Assurance EYe

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EY

Building a better working world

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SEBI amendments to Related Party Transactions

Related Party transactions has been a hot topic for all regulators worldwide. In India, this topic is super-hot because a large part of corporate India is still family owned and influenced by promoters / their family. If one looks at the regulatory landscape, the definition of who is a related party is itself not consistent, probably across various regulations. The Securities and Exchange Board of India ("SEBI") made some landmark changes to Regulation 23 of the SEBI Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR") and connected definitions. The objective of these amendments has been to protect the interests of minority shareholders from controlling shareholders/Promoters. Some of these changes are already applicable from 1 April 2022 and some are applicable from 1 April 2023. These will have significant implications on Companies, Audit Committees ("AC"), Board of Directors and Auditors. Let us understand what some of these key changes are:

Expansion of who is deemed to be a Related Party

"Related Party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards. Provided that the following shall be deemed to be related parties:

a) any person or entity forming part of the promoter or promoter group of the listed entity.

b) any person or any entity holding equity shares: (i) of 20% or more; or (ii) of 10% or more, with effect from 1 April 2023; in the listed entity either directly or on a beneficial interest basis as provided under section 89 of the Companies Act, 2013, at any time, during the immediate preceding financial year.

Snapshot of key changes to the deeming provisions are:

a) Prior to 1 April 2022, a person/entity forming part of promoter or promoter group AND holding 20% or more of shareholding was deemed to be a related party.

b) From 1 April 2022, any person/entity forming part of the promoter/promoter group is deemed to be a related party irrespective of shareholding.

c) From 1 April 2022, every other person (meaning other than promoter/promoter group) is deemed to be a related party *if he holds 20% or more of equity shareholding/ beneficial interest*.

d) From 1 April 2023, every other person is deemed to be a related party *if he holds >10% or more of the equity shareholding/beneficial interest*.

e) For points c and d above, the shareholding of 20% or 10% is to be evaluated based on previous years' holding.

Key considerations - Related Party definition

a) Classifying every entity of the Promoter/Promoter Group as a related party could be argued to be a low hanging fruit considering that in many cases it is the Promoter who is in control of decision making irrespective of the shareholding of the entity within the promoter group.

b) Classifying every entity/person having more than 10% equity shareholding in the listed entity as a related party may result in many private equity investors/FIIs/large independent shareholders becoming related parties. If this is an unintended consequence, then SEBI may consider providing certain practical expedients to avoid such unintended consequence. One such instance is Synnex Mauritius Ltd (FII) which holds 24.13% of Redington (India) Limited as on 31 March 2022 *(Source: Redington (India) Limited Annual Report 31 March 2022)*.

c) The issue highlighted in "b" above gets accentuated if one considers the expanded definition of Related Party Transaction (discussed in the later section). So, for example, If Company X and Company Y are related parties, then all subsidiaries of Company X would also be related parties of Company Y. Theoretically if Company X contributions to Gratuity fund, Superannuation etc., is maintained with Company Y, then all the transactions, such as contributions to Gratuity, Superannuation trusts etc., maintained with Company Y would be RPTs.

d) Threshold percentage like 20% or 10% for considering a party as a related party is limited only to stake in the listed entity. If an investor has a stake of >20% or 10% in a subsidiary of a listed entity (assuming it is not related through any other criteria), it will not be a related party but if it holds 20% or 10% in the listed entity, then it is a related party. SEBI may clarify as to whether this needs further amendment/clarification to cover listed entity and group.

Identification of parties as related parties is based on 20% or 10% equity shareholding of the previous year. Hence, it is possible that a party was holding 25% stake in equity shares in 2022-23 in the Company and sold off its entire stake in 2022-23, but its transactions in 2023-24 will still be considered as related party transactions and will need to follow the compliance requirements. The perspective of the Working Group of SEBI on Related Party Transactions might be that shareholders who hold significant shareholding could influence decision making. The current regulations did not capture the transactions as Related Party Transactions during their period of shareholding and hence may have been ineffective.

Voting on Related Party Transactions

a) Regulation 23(4) of SEBI LODR regulation states as follows *"All material related party, transactions and subsequent material modifications as defined by the audit committee under sub-regulation (2) shall require prior approval of the shareholders through resolution and no related party, shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not"*.

b) The common belief is that if a party is a related party, it is not allowed to vote on ANY transaction of another related party. However, that is not true. SEBI LODR has a concept of "vote to approve", which means that if a party is a related party it cannot vote to approve on ANY other related party transaction whether it is party to that transaction or not. But it can vote to dissent. This is an interesting concept whereby large shareholders, if they are classified as related parties, can still vote to dissent on promoter or any other related party transactions. In a sense, negative voting is allowed but positive voting is not allowed.

Change to the definition of Related Party Transaction

There are certain significant changes which have been made to the definition of Related Party Transaction. They are captured in the two diagrams below.

Diagram 1: Shows the changes applicable from 1 April 2022 (which are already effective)

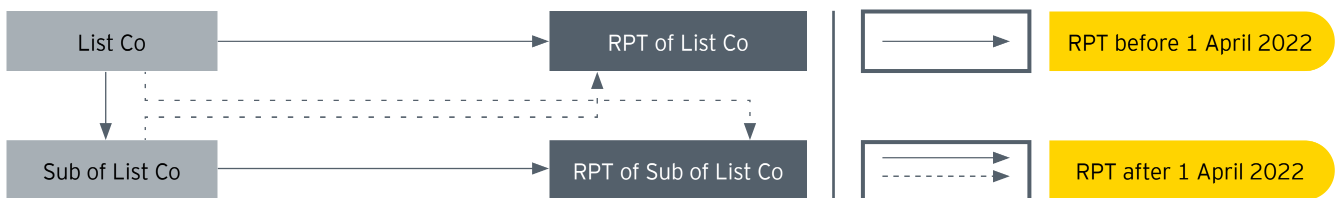
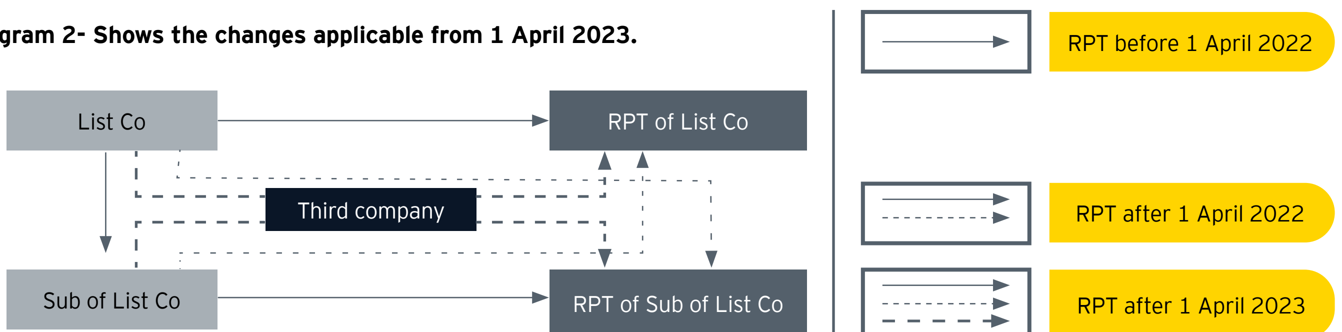


Diagram 2- Shows the changes applicable from 1 April 2023.



a) With effect from 1 April 2022, a transaction between Related Party ("RP") of Holdco (List Co)/subsidiary with List Co or subsidiary is treated as a related party transaction of the Group of List Co and subsidiary.

b) With effect from 1 April 2023, a transaction with a Third Party ("TP") is treated as Related Party transaction if the purpose and effect of that transaction is to benefit the RP of List Co or its subsidiaries.

Key considerations - Related Party transaction

This is probably the first time that a transaction is treated as a Related Party Transaction if it is beneficial to the other party. Also, determination of a related party transaction is based on the books of account and accounting records which in this case mean the Listco and subsidiary. It would however be extremely difficult for the Board/ Audit Committee/ Auditor to determine whether the onward transaction done by the Third Party benefitted the related party of the Hold co/Sub. Further, determining whether there is "benefit" is very subjective and AC and Board would have tough time to conclude this. Suppose there is a transaction with a third party and an onward transaction with a Related Party of Listco or Sub of Listco and the transaction is at arm's length, then can one argue that there is no benefit because both legs of the transaction are at arm's length? The word benefit has an immense significance in the drafting. A clarification from SEBI on what is meant by benefit and what type of transactions would get covered/excluded would help understand the intent of SEBI on introducing this clause.

Regulatory oversight to Related Party transactions is an extremely important part of ensuring robust governance mechanism and hence constant change to the regulations is an extremely necessary step. At the same time, ease of implementation and ensuring that the regulatory changes do not cause unintended inconveniences is also an important aspect of any change. Whilst some of the changes are welcome, few changes, especially those relating to treating 10% equity shareholding as a Related Party and the clause relating to meaning of the word "benefit" in dealings with third party need further clarification.

Year-end considerations

As companies approach financial year 2022-23 end, they are facing an ever-increasing level of uncertainty resulting from regulatory changes/ oversight, high interest rates, inflation as well as hyperinflation/ economic slowdown in certain parts of the world. In addition, ever-increasing focus on addressing climate risks is impacting businesses. The resulting financial reporting considerations are important and need careful consideration. In this article, we highlight certain key areas which may require higher attention from companies.

Economic uncertainty

The economic uncertainty is affecting companies and businesses all over the world. Particularly, rising interest rates, inflation, geopolitical instability, including the Russia-Ukraine war, and lingering impacts of COVID-19 (e.g., supply chain disruptions) continue to be key concerns. From the financial statements' perspective, some likely impacts requiring evaluation are given below:

- Impairment of financial and non-financial assets – Rising interest rates and inflation may impact cash flows, increase cost of capital and put downward pressure on recoverable amount of various tangible and intangible assets, including goodwill, which may potentially lead to impairments. Similarly, uncertainty in the global capital markets, including India, has led to significant volatility impacting financial asset and liability valuations.
- Reduced cash flows – Supply chain disruptions, availability of talent, and inflation coupled with customers impacted by instability could result in lower output, lower demand, and thereby lower cash flow from operations. This could further enhance the risk of impairments, put pressure on achieving debt covenants, and result in liquidity challenges.
- Going concern - In more severe cases, recession and growth concerns may initiate or increase the risk that a company cannot continue as a going concern. If there are any such concerns, companies and their auditors will need to evaluate and address related financial statements and audit report implications.

Each company should evaluate these challenges upfront and discuss with the auditors.

Amendments to Indian Accounting Standards (Ind AS)

There is no new Ind AS applicable for the financial year beginning 1 April 2022. However, the below key amendments to Ind AS are applicable for financial year beginning on or after April 1, 2022:

- Accounting for proceeds before intended use (amendment to Ind AS 16, Property, Plant and Equipment) – The amendment clarifies that during the trial run period, any excess or deficit of net sale proceeds of items produced over the cost of testing, if any, will be deducted from or added to directly attributable costs considered as cost of an item of property, plant and equipment.
- Onerous contracts – costs of fulfilling a contract (amendments to Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets) – The amendment specifies that for determining onerous contract provision and comparison with termination penalty, cost of fulfilling a contract should comprise both incremental costs and an allocation of other costs that relate directly to fulfilling contracts. The amendment will likely require companies, which were earlier using the incremental cost approach, to recognize higher amount of provisions for onerous contracts.
- Amendment to Ind AS 109, Financial Instruments – The amendment clarifies that in a debt modification scenario, only fees paid or received between the borrower and the lender, including fees paid or received on each other's behalf, are included in the assessment. Fees paid to third parties (e.g., fee paid to lawyers) are not included in the 10% test.
- Amendment to Ind AS 41, Agriculture –This amendment removes the requirement to exclude cash flows for taxation when measuring fair value. Rather, in-line with Ind AS 113 Fair Value Measurement, companies will have an option to use either pre-tax or post-tax cash flows and discount rates provided that they use internally consistent assumptions.

We believe that companies having such transactions will need to consider changes carefully, particularly, the first two amendments may be more relevant if companies have such transactions. Further details for these amendments are covered in the July 2022 edition of Assurance EYe.

Amendments to Division II to Ind AS Schedule III to the Companies Act, 2013

All companies having 31 March year-end were required to apply amendments to Division II to Ind AS Schedule III to the Companies Act, 2013 during the year ended 31 March 2022. These amendments were quite comprehensive and included changes related to disclosure of ageing for trade receivables/ payables as well as capital work in progress (CWIP), disclosure of ratios and many more disclosures. These amendments were aimed at strengthening the corporate governance framework by imbuing transparency in the financial statements. To provide guidance to the professionals and stakeholders in applying the amendments, the Institute of Chartered Accountants of India (ICAI) had revised the "Guidance Note on Division-II to the Schedule III to the Companies Act, 2013." Whilst the revised Guidance Note helped companies in applying amendments, there were areas requiring companies to exercise judgment. Whilst preparing financial statements for the year ended 31 March 2023, companies may want to benchmark judgment used by them vis-à-vis their peer group companies as well as other large companies. If needed, they may update disclosure made to ensure better compliance.

We have analysed analytical ratio disclosures made by 10 listed companies to comply with Amendments in Division II to Ind AS Schedule III and noted few differences in the formula used. Given below is a broad summary of disclosures made considering general practice followed by majority of companies in our analysis:

Ratio	Formula Used	Numerator	Denominator	Remarks
Current Ratio	Current Asset/ Current Liabilities	Total Current Asset	Total Current Liabilities	One company seems to have not included current maturities of non-current borrowings and lease obligations while computing Total Current Liabilities, without specifying reason for such exclusion.
Debt-Equity Ratio	Total Debt/Equity	Total Debt	Equity	There seems to be mixed practices on including lease liabilities in total debt. Majority of companies have considered lease liabilities as part of total debt. Also refer below.
Debt Service Coverage Ratio	Earnings available for Debt Service/ Debt Serviced	Net Profit after taxes + Non-Cash Operating Expenses + Interest + Other Non-Cash Adjustments	Interest and Principal repayment toward lease and other borrowings	Exceptional items, if any, were excluded by companies while considering profits. One company has added back only net finance charges instead of total interest expense for computing earnings available for debt service. Net finance charges are determined as: Finance costs (excluding interest on current borrowings) less Interest income less dividend income from current investments less Net gain/(loss) on sale of current investments}. This effectively means that the company has considered that finance income was not available for debt servicing.
Return on Equity	Profit for the year after tax/ Average Shareholder Equity	Profit after tax	Average Shareholder's Equity	Two companies have subtracted preference dividend, if any, from profit after tax to arrive at the numerator.
Inventory Turnover Ratio	Sales/ Average Inventory	Sales	(Opening Inventory Balance + Closing Inventory Balance)/2	Few companies have taken Cost of Goods Sold instead of Sales for measuring this ratio.
Trade Receivable Turnover Ratio	Revenue from operations/ Average Trade Receivable	Revenue from operations	Average Trade Receivable	One company has considered net credit sales instead of Revenue from operations to determine this ratio.

Ratio	Formula Used	Numerator	Denominator	Remarks
Trade Payable Turnover Ratio	Purchases/ Average Trade Payable	Purchase of goods or services	Average Trade Payable	Formula used is generally in line with ICAI's Guidance Note.
Net Capital Turnover Ratio	Revenue from operations/ Working Capital	Revenue from operations	Current Assets- Current Liabilities	One company has excluded current maturities of long-term debt and lease liabilities from Total Current Liabilities.
Net Profit Ratio	Profit after tax/ Revenue from operations	Profit after tax	Revenue from operations	Formula used is generally in line with ICAI's Guidance Note.
Return on Capital employed	Earnings Before Interest and Tax/ Capital Employed	Earnings Before Interest and Tax	Net Worth + Total Debt + Deferred Tax Liability	▶ One company has determined Capital employed by reducing Current investments from Equity plus Net Debt. ▶ One company has considered Capital employed as "Equity plus Borrowings plus Deferred Tax Liabilities plus Creditor for Capital Expenditure and reduced by Investments, Cash and Cash Equivalents, Capital Work-in-Progress and Intangible Assets under Development.
Return on Investments	Income generated from investments/ Time Weighted Average Investments			We noted that most of the companies have used customized formulas to determine this ratio.

It appears that in particular, companies have taken differing approach on inclusion or exclusion of lease liability in determining debt. Apparently, this can be linked to two differing arguments that are possible on this matter:

- One argument is that the lease payments in substance are a debt and should be included in determining debt/ borrowing. A company may finance its assets either using a bank borrowing or a lease borrowing. Also, the ICAI in its Guidance Note on Schedule III has included lease payments in debt service coverage ratio.
- However, the counter argument is that under Schedule III, lease liability is presented as other financial liability and not as borrowing. Consequently, lease liability is not included in debt. Also, one may argue this liability is arising primarily due to right of use asset accounting under Ind AS 116, Leases.

We recommend that the ICAI should provide further guidance on such judgmental matters and/ or matters involving differing practices.

Areas requiring focus due to findings by the Financial Reporting Review Board (FRRB) of the ICAI

FRRB of the ICAI reviews the General-Purpose Financial Statements (GPFS) of enterprises with the view to identify non-compliances with Accounting Standards/ Ind AS and Standards of Auditing, CARO, and other applicable statutory requirements. The non-compliances observed by the FRRB is compiled and published under the name of "Study on Compliance with Financial Reporting Requirement". In addition, the ICAI publishes such non-compliances observed by way of articles in the Chartered Accountant Journal of the Institute. Various publications of the FRRB are available on the ICAI Website.

Given below are few observations of the FRRB which may have general implications:

a) The movement in capital work in progress (CWIP) value was not disclosed in notes to the financial statements. Since CWIP is also part of property, plant and equipment, any movement in its carrying amount should be disclosed in line with disclosure requirements of paragraph 74(b) of Ind AS 16 Property, Plant and Equipment.

b) The accounting policy for Inventories of a company stated that "Inventories are stated at lower of cost and fair value …". In accordance with Ind AS 2, Inventories, the inventories should be valued at lower of the cost and net realizable value (and not the fair value). Under Ind AS, measurement of net realizable value is different from the fair value.

c) A company had designated certain investments in equity shares at Fair Value Through Other Comprehensive Income (FVTOCI). If such designation is used, Ind AS 107, Financial Instruments: Disclosures, among other disclosures, require disclosure of the reasons for using this presentation alternative. However, the company had not disclosed the reason.

d) In notes on the financial statements of a company, various reserves such as Revaluation Reserve and General Reserve were disclosed. However, the nature and purpose of these reserves were not disclosed by the company. Ind AS Schedule III as well as paragraph 79 of Ind AS 1, Presentation of Financial Statements, require such disclosures.

There are numerous such non-compliances which have been observed by the FRRB. We recommend that each company should carefully review their financial statements vis-à-vis FRRB observations to ensure that similar issue does exist in their financial statements. We also recommend that each company should carefully complete the disclosure checklist issued by the ICAI to ensure appropriate disclosures.

Climate-related matters

The efforts to reduce the society's impact on climate change have never been greater. At the same time, there is unprecedented pressure from stakeholders across the globe on entities to clearly communicate commitments which are set to continue for the foreseeable future.

Although there is no single explicit standard on climate-related matters under Ind AS, climate risk and other climate-related matters may impact a number of areas of accounting. Examples include impairment of assets, measurement of provision, determination of fair values, and disclosure of significant estimates and judgments. While the immediate impact to the financial statements may not necessarily be quantitatively significant, there are increasing expectations from stakeholders that entities explain how climate-related matters are considered in preparing their financial statements to the extent they are material from a qualitative perspective. Climate related matters impact non-financial reporting as well. Global standard setters are in the process of developing a baseline standard on sustainability to deal with the growing needs of various stakeholders on non-financial reporting. For detailed considerations relating to effects of climate-related matters on financial statements you may refer to Assurance EYe – January 2022 and October 2022.

How we look at it

While preparing the financial statements, it is important for companies to consider and address appropriately the amendments to Ind AS, observations of FRRB, economic uncertainties surrounding the businesses, updated assessment of climate-related risks and their impact on the financial statements. Furthermore, companies should ensure consistency between information communicated in the financial statements and the information communicated to stakeholders outside the financial statements, such as in press releases, investor updates and disclosures in other parts of the annual report.

3

What audit committees should prioritize in 2023

Audit committee's role continues to grow more demanding and complex amid the uncertain and dynamic business environment. Rampant inflation fears across other jurisdictions, geopolitical tensions, and the shadow of the uncertainties are the critical threats occupying the minds of audit committees. This edition summarizes key considerations for audit committees during the 2023 year-end and beyond.

Risk Management

Boards and audit committees are revisiting risk management practices to make sure that risks are managed effectively across the organization and building more resiliency and overall preparedness to respond and manage these headwinds going into 2023. Key considerations include:

- To combat inflation and surging interest rates leading to increased distress among households and severe constraints for businesses and to mitigate these risks, leading organizations are reshaping their operations, which includes building sustainability as a core aspect of all products and services; boosting customer loyalty using technology; and adopting new pricing constructs or innovative pricing models to improve profitability and performance to protect margins.

  Audit committees are expected to spend more time in discussing resiliency and using scenario planning to bolster such efforts. Further, they would need to re-examine the processes for risk identification and assessment to ensure that a holistic view of interrelated risks is provided and better understand the related implications.

- Cybersecurity risks continues to multiply and accelerate, marked this year by potential threats tied to the war in Ukraine. Following may be considered by the audit committees while overseeing cyber risk:
  - Reconcile value at risk against the board's risk tolerance, including the efficacy of cyber insurance coverage.
  - Address new issues and threats stemming from remote work and the expansion of digital transformation.
  - Leverage new analytical tools. Such tools inform the board of cyber risks ranging from high-likelihood, low-impact events to low-likelihood, high-impact events (i.e., a black swan event).
  - Enhance enterprise resilience by conducting rigorous simulations and arranging protocols with third-party specialists before a crisis.

- Organizations are transforming their risk management approach by embedding data science and technologies (such as analytics, artificial intelligence, robotic process automation and machine learning) across the entire risk management process, from identification to assessment to mitigation to monitoring. Integrated risk management platforms and cloud infrastructure are also enabling teams to analyze risk trends more easily and providing the data storage capacity and analytics firepower needed to conduct horizon scanning, scenario planning and stress testing based on multiple variables.

  Boards and audit committees should assess whether management has a robust strategy for an integrated risk management program leveraging data and technology, with a particular focus on talent and skill sets that may be required.

- With the growing demands and expectations around transparency and sustainability, there is heightened importance of creating a culture that supports ethical decision-making. Key actions audit committees can take to bolster integrity include:
  - Verify that the organization is performing fraud and corruption risk assessments to protect the organization. These assessments should be taken seriously from the top down and be regularly and robustly performed.
  - Recognize that systems and processes do not commit fraud, humans do. The best compliance frameworks can be breached if there is not a culture of doing the right thing, which makes building a strong integrity culture as important as the control environment.
  - Support whistle-blower processes – validate that employees are given the opportunity to report suspected wrongdoing in good faith and make them feel assured that there is protection against retaliation.

Questions for audit committees to consider

- What data science techniques and analytic tools is being used to evolve enterprise risk management to deliver deeper insights and create real-time alerts around emerging and disruptive trends?
- How can the organization build resiliency while remaining lean and agile enough to respond to unforeseen risks? Are contingency and response plans related to risks, including cybersecurity and supply chain, periodically simulated and reviewed with the audit committee?
- Did the organization's stress testing account for ongoing inflation, rate hikes, geopolitical tensions, labor shortages, technology changes, shifts in consumer preferences or climate change?

Financial reporting

Companies are continuing to re-evaluate their disclosures as stakeholders seek to understand the impact of various external developments on the business. We anticipate that audit committees will continue to evaluate impacts and changes in the business environment on their financial reporting processes, including the following:

- Continue to assess changes in the business, trends or uncertainties and the implications for financial reporting. This includes determining how inflation and supply chain issues may be affecting cash flow projections used in forward looking financial information and what discount rate is used to discount those cash flows.
- Revisit disclosures such as risk factors, critical accounting estimates, liquidity, and capital resources to address certain risk concentrations (e.g., customer, supplier, geographic) and other known trends, events, and risks and uncertainties that have had or are reasonably expected to have a material effect on the business.
- Revisit disclosures which are required pursuant to the requirements of Schedule III to the Companies Act, 2013, including those which require exercise of judgement.
- Companies experiencing liquidity issues may be at risk of violating debt covenants, which could affect debt classification.
- Continue to assess whether disclosures were updated and consider the financial statement effects of the current market conditions (e.g., inflation) and their expectations for the future. It will be important for audit committees not only to understand management's view of future economic conditions but also to validate that the organization provides transparent disclosures regarding these views. Audit committee would also be interested in validating that the financial information is consistent with those disclosed/ explained in the Annual Report, e.g., Business Responsibility and Sustainability Report.

Questions for audit committees to consider

- Has management assessed whether the company's current disclosures on climate related matters are relevant and provide insights for objective decision making?
- Have there been any material changes to internal controls over financial reporting or disclosure controls and procedures to address the changing operating environment? Have any cost-saving initiatives and related efforts impacted resources or processes that are key to internal controls over financial reporting? If so, has management identified mitigating controls to address any potential gaps?
- How have economic factors (e.g., supply chain disruption, inflation) influenced the entity's risk assessment?

Tax and other policy-related developments

Union Budget 2023 is a befitting budget to usher India into Amrit Kaal. The Budget continues its growth focus led by capex push, which should result in a positive multiplier impact for the economy. The thrust on areas like transport connectivity projects and green projects will create new opportunities for the private sector and uplift demand. The Budget considers Green Growth as one of the 'Saptarishi' guiding through the vision of the Amrit Kaal, which is likely to place India in a strategically competitive position globally.

Global tax policy is in a period of flux. The Organisation for Economic Co-operation and Development continues to encourage countries to adopt its two-pillar approach to reform of the international tax system (Pillars One and Two of its "BEPS 2.0" initiative, including the Global Anti-Base Erosion model rules). These rules are part of a two-pillar solution to address the tax challenges arising from the digitalization of the economy with an aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate, i.e., a system of top-up taxes that results in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15%. The model typically requires the ultimate parent entity of the group to pay top-up tax—in the jurisdiction in which it is domiciled—with respect to profits of its subsidiaries that are taxed below 15%.

Entities need to closely monitor the tax environment to recognize both potential challenges and opportunities and to remain agile in the face of uncertainty. Key focus includes the following:

- Audit committees should know how management is both preparing for any new tax liability and determining the applicability of new incentives stemming from these legislative changes. Companies should be tracking new compliance obligations, as well as examining their supply chains and expansion plans where applicable, incorporating potential tax obligations and opportunities into future plans.
- Audit committees should receive a report from management on how the company executed against its internal controls over income taxes for the year. The report should review tax positions, data sources, and non-automatic method changes that might be needed for the upcoming year – all of these areas should be documented and put into an actionable plan for future use.
- Given the current uncertain geopolitical environment, companies and their audit committees should monitor political risks and watch for shifts in leadership and elections in key countries in which they operate, foreign policy actions, tariff changes and regional trade agreements.
- With countries around the world beginning to take steps toward action on the Pillar Two global minimum tax, audit committees should be monitoring and anticipating potential tax changes at the individual country level in relevant jurisdictions.

Questions for audit committees to consider

- Has the organization analyzed the impacts of Budget 2023? Has the company performed modeling and scenario planning reflecting potential tax policy changes and trade developments?
- Does management have the resources within the tax function to monitor international and local legislative and regulatory developments and their impacts on the company, and what oversight does the committee have of the processes?
- Does the organization have a plan for the BEPS 2.0 Pillar Two impact on the provision, compliance, and reporting functions?
- Are any transactions anticipated that could result in the company being subject to these new taxes?

Regulatory developments

Regulatory developments in India continue to evolve with focus on stronger internal controls, company disclosures and investor protection, especially developments which are effective from April 2023. For example - MCA requires all companies to ensure that the accounting software used to maintain books of accounts has prescribed features and attributes of audit trail. These requirements lack specificity and are open for interpretation, e.g., fields or data sets for which audit trails are required to be maintained.

Recently ICAI has issued an Implementation Guide to deal with key implementation challenges. The Implementation Guide provides that management is primarily responsible for ensuring selection of the appropriate accounting software for ensuring compliance with applicable laws and regulations (including those related to retention of audit logs). These requirements are applicable prospectively from financial years commencing on or after 1 April 2023. The Implementation Guide further provides that any software used to maintain books of account will be covered within the ambit of this requirement. For example – if sales are recorded in a standalone software and only consolidated entries are recorded monthly into the software used to maintain the general ledger, the sales software should also have the audit trail feature since sales invoices qualify as books of account defined under Companies Act, 2013. Further, it may be noted that companies are required to maintain audit trail (edit log) for each change made in the books of account. For example, creation of a user in the accounting software may be construed as a transaction in the software.

Related party transactions continue to be an area of focus, especially for listed companies where ambit of related party and related party transactions have been widened. For example, from April 2023, any person/ entity holding 10% (earlier: 20%) or more equity shares in listed entity would be deemed to be a related party under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. Further, top 1,000 listed entities are required to prepare Business Responsibility and Sustainability Report where disclosure is not limited to environment related metrics but also includes reporting on quantitative social metrics.

Given these priorities and the changing regulatory landscape, audit committees and entities should keep abreast of the evolving agenda and the impact that such changes have on the organization. Audit committees should consider how their companies should be preparing for potential regulatory changes, which could impact reporting requirements, disclosures, and policies and procedures. Key actions for the audit committee may include:

- Evaluate whether the accounting software has 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 and/or auditors to implement changes to ensure compliance.
- Evaluate the implications arising from sustainability matters, including climate and cybersecurity risk and how the audit committee oversees these risks.
- Evaluate whether the company has robust and adequate disclosure controls and procedures over the company's existing climate- related disclosures (including any potential need for third-party assurance).
- Enquire as to ways management can enhance data and information gathering practices to further enhance the overall quality of these disclosures.
- Evaluate how the company is effectively engaging with shareholders regarding shareholder proposals.

Questions for audit committees to consider

- Does the company have sufficient controls and procedures over nonfinancial data? Is internal audit providing any type of audit coverage on sustainability-related data or is the company obtaining any external assurance?
- If sustainability-related matters are being discussed in more than one place (e.g., filings with stock exchange, earnings releases, analyst communications, annual report and shareholder letter), is there consistency in the disclosures? Has the company evaluated controls related to such disclosures?
- What process does the committee have in place for regulatory updates and is the committee sufficiently engaged in dialogue providing views and input as needed on the related impacts?
- Whether the existing accounting software of the company has the feature of audit trail? Are any changes in IT configuration would be required to comply with the audit trail requirements - especially after considering the Implementation Guide of ICAI?
- What controls have been modified to assess the completeness of related parties as covered in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

4

Accounting solutions

This section provides practical application issues with reference to impairment in the disposal group, and capitalization of borrowing cost.

Impairment in disposal group

Fact pattern

An entity decided to sell a group of three assets in one transaction to the same acquirer. Each asset originally belonged to a different cash-generating unit (CGU) and was tested for impairment within its CGU.

The decision to sell was made on 20 December 20X1 and the end of the entity's reporting period is 31 December 20X1. The assets did not meet the Ind AS 105 requirements for classification as a disposal group until 10 January 20X2.

The information about the carrying amounts and fair values less costs of disposal of the individual assets as at 20 December 20X1 is summarized below. There was no change in the fair values less costs of disposal and the carrying amounts of assets X, Y and Z and the total disposal group between 20 December 20X1 and 10 January 20X2.

Asset number	Carrying amount (CU)	Fair value less costs of disposal of separate assets (CU)	Aggregate of the lower of the carrying amount and Fair value less costs of disposal (CU)	Fair value less cost to sell of the group (CU)
X	4,600	4,300	4,300	-
Y	5,700	5,800	5,700	-
Z	2,400	2,500	2,400	-
Total	**12,700**	**12,600**	**12,400**	**12,600**

The assets X, Y and Z are not regarded as a single CGU.

Issue

1. Is an entity required to perform the impairment test at the end of the reporting period under IND AS 36 Impairment of Assets when the decision to sell has been made during the reporting period, but not all the (other) requirements of IND AS 105 Non-current Assets Held for Sale and Discontinued Operations have been met at the end of the reporting period?
2. Is an entity required to perform the impairment test immediately before it applies the classification and measurement rules under IND AS 105?
3. What are the accounting implications?

Viewpoint

Issue 1

Paragraph 9 of IND AS 36 states:

"An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

Paragraph 12 of IND AS 36 identifies various internal indicators of impairment, including the following in paragraph 12(f):

" ...plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date..."

Considering above, making the decision to sell the assets is a triggering event under IND AS 36. Hence, an entity is required to perform an impairment test under Ind AS 36 at the end of the reporting period when the decision to sell has been made during the reporting period, even if the asset does not qualify as held for sale under Ind AS105 at the end of the reporting period. The classification as "held for sale" under Ind AS 105 is subsequent to the end of the reporting period. However, at the end of the reporting period, there is an indicator of impairment, since a decision to sell the asset was made. This requires an entity to test for impairment at the end of the reporting period.

Issue 2

An entity may only apply the classification and measurement rules in IND AS 105 when all the classification criteria of IND AS are met. Paragraphs 6 - 8 of IND AS 105 detail these criteria.

Paragraph 6 of IND AS 105 states that:

"An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use."

Paragraph 7 of IND AS 105 states that:

"For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable."

Paragraph 8 of IND AS 105 states that:

"For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable."

In the fact pattern, while a decision is made on 20 December 20X1, the classification criteria under Ind AS 105 are not met until 10 January 20X2. On 10 January 20X2, the entity is required to apply paragraph 18 of IND AS 105 before applying any IND AS 105 measurement guidance.

Paragraph 18 of IND AS 105 states:

"Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable IND ASs."

This paragraph implies that IND AS 36 must be applied just before classification of the asset (or disposal group) as held for sale under IND AS 105. This sequence of applying IND AS is important for the presentation of results of disposal groups and may have implications on the timing of recognition and measurement of impairment losses in accordance with IND AS 36.

Considering above, an entity is required to perform an impairment test under IND AS 36 immediately before applying the classification and measurement rules under IND AS 105

Issue 3

Paragraph 22 of IND AS 36 states:

"Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets…"

The recoverable amount of an asset is defined by paragraph 6 of IND AS 36 as:

"…the higher of its fair value less costs of disposal and its value in use".

Paragraph 59 of Ind AS 36 sets out the requirements for recognizing an impairment loss as follows:

"If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss."

Paragraph 15 of IND AS 105 states:

"An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell."

Paragraph 21 of IND AS 105 explains an entity reverses a previous impairment loss:

"An entity shall recognize a gain for any subsequent increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognized either in accordance with this Ind ASor previously in accordance with IND AS 36 Impairment of Assets."

Considering above, the accounting implications, in the fact pattern, are as follows:

- The entity must determine whether the three assets together comprise a new CGU. If so, impairment is assessed on the three assets together prior to reclassifying and re-measuring under Ind AS 105. The entity needs to consider whether the assets together are the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.
- In the fact pattern, it is assumed the three assets together do not comprise a single CGU. Therefore, impairment is required to be assessed on an individual asset basis under Ind AS 36.

- Assessing the assets on an individual basis at the end of the reporting period results in an impairment loss on Asset X of CU300, since the recoverable amount of Asset X is less than the carrying amount. Immediately before classification under Ind AS 105, the entity tests for impairment again. However, since there is no change in the recoverable amount between the end of the reporting period and immediately before the classification under Ind AS 105, in the fact pattern, the aggregate value of these assets prior to classification under Ind AS 105 is CU12,400 (CU4,300 + CU5,700 + CU2,400).
- The fair value less costs to sell of the disposal group at the date of applying I Ind AS 105 (10 January 20X2) is CU12,600. Therefore, according to the measurement criteria under Ind AS 105, the carrying amount of the disposal group remains at CU12,400 and the impairment loss on Asset X (previously recognized) is only reversed when the fair value less costs to sell of the disposal group exceeds CU12,600. If the fair value less costs to sell of the disposal group increases to CU 12,700, CU 100 of the impairment is reversed, so the total carrying amount of the disposal group will become CU 12,500.

Fact pattern

An entire building itself is not complete, yet individual floors are complete and ready for use (for example, a high-rise office building).

Issue

When does an entity cease capitalizations of borrowing costs when an asset consists of parts?

Viewpoint

Paragraph 24 of IND AS 23 Borrowing Costs states that when a part is capable of being used, while construction continues on other parts, capitalization of borrowing costs ceases when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

Paragraph 25 of IND AS 23 cites a business park comprising several buildings, each of which can be used individually, as an example of an asset that may be completed in parts. In the example in paragraph 25, the "parts" are physically distinct (that is, each building is distinct from other buildings in the business park). However, other circumstances may not be as straightforward.

Paragraph 8 of IND AS 23 sets out the principle to be used when capitalizing borrowing costs:

"An entity shall capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognize other borrowing costs as an expense in the period in which it incurs them."

From this principle, it can be derived that an entity capitalizes borrowing costs to a qualifying asset when a necessary activity is taking place in respect of the asset. This principle is further emphasized in paragraphs 20 and 21 of IND AS 23. These paragraphs deal with the suspension of capitalization of borrowing costs during an extended period in which the entity suspends the activities necessary to prepare an asset for its intended use or sale.

Hence, if all the activities necessary to prepare that part for its intended use or sale are substantially complete, and the part is capable of being used while construction continues on other parts, the entity ceases capitalization of borrowing costs to the part.

However, IND AS 23 does not provide guidance on what constitutes a part. Neither does paragraphs from 43 to 47 of IND AS 16 Property, Plant and Equipment. It is therefore a matter of judgement as to what constitutes a part. Where this judgement is significant to the understanding of the financial statements, the entity discloses this judgement in accordance with paragraph 122 of Ind AS 1 Presentation of Financial Statements.

Based on above, if a 'part' of an asset is complete and ready for its intended use, the entity ceases capitalization on that part. In the fact pattern, if individual floors of a large building are substantially complete and ready for their intended use, the entity ceases capitalization of borrowing costs on those parts.

5

Regulatory updates

SEBI updates

Amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations')

SEBI vide notification dated 17 January 2023 has amended the Listing Regulations to interalia provide that annual report should disclose details of material subsidiaries of the listed entity; including the date and place of incorporation and the name and date of appointment of the statutory auditors of such subsidiaries. These amendments are effective from the dates mentioned in the amendment regulations. To access the amendments, click here.

SEBI board meeting

SEBI has taken the following key decisions on 29 March 2023:

Amendments to SEBI Listing Regulations

- Business Responsibility and Sustainability Report (BRSR) Core, containing a limited set of Key Performance Indicators, to be introduced - for which listed entities would need to obtain reasonable assurance. BRSR Core would be applicable to top 150 listed entities (by market capitalization) from FY 2023 – 24 which would be gradually extended to the top 1000 listed entities by FY 2026 - 27.
- Extension of 'Comply or Explain' period for the High Value Debt Listed Entities (HVDLEs) in respect of corporate governance norms till 31 March 2024 and simplification of disclosure requirements pertaining to the payment of interest/ coupon and redemption amount.
- Disclosure to stock exchange for certain types of agreements binding listed entities.

Amendments to SEBI (Mutual Funds) Regulations, 1996

- ESG schemes to invest at least 65% of asset under management in listed entities, where assurance on BRSR Core is undertaken. Mandatory third party assurance and certification by Board of Asset Management Companies on compliance with objective of the ESG scheme.
- Provided clarity on the roles and responsibilities of Trustees and Board of Asset Management Companies of Mutual Funds with a focus on unitholder protection.

To access the SEBI Board Meeting click here.

Amendments to SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ('NCS Regulations')

SEBI vide notification dated 2 February 2023 has made the following key amendments to NCS Regulations:

- Expansion of the definition 'green debt security' to include bonds such as blue bonds, yellow bonds and transition bonds.
- Article of Association of the issuer company should require the Board of Directors to appoint the person nominated by the debenture trustee(s) in terms of Regulation 15(1)(e) of the SEBI (Debenture Trustees) Regulations, 1993 as a director on its Board of Directors.

  Issuer whose debt securities are listed as on the date of publication of the amendment in the Official Gazette, should amend its Articles of Association to comply with this provision, on or before 30 September 2023

These amendments are effective from the date of publication in the Official Gazette. To access amendments, click here.

Further, SEBI has issued the following in respect of green debt securities:

- SEBI on 3 February 2022 has issued a circular with respect to dos and don'ts relating to green debt securities to avoid occurrences of greenwashing. To access the SEBI circular, click here.
- SEBI on 6 February 2023 has revised the disclosure requirements for issuance and listing of green debt securities with a view to align the extant framework with the updated Green Bond Principles recognized by IOSCO. To access the SEBI circular, click here.
- SEBI on 9 February 2023 issued a clarification in relation to first time issuer who is in process of preparing for their first listed privately placed Non-Convertible Debentures (NCD) or public issue of NCDs. In the said clarification, SEBI has advised that the stock exchanges should take an undertaking from such first-time issuers that they will ensure that their AoA is amended within a period of six months from the date of the listing of the debt securities. To access the SEBI circular, click here.

Amendment to SEBI (Buy-Back of Securities) Regulations, 2018 ('Buy Back Regulations')

SEBI has amended the Buy Back Regulations to simplify the buyback process, by eliminating certain methods of buyback and reducing overall timelines e.g., reduction in the number of days for which the tendering period is open for participation/ tendering by eligible shareholders, the maximum buyback size (as prescribed) would be based on the standalone or consolidated financial statements, whichever is lower. These amendments are effective from 9 March 2023. To access the amendments, click here.

Further, SEBI vide circular dated 8 March 2023 has inter alia clarified that these amendments would apply to buy-back offers where the Board of Directors of the company approve resolution with respect to buy-back on or after the 30th day of the date of notification of this amendment (i.e., 9 March 2023). To access the SEBI circular, click here.

Amendment to REITs/InvITs Regulations

SEBI vide notifications dated 14 February 2023, has amended the SEBI (Real Estate Investment Trusts) Regulations, 2014 and SEBI (Infrastructure Investment Trusts) Regulations, 2014 to inter alia provide the following:

- Introduced definition of an independent director and senior management
- Provides requirements for eligibility, appointment and other governance requirements relating to independent directors.
- Tenure of appointment of an auditor firm limited to two terms of five consecutive years

These amendments come into force with effect from 1 April 2023. To access the amendments for REITs, click here and for InvITs, click here.

Amendment to 'change in control definition'

SEBI vide notification dated 17 January 2023 has substituted the definition of "Change in Control" in various regulations of including the following:

- SEBI (Debenture Trustees) Regulations, 1993
- SEBI (Alternative Investment Funds) Regulations, 2012
- SEBI (Portfolio Managers) Regulations, 2020.

These amendments are effective from the date of publication in the Official Gazette. To access the amendments, click here.

Extension of relaxation in sending physical copies of annual reports

SEBI has extended relaxation from sending physical copies of financial statements, etc., due in the year 2023 until 30 September 2023 (earlier December 2022) subject to compliance with prescribed conditions by entities having listed specified securities and non-convertible securities as contained in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

To access the SEBI circulars, click here and click here.

SEBI prescribes manner of achieving Minimum Public Shareholding ('MPS')

SEBI vide circular dated 3 February 2023, has reviewed and rationalized few of the existing methods of achieving MPS [which have been mandated under the Securities Contracts (Regulation) Rules, 1957 read with SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015] and have also prescribed two additional methods of achieving the MPS. To access the SEBI circular, click here.

Cybersecurity best practices

In view of the increasing cybersecurity threat to the securities market, SEBI on 22 February 2023 has issued an advisory relating to best practices with respect to cybersecurity. To access the circular, click here.

Framework for adoption of cloud services by SEBI regulated entities

In view of the increasing cybersecurity threat SEBI regulated entities, SEBI on 6 March 2023 has provided baseline standards of security and for the legal and regulatory compliances by these entities. The framework is in addition to already existing SEBI circulars /guidelines /advisories. To access the circular, click here.

RBI update

Master Directions and Guidelines on Acquisition and Holding of Shares or Voting Rights

RBI vide notification dated 16 January 2023 has issued Master Directions along with Guidelines on Acquisition and Holding of Shares or Voting Rights in Banking Companies with the intent of ensuring that the ultimate ownership and control of banking companies are well diversified and the major shareholders of banking companies are 'fit and proper' on a continuing basis.
To access the Master Directions, click here. To access the Guidelines, click here.

Computation of Capital Adequacy Ratio and amount for payment of dividend by Asset Reconstruction Companies

RBI vide notification dated 20 February 2023 has inter alia decided that Asset Reconstruction Companies preparing their financial statements as per Ind AS, should reduce prescribed amounts from their net owned funds while calculating the Capital Adequacy Ratio and the amount available for payment of dividend. To access the notification, click here.

ICAI updates

Implementation Guide on auditor's reporting on audit trail

ICAI has issued an Implementation Guide to provide guidance on reporting on audit trail as prescribed under Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014 of Companies Act, 2013. This guide provides that the auditor's reporting requirement apply prospectively from 1 April 2023 and deals with key implementation challenges. To access the Implementation guide click here.

Standard on Sustainability Assurance Engagements ('SSAE') 3000 *"Assurance Engagements on Sustainability Information"*

ICAI has issued SSAE 3000 to deal with assurance engagements on an entity's sustainability information. This Standard should be read in conjunction with the "Framework for Assurance Engagements" issued by ICAI. The Standard applies to assurance engagements, which pertain to providing reasonable or limited assurance on sustainability information.

The effective date of application of SSAE 3000 as follows:

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

To access the SSAE 3000, click here.

Social Audit Standards ('SAS') and its Framework

ICAI has issued SAS that should be applied while conducting the social impact assessment. The Standards set out the minimum requirements to be followed while conducting impact assessment. Laws or regulations may establish additional requirements which should be followed, as applicable

Further, the framework for SAS are issued which describes the elements and objectives of a social audit performed by social auditors. It provides a frame of reference for.

- Social auditors when performing social audit i.e., social impact assessment of project/ program executed by social enterprises.
- The responsible party, the engaging party, if any, and other stakeholders who are the intended users of social audit report.

To access the standards issued by ICAI, click here.

To access the framework, click here.

Other ICAI publications

ICAI has issued the following publications:

- Guidance note on audit of banks (2023 Edition) To access the guidance note, click here.
- EAC compendium of opinions – Volume XLII. To access the compendium, click here.
- EAC compendium of opinions – Volume XLI To access the compendium, click here.
- Educational Material on Ind AS 21, The Effects of Changes in Foreign Exchange Rates – To access the educational material, click here.
- Implementation Guide to Standard on Auditing (SA) 580 – To access the implementation guide, click here.
- Technical Guide on Digital Assurance – To access the technical guide, click here.
- Technical Guide on Royalty and Fees for Technical services- To access the publication, click here.
- A Primer on the Concept of Social Stock Exchange – To access the publication, click here.

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- Disha Mehta
- Hiral N Rajput

Contact us

Please write to : faas.in@in.ey.com in case you have any queries, feedback or inputs.

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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