Assurance EYe

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Disclosure of accounting policy information: Material updates

On 31 March 2023, the Ministry of Corporate Affairs (MCA) notified the Companies (Indian Accounting Standards) Amendment Rules, 2023, whereby amendments have been notified to 10 Ind AS including Ind AS 1 *Presentation of Financial Statements*. In particular, the amendments to Ind AS 1 aim to help entities in providing accounting policy disclosures that are more useful by:

- Replacing the requirement for entities to disclose their 'significant accounting policies' with a requirement to disclose their 'material accounting policy information', and
- Adding guidance on how entities apply the concept of materiality in making decisions about accounting policy disclosures.

These amendments to Ind AS are aligned to similar amendments in IAS 1. The amendments are applicable for annual periods beginning on or after 1 April 2023. In this Article, we provide an overview of the amendments and related application guidance.

Replacement of the term 'significant' with 'material'

Ind AS 1 previously required the disclosure of significant accounting policies comprising the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

Now, according to the revised Ind AS 1, material accounting policy information needs to be disclosed. 'Material' is a defined term in Ind AS and is commonly understood by the users of financial statements.

How we see it

In assessing the materiality of accounting policy information, both quantitative and qualitative aspects need to be considered.

Guidance in applying the materiality definition

As per the amended Ind AS 1, "*Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements*." In our view, accounting policy information would rarely be assessed as material when considered in isolation, since accounting policy information on its own is unlikely to influence the decisions, primary users make based on the financial statements. However, accounting policy information could be material when considered together with other information in the financial statements. We believe that to apply new requirement, an entity will need to first identify material accounting policies. After identification, the entity will need to determine information requiring disclosure under each policy.

Identification of material accounting policy information

To assess whether accounting policy information is material, an entity needs to consider whether primary users of the entity's financial statements need that information to understand other material information in the financial statements. This assessment involves the use of judgement and requires consideration of both qualitative and quantitative factors.

Quantitative factors

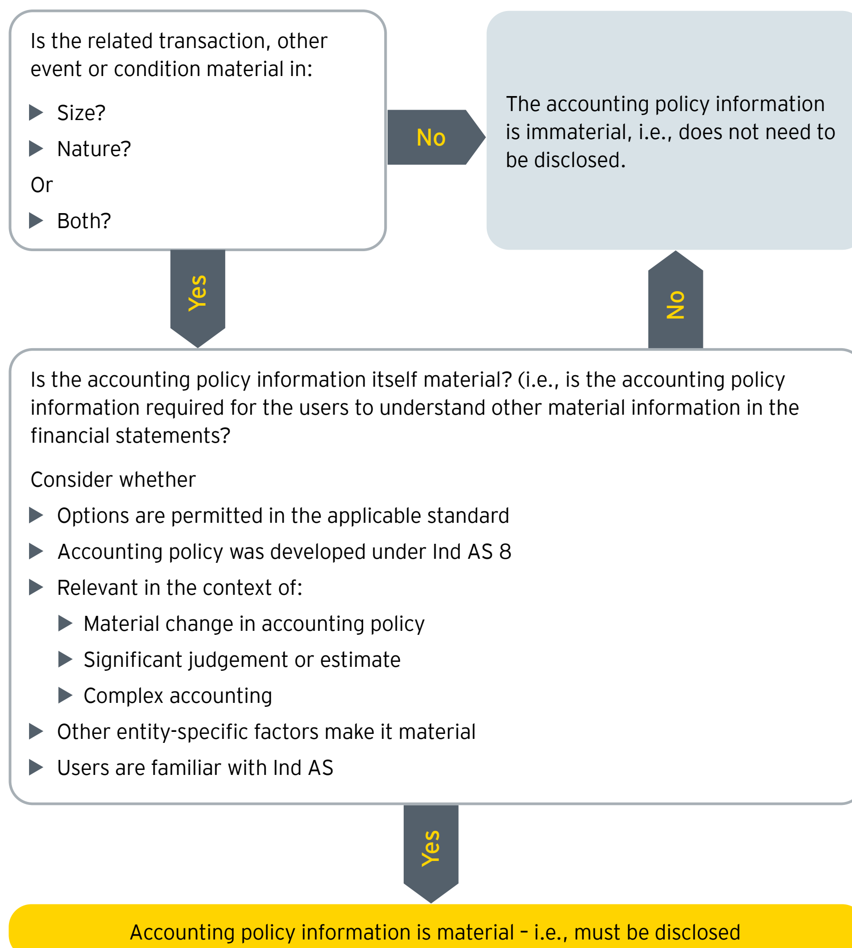
In assessing whether information is quantitatively material, an entity considers not only the size of the impact that it recognizes in its primary financial statements, but also any unrecognized items that could ultimately affect primary users' overall perception of the entity's financial position, financial performance and cash flows (e.g., contingent liabilities or contingent assets).

Qualitative factors

Qualitative factors are characteristics of an entity's transactions, other events or conditions, or of their context, that, if present, make information more likely to influence the decisions of the primary users of the entity's financial statements. While it will not necessarily make information material, the presence of qualitative factors is likely to increase the primary users' interest in that information. An entity considers both entity-specific and external qualitative factors.

Entity-specific qualitative factors include the involvement of related parties, uncommon or non-standard features in transactions, other events or conditions, and unexpected variations or changes in trends. External qualitative factors include geographical locations, industry sector, and the state of the economy in which the entity operates. Sometimes, the absence of an external qualitative factor is relevant. For example, if the entity is not exposed to a certain risk to which many other entities in its industry are exposed, information about that lack of exposure could be material information.

In Ind AS 1 amendment, specific guidance has been added to help entities determine when accounting policy information is material and, therefore, needs to be disclosed. Refer below diagram illustrating how entities incorporate different factors in materiality assessment.



The first step in the diagram considers whether the related transaction, other event or condition is material due to its size, nature, or a combination of both (in the current or comparative period) before assessing the materiality of the accounting policy information. If the related transaction, other event or condition is immaterial, the accounting policy information is also immaterial and does not need to be disclosed.

Although a transaction, other event, or condition to which the accounting policy information relates could be material, it does not necessarily mean that the corresponding accounting policy information is also material to the entity's financial statements. In assessing the materiality of the accounting policy information, an entity considers the list of indicators as stated below:

1. *A choice of accounting policy is permitted by the Ind AS*: Where an Ind AS provides preparers with an accounting policy choice on how to account for a material class of transactions, other events or conditions (e.g., Ind AS 16 *Property, Plant and Equipment* provides entities option to measure property, plant and equipment using either historical cost or revaluation model), the disclosure of accounting policy information indicating the choice selected by the entity is normally material. This is because a primary user would require the information to understand the other material information provided about the related amounts and balances in the financial statements.
2. An entity develops an accounting policy in accordance with *Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors in the absence of an Ind AS specifically applies*. Since an accounting policy developed under Ind AS 8 is, by nature, not a policy prescribed by Ind AS accounting standard, a primary user normally needs further information about the chosen policy in order to understand the related accounting impacts.
3. *It is needed to provide context for a change of accounting policy that had a material effect on the information in the financial statements*. If an entity has changed an accounting policy, in the current reporting period, that resulted in a material change to the information in the financial statements, the related accounting policy information is normally material as it provides the context a primary user would likely need to understand the other material information in the financial statements (e.g., under paragraphs 28-29 of Ind AS 8) related to the impact of the change. This information could be easier to access if disclosed along with the change in accounting policy information rather than separately in the general accounting policies disclosures.
4. *It is needed to provide a context to significant judgements and estimates which are disclosed under Ind AS 1*. Accounting policy information that relates to areas for which the entity is disclosing significant judgements or estimates (e.g., under paragraphs 122 and Ind AS 125 of Ind AS 1) are more likely to be required in order for a primary user to understand the other material information in the financial statements as these provide context to the significant judgements and estimates being made. However, the fact that an entity discloses significant judgements and estimates does not automatically mean that the related accounting policy information is also material. In some instances, this accounting policy information is most useful if presented with the significant estimate disclosure, rather than in a separate accounting policy information note.
5. *The required accounting (recognition, measurement, presentation, disclosure) is complex and users would otherwise not understand the material transaction, other event, or condition (e.g., when more than one Ind AS is applied).* Although entity-specific accounting policies information is generally more useful, but in case the accounting is complex, the disclosure of standardized accounting policy information could also be material. This is the case since primary users are less likely to understand the complex accounting treatment without being provided with the standardized information in the same context.
6. *There are other qualitative factors that make the accounting policy information material (e.g., entity-specific facts require the application of the accounting policy in some entities, but not others).* For example, an entity could act as a principal in some classes of transactions and as an agent in other similar transactions depending on whether it controls the goods or services before transferring them to the customer or not. In such instances, in addition to the disclosures about significant judgements (see above), a primary user could require accounting policy information explaining the two situations and the accounting policy differences to understand the related information in the financial statements.

Determination of information requiring disclosure for material accounting policies

The amended standard highlights that accounting policy information which explains how an entity has applied the requirements of Ind AS to its own circumstances and therefore provides entity-specific information that is generally more useful to users than standardized information which simply repeats what the applicable Ind AS generally requires. The entity-specific accounting policy information is particularly useful when it relates to an area where the entity has exercised judgement, e.g., when an entity applies an Ind AS accounting standard differently from similar entities in the same industry. Tailoring accounting policy information is particularly relevant when judgement is applied.

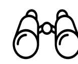
Disclosure of standardized information

Entities often disclose information describing how they have applied the requirements of a specific standard and provide "standardized information, or information that only duplicates or summarizes the requirements of the Ind AS" sometimes referred to as 'boilerplate disclosures.' Generally, such information is less useful to users than entity-specific accounting policy information. However, in some circumstances, standardized accounting policy information could be needed for users to understand other material information in the financial statements. In those situations, standardized accounting policy information is material, and must be disclosed. Give below are examples where standardized information can also be relevant:

- The information is necessary for the users to understand other material information provided in the financial statements.
- The users of the financial statements are in a jurisdiction outside India who may not be familiar with Ind AS requirements.
- Complex accounting is required by Ind AS and the standardized information is needed to understand the accounting (e.g., where more than one Ind AS is applied).

Disclosure of immaterial accounting policy information

The amended Ind AS 1 requires that if an entity decides to disclose accounting policy information that is not material, it needs to ensure that immaterial information does not obscure material information. For example, an entity could obscure material accounting policy information by giving the immaterial accounting policy information more prominence or presenting immaterial information with material information such that the reader is unable to distinguish the two.



How we see it

While the amended Ind AS 1 implicitly acknowledges that disclosure of immaterial accounting policy information could be acceptable, it is clear that entities must ensure that such immaterial information does not obscure material accounting policy information.

Immaterial accounting policy information could be removed from the accounting policies disclosures (or relocated) to avoid obscuring material accounting policy information.

Illustrative updated accounting policies

For illustrative purposes, the section below explains certain consideration which may be relevant for changes in the accounting policy information.

Existing policy	Updated policy	Points Considered
Revenue from contract with customer Revenue from sale of equipment is recognized at the point in time when control of the asset is transferred to the customer, generally on delivery of the equipment. The normal credit term is 30 to 90 days upon delivery. The entity considers whether there are other promises in the contract that are separate performance obligations to which a portion of the transaction price needs to be allocated (e.g., warranties, customer loyalty points). In determining the transaction price for the sale of equipment, the Group considers the effects of variable consideration, the existence of significant financing components, (if any).	Revenue from sale of fire prevention equipment is recognized at the point in time when control of the asset is transferred to the customer, generally on delivery of the equipment at the customer premise. The normal credit term is 30 to 90 days from the delivery date. **Warranty obligations** The Group typically provides warranties for general repairs of defects that existed at the time of sale, as required by law. These assurance-type warranties are accounted for as warranty provisions. Refer to the accounting policy on warranty provisions in section xx Provisions. The Group also provides a warranty beyond fixing defects that existed at the time of sale. These service-type warranties are sold either separately or bundled together with the sale of fire prevention equipment. Contracts for bundled sales of equipment and service-type warranty comprise two performance obligations because the equipment and service-type warranty are both sold on a stand-alone basis and are distinct within the context of the contract. Using the relative stand-alone selling price method, a portion of the transaction price is allocated to the service-type warranty and recognized as a contract liability. Revenue for service-type warranties is recognized over the period in which the service is provided based on the time elapsed. **Rights of return** A majority of sales contract generally provide customer a right to return an item for a limited period of time. Returned goods are exchanged only for new goods and no cash refunds are allowed. Revenue is recognized when goods are delivered at the customer's premise and have been accepted by the customer. For contracts permitting the customer to return an item, revenue is recognized to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur. Thus, the amount of revenue recognized is adjusted for expected returns, which are estimated based on the historical data for a specific type of customer, equipment, area, etc. In these circumstances, a refund liability and a right to receive returned goods (and corresponding adjustment to cost of sales) are recognized. The entity measures right to receive returned goods at the carrying amount of the inventory sold less any expected costs to recover goods. The refund liability and return assets (right to receive returned goods) are presented separately on the face of the Balance Sheet. The Group reviews its estimate of expected returns at each reporting date and updates the amounts of the asset and liability accordingly.	Management revises its accounting policy to include more entity specific details related to : ▶ Warranty obligations ▶ Right of return

<table>
<tr><th>Existing policy</th><th>Updated policy</th><th>Points Considered</th></tr>
<tr><td>Contract assets

Contract assets represent entity's right to consideration in exchange for goods or services transferred to the customer such that right is conditional on events ad circumstances other than the passage of time. Contract assets are subject to impairment requirements of Ind AS 109 Financial Instruments.</td><td>A contract asset is initially recognized for revenue earned from installation services because the receipt of consideration is conditional on successful completion of the installation. Upon completion of the installation and acceptance by the customer, the amount recognized as contract assets is reclassified to trade receivables.

Contract assets are subject to impairment assessment. Refer to accounting policies on impairment of financial assets in section XX Financial instruments – initial recognition and subsequent measurement.</td><td>The existing policy on contract assets primarily summarizes requirements of Ind AS 115 and does not cover entity specific aspects. These aspects are more clearly highlighted in the revised policy.</td></tr>
<tr><td>Leases – Entity as a lessor

Finance leases, which effectively transfer to the company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease term at the lower of the fair value of the leased property and present value of minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognized as finance costs in the statement of profit and loss. Lease management fees, legal charges and other initial direct costs of lease are capitalized.

A leased asset is depreciated on a straight-line basis over the useful life of the asset. However, if there is no reasonable certainty that the company will obtain the ownership by the end of the lease term, the capitalized asset is depreciated on a straight-line basis over the shorter of the estimated useful life of the asset or the lease term.

Leases, where the lessor effectively retains substantially all the risks and benefits of ownership of the leased item, are classified as operating leases. Operating lease payments are recognized as an expense in the statement of profit and loss on a straight-line basis over the lease term.</td><td>Policy deleted</td><td>▶ Amounts in the financial statements for leasing activities where the entity is acting as a lessor are immaterial

▶ There was no change in accounting policy during the year

▶ The accounting policy described earlier was merely summarizing Ind AS 116 requirement, and

▶ Leasing transactions entered by the entity are relatively simple and there are no entity specific aspects requiring explanation in policy

Please note: Whilst entity has deleted leases accounting policy, it may still be required to give disclosures required by Ind AS 116 in notes.</td></tr>
</table>

Existing policy	Updated policy	Points Considered
Current versus non-current classification The Entity presents assets and liabilities in the balance sheet based on current/ non-current classification. An asset is treated as current when it is: ▶ Expected to be realised or intended to be sold or consumed in normal operating cycle, ▶ Held primarily for the purpose of trading, ▶ Expected to be realised within twelve months after the reporting period, or ▶ Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period. All other assets are classified as non-current. A liability is current when: ▶ It is expected to be settled in normal operating cycle ▶ It is held primarily for the purpose of trading ▶ It is due to be settled within twelve months after the reporting period, or ▶ There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period The terms of the liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification. The Group classifies all other liabilities as non-current. Deferred tax assets and liabilities are classified as non-current assets and liabilities. The operating cycle is the time between the acquisition of assets for processing and their realization in cash and cash equivalents. The group has identified twelve months as its operating cycle.	Based on the time involved between the acquisition of assets for processing and their realization in cash and cash equivalents, the group has identified twelve months as its operating cycle for determining current and non-current classification of assets and liabilities in the balance sheet.	The requirement of current versus non-current primarily repeat the requirements of Ind-AS 1 *Presentation of Financial Statements* and Schedule III to the Companies Act, 2013 (as amended). Hence, they may not represent material accounting policy information. However, the duration of the operating cycle may vary based on industry in which the entity operates and, therefore, is considered material accounting policy information.

Way forward

The replacement of 'significant' with 'material' accounting policy information in Ind AS 1 and the corresponding new guidance in Ind AS 1 may impact the accounting policy disclosures of entities. Determining whether accounting policies are material or not requires greater use of judgement. Therefore, entities are encouraged to revisit their accounting policy information disclosures to ensure consistency with the amended standard.

The use of boilerplate disclosures for accounting policy information has been observed in practice. Entities should carefully consider whether "standardized information, or information that only duplicates or summarizes the requirements of the Ind AS" is material information and, if not, whether it should be removed from the accounting policies disclosures to enhance the usefulness of the financial statements.

Entities should appreciate that drafting tailor made policies and taking a decision on which policies not to disclose on grounds of materiality would need extensive time and effort. Also, these tailor-made policies may end up disclosing information which earlier was not explicitly mentioned. Entities in competing industries would also end up reading these policies in finer detail, which obligates the right level of management attention to this exercise.

02

Key accounting considerations for supplier finance arrangement

Background

In recent years, supplier finance arrangements, also commonly referred to as supply chain finance (SCF), trade payable financing, reverse factoring arrangements or structured payable transactions, are becoming popular as a means to facilitate faster payment by customers of their supplier invoices. These arrangements are popular across industries but more common in metal & mining and FMCG sector. In such arrangements, generally a financial intermediary, viz., bank agrees to make upfront payment for amounts owed by an entity to its suppliers and the entity will make payment to the bank at a date later when payment to the suppliers is due or at the end of extended credit period. These arrangements may take various forms and terms and conditions of these arrangements may also vary significantly. Based on our understanding, given below are typical features of a common supplier finance arrangement:

- Involvement of a purchaser of goods/ services, a group of its suppliers and a financial intermediary (bank) who enter into a tri-partite or a series of bilateral agreements.
- Purchaser is often a large, creditworthy entity that uses a number of suppliers, many of which will have a higher credit risk/ lower credit worthiness than the purchaser.
- Arrangement is generally initiated by the purchaser as against the supplier.
- In many cases, these arrangements are put in place so that the purchaser gets extended payment terms from its suppliers. However, in other cases, the purpose may simply be to secure early payment for the supplier.
- Bank makes available to suppliers invoice discounting or factoring facility for invoices accepted by the purchaser.
- Purchaser will commit to pay the invoice on the due date or at the end of extended credit period.
- Interest and cross-default terms are included in the agreement to protect the bank in the event of the purchaser defaulting or missing the payment date.

Key accounting question

Whether the purchaser should present amount payable as a trade payable or as a debt-like liability. This determination could have a significant impact on the purchaser's financial position, particularly its leverage and/ or gearing ratios.

- Generally, the bank considers credit risk of the purchaser to decide minimum interest rate, but it may still be able to charge somewhat higher financing cost to the supplier (as discount charge).
- It can be difficult to determine the overall financing costs of the arrangement, and who bears those costs, especially if the supply involves items for which the pricing is subjective/ unobservable.

Key accounting considerations

With regard to payables covered under such arrangements, the following key questions arise:

a) There is no doubt that the purchaser has a financial liability till it settles dues under the arrangement. The question is how should such payable be presented in the balance sheet? What are the key considerations to decide such a presentation?

b) How should cash flows related to such arrangements be presented in the statement of cash flows of the purchaser?

c) Are there any disclosures required for such arrangements in notes for the financial statements?

Recent development/ IFRIC Agenda Decision

In early 2020, Moody's Investors Service (MIS) wrote to the IFRS Interpretations Committee (IFRIC) highlighting their concerns about the classification and disclosure of liabilities and liquidity risks arising from supply chain finance arrangements and asked the IFRIC to consider providing guidance. The MIS was mainly concerned that without adequate disclosure it is difficult for users of financial statements to compare entities using supply chain finance arrangement with those that do not, inadequate/ inappropriate disclosure of supply chain finance arrangements obscure the nature of debt-like liabilities and blurs the important distinction between operating and financing cashflows. The IFRIC, while considering this matter, described reverse factoring arrangements simply as ones in which a financial institution agrees to pay amounts an entity owes to the entity's suppliers and the entity agrees to pay the financial institution at a date later than suppliers are paid. The IFRIC issued a final agenda decision in December 2020, stating that IFRS accounting standards (IFRS) already provide guidance on the appropriate accounting classification and disclosures for reverse factoring arrangements. Consequently, the IFRIC decided not to add supplier financing to its work plan.

Nevertheless, feedback and input received by the IFRIC, from investors and analysts, suggested the information entities provide about supplier finance arrangements applying existing IFRS requirements does not meet all the information needs which would allow the users of the financial statements to fully understand the arrangement in place and associated risks. As a result, in May 2023, the IASB has amended IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments*: *Disclosures* to prescribe specific disclosures for such arrangements. An entity shall apply these amendments to IAS 7 and IFRS 7 for annual reporting periods beginning on or after 1 January 2024 with earlier application permitted.

On the lines of the amendments to IAS 7 and IFRS 7, the Institute of Chartered Accountants of India (ICAI) has also issued the "*Exposure Draft on Supplier Finance Arrangements – Amendments to Ind AS 7* and *Ind AS 107*" which will require additional disclosures and thereby enable users of financial statements to assess effects of those arrangements on the entity's liabilities and cash flows and its exposure to liquidity risk. The proposed disclosures are likely to be effective for financial year beginning 1 April 2024.

Although IFRIC Agenda Decision was issued in the context of IFRS, it is clear that Ind AS requirements are substantially aligned to Ind AS albeit Schedule III to the Companies Act 2013 (as amended) contains additional/ top-up requirements for presentation of financial statements. Hence, similar considerations will apply with regard to presentation of such arrangements under Ind AS. Considering this, Ind AS and requirements under Division II of Schedule III (applicable to Ind AS companies) (hereinafter referred to as 'Schedule III'), this article discusses key considerations for supplier finance arrangements.

Presentation in the balance sheet

There is no single Ind AS which deals with accounting/ presentation of such arrangements. Rather, there are multiple requirements which need to be considered. For example, Ind AS 1 *Presentation of Financial Statements* requires separate presentation of trade and other payables from financial liabilities. It also requires presentation of separate line item based on size, nature, and function of an item. Format of balance sheet given in Schedule III requires borrowings, trade payables and other financial liabilities to be presented separately on the face of the balance sheet. Whilst Schedule III requires separate presentation of borrowings on the face of the balance sheet, neither Ind AS nor Schedule III nor *Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013* defines the term borrowing. However, Schedule III contains a list of items to be included/ presented under the head borrowing. Also, *Guidance Note on Division II - Ind AS Schedule III to the Companies Act 2013* and Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*, contain guidance on liabilities to be included under the head trade payable.

How we see it

There is no single Ind AS which deals with accounting/ presentation of payables covered under supplier finance arrangements. Rather, there are multiple requirements which need to be considered which makes evaluation complex and judgmental.

In addition to the above, Ind AS 109 *Financial Instruments* contains specific guidance on when an entity needs to derecognize old liability and recognize new liability. For example, it requires that an entity shall remove a financial liability from its balance sheet when, and only when, it is extinguished – i.e., when the obligation specified in the contract is discharged or canceled or expires. Further, an exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

There are further format changes/ disclosures required/ allowed in the financial statements depending on materiality, nature of items and to bring substance of the arrangement.

Considering the requirements, an entity will need to evaluate carefully and determine whether it should present liabilities that are part of a supplier finance arrangement:

- Within trade payables
- Within borrowings, or
- Within other financial liabilities/ as a separate line item on the face of the balance sheet.

The above evaluation is not an accounting policy choice but requires exercise of judgment basis evaluation of terms of the arrangement and relevant guidance. We believe some key factors requiring consideration/ evaluation include:

- What are roles, responsibilities and relationships of each party (i.e., the entity, bank and supplier)?
- What is the purpose of introducing supplier finance and who negotiates the terms of the supplier finance arrangement?
- Is the supplier's participation in the supplier finance arrangement optional?

- Has the entity directly/ indirectly received an extended credit period beyond the invoice original due date/ credit period normally available for purchases of similar nature?
- Have any discounts or rebates been received by the entity that would not have otherwise been received without bank's involvement?
- Does the entity receive any fees or other payments from the bank, or make any payments to the bank other than payment of the original invoice under its terms? If not directly, has the entity made such payment indirectly say through adjustment in purchase price of goods/ services?
- Is there acceleration of payment on specified events of default?
- Does the arrangement directly/ indirectly involve utilisation of the entity's line of credit with the bank?
- Is the entity obligated to maintain cash balances or are there credit facilities with the bank outside of the supplier finance arrangement that the bank can draw upon in the event of non-collection of the invoice from the entity?
- Whether additional security is provided as part of the arrangement, that would not be provided without the arrangement?
- Whether the terms of liabilities that are part of the arrangement are substantially different from the terms of the entity's trade payables that are not part of the arrangement?
- Do the terms of the supplier finance arrangement preclude the entity from negotiating returns of damaged goods to the supplier?
- Is the entity/ buyer released from its original obligation to the supplier? More specifically, in case of non-payment, who has the legal right to initiate action against the entity – the bank directly or through seller?

The analysis of these as well as other indicators will likely help entities to decide appropriate presentation of payables covered under such arrangements. While the analysis should consider the indicators in totality, some indicators might carry more weight than others.

In our view, amount payable and covered under supplier finance arrangement can continue to be presented as trade payable only if the entity's trade payables do not meet derecognition criteria of Ind AS 109 on payable getting covered under such arrangement and also such payable:

- Represents a liability to pay for goods and services
- Is invoiced and formally agreed with the supplier, and
- Is part of the working capital used in its normal operating cycle.

The entity will apply Ind AS 109 requirements to assess whether and when to derecognize trade payable and recognize a new liability at its fair value with resulting impact in the statement of profit and loss. Under Ind AS 109, an entity will need to derecognize trade payable and recognize a new liability, if:

- The entity is legally released from its original obligation to the supplier, and it assumes a new obligation toward another party, say, bank.
- Derecognition can also occur if the purchaser is not legally released from the original obligation, but the terms of the obligation are amended in a way that is considered a substantial modification. For example, the following changes indicate a substantial modification of liability.

  Trade payables normally do not entail a transfer of any collateral; however, such collateral is provided in a supplier finance arrangement.

  Under normal circumstances, a factoring arrangement between an entity's supplier and a bank does not benefit the entity. However, in a case, where bank purchases a supplier's receivables in a factoring arrangement at 95% of its face amount. Further, rather than collecting full amount of payable from the entity, the bank requires the entity to pay only 98% of that amount. In this case, the entity is receiving a benefit that it would not have received without the bank's involvement, indicating a substantial change in liability terms.

  Supplier finance arrangement with a bank allows the entity to remit payment to the bank on a date later than the original due date of the invoice.

  In such cases, it is appropriate to derecognize trade payable to supplier and recognition of new financial liability immediately on the date of change in terms, i.e., on the date of supplier finance arrangement and not at expiry of credit period allowed under the trade payable invoice.

How we see it

A purchaser will need to derecognise trade payable and recognise new debt like liability if the purchaser is legally released from its original obligation to the supplier, and/ or there is a significant change in terms of the original obligation to the supplier.

Based on an evaluation of derecognition requirements as well as other aspects stated above, if an entity concludes that presentation as trade payable is no longer justified, then it should evaluate other appropriate presentation of such liability, i.e., as borrowing, separate line item or as part of other financial liability. In the absence of any specific definition of the term 'borrowing,' such evaluation will depend on having a clear understanding of terms, nature and function of obligation for the entity and other related aspects. For example, assume an entity, which pursuant to supplier finance arrangement, has (i) obligation toward bank, (ii) is getting extended credit period such that obligation is no longer part of its working capital cycle, (iii) is paying interest directly or indirectly, (iv) has provided additional security, and/ or (v) is recognized as borrower in bank books. In this case, it seems clear that nature of the obligation is borrowing for the entity and should be presented as such in the balance sheet.

Consider one more example - An entity has entered into supplier finance arrangement and pursuant to the arrangement it is getting an extended credit period beyond credit period normally allowed by the supplier. However, the overall period is still such that it is still part of the working capital cycle. Also, other terms of the arrangement are such that the entity (i) continues to have an obligation toward the supplier such that in case entity does not make timely payment only supplier will have legal recourse against the entity, (ii) will not directly/ indirectly pay interest, (iii) has not provided any security or guarantee, and (iv) is not treated as borrower in the bank books nor bank has used any credit limit of the entity. In such cases, one may argue that whilst the obligation is no longer trade payable due to extended credit period; however, its nature is not borrowing for the entity and there is a need to consider alternate presentation in the balance sheet.

How we see it

Appropriate presentation of payable under supplier finance arrangements requires careful evaluation of terms and conditions of the arrangement as well as exercise of significant judgment. This may result in diversity of presentation as borrowings or otherwise, if presentation as trade payable is no longer justified. To avoid such diversity, we recommend that the Institute of Chartered Accountants of India (ICAI), the National Financial Reporting Authority (NFRA) or the Ministry of Corporate Affairs (MCA) should provide additional guidance on the matter. Till such guidance is provided, each entity should consider guidance available and develop its accounting policy for presentation of obligation covered under such arrangements. If impact is material, accounting policy as well as judgment exercised should be appropriately disclosed.

Presentation in the statement of cash flows

In respect of the presentation in the statement of cash flows, an entity that has entered into a supplier finance arrangement would need to determine whether to classify cash flows under the arrangement as cash flows from operating activities or cash flows from financing activities. This in turn poses the following challenges:

- Should the remittance of cash directly to the supplier by the bank be reflected at all in the statement of cash flow or is it a non-cash transaction?
- Should the presentation of the liability to the bank in the balance sheet impact the presentation of cash flows? For example, if the liability is presented outside of trade and other payables, should the ultimate payment to the bank be presented as a financing outflow?

With regard to the first question above, paragraph 43 of Ind AS 7 provides that "Investing and financing transactions that do not require the use of cash or cash equivalents are excluded from an entity's statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities." Hence, if a cash inflow and cash outflow occur for an entity when an invoice is factored as part of a reverse factoring arrangement, the entity presents those cash flows in its statement of cash flows. If no cash inflow or cash outflow occurs for an entity in a financing transaction, the entity discloses the transaction elsewhere in the financial statements in a way that provides all the relevant information about the financing activity.

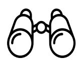
How we see it

With regard to the first question above, certain entities may argue that the relationship between themselves and the bank is, in substance, a principal/ agent relationship and the bank is acting as an agent of the entity and is, therefore, incurring cash flows on behalf of the entity when paying the supplier. Hence, they need to present operating cash outflow and financing cash inflow.

Alternatively, some entities may assess payment made by the bank to the supplier as non-cash transaction for the entity requiring disclosure in notes.

In our view, entities will need to consider the facts and circumstances and apply judgement when determining the appropriate impact on the cash flow statement.

With respect to the second question above, we believe that an entity's assessment of the nature of the liabilities that are part of the arrangement may help in determining whether the related cash flows arise from operating or financing activities. For example, if the entity considers the related liability to be a trade payable or other financial liability/ separate line item that is still part of the working capital used in the entity's principal revenue-producing activities, the entity presents cash outflows to settle the liability as arising from operating activities in its statement of cash flows. In contrast, if the entity considers that the related liability is neither a trade payable nor part of the working capital because the liability represents borrowings/ other financing of the entity, the entity presents cash outflows to settle the liability as arising from financing activities in its statement of cash flows.



How we see it

Assessing how to present liabilities and cash flows related to supplier finance arrangements may involve judgement and attention is drawn to Ind AS 1 requirement for disclosure of material judgements.

Disclosure in notes to financial statements

Existing disclosures required under Ind AS

With regard to supplier finance arrangement, the following disclosures required under Ind AS may be particularly relevant:

a) Since an entity applies judgement in determining appropriate presentation of payable in the balance sheet and cash flow statement and it may have a material impact on financial statements, the following disclosures may be relevant:

   (i) An entity discloses judgements that management has made in this respect if they are among the judgements made that have the most significant effect on the amounts recognized in the financial statements (paragraph 122 of Ind AS 1).

   (ii) An entity provides information about reverse factoring arrangements in its financial statements to the extent that such information is relevant to an understanding of those financial statements (paragraph 112 of Ind AS 1)..

b) Paragraph 44A of Ind AS 7 requires an entity to provide 'disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.' Such a disclosure is required for liabilities that are part of a supplier finance arrangement if the cash flows for those liabilities were, or future cash flows will be, classified as cash flows from financing activities.

c) Ind AS 107 defines liquidity risk as 'the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset'. Reverse factoring arrangements often give rise to liquidity risk because:

   (i) The entity has concentrated a portion of its liabilities with one bank rather than a diverse group of suppliers. The entity may also obtain other sources of funding from the same bank providing the supplier's finance arrangement. If the entity were to encounter any difficulty in meeting its obligations, such a concentration would increase the risk that the entity may have to pay a significant amount, at one time, to one counter party.

   (ii) Some suppliers may have become accustomed to, or reliant on, earlier payment of their trade receivables under the supplier finance arrangement. If the bank were to withdraw the supplier's finance arrangement,

those suppliers could demand shorter credit terms. Shorter credit terms could affect the entity's ability to settle liabilities, particularly if the entity was already in financial distress.

d) Paragraphs 33-35 of Ind AS 107 require an entity to disclose how exposures to risk arising from financial instruments including liquidity risk arise, the entity's objectives, policies and processes for managing the risk, summary quantitative data about the entity's exposure to liquidity risk at the end of the reporting period (including further information if this data is unrepresentative of the entity's exposure to liquidity risk during the period), and concentrations of risk. Paragraphs 39 and B11F of Ind AS 107 specify further requirements and factors an entity might consider in providing liquidity risk disclosures.

Proposed disclosures

As stated above, the ICAI has issued Exposure Draft on amendments to Ind AS 7 and Ind AS 107 (ED) to increase the level of disclosure and transparency about entities' supplier finance arrangements. The ED proposes the following disclosure for supplier finance arrangements:

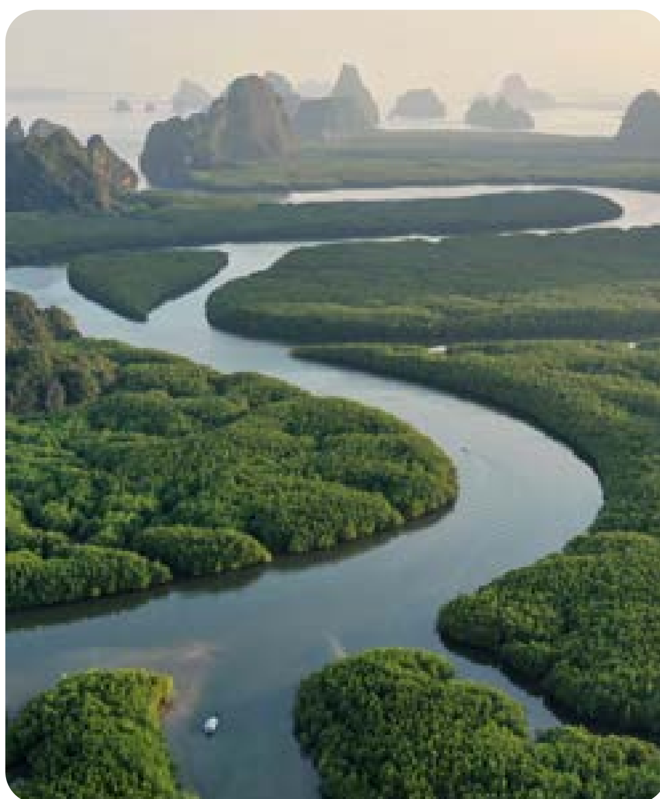
- Terms and conditions of the arrangements
- As at the beginning and end of the reporting period:
  - The carrying amounts of supplier finance arrangement financial liabilities and the line items in which those liabilities are presented.
  - The carrying amounts of financial liabilities and the line items for which the finance providers have already settled the corresponding trade payables.
  - The range of payment due dates for financial liabilities owed to the finance providers and for comparable trade payables that are not part of those arrangements.
- The type and effect of non-cash changes in the carrying amounts of supplier finance arrangement financial liabilities, which prevent the carrying amounts of the financial liabilities from being comparable.

The proposed amendments will require an entity to aggregate information about its supplier finance arrangements. However, the entity must disaggregate information about unusual or unique terms and conditions of individual arrangements when they are dissimilar. Explanatory information about payment due dates, when those payment due date ranges are wide, must also be disaggregated.

How we see it

The proposed amendments are particularly relevant considering that supplier finance arrangements are becoming more popular. However, the fact that the amendments do not define arrangements that are within the scope will make their application more challenging and increase the amount of judgement that entities will have to apply.

In order to prepare for compliance with the proposed requirements, entities must consider if they need to improve their financial reporting systems and/or obtain legal permission from finance providers in order to collect the information that is required to provide the new disclosures. As a result, it is key that entities allow sufficient time to prepare for the implementation of the new disclosure requirements.



REGULATORY COMPLIANCE

03

Assurance updates

Ministry of Corporate Affairs (MCA) updates

Audit trail

Amendment in Rule 3(1) of the Companies (Accounts) Rules, 2014 requires that for financial year beginning on or after 01 April 2023, all companies which use accounting software for maintaining their books of account should use only such accounting software which has a feature of recording audit trail. An audit trail has not been defined but can be colloquially understood to be a chronological sequence of the history of a particular transaction, tracking who created a record, who changed it after creation, what record, time of creation/ each subsequent change, etc. This feature should remain enabled throughout the financial year and should record the audit trail of every transaction by creating an edit log of each change made in the books of account along with the date when such changes were made and who made such change. It should also be ensured that trail cannot be disabled.

Section 143(3) of the Companies Act, 2013 provides various matters on which auditors are required to report in their auditor's report. Clause (j) of Section 143(3) states that auditor's report shall also state such other matters as may be prescribed. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 specifies such other matters that are to be reported by the auditor. MCA vide its notification No. GSR 206(E) dated 24 March 2021 has issued the Companies (Audit and Auditors) Amendment Rules, 2021. Vide these amendment Rules, the MCA introduced a new Rule 11(g) which casts responsibility on the auditor to report on audit trail by making a specific assertion in the audit report under the section 'Report on Other Legal and Regulatory Requirements'.

Specifically, the auditor needs to report on the following:

- whether the company is using an accounting software which has a feature of recording audit trail?
- whether the audit trail feature was enabled/operated throughout the year?
- whether the audit trail feature has been disabled or tampered with during the year?
- whether all transactions recorded in the software are covered in the audit trail feature?
- whether the audit trail has been preserved as per statutory requirements for record retention?

Consequent to above amendment, ICAI has issued an Implementation Guide on Reporting under Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014 to provide detailed guidance on various aspects so that the auditors can discharge their duties more efficiently and effectively. Key considerations from the guidance are mentioned below:

- The amendment is applicable to all companies. No exemption has been provided to one person company/ section 8 company/ private limited company/ public unlisted company.
- Software used to maintain books of account is within the ambit of these rules. The books of account are defined under Section 2(13) of the Companies Act. For example, if sales are recorded in a standalone system and only consolidated entries are recorded monthly into the General Ledger ERP, the sales system should have audit trail. Appendix 1 to the Guide provides an illustrative example of accounting software used by a Company for maintaining audit trail. Identified software in the Appendix include (i) Journal entries, subledgers and general ledger, (ii) Sales Invoices, Inventory, Customer Ledger, and (iii) Manufacturing Cost Records. Management has responsibility to identify accounting software on which trail needs to be maintained.
- There is no requirement to report on audit trail in limited reviews/ interim period reporting.
- In case where accounting software is provided by a service provider, the auditor may consider independent auditor's report on service organization (for example, SOC 2/ SAE 3402) for compliance with audit trail requirements.
- Failure of IT General Controls may impact auditor's reliance on audit trail feature in accounting software.
- Books of account maintained manually (in entirety) are not covered.
- To demonstrate that the audit trail feature was functional, operated and was not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors, as appropriate.
- Reporting on consolidated financial statements would be basis the reports of the statutory auditors of subsidiaries, associates and Joint Venture that are Indian companies.

What is next

Since reporting is applicable from 01 April 2023 onwards, all companies should evaluate on priority accounting software used and requiring audit trail, whether such accounting software used for maintaining books of account have the requisite functional parameters and attributes which would be considered as being compliant with the requirements and where it is necessary to engage with service providers to implement changes to ensure compliance. Any non-compliance with the mandatory requirements in law may have a reporting implication. Timely discussions with the statutory auditors will help in ensuring compliance with the requirements.

Designated person for furnishing details of beneficial interest in shares

Section 89 and 90 of the Companies Act, 2013 read with Rules made thereunder, put onus on every person who holds/ acquires a beneficial interest in share of a company to make a declaration to the company specifying the nature of his interest. The Company in turn needs to file a return of the declaration to the Registrar.

MCA has amended *Companies (Management and Administration) Rules, 2014* by inserting sub rules (4) to (8) to Rule 9. Basis this amendment, every company has to designate a person who will be responsible for furnishing and extending co-operation for providing information to the Registrar or any other authorized officer with respect to beneficial interest in shares of the company. The Company may designate:

- company secretary, if there is a requirement of appointment of such company secretary under the Act and the rules made thereunder; or
- Key Managerial Personnel (KMP), other than the company secretary; or
- every director, if there is no company secretary or KMP

Until a person is designated by the Company, the following persons will be deemed to be designated person:

- company secretary, if there is a requirement of appointment of such company secretary under the Act and the rules made thereunder; or
- every Managing Director or Manager, in case a company secretary has not been appointed; or
- every director, if there is no company secretary or a Managing Director or Manager

Company needs to inform the details of the designated person in Annual Return. Registrar needs to be intimated in case there is change in the designated person at any time in the prescribed form GNL-2.

What is next

This amendment has fixed responsibility and accountability for the designated person/ deemed designated person. Companies now need to appoint designated person for the purpose of providing information on beneficial interest in shares and disclose the same to the Registrar.

Securities and Exchange Board of India (SEBI) updates

Revised framework for computation of Net Distributable Cash Flow (NDCF) by Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs)

Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs) (hereinafter InvITs and REITs are collectively referred as 'Business Trust' or 'Trust') invest in income generating infrastructure assets and commercial real estate properties via special purpose vehicles (SPV) through equity or debt instruments. The investment in infrastructure assets and commercial real estate properties is typically made through special purpose vehicle (SPV) or HoldCo which in turns owns the infrastructure assets and commercial real estate properties. InvITs and REITs make distributions to their unitholders in the form of interest, dividend income, loan and capital repayment. The distribution by the Trust is dependent on the net cash flow generated by the Trust/SPVs, which is commonly called as net distributable cash flows (NDCF).

The existing framework provided under the SEBI (Infrastructure Investment Trust) Regulations, 2014 and the SEBI (Real Estate Investment Trust) Regulations, 2014 ("Regulations" or "framework") does not define NDCF but only provide indicative guidance on its calculation. As per the Regulations, Trusts must state the method/formula for computation of NDCF in the offer document and has to follow it consistently. The method prescribed by the Trust in the offer document can be different from the indicative guidance given under the Regulations.

As per existing indicative guidance, NDCF calculation starts with Profit after Tax (PAT) as per the statement of profit and loss and adjustment are made for items such as non-cash income/expense and few other items. It is noted that, in practice, many trusts include utilization of previously held cash for distribution to unitholders as part of NDCF measurement.

Whilst the existing framework does not define NDCF but once NDCF has been calculated as per the method prescribed in the offer document, there are other Regulations containing requirement for minimum distribution to unitholders as below:

- Not less than 90% of net distributable cash flows of the SPV shall be distributed to the Trusts/ holdco in proportion of its holding in the SPV subject to applicable provisions in the Companies Act, 2013 or the Limited Liability Partnership Act, 2008
- Not less than 90% of net distributable cash flows of the Trusts shall be distributed to the unit holders
- With regard to distribution of net distributable cash flows by the holdco to the Trusts, the following shall be complied:
  - With respect to cash flows received by the holdco from underlying SPVs, 100% of such cash flows received by the holdco shall be distributed to the Trusts; and
  - With respect to the cash flows generated by the holdco on its own, not less than 90% of such net distributable cash flows shall be distributed by the holdco to the Trusts.

Hence, the existing framework seems to require a distribution of at least 90% of NDCF from SPV to the Business Trust and distribution of at least 90% of Business Trust NDCF to unit holders. Effectively, it appears that there is a requirement to distribute at least 81% of SPV level NDCF to unit holders.

Vide Circular dated 06 December 2023, the SEBI has issued a revised framework for computation of Net Distributable Cash Flow (NDCF) by InvITs and REITs. The objective of issuance of standard framework to compute NDCF is to make more consistent and comparable across the Business Trusts as well as to plug certain practices based on recent learnings. The focus is to standardize the computation methodology, transparency and promoting ease of doing business. The revised framework shall be applicable with effect from 1 April 2024 and supersedes the existing Framework for calculation of NDCF. As per the revised framework:

- There is a specific formula prescribed for measurement of NDCF, requiring consistency amongst all trust. As per the formula, NDCF measurement starts with cash flow from operations as per Ind AS 7 and only specific adjustments are to be made. Some key adjustments include:
  - Finance cost on borrowings, excluding amortisation of any transaction costs as per the statement of profit and loss and any shareholder debt / loan from Trust, have to be mandatorily deducted on an accrual basis. This amendment plugs an anomaly of enhancing NDCF by obtaining loans with bullet payments of interest at the end. So, now as per the amendment, even if interest (or any finance cost like redemption premium) on a loan is payable later, it is deducted in computation of NDCF on an accrual basis.
  - Any restricted cash should not be considered for NDCF computation by the SPV or Trust (e.g., unspent CSR balance for any year deposited in a separate account as per the Companies Act which will be utilized in subsequent years, DSRA reserve, major maintenance reserve etc.)
  - No Trust or SPVs can distribute any cashflows by obtaining external debt. However, the Trust retains the option to distribute any surplus amounts, unless such

surplus is required to create reserves for any subsequent period. This will exclude any working capital / OD facilities obtained by Trust/ SPVs as part of Treasury management / working capital purposes as long as they are squared off within the quarter.

- Since money is fungible, management needs to develop a system to ascertain that distribution is not made from external debt. The amendments will change the existing practice of obtaining external debt at SPV level and using it to repay Holdco/Trust Loans and ultimately distribute it as NDCF. Whilst the change is welcome, the exception provided to use working capital/OD facility would be challenging to implement, since money is fungible. Also, the additional subsequent condition that requires that working capital should be squared off within the quarter, if NDCF was used from working capital makes it even more challenging. What happens if NDCF is distributed from working capital and it is not squared off during the quarter? The consequences are not clear.
- Proceeds from sale of real estate investments, real estate assets in case of REITs and infrastructure investments/ infrastructure assets in case of InvITs or shares of SPVs or Investment Entity adjusted for transaction costs or repayment of debt taken for such assets or other items, which are intended/ reinvested or planned to be reinvested as per the Regulations, could be temporarily parked in overdraft accounts or used to repay any additional/ unrelated debt. Further, if such proceeds are not intended to be reinvested as per the timeline provided in the Regulations and such net proceeds are to be distributed back to Unitholders.
- Currently, trusts may define their NDCF framework in such a way that proceeds from sale of any other assets (say, mutual fund investments or bank FD), which are intended to be reinvested, are excluded from the computation of NDCF. However, under revised farmwork, it seems only the sale proceeds of real estate assets/ infrastructure assets, which are intended to be reinvested, can be excluded from the NDCF computation.
- Cash flows received from SPV's / Investment entities which represent distributions of NDCF computed as per relevant framework at the Trust level for further distribution to Unitholders shall exclude any such cash flows used by the Trust for onward lending to any other SPVs / Investment entities to meet operational / interest expenses or debt servicing of such other SPVs / Investment entities.
- Capital expenditure includes amounts incurred and paid towards asset enhancement and are capitalized to asset value in the financial statements, including lease payments. Further Existing Assets includes any new structure / building / other infrastructure constructed on an existing infrastructure asset, which is already a part of the Trust.
- NDCF computed at SPV level for a particular period should be considered to determine NDCF at the trust level, even if the actual cashflows from SPV to Business Trust have taken place post that particular period, but before finalization and adoption of accounts of the Business Trust. This negates the compulsive hassle of upstreaming cash within the closing period in order for it to be considered for NDFC calculation at Trust level.
- Trust along with its SPVs needs to ensure that minimum 90% distribution of NDCF be met for a given financial year on a cumulative periodic basis as specified for mandatory distributions in the regulations. This was typically an issue during quarter/half year close which has now been clarified vide this amendment. For e.g., if a Trust distributes 95% of NDCF in Q1, but distributes lesser than the mandatory 90% in Q2, it will be considered compliant if on a cumulative basis, at the end of Q2, it is distributing minimum 90% of cumulative NDCF. So, the compliance is to be achieved on YTD basis and not for each quarter.
- The option to retain 10% distribution under the regulations needs to be computed by taking together the retention done at the SPV level and Trust level, i.e., separate retention of 10% at SPV and at trust level is no longer allowed. This clarifies the intention of SEBI that the distribution is 90% of consolidated NDCF. The earlier method was interpreted sometimes to mean 81% distribution at a consolidated level (90% distributed by SPV to Trust and 90% of 90% distributed by trust to unit holders).
- Any surplus cash available in SPVs and being used for distribution due to the following should be disclosed separately :
  - 10% of NDCF is withheld in line with the Regulations in any earlier year or half year
  - Surplus being available in a new SPV on acquisition of such SPV by the Business Trust
  - Any other reason, excluding if such surplus cash is available due to any debt raise, could be considered for distribution by the SPV to the Trust, or by the Trust to its Unitholders in part or in full.

This will likely enable allow unitholder to identify separately return received from current NDCF and from other items. However, it is not very clear from the revised framework that if there are any such items, where these should be disclosed in the NDCF computation and whether limit of 90% needs to be applied on these items and whether this requirement is applicable to Trust and holdco as well. The SEBI should clarify these matters on priority to avoid evolvement of any inconsistent practices amongst business trusts.

What is next

The revised framework has defined standard methodology for all the Business Trusts to compute the NDCF with additional disclosures. Considering the same, management of the Trusts should act proactively and consider the impact of revised framework on the projected NDCF and disclosures. The SEBI has clearly brought in welcome changes in the NDCF computations based on industry learnings. These changes will definitely impact the NDCF calculations of most incumbents and hence distributions to their unit holders. Considering these are yield based instruments, the sensitivity around NDCF is very high and can have far reaching implications. Hence, the impact of the changes in NDCF should be assessed and discussed by Investment Managers and if required a communication to Unit holders should be planned to make them aware of any material impacts to their distributions. Also for IPO transactions in pipeline, this may require discussions with potential investors as the future cash flow streams from the trusts may get impacted.

Business Responsibility and Sustainability Report (BRSR)

Vide circular no. SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122 dated 12 July 2023, SEBI has mandated reporting of ESG disclosures by top 1000 listed companies (by market capitalization) from FY 2023-24 onwards in the revised BRSR format. The revised format has added some additional questions in Section C, *Principle Wise Performance Disclosures* besides making some Leadership indicators as Essential Indicators. To enhance the reliability of disclosures in BRSR, SEBI vide amendment in Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 (LODR Regulations), has mandated the reasonable assurance of BRSR Core to top 150 listed entities (by market capitalization) from FY 2023-24 onwards which will be extended to top 1000 listed entities (by market capitalization) by FY 2026-27 in a phased manner. BRSR core is a sub-set of BRSR.

In addition, KPIs for value chain need to be disclosed by the top 250 listed entities (by market capitalization) from FY 2024-25 on comply-or-explain basis. Limited assurance on the same is required to be obtained with effect from FY 2025-26 on a comply-or-explain basis. For this purpose, value chain encompasses the top upstream and downstream partners of a listed entity, cumulatively comprising 75% of its purchases / sales (by value) respectively. However, extracting relevant information from these value chain partners could be a daunting task for the companies as they may not be aware of the requirement, or they may not want to share the information on account of confidentiality.

Besides the above, there are many sustainability reporting frameworks which are commonly used by companies in various parts of the world for disclosing their sustainability related information viz. GRI Standards issued by Global Sustainability Standards Board, Task Force on Climate related Financial Disclosures, recommendations issued by Financial Stability Board, SASB standards issued by SASB Standards Board (now part of International Sustainability Standards Board (ISSB)). ISSB has recently issued IFRS S1 (*General Requirements for Disclosure of Sustainability-related Financial Information*) and IFRS S2 (*Climate-related disclosures*) which will be effective for annual reporting periods beginning on or after 1 January 2024, with a 'climate first' transition option available to entities, allowing them to provide only climate-related disclosures in the first year of applying IFRS S1 and IFRS S2. Many countries are in the process of adoption of the IFRS S1 and S2.

Assurance providers provide assurance on the ESG disclosures made by the company under various assurance frameworks and guidance like International Standard on Assurance Engagements (ISAE) 3000 (*Assurance Engagements Other than Audits or Reviews of Historical Financial Information*)/ ISAE 3410 (*Assurance Engagements on Greenhouse Gas Statements*) (issued by International Auditing and Assurance Standards Board (IAASB)). IAASB has issued Exposure draft of International Standard on Sustainability Assurance 5000, *General Requirements for Sustainability Assurance Engagements*. Once the final standard is issued, it will be applicable to all sustainability assurance engagements.

What is next

Regulators and Investors are increasingly focussing on the ESG disclosures and their accuracy. Companies need to gear up for providing adequate information in the BRSR as part of their annual report. As reporting and assurance of sustainability related disclosures evolves, audit committees have a critical role to play in expanding their existing oversight responsibilities for financial reporting and compliance to sustainability-related disclosures. Instances of unintentional errors and intentional 'green washing' must be addressed by designing and implementing internal controls over the processes and systems where the assessed risk is material. The companies should also ensure that the financial impact of material climate-related risks have been considered and, where appropriate, are reflected in the audited financial statements. The audit committees can play a key role in ensuring the consistency and connectivity of sustainability/ESG related disclosures across general purpose financial reporting and other public disclosures.

Reserve Bank of India (RBI) updates

RBI implements stringent measures to curb rising consumer credit risks

The Reserve Bank of India (RBI), in response to escalating challenges in specific consumer credit components and its Governor's advisory statement dated 6 October 2023, issued regulatory measures vide its notification no RBI/2023-24/85 dated 16 November 2023. The primary focus of these measures is to mandate increased capital allocation against unsecured customer credit to mitigate associated risks by assigning higher risk weights.

The enhanced risk weights for consumer credit exposure of commercial banks and of the Non-Banking Finance Companies (NBFCs) and the increased scrutiny on credit card receivables are part of this directive. Furthermore, the circular extends its purview to the realm of bank credit to NBFCs, introducing stringent measures to ensure that exposures align with prudent risk management practices.

The below table summarizes significant changes as per the new circular:

Particular	Existing risk weights	Revised risk weights
Consumer Credit Exposure		
▶ Commercial Banks and NBFCs	100%	125%
Credit Card Receivables		
▶ Scheduled Commercial Banks	125%	150%
▶ NBFCs	100%	125%
Bank Credit to NBFCs	Risk Weight associated with external credit rating as provided in para 5.8 of Master Circular – Basel III Capital Regulations	Existing risk weight is Increased by 25% if the risk weights as per external credit rating is below 100%. There is no change if the risk weights are already 100% or more.

Strengthening credit standards

The RBI mandates regulated entities to review and set board-approved limits for sub-segments in consumer credit, emphasizing prudent risk management. Strict adherence to these limits, monitored by the Risk Management Committee, is required. Additionally, the RBI has required that all top-up loans against inherently depreciating movable assets, such as vehicles, should be classified as unsecured loans for credit appraisal, prudential limits, and exposure purposes.

Immediate implementation

The regulatory measures are effective immediately from the date of the notification, except requirements related to board-approved limits in consumer credit sub-segments which need compliance by the covered entities by 29 February 2024.

What is next

The move by the RBI is a prudent regulatory practice which aims at enhancing financial stability by curbing the issuing of loans against riskier assets, which has been on the rise since the fintech revolution in online, mobile-based and instant lending and lending through business correspondents. The increased risk weights will serve as a safeguard, compelling SCBs and NBFCs to allocate more capital to cover potential losses, thereby minimizing systemic risks.

While increase in risk weights do not necessarily lead to an increase in Expected Credit Loss (ECL) provisioning, it may be useful to re-assess estimates and assumptions including forward looking factors in computing the ECL provision for the impacted portfolios, considering that the regulatory measure is on account of the perceived stress in such portfolio by the regulator.

This shift also prompts a comprehensive impact assessment by management, focusing on reassessing Expected Credit Loss (ECL) provisioning, capital mobilization, exposure reallocation, and immediate target adjustments, all of which require a delicate balance to optimize returns while adhering to the revised risk framework.

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- Preeti D Poojary
- Rashika Kewte
- Viral Virvadia
- Vishal Bansal
- Yash Mantri

EY offices

Ahmedabad
22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru
12th & 13th floor
"UB City", Canberra Block
No. 24, Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh
Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai
Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR
Golf View Corporate Tower B
Sector 42, Sector Road
Gurugram - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad
THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jamshedpur
1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur – 831 001
Tel: + 91 657 663 1000

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune
C-401, 4th floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

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