has been inserted in Form No. 3CD pursuant to section 43CA (in the IT Act) inserted by the Finance Act 2013. In respect of deemed income under section 43CA, paragraph 25.15 of the Guidance Note provides as below:

"25.15 If during the course of audit, auditor finds that certain income (e.g. income referred to in section 41(1) or section 43CA) are not credited to profit and loss account, the particulars of the same along with the amount is required to be reported under this clause."

In accordance with above guidance in the Guidance Note, deemed income under section 43CA was previously required to be reported as capital receipts and not credited to the statement of profit and loss under clause 25(e) of old Form No. 3CD. With the insertion of this specific clause in Form No. 3CD, particulars of deemed income under section 43CA are required to be disclosed separately.

The Guidance Note clarifies that in case the property is not registered, the auditor may verify relevant documents from relevant authorities or obtain third party expert (like lawyer, solicitor) representation to satisfy the compliance of section 43CA/section 50C of the IT Act. In exceptional cases where the auditor is not able to obtain relevant documents, he may state the same through an observation in his report under Form No. 3CA/3CB.

VI. Clause 21(b) in respect of amounts inadmissible under section 40(a) has been amended to require detailed disclosures.

In respect of amounts inadmissible under section 40(a), more detailed and specific disclosures are now required under clause 21(b) of the Form No. 3CD. In the old Form No. 3CD, disclosure of amounts inadmissible was required under clause 17(f). Disclosures required to be given under clause 21(b) of the Form No. 3CD are summarised below:

i. In case of payments made to a non-resident referred to in sub-clause (i) for interest, royalty, fees for technical services (FTS) or any other sum chargeable under the IT Act, following details are required to be given:

– Details of payment on which tax is not deducted

– Details of payment on which tax has been deducted but has not been paid during the previous year or in the subsequent year before the expiry of time prescribed under section 200(1) of the IT Act.

ii. In case of payment made to residents for any interest, commission or brokerage, rent, royalty, fees for professional services or FTS, amounts payable to a contractor or subcontractor, following details are required to be given:

– Details of payments on which tax is not deducted

– Details of payment on which tax has been deducted but has not been paid during the previous year or in the subsequent year before the expiry of time prescribed under section 139(1) of the IT Act.

iii. Any sum paid on account of wealth-tax.

iv. Any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on or which is appropriated directly or indirectly from a state government undertaking or by the state government.

v. Any payment which is chargeable under the head 'salaries', if it is payable outside India or to a non-resident, and if tax has not been paid thereon nor deducted therefrom. The details regarding the date of payment, amount of payment, and name and address of the payee are to be provided.

vi. Any payment to a provident or other fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'salaries'.

vii. Any tax actually paid by an employer referred in section 10(10CC) of the IT Act.

Further, under each sub-clause, date of payment and name and address of the payee is mandatorily required to be given along with the amount of payment and nature of payment.

Though specific disclosures have been prescribed under each sub-clause of section 40(a), disclosures related to the amounts inadmissible under sub-clause (ii) of section 40(a) have not been included. Sub-clause (ii) of section 40(a) refers to any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains. Paragraph 35.8 of the Guidance Note provides that the amount of provision or payment of income tax, surcharge, education cess including interest under section 234A, 234B, 234C and 234D will not be allowed as deduction under section 40(a)(ii), and thus the same is required to be reported as amount inadmissible under section 40(a). Since disclosures related to the amounts inadmissible under sub-clause (ii) has not been included above in clause 21(b), it appears that the same is not required to be disclosed in the new Form No. 3CD.

VII. Clause 21(d) (A) related to disallowance/deemed income under section 40A(3) has been amended and a new clause 21(d)(B) has been inserted as below:

(A) On the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, provide prescribed information.

(B) On the basis of the examination of books of account and other relevant documents/evidence, whether the payment referred to in section 40A(3A) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft, If not, please furnish the details of amount deemed to be the profits and gains of business or profession under section 40A(3A).

As per the amended clause, the auditor's responsibilities have been increased to include the examination of the books of account and other relevant documents/evidence in respect of payment referred to in section 40A(3). As per the Guidance Note, considering the voluminous nature of the transactions, the auditor should consider appropriate audit procedures under generally accepted auditing principles and apply the concept of materiality and test checks. The Guidance Note further clarifies as below:

"Practically, it may not be possible to verify each payment, reflected in the bank statement, as to whether the payment has been made through account payee cheque, demand draft, pay order or not, it is thus desirable that the auditor should obtain suitable certificate from the assessee to the effect that the payments for expenditure referred to in section 40A(3) and section 40A(3A) were made by account payee cheque drawn on a bank or account payee bank draft, as the case may be. Where the reporting has been done on the basis of the certificate of the assessee, the fact shall be reported as an observation in clause (3) of Form No. 3CA and clause (5) of Form No. 3CB, as the case may be."

VIII. Two new clauses 28 and 29 related to a property received without consideration or for inadequate consideration and a share issued for consideration which exceeds the fair market value have been inserted as below:

Clause 28: "Whether during the previous year, the assessee has received any property, being share of a company not being a company in which the public are substantially interested, without consideration or for inadequate consideration as referred to in section 56(2)(viia) of the IT Act, if yes, details of the same to be furnished."

Clause 29: "Whether during the previous year, the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in section 56(2)(viib) of the IT Act, if yes, details of the same to be furnished."

For the purpose of reporting under clause 28 and 29, following points need to be considered:

- Clause (viia) and (viib) of sections 56(2) is applicable only to companies in which public is not substantially interested. Therefore, reporting under clause 28 and 29 is required only for them and not for other assessees.
- Section 56(2)(viib) is applicable only where consideration for issue of shares is received from any person being a resident. Therefore, reporting under clause 29 needs to be evaluated only where shares are issued to any person being a resident.
- Compliance with the rules issued under section 56(2)(viia) and (viib) is required for the purpose of determining the fair value of shares.
- If the value has been computed basis independent valuer's report, the auditor should obtain and examine that the valuation report is in compliance with these Rules.

IX. Clause 32 has been amended to incorporate following three new sub-clauses:

(c) Whether the assessee has incurred any speculation loss referred to in section 73 of the IT Act during the previous year, if yes, please furnish the details.

(d) Whether the assessee has incurred any loss referred to in section 73A of the IT Act in respect of any specified business during the previous year, if yes, furnish relevant details.

(e) In case of a company, please state that whether the company is deemed to be carrying on a speculation business as referred in Explanation to section 73 of the IT Act, if yes, please furnish the details of speculation loss, if any, incurred during the previous year."

The above new sub-clauses require disclosure of losses in speculation business. Disclosure has been restricted only for speculation loss incurred during the previous year. Clause 32(a) deals with the disclosures of brought forward losses/deprecation and detailed disclosures are required to be made for all the years. However, disclosures for speculation losses are required to be made only for loss incurred during the previous year. Details of speculative losses brought forward are not required to be disclosed.

X. Clause 33 has been amended to additionally require section-wise details of deductions, if any, admissible under chapter III (section 10A, section 10AA of the IT Act) as well. Further, it is specifically required to be mentioned that the amount admissible fulfills the conditions, if any, specified under the relevant provisions of the IT Act or the IT Rules or any other guidelines, circular, etc. issued in this behalf.

Clause 33 has been amended to cover deductions admissible under the chapter III. Further, the Form No. 3CD specifically require auditor to opine that the amount admissible fulfils the underlying conditions specified in the IT Act or the IT Rules or any other guidance, circular, etc.

XI. As per revised clause 34(a), if the assessee is required to deduct or collect tax as per the provisions of the chapter XVII-B or the chapter XVII-BB, prescribed details are required to be furnished.

The following table summarises the details which are required to be furnished in respect of tax deducted at source vis–a-vis the details required to be furnished earlier in old Form No. 3CD.

As per revised clause of Form No. 3CD	As per the clause in old Form No. 3CD
Prescribed details if the assessee is required to deduct tax*	Prescribed details if the provision of the chapter XVII-B not complied with:
(1) Tax Deduction Number	Tax deductible and not deducted at all
(2) Section reference	Shortfall on account of lesser deduction than required to be deducted
(3) Nature of payment	Tax deducted late
(4) Total amount of payment of the nature specified in (3) above	Tax deducted but not paid to the credit of the Central Government
(5) Total amount on which tax was required to be deducted out of (4) above	
(6) Total amount on which tax was deducted at the specified rate out of (5) above	
(7) Amount of tax deducted out of (6) above	
(8) Total amount out of which tax was deducted at less than specified rate out of (7) above	
(9) Amount of tax deducted on (8) above	
(10) Amount of tax deducted but not deposited	

*Prescribed information is also required to be submitted for tax collected at source which was not covered earlier.

As per the revised clause, the above prescribed information is required to be furnished if the assessee is liable to deduct tax. In the old Form No. 3CD, information was to be furnished only for cases/instances which were in non-compliance with the provisions of the chapter XVII-B.

XII. As per the amendment in the clause 34(b), the tax auditor is required to report whether the assessee has furnished the statement of tax deducted or tax collected within the prescribed time. If not, prescribed details are required to be furnished.

With the insertion of this new clause in Form No. 3CD, the auditor needs to ascertain and report whether the assessee has submitted the statement of tax deducted or collected within the prescribed time. Further, if the statement of tax deducted or tax collected has not been furnished within the prescribed timelines, the auditor also needs to check whether the statement of tax deducted or collected contains information about all the transactions which are required to be reported.

XIII. As per clause 34(c), the tax auditor is required to report whether the assessee is liable to pay interest under section 201(1A) or section 206C(7) of the IT Act. If yes, prescribed details are required to be furnished.

The auditor should obtain details of all the transactions from the assessee where there is a delay in deposit of tax deducted or collected within the prescribed time. Amount of interest payable under section 201(1A)/206C(7) and details of actual deposit of same are required to be furnished under this new clause. The reporting under this clause should be in consonance with the reporting under clause 34(a) where the details of non-deduction are required to be reported.

XIV. Under clause 36, in addition to the total amount of distributed profits, total tax paid thereon and dates of payment, the following additional details are required to be disclosed:

- amount of reduction as referred to in section 115-O(1A)(i) of the IT Act
- amount of reduction as referred to in section 115-O(1A)(ii) of the IT Act.

The amount of distributed profits was previously reported net of amount referred to in section 115-O(1A). Since disclosures related to tax on distributed profits of domestic companies have been amended to include the disclosure of amount of reduction referred to section 115-O(1A) (i) and (ii), the amount of distributed profits now will be the gross amount under this clause.

XIV. Clauses 37 to 39 have been amended to increase the reporting requirements related to cost audit, excise audit and service tax audit.

Reporting requirements related to the cost audit and excise audit have been amended. Previously, a report of cost audit and excise audit was required to be attached along with the Form No. 3CD. Related requirements have now been amended and the reports of cost audit/excise audit are no longer required to be attached with the Form No. 3CD. As per the amended clause, if there is any disqualification or disagreement on any matter/item/ value/quantity reported by the cost auditor/excise auditor, the same is required to be disclosed in the Form No. 3CD.

Further, if any audit was conducted under section 72A of the Finance Act, 1994 in relation to valuation of taxable services, the details of disqualification or disagreement on any matter/item/ value/quantity reported/identified by the auditor is also required to be disclosed in the Form No. 3CD.

XVI. Under clause 41, the details of demand raised or refund issued during the previous year under any tax laws other than the IT Act and Wealth tax Act, 1957 along with details of relevant proceedings.

This is a new clause inserted in the Form No. 3CD and the auditor is required to obtain details of all demands raised/refunds issued and furnish required information under this clause. It may be noted that even though the demand/refund order is issued during the previous year, it may pertain to a period other than the relevant previous year. In such cases also, reporting has to be done under this clause.

The changes reported above in the Form No. 3CD have increased the assessee and the tax auditor's responsibility very significantly. The assessee is now required to have robust internal control processes and systems in place to capture all the details which are required to be disclosed in the Form No. 3CD. The tax auditor's responsibilities have been increased to include reporting on indirect tax matters, comparison of consideration for transfer of assets with the minimum value defined by stamp value authority, reporting the detailed disclosures related to compliance of tax deduction/collection. The tax auditor's responsibilities related to the compliance with the various conditions for claiming deductions under chapter VIA and III have been clarified in the Form No. 3CD itself in line with the existing guidance from the ICAI.

It is, therefore, imperative that both the assessee and the tax auditor obtain a detailed understanding of the new requirements as applicable to them and provide themselves with sufficient time to collate and verify the information pertaining to the additional/amended clauses.

Challenges in complying with the FDI regulations in the retail cash and carry sector

This article aims to

- Highlight issues faced by entities functioning in retail sector with foreign direct investment (FDI).

Foreign direct investment (100 per cent) in the retail sector was first permitted by the Government of India (GoI) in 1997 in the form of 'Cash and Carry Wholesale Trading' (WCCT) with the prior government approval. The FDI policy related to WCCT was further liberalised and brought under the automatic route (i.e. prior approval of the GoI not required) in the year 2006. The GoI also liberalised the FDI policy in the retail sector, permitting up to 51 per cent and 100 per cent foreign investment in the 'Single Brand Retail Trading' (SBRT) in the year 2006 and 2012 respectively. The scope for 'Multi Brand Retail Trading' (MBRT) under the FDI policy was also widened in the year 2012, permitting FDI up to 51 per cent, however, with prior approval from the GOI, subject to prescribed conditions [1].

Even though 100 per cent FDI in the SBRT was permitted in 2012, a number of international brands have entered into Indian retail market in the form of WCCT through franchisee model or joint ventures. Wholesale trading continues to be a preferred mode of operation for companies due to certain stringent conditions imposed for foreign investment in the SBRT.

The objective of this article is to highlight some of the practical difficulties/ challenges being faced by the companies/ investors in complying with the FDI guidelines while operating under the WCCT model. Since a company, operating as a wholesale trader, is not allowed to enter into retail trade to sell the products to the end-consumers directly, a detailed analysis of transactions with the franchise/ distributor is necessary from the FDI compliance perspective.

1. Consolidated FDI policy circular of 2014 effective from 17 April 2014 and related press notes/press releases/ clarifications/circulars issued by the Government of India

The following table summarises the FDI policy for WCCT and SBRT and highlights the areas of differences in the policy.

WCCT	SBRT
The policy allows 100 per cent FDI under automatic government route.	The policy allows up to 100 per cent FDI. However, 49 per cent is through automatic government route and above 49 per cent with prior government approval.
Key conditions specified in the policy	**Key conditions specified in the policy**
The company (wholesaler) should obtain requisite licenses/ registration/permits as specified by thr respective the state government(s) to operate its business.	The company should sell products of a single brand only.
Except in case the company (wholesaler) makes sale to the government, sales made by the company (wholesaler) to be considered as wholesale trade only when wholesale trade are made to the entities who have obtained valid registration/ licenses/ permits, etc. issued by the prescribed authorities.	Products should be sold under the same brand internationally (in one or more countries other than India) as well.
The wholesaler should maintain records indicating details of sales on a day to day basis.	Products sold under SBRT should be those that have been branded during manufacturing process.
The regulation allows wholesale trade amongst group companies. However, wholesale trade to group companies (as defined in the regulation) taken together should not exceed 25 per cent of the total turnover of the wholesale venture.	A non-resident entity or entities, shall be permitted to undertake SBRT, for a specific brand, through a legally tenable agreement with the brand owner, the onus of compliance shall rest with the Indian entity carrying out SBRT in India.
The regulations allow wholesale trade may be undertaken as per normal business practice, including extending credit facilities subject to applicable regulations.	Retail trading through e-commerce (in any form) is not permitted.
The regulations do not permit a wholesale trader to open retail shops in order to sell directly to the end-consumers.	In respect of proposals involving FDI greater than 51 per cent, there is a mandatory requirement to source 30 per cent of the value of goods from India, preferably from the Micro, Small and Medium Enterprises (MSMEs), village and cottage industries, artisans and craftsmen, in all sectors,

Source: KPMG in India analysis

One of the key conditions of WCCT model is that a wholesale trader is not permitted to undertake retail trading to sell to end-consumers directly. The term, 'cash and carry wholesale trade' has been defined in the FDI policy of 2010 as sale of goods/merchandise to retailers, industrial, commercial, institutional or other professional business users, etc. Wholesale trading has also been defined to mean sale for the purposes of trade, business and profession, and not for personal consumption. The yardstick to determine whether sale is wholesale or not, would be the category of customers to whom such sale is being made and not the size or volume of sales.

An Indian company (wholesaler) with FDI operating under the WCCT model usually enters into an agreement with the franchisee/distributor to sell the branded products to the franchisee for further sale into the retail market to the end consumers.

In order to meet the requirements of the FDI policy on WCCT, a detailed analysis of the terms of agreement between the wholesaler and the franchisee/distributor is necessary. Certain types of transactions between the wholesaler and franchisee/ distributor could entail violation of the FDI norms on WCCT i.e. wholesaler stepping into retail business. The list below is an illustrative list and provides a brief description of certain transactions in which an Indian company operating as a wholesale trader could be in a violation of the FDI norms. The wholesaler following FDI norms for WCCT purposes should carry out a detailed analysis of each type of such transactions to ensure compliance with the FDI norms under the WCCT model.

1. **Wholesaler providing an assured return on investment of the franchisee:** Since the wholesaler under the WCCT model is not permitted to enter into the retail market to sell directly to end-customer, it may be advisable for the wholesaler to not enter into an arrangement with the franchisee which results in providing an assurance of minimum return to the franchisee/distributor for its investment to set-up retail stores.

2. Franchise given the right to sales returns: A wholesaler should analyse the terms of an agreement with the franchisee(s)/distributor(s) which allow them to return the products if the products are not sold within a specified time period. Additionally, the agreement with the franchisee should not contain a clause that in case of termination of the agreement, the wholesaler is under an obligation to buy-back the unsold inventory lying with the franchisee/distributor. Transactions between the wholesaler and the franchisee/distributor should be on a principal to principal basis (B2B) and the franchisee/distributor should not be operating as an agent of the wholesaler.
3. Retrospective price revision: A wholesaler should not retain the right to fix/revise the maximum retail price (MRP) of the products sold to the franchisee(s)/distributor(s) i.e. the wholesaler should not be governing product margins even after the sale to the franchisee/distributor. The implication of such a right is that though the products have been sold to the franchisee/distributor, it might appear that the control of such products still remains with the wholesaler.
4. Payment terms: A wholesaler should be careful while agreeing to the payment terms with the franchisee(s)/ distributor(s). The situations where franchisee/distributor are allowed to pay for the outstanding receivables only upon further sale of products to the end-consumer in retail market should be evaluated carefully.
5. Infrastructure support and human resources: In practice, cost of infrastructure support for setting up retail stores, i.e. structuring, decorating and equipping the same, is sometimes provided by the wholesaler. In some instances, a wholesaler may also agree to reimburse cost of staff working at the franchisee/distributor retail stores. It is advisable to evaluate these commercial terms.
6. Lease support: In some instances, a wholesaler may lease property for the stores directly with the landlords or it may co-sign a tri-partite lease agreement with the lessor and the franchisee. Specific terms in the agreement related to payment of security deposit or sharing of lease rent on behalf of franchisee/distributor should be analysed carefully.
7. Inventory risk: After sale of goods to the franchisee/distributor, it may be advisable that the wholesaler should not assume any risk related to the inventory lying with the franchisee/distributor. Specific terms in the agreement with the franchisee/ distributor related to inventory risk/cost such as insurance cost of the inventory being borne by the wholesale, cost of damaged inventory reimbursed by the wholesales, etc. should be analysed carefully.
8. Slow moving inventory: It may be advisable that the wholesaler should not be responsible for slowing moving inventory lying with the franchisee, or agree for clearance of the same at reduced prices and reimburse the loss incurred by the franchisee/distributor.
9. Barter transactions: A company sometimes may enter into an agreement with a third party to transfer the slow moving products in consideration of advertisement/ marketing services provided by the third party. Any type of barter transaction should be analysed carefully that it meets the definition of WCCT as defined in the FDI policy.
10. Direct delivery of goods: Any arrangement entered into by the wholesaler with the franchisee/ distributor which provides for delivery of products directly to the end customer on specific request of the franchisee to reduce delivery cost/ time should be anlysed even though the products are billed to the end customer by the franchisee/distributor.

A wholesaler operating under WCCT should evaluate the above terms in their arrangements with the franchisee/ distributors to ensure compliance. A robust process must be established to analyse all the transactions with the franchisee/distributor in order to ensure that the sales made to the franchisee/ distributor meets the wholesale trade norms.

Related party transactions: accounting challenges

This article aims to

- Highlight the accounting challenges posed by the related party transactions under Indian GAAP.

Companies frequently enter into related party transactions as a part of normal business activity. Related party transactions, due to their very nature, have been a subject-matter of greater scrutiny by various stakeholders including investors, regulatory and taxation authorities. This is evident from various requirements of accounting standards and corporate laws which prescribe specific disclosures about related party transactions, stringent approval mechanism and, in some cases, restrictions with regard to related party transactions.

Challenges in accounting for related party transactions

The basic presumption in a related party transaction is that, due to the underlying relationship, one party is in a position to control/ influence the other party and, therefore, the consideration and other terms and conditions of the transaction may not be comparable with those with unrelated parties. Sometimes, related parties enter into transactions which unrelated parties may not enter into.

While the relevant accounting standard (AS 18, *Related Party Disclosures*) and the Companies Act/equity listing rules of the stock exchanges prescribe disclosure requirements and approval mechanisms for related party transactions, there is no specific guidance with regard to recognition and measurement of related party transactions under AS 18. Related party transactions are accounted for in accordance with the requirements of relevant accounting standards. However, in some cases, due to substance of the transaction being different as compared to the legal form in related party transactions, there is a need for a detailed evaluation of the substance and to apply special considerations with regard to such transactions. For example, take the situation where the parent company may forgive a loan given to its subsidiary. In this situation, a question arises whether the subsidiary company should recognise a gain on extinguishment of the liability or it should be accounted for as a capital contribution from the parent company. There can be other related party transactions which may need careful evaluation in the absence of specific guidance under accounting pronouncements. Some of the examples are as below:

– A parent company provides stock options to the employees of its subsidiary companies with no recharge to the subsidiary companies

– A parent company transfers one of its brands to its wholly-owned subsidiary, at fair value. This is an in-house developed brand for the parent, and, hence, has a nil carrying amount in the parent company's books. In such a case, the question arises whether the parent company can recognise a gain (equivalent to the sale consideration of such brand) in its separate financial statements, although from the overall consolidated group's perspective nothing has changed.

– A company has a centralised IT infrastructure and shared service centre, which provides IT and accounting support to its subsidiaries across the world. The company does not recharge the cost to its subsidiary companies.

– A parent company provides interest-free loan to its subsidiary company with a view to provide financial support and protect its investment in the subsidiary company

– A company makes a sale of a property to a controlling shareholder at a price above or below fair market value.

There may be various other transactions of similar nature where, besides the regulatory and taxation related implications, the accounting may not be straight forward. Besides this, there may be a divergence in accounting treatment depending on the availability of specific guidance. For example, in case a parent company provides its equity settled stock-options to the employees of its unlisted subsidiary company, the accounting for the stock compensation cost is carried out in the books of the subsidiary company pursuant to the requirements of the Guidance Note on '*Accounting for Employee Share-based Payments'* (Guidance Note), issued by the Institute of Chartered Accountants of India (ICAI). In such a case, the stock compensation cost is recognised as an expense to the statement of profit and loss of the subsidiary company (being the company which is receiving the services of the employees) with a corresponding credit to the capital reserve considering this as a contribution by the parent company. However, the accounting is different in case of a listed subsidiary since the relevant SEBI guidelines, viz., *SEBI (Employee Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999*, do not require recognition of compensation cost in the books of the listed subsidiary company in the above case. It may also be noted that even though in case of stock-options given to the employees of an unlisted subsidiary company, the cost is recognised in the books of subsidiary company based on the substance of the transaction based on the Guidance Note.

There is no specific accounting guidance to deal with recognition and measurement of other kinds of related party transactions.

AS 18, *Related Party Disclosures* and SA 550, *Related Parties*

AS 18, *inter alia,* requires the disclosure of 'any other elements of the related party transactions necessary for an understanding of the financial statements'. It further provides that an example of such a disclosure would be an indication that the transfer of a major asset has taken place at an amount materially different from that obtainable on normal commercial terms. Therefore, even if a transaction is not made on an arm's length basis, AS 18 only requires disclosures thereof. However, AS 18 does not establish any recognition or measurement requirements for the related party transactions.

In this context, it may be noted that SA 550, issued by the ICAI contains certain requirements which are not only relevant from an auditing perspective, but are also worth considering while preparing the financial statements. One of the paragraphs of SA 550 which is relevant in this context is as under

"In the context of a fair presentation framework, related party relationships and transactions may cause the financial statements to fail to achieve true and fair presentation if, for example, the economic reality of such relationships and transactions is not appropriately reflected in the financial statements. For instance, true and fair presentation may not be achieved if the sale of a property by the entity to a controlling shareholder at a price above or below fair market value has been accounted for as a transaction involving a profit or loss for the entity when it may constitute a contribution or return of capital or the payment of a dividend." (paragraph A2 of SA 550)

From the above, it may be noted that the accounting for a related party transaction may need a careful evaluation, based on its substance. As per the above paragraph, in case a transaction is made on a fair market value by the controlling shareholder, the recognition of profit or loss may be appropriate; however, in case it is not at fair market value (assuming this is permissible under the relevant corporate laws), it may involve contribution or return of capital or the payment of a dividend, and should be accounted for accordingly.

While the above paragraph of SA 550 provides the example of a specific situation, it is not clear as to what extent the above requirement is applied to other related party transactions. For example, in case a parent company provides an interest-free loan to a subsidiary company; unlike IFRS, there is no requirement under Indian GAAP to account for the loan at a fair value, impute the interest cost, and consider the same as a contribution by the parent company. In such a case, only a disclosure under AS 18 is required to be made. Similar may be the case of centralised infrastructure and IT cost incurred by the parent company, for which no recharge is being made to the subsidiary company.

Conclusion

Considering that related party transactions can be carried out in various forms, it is important that the substance is evaluated carefully while accounting for the same in the light of the requirements of SA 550. Further, a clarification from ICAI would also be useful with regard to the extent of application of SA 550 with a view to avoid divergent practices in accounting for related party transactions.

Amendments to Ind AS: Carve-outs[1]

This article aims to

- Provide a summary of the proposed amendments to Ind AS
- Identify the basis for the proposed amendment to Ind AS.

The finance minister in his budget speech recognised the need to converge the current accounting standards under Indian GAAP with IFRS. He proposed to make these IFRS converged Indian Accounting Standards (Ind AS) mandatory for Indian companies from the financial year 2016-17. He also mentioned that the companies could opt to adopt Ind AS voluntarily from the financial year 2015-16.

The date of implementation of Ind AS for banks and insurance companies is likely to be notified separately by the respective regulators. Similarly, the finance minister has stated that standards for computation of tax will be notified separately.

With the finance minister having set the ball in motion, various stakeholders including regulators and standard setters have been working towards ensuring their readiness to facilitate convergence with IFRS by Indian companies.

The Ministry of Corporate Affairs (MCA) had published 35 Ind AS on 25 February 2011. The MCA did not finalise and declare the exact implementation date of the Ind AS. The Ind AS published by the MCA had certain important aspects where Ind AS is not in conformity with IFRS (commonly, known as carve-outs).

Recently, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) has started revisiting the earlier carve-outs and certain other issues for further possible carve-outs/ins in the Ind AS. On 17 September 2014 and 24 September 2014, the ICAI has issued in two tranches, exposure drafts on the 'Amendments to Indian Accounting Standards – Consideration of carve-outs/ins'.

In this article, we have summarised the proposed amendments into three categories:

- areas different from IFRS (carve-outs from IFRS)
- areas where Ind AS is proposed to be aligned with IFRS (i.e. earlier there was a carve-out)
- areas where Ind AS proposes to provide additional guidance (carve-ins).

Last date to provide comments to these exposure drafts is 15 October 2014.

1. KPMG in India publication IFRS Notes issued on 29 September 2014 and ICAI exposure drafts on 'Amendments to Indian Accounting Standards - Consideration of carve-outs/ins'.

The table below provides a summary of the proposed amendments:

Areas different from IFRS

Ind AS 1, *Presentation of Financial Statements*

Current and non-current classification of liabilities

According to IAS 1, *Presentation of Financial Statements* , a liability that is payable on demand because a loan condition has been breached is classified as current even if the lender has agreed, after the end of the reporting period but before the financial statements are authorised for issue, not to demand repayment as a result of the breach.

The proposed carve-out in Ind AS states that if there is a minor procedural breach of the nature that does not result in payment on demand based on the past experience of the entity, then it would not result in classifying the liability as current liability.

Basis of this proposed amendment

The ICAI has proposed this as a practical expedient for cases when there is a default in compliance with minor procedural loan covenants where lenders do not exercise their rights to recall the loan. This carve-out is based on the similar guidance provided in the Guidance Note on Schedule VI (now Schedule III under the Companies Act, 2013) issued by the ICAI. However, this exception should not be applied by analogy to events, conditions and transactions other than loan contracts that have a specified schedule of payment of interest and principal measured at amortised cost in accordance with Ind AS 109, *Financial Instruments.*

Ind AS 17, *Leases*

Amortisation of lease payments

According to IAS 17, *Leases*, for an operating lease, a lessee recognises rent expense on a straight-line basis over the lease term, or on another systematic basis if it is more representative of the pattern of benefits to the lessee over time. The proposed carve-out provides exceptions to the principle of straight-lining rent expense and the exceptions allow a lessee to either:

- recognise rent expense by using another systematic basis if it is more representative of the pattern of benefits to the lessee over time even if the payments are not on that basis, or
- not straight-line over the lease term where the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary because of factors other than general inflation, then this carve-out would not be available.

Amortisation of lease income

According to IAS 17, for an operating lease, a lessor recognises lease income on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

The proposed carve-out clarifies that the lease income from operating lease would exclude amounts for services such as insurance and maintenance. Further, the proposed carve-out provides exceptions to the principle of straight-lining lease income and the exceptions allow a lessor to either:

- recognise lease income by using another systematic basis if it is more representative of the pattern of benefits from the leased asset is diminished, even if the receipt of income is not on that basis, or
- not straight-line over the lease term where the payments to the lessor are structured to increase in line with expected general inflation to compensate for the lessor's expected inflationary cost increases. If payments to the lessor vary according to the factors other than general inflation, then this carve-out is not available.

Basis of this proposed amendment

The ICAI has proposed this amendment in view of the Indian inflationary situation. This is a departure from IAS 17. The straight-lining of lease rentals would not be required in case the periodic rent escalation is due to inflation. However, if escalation is for reasons other than inflation, then straight-lining would be required.

Ind AS 27, *Separate Financial Statements*

Method of accounting of investments in separate financial statements

On 12 August 2014, the International Accounting Standards Board (IASB) amended IAS 27, *Separate Financial Statements*, which allows entities to use the equity method to account for investment in subsidiaries, joint ventures and associates in their separate financial statements. However, Ind AS 27 (published by the MCA in February 2011) does not allow use of equity method in the separate financial statements.

The proposal of the ICAI is that Ind AS would continue to not allow use of equity method in the separate financial statements.

Basis of this proposed amendment

The ICAI has proposed this as the equity method is not a measurement basis like cost or fair value. It is a manner of consolidation and therefore, may lead to inconsistent accounting conceptually.

Areas where Ind AS is proposed to be aligned with IFRS

Ind AS 24, *Related Party Disclosures*

Definition of close members of the family of a person

According to the Ind AS 24 (published by the MCA in February 2011), the definition of 'close members of the family of a person' is the persons specified within the meaning of 'relative' under the Companies Act, 1956 and that person's domestic partner, children of that person's domestic partner and dependants of that person's domestic partner.

The proposed amendment to Ind AS 24 modifies the definition of 'close members of the family of a person' to bring it in line with the definition in IAS 24, *Related Party Disclosures* , and reference to the Companies Act, 1956 has been removed.

According to the proposed amendment, the definition of 'close members of the family of a person' are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:

- that person's children and spouse or domestic partner
- children of that person's spouse or domestic partner
- dependants of that person or that person's spouse or domestic partner.

Basis of this proposed amendment

The ICAI has proposed the amendment to bring a principle-based definition of 'close members of the family of a person' as defined in IAS 24. However, the definition in the Companies Act, 1956 is primarily regulatory in nature to ensure governance, the ASB is of the view that the definition of 'close members of the family of a person' as given in IAS 24 would also cover relatives in case they influence or be influenced by the person. This definition may also cover other relatives that are not covered by the definition of 'relative' as per the Companies Act, 1956, in case a person can influence or be influenced by that other relative.

Ind AS 28, *Investments in Associates*

Scope of entities covered

According to Ind AS 28 (published by the MCA in February 2011), an entity (the investor) is required to account for investments in associates and joint ventures using the equity method except when the entity is a venture capital organisation. Venture capital organisations have an exemption to measure investments in associates and joint ventures at fair value through profit or loss (as per Ind AS 109).

The proposed amendment aligns the exemption to bring it in line with IFRS. Thus, allowing not only venture capital organisations but also mutual fund, unit trust and similar entities including investment-linked insurance funds to measure their investments in those associates and joint ventures at fair value through profit or loss (as per Ind AS 109).

Additionally, this proposed exemption would also be available when an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation or a mutual fund, unit trust, and similar entities including investment-linked insurance funds.

Alignment of reporting date and accounting policies

Ind AS 28 (published by the MCA in February 2011) provides a choice to an entity to follow different accounting policies while accounting for associates or joint ventures, where it is impracticable to follow uniform accounting policies of the investor. Similarly, if the financial year end date of an associate or a joint venture is different from that of an investor, Ind AS 28 (published by the MCA in February 2011) allowed the difference to be more than three months, if it was impracticable to use uniform accounting policies.

The proposed amendment removes these carve-outs for situations where it was considered previously impracticable to align the requirements of Ind AS with those in IFRS.

Basis of this proposed amendment

In Ind AS 28 (published by the MCA in February 2011) the references to mutual funds, unit trusts and similar entities including investment linked insurance funds were deleted as the Companies Act, 1956 was not applicable to such entities and thus the standard would not be applicable to such entities. Therefore, the ICAI has proposed this amendment in order to avoid different interpretations of such deletion i.e. entities could interpret that Ind AS 28 would be applicable to such entities in absence of the specific exemptions from applying the equity method.

The ICAI has proposed the amendment to remove the carve-outs relating to alignment of the reporting date and accounting policies for situations where it was considered impracticable. The reason for the change is that impracticability to obtain financial statements prepared in accordance with the uniform accounting policies of the investor as on the date on which the financial statements of the investor are drawn be representative of a situation where the investor possibly may not actually have significant influence over the investee.

Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*

Removal of option to defer exchange rate fluctuations on certain long-term monetary assets and liabilities

Ind AS 21 (published by the MCA in February 2011) provided an option for unrealised exchange differences arising on certain long-term monetary assets and long-term monetary liabilities denominated in a foreign currency to be recognised directly in equity.

The proposed amendment removes the carve-out to align the requirements with that in IAS 21, *The Effects of Changes in Foreign Exchange Rates* , and also in view of IFRS 9, *Financial Instruments* .

Basis of this proposed amendment

The ICAI has sought to align the requirements of Ind AS 21 with its corresponding standard under IFRS. There were some conceptual weaknesses and criticisms of the previously proposed carve-out and this has been amended accordingly.

Ind AS 110, *Consolidated Financial Statements*

Exemption from consolidated financial statements

IFRS 10, *Consolidated Financial Statements*, allows an intermediate parent an exemption from preparing consolidated financial statements if certain criteria are fulfilled. Ind AS (published by the MCA in February 2011) did not allow this exemption to intermediate parent entities and such entities were required to prepare consolidated financial statements.

The proposed amendment would align Ind AS to the requirements in IFRS by providing exemption to intermediate parent entities from preparing consolidated financial statements when certain criteria are fulfilled.

Similar to the proposed exemption from preparing consolidated financial statements under Ind AS 110, it has been proposed that Ind AS 28 would also provide an exemption to intermediate parent entities from applying equity method, if certain criteria are met.

Further, as a consequence to the above proposals, it is proposed to amend Ind AS 27 to allow an intermediate parent entity to prepare separate financial statements as its only financial statements (where such an entity is exempted from preparing consolidated financial statements as per Ind AS 110 or applying equity method as per Ind AS 28, if certain conditions are met).

Basis of this proposed amendment

The ICAI has proposed this amendment as IFRS 10 does not exempt any listed entity from the preparation of consolidated financial statements. The exemption from consolidated financial statements is only to unlisted intermediate entities. The ASB is of the view that the consolidated financial statements prepared by the intermediary subsidiaries do not provide useful information, in case their ultimate parent is preparing consolidated financial statements that are publically available.

Areas where Ind AS proposes to provide additional guidance

Ind AS 102, *Share-based Payment*

Accounting for employee share-based payment administered by an entity through creation of trust

Neither Ind AS 102 (published by the MCA in February 2011) nor IFRS 2, *Share-based Payment* , provide guidance on accounting of employee share-based payments administered by an entity through creation of a separate trust. The proposed amendment includes new guidance in Ind AS 102 regarding accounting of share-based payment plan administered through a trust.

According to the proposed amendment, an entity may administer a share-based payment plan through a trust constituted for this purpose. The trust may have different kinds of arrangements, for example, the following:

a. The entity allots shares to the trust as and when the stock options are exercised

b. The entity provides finance to the trust for subscription to the shares issued by the entity at the beginning of the plan

c. The entity provides finance to the trust to purchase shares from the market at the beginning of the plan.

The proposed amendment mentions that since the trust administers the plan on behalf of the entity, it is an extension of the entity as a branch/agent. The financial statements of the entity shall be prepared as if the entity itself is administering the plan.

Accordingly, the transactions of the trust should be included in the separate financial statements of the entity as if all the transactions of the trust are those of the entity. The transactions between the trust and third parties should be reflected in those financial statements as if these had been carried out by the entity itself. Loan, if any, given by the entity to the trust will not appear in the entity's separate financial statements. Any profit made by the trust on market operations shall be recognised in the equity of the entity.

The shares held by the trust shall be reflected in the separate financial statements of the entity. The face value of these shares shall be shown as a deduction from share capital and the excess paid over and above the face value shall be shown as deduction from securities premium with a detailed note explaining the facts. In the books of account, these shares will continue to remain recorded in a separate account and only for presentation purposes would be shown as deduction from share capital/securities premium.

Basis of this proposed amendment

The ICAI has proposed this amendment as both Ind AS 102 (published by the MCA in February 2011) and IFRS 2, *Share-based Payment* , do not provide guidance on accounting of employee share-based payments administered by an entity through creation of a separate trust.

The ASB is of the view that in India many entities administer share-based payments to employees through a separate trust. Therefore, such accounting guidance should be provided in the Ind AS 102.

Ind AS 103, *Business Combinations*

Common control transactions

IFRS 3, *Business Combinations,* deals with the accounting for business combinations but scopes out business combinations of entities under common control. However, Ind AS 103 (published by the MCA in February 2011) provides guidance on accounting of the business combinations under common control and requires such combinations to be accounted for using pooling of interest method. The proposed amendment requires that any difference between consideration paid and share capital of the transferor should be transferred to a separate component of equity called 'common control transaction capital reserve' instead of recognising goodwill/capital reserve.

Basis of this proposed amendment

The ICAI has proposed this amendment to provide further guidance on method of accounting for common control business combinations.

The ICAI is finalising the Ind AS for consideration and recommendation to the National Advisory Committee on Accounting Standards (NACAS). Through these amendments, ICAI is proposing to reduce the number of differences between Ind AS and IFRS. However, areas different from IFRS still remain and some of the significant ones are current and non-current classification of liabilities and straight-lining of lease amounts in the case of operating lease.

The IFRS has recently incorporated new standards e.g. IFRS 15, *Revenue from Contract with Customers* and IFRS 9, *Financial Instruments* . ICAI has recently released exposure drafts to incorporate these latest standards into the Ind AS framework.

Regulatory updates

The MCA amends norms relating to useful life and residual value; clarifies certain aspects of capitalisation of costs

The Ministry of Corporate Affairs (MCA), vide notification dated 29 August 2014, has made certain amendments to the schedule II which deals with useful lives to compute depreciation under the Companies Act, 2013 (2013 Act). The amendments are effective from 29 August 2014, which is the date of publication of the said notification in the Official Gazette.

Through a general circular dated 27 August 2014, the MCA has issued clarifications regarding capitalisation of costs incurred during extended delay in commercial production (for reasons beyond the developer's control), whether capitalisation of power plants should be unit-wise or project-wise, and applicability of accounting standard on Accounting for Fixed Assets (AS 10) and Borrowing Costs (AS 16) on 'cost plus project' or 'competitive bid project'.

For an overview of these amendments to the schedule II and the MCA clarification regarding the capitalisation of borrowing costs in the power sector, please refer to KPMG in India's First Notes dated 1 September 2014.

[MCA's General circular No. 35/2014 dated 27 August 2014 and MCA's notification dated 29 August 2014]

Corporate governance in listed entities amendments to clause 49 of the Equity Listing Agreement considered

Clause 49 of the Equity Listing Agreement (ELA) was amended by the Securities and Exchange Board of India (SEBI) in April 2014, and the revised requirements are to become applicable from 1 October 2014.

Since then, the SEBI has received various representations from industry associations, companies and other market participants seeking clarifications and interpretation relating to certain of these amended provisions of clause 49. Additionally, SEBI recently sought feedback on the status of preparedness of the top 500 listed companies by market capitalisation for ensuring timely compliance with the clause 49.

To address the concerns and help the listed companies to ensure compliance with the revised provisions of the clause 49, the SEBI has made further amendments to some of the provisions of clause 49.

The amendments provide amended applicability criteria along with amendments to clauses related to the appointment of a woman director, independent directors, nomination and remuneration committee, material subsidiaries, risk and management committee, related party transactions, certain disclosures and certification of financial statements by the CEO.

The clause 49 continues to be applicable to all listed companies with effect from 1 October 2014 except for appointment of woman director which will be applicable from 1 April 2015. Additionally, the SEBI has amended the applicability criteria to provide that the clause 49 is not mandatory for the time being, to the following class of companies:

a. companies having paid up equity share capital not exceeding INR100 million and net worth INR250 million, as on the last day of the previous financial year.

b. Companies whose equity share capital is listed exclusively on the SME (small and medium enterprises) platforms and SME-ITP (institutional trading platforms).

Please refer to KPMG in India's First Notes dated 17 September 2014 for a summary of these amendments.

[SEBI's Circular CIR/CFD/POLICY CELL/7/2014 dated 15 September 2014]

Extension of due date for filing of income-tax return

The Central Board of Direct Taxes (CBDT) vide the Income-tax (Seventh Amendment) Rules, 2014 dated 25 July 2014 had amended Appendix II (i.e. Form No. 3CA, Form No. 3CB and Form No. 3CD) of the Income-tax Rules, 1962.

In view of the representation received by the CBDT, the due date of obtaining and furnishing the tax audit report for assessment year 2014-15 has been extended from 30 September 2014 to 30 November 2014. In this regard it is clarified that tax audit reports filed during the period from 1 April 2014 to 24 July 2014 as per pre-revised forms will be treated as valid tax audit reports under section 44AB of the Income-tax Act, 1961 (IT Act).

Additionally, the due date of furnishing return of income under section 139(1) of the Act for the assesses who are required to obtain and furnish the tax audit report under section 44AB of the Act has now been extended from 30 September 2014 to 30 November 2014 for the assessment year 2014-15. However, it has been clarified that there is no extension of the 'due date' for the purposes of calculating 'interest for defaults in furnishing return of income' as per section 234A of the IT Act.

[CBDT's order dated 26 September 2014; F.No.153/53/2014-TPL (Pt.I)]

Amendment to the Corporate Social Responsibility Rules

Rule 4(6) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 (CSR Rules) provide that 'companies may build CSR capacities of their own personnel as well as those of their implementing agencies through institutions with established track records of at least three financial years, but such expenditure shall not exceed five per cent of the total CSR expenditure of the company in one financial year.'

The CSR Rules have been amended to state that expenditure on building CSR capacities of their own personnel as well as those of their implementing agencies including 'expenditure on administrative overheads' should not exceed five percent of the total CSR expenditure of the company in one financial year. The amended rules are effective from 12 September 2014 i.e. the date of their publication in the official gazette.

In this regard, the MCA has also clarified that its earlier clarification where it clarified that 'salaries paid by the companies to regular CSR staff as well as to volunteers of the companies (in proportion to company's time/hours spent specifically on CSR) can be factored into the CSR project cost as part of the CSR expenditure stands withdrawn.

[General circular No. 36/2014 dated 17 September 2014; MCA's notification dated 12 September 2014; General Circular 21/2014 dated 18 June 2014]

Constitution of National Advisory Committee on Accounting Standards

The Ministry of Corporate Affairs (MCA) vide notification dated 18 September 2014 has constituted National Advisory Committee on Accounting Standards (NACAS) under section 210A of the Companies Act, 1956 to advise the central government on the formulation and laying down of accounting policies and accounting standards for adoption by companies.

The chairman and members shall hold office up to 17 September 2015 (i.e. for a period of one year from 18 September 2014 which is the date of publication of this notification in the Official Gazette) or till the constitution of National Financial reporting Authority (NFRA) under section 132 of the Companies Act, 2013, whichever is earlier.

[MCA's notification dated 18 September 2014]

KPMG in India offices

Ahmedabad
Commerce House V
9th Floor, 902 & 903
Near Vodafone House,
Corporate Road, Prahlad Nagar
Ahmedabad - 380 051.
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bengaluru 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,6th Floor,
Tower – 1,Godrej Waterside,
Sector – V,Salt Lake,
Kolkata – 700091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3058 5764/65
Fax: +91 20 3058 5775

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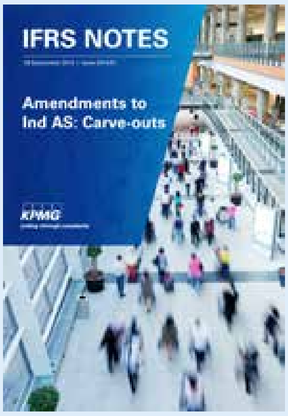
Introducing IFRS Notes

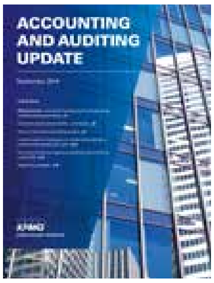


Amendments to Ind AS: Carve-outs

The finance minister in his budget speech recognised the urgent need to converge the existing notified standards under Indian GAAP with the IFRS. Towards this objective, he proposed to make Indian Accounting Standards converged with IFRS ('Ind AS') mandatory for Indian companies from the financial year 2016-17, with the option to voluntarily adopt them from the financial year 2015-16. The date of implementation of Ind AS for banks and insurance companies will be notified separately by the respective regulators.

As a part of implementation of this budget announcement, the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) has released two exposure drafts dealing with 'Amendments to Indian Accounting Standards (Ind AS) – consideration of carve outs/ins'. Through these exposure drafts the ICAI is trying to reduce the differences between Ind AS and IFRS, and substantially reduce the carve-outs. However, at the same time, the ICAI is also assessing the need of any further possible carve-outs considering various new developments under IFRS. The ICAI has also included in these exposure drafts additional areas where it has removed policy choices to enhance comparability and certain other areas where it provides additional guidance. The ICAI has released these exposure drafts for public comments. The last date of comments is 15 October 2014.

Missed an issue of Accounting and Auditing Update or First Notes?



September 2014

The September 2014 edition of the Accounting and Auditing Update provides insights into actions that can be taken by regulators and highlights related accounting and reporting considerations that impact companies primarily in the pharmaceutical sector.

We also cover two articles on the Companies Act, 2013 where we share some practical experience and implementation challenges – one is on corporate social responsibility and second on the related party transactions. Under the International Financial Reporting Standards, we cover the status of the lease accounting project and some of the narrow scope but significant amendments issued by the International Accounting Standards Board. As always, we have also covered key regulatory developments during the recent past.

SEBI's recent amendments of clause 49

Clause 49 of the Equity Listing Agreement (ELA) was amended by the Securities and Exchange Board of India (SEBI) in April 2014, and the revised requirements were to be applicable from 1 October 2014.

Since then, the SEBI has received various representations from industry associations, companies and other market participants seeking clarifications and interpretation relating to certain of these amended provisions of clause 49. Additionally, SEBI recently sought feedback on the status of preparedness of the top 500 listed companies by market capitalisation for ensuring timely compliance with the clause 49.

To address the concerns and help the listed companies to ensure compliance with the revised provisions of the clause 49, the SEBI has made further amendments to some of the provisions of clause 49.

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

On September 24, 2014 we covered two topics:

1. Amendments relating to tax audit reports in India: There are a number of significant amendments to the Form No. 3CD Due to the amendments made in the Form No. 3CD, the reporting responsibilities of the assessee and the auditor have increased considerably.
2. Recent amendments to the clause 49 of the Equity Listing Agreement: To address the concerns industry associations, companies and other market participants and to help the listed companies to ensure compliance with the provisions of the revised clause 49, the Securities and Exchange Board of India (SEBI) vide circular dated 15 September 2014 has amended some of the requirements of the revised clause 49.

In our call, we discussed these amendments and developments.

Feedback/Queries can be sent to aaupdate@kpmg.com

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