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1 Evolving regulatory landscape – *Changes in controls, processes and systems*

Over the last 2 years the companies had to manage the risks caused by COVID 19 and ensure compliance with applicable laws and regulations. With the persisting effects of disruptions, the companies would need to brace themselves to manage slew of regulatory changes which are effective from April 1, 2021 and April 1, 2022.

This article provides an overview of key regulatory changes and the consequential impact on internal controls, processes and IT systems.

Overview of key regulatory changes

Ministry of Corporate Affairs (MCA) and Securities and Exchange Board of India (SEBI) have issued amendments to certain regulations which are likely to have significant bearing on financial reporting. Overview of key changes are summarised as under:

A. Maintenance of audit trail

MCA has amended the Companies (Accounts) Rules, 2014 relating to the manner of maintaining books of account in electronic mode. As per the amendment, every company which uses accounting software for maintaining its books of account, should use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled. This amendment is applicable for the financial year commencing on or after the April, 1 2022.

B. Amendment to Schedule III to the Companies Act, 2013

MCA has issued amendments to Schedule III with an aim to enhance disclosures in financial statements. These amendments are effective from April 1, 2021. However, companies need to also provide comparative information for financial year March 31, 2021 in the financial statements. Some of the key requirements are:

- Ageing analysis for trade receivables, trade payables, Capital work-in-progress and Intangible asset under development; and bifurcation of trade receivables and trade payables into disputed and undisputed dues.
- Disclosure of prescribed ratios for assessing financial health e.g., Current ratio, Debt-Equity ratio. Further explanation required to be provided for any change in the ratio by more than 25% as compared to the preceding year.
- Disclosures to ensure debt covenant compliances or manage risks of lenders.
- Disclosures of material discrepancies between quarterly returns of current assets filed by the company with banks/ financial institutions and books of account for borrowings obtained on the basis of on security of current assets like inventories and trade receivables.
- Disclosures related to appropriate utilisation of borrowings from banks and financial institutions.
- Disclosures aimed to curb money laundering:
  - Details of benami property held
  - Undisclosed income
  - Relationship with struck off companies
  - Details of ultimate beneficiaries with respect to utilisation/ receipt of funds
  - Wilful defaulters
  - Title deeds of property not held in the company's name.

C. Companies (Auditor's Report) Order, 2020 ('CARO 2020')

CARO 2020 significantly enhances reporting responsibilities of auditors. CARO 2020 requires reporting on 50 assertions (included in 21 clauses) as against 21 assertions (included in 16 clauses) in CARO 2016. Many of those reporting requirements are in sync with disclosures requirements mandated in financial statements through amendments to Schedule III and are applicable for financial years commencing on or after April 1, 2021. While the companies would have to gear up for the disclosures under Schedule III, Company management would also have to prepare the information required for enhanced reporting and engage with their auditors early to understand the reporting implications. Some key amendments in CARO 2020 where auditors are required to opine are as follows:

- Reporting on prescribed matters for loans/ advances in the nature of loans e.g., evergreening of loans, loans given on demand or without repayment stipulation

- Reporting on all investments, guarantees, loans and advances provided by the company to any party
- Auditor to consider financial ratios, ageing and expected dates of realization of financial assets/payment of financial liabilities, etc and comment whether material uncertainty on the date of audit report exists on capability to meet its liabilities;
- Auditors are required to report on whether the internal audit system is commensurate with size and nature of business of the company;
- Appropriateness of coverage and procedure of physical verification of inventory and whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;
- Whether the quarterly returns or statements filed by the company with banks or financial institutions are in agreement with the books of account of the Company with respect to sanctioned working capital limits (during any point of time of the year) in excess of INR 5 crores, in aggregate, from banks or financial institutions on the basis of security of current assets.

D. Amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 in relation to provisions on related party transactions for listed entities.

The amendments are aimed at widening the scope of related party and related party transactions and strengthening corporate governance framework of related party transactions. The amendments will come into force with effect from April 1, 2022 unless otherwise specified. Key amendments are with respect to:

- Definition of related party and related party transactions
- Approval of Shareholders and Audit Committee
- Half yearly disclosure of related party transactions to stock exchanges
- Enhanced disclosures requirements while seeking shareholder approval.

What does it mean for companies?

The above amendments will have far-reaching impact on companies. They are not merely disclosure requirements but have consequential impact on Internal controls, IT systems and processes as well. Following are key considerations which companies need to focus:

- *Assess whether the current accounting system is geared up to furnish data required for compliance with above regulatory changes*

Amendments summarised above requires significant new data which were not required earlier for financial reporting. For e.g. (a) ageing data for trade payables and Capital Works in Progress (b) Budget vs actual monitoring for Capital Works in Progress (c) Transactions and balance outstanding with struck-off companies (d) Transaction and balances with new related parties.

Further, the companies would need to assess their current accounting system as to whether it has the feature of maintaining audit trail or the ERP would require modification.

- *Identify changes in systems and processes including ERP*

Companies will need to either institute new systems and processes or modify existing processes to manage the changes effectively. Some key areas to focus are:

  - Robust debt management systems to manage reconciliation with filings made to banks/ financial institutions with financial statements.
  - Capex monitoring system to track project wise original budget, data of completion and progress.
  - Identification of undisputed and disputed trade receivables and trade payables.
  - Related party identification process considering significant change in definition of related party and approval thresholds.
  - Financial statement close process will need to change to manage new disclosure requirements required in the financial statements. For e.g., companies will need to ensure robust quarterly closing process to ensure that there are no material differences between books of account and quarterly filings to banks/ financial institutions.
  - Institute process to manage transactions with companies whose names are struck-off from Register of companies. Process should be robust to compile names of all struck-off companies, identification of same in company's vendors and customer list, tracking all transactions and balances with the same.

- *Assess impact on Internal control over financial reporting (ICFR)*

Companies will need to rewire their existing ICFR or institute new controls to manage these regulatory changes. Following are some illustrative areas which companies need to revisit:

  - Companies will need to update their disclosure checklists to ensure completeness of disclosures.
  - Companies will need to institute robust controls over monitoring of reporting to lenders – maker-checker control with appropriate documentation.
  - Companies will need to revisit controls over capex management – documentation of project wise data – original budget, original completion date and budget v actual monitoring.
  - Companies will need to institute proper controls for identification of disputes with customers and vendors.

How we look at it

The regulatory changes stated above will have pervasive impact on companies. Many of these requirements would involve higher level of professional judgement and provide more information to stakeholders. It is critical that organisations take proactive steps to become ready for these changes. Companies should do readiness assessment and take remedial actions for any red flags. Also, they should communicate with relevant stakeholders like Board of Directors and Audit Committee on the potential impact and how they plan to manage transition to these new requirements. An early engagement between the auditors, audit committees/those charged with governance and understanding of the reporting requirements along with its possible implications is imperative for the effective implementation of these requirements.

2 Renewed focus on related party transactions

Related party transactions ('RPTs') have always been in focus by regulators and other stakeholders. In certain instances, regulators have noticed issues where certain related party transactions were not entered in the interest of stakeholders including minority shareholders. Over a period of time the regulators have strengthened the mechanism with an aim to enhance transparency, improve quality of information to investors and expand the scope of reporting by companies/ auditors. The RBI Governor in his speech on October 25, 2021 has also re-emphasised the need to identify and thoroughly scrutinize related or connected party transactions to ensure that there is no undue transfer of income or assets. This article seeks to provide an overview of the increased focus on RPTs by regulators and the recent changes made in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations').

Increasing ambit of the definition of related party

Companies Act, 1956 did not specially regulate RPTs. It had provisions that only restricted certain types of transactions.

The Companies Act, 2013 ('2013 Act') introduced the definition of a related party and provisions to regulate certain types of RPTs through an approval and disclosure-based framework e.g. RPTs exceeding prescribed sums should be not be entered into except with the prior approval of the shareholders.

Listing Regulations provides stricter norms and states that the definition of related party includes related parties defined under the 2013 Act or under the applicable accounting standards. Further as per the existing requirements any person/ entity belonging to the promoter/ promoter group of the listed entity and holding 20% or more of shareholding in the listed entity shall be deemed to be a related party.

With the evolution of a corporate eco-system in the area of corporate governance including RPTs and due to instances of circumvention of existing frameworks by use of certain innovative structures and circular transactions, the definition of related party continues to be in focus. The definition and disclosures has been amended over a period of time to make it robust e.g., [1]related party definition under 2013 Act was amended to include companies incorporated outside India and to include investing company or the venturer of a company. The Listing Regulations were amended on November 9, 2021 ('Amended Listing Regulations') to widen the ambit of the existing framework in a phased manner. SEBI also issued a circular on November 22, 2021 ('SEBI Circular') to operationalize the amended requirements. The

Amended Listing Regulation provides that a related party would deem to include any person/ entity:

- Forming part of promoter or promoter group of the listed entity irrespective of their shareholding.
- Holding equity shares in the listed entity:
  - 20% or more (w.e.f. April 1, 2022)
  - 10% or more (w.e.f. April 1, 2023)

in the listed entity either directly or on a beneficial interest basis as provided under section 89 of the 2013 Act, at any time, during the immediate preceding financial year.

1 Companies (Amendment) Act,2017

Coverage of RPTs

The Listing Regulations currently defines RPTs as any transfer of resources, services or obligations between a listed entity and a related party regardless of whether a price is charged or not and include a single transaction or a group of transactions. SEBI observed instances to avoid classification of transactions as RPTs wherein certain transactions were undertaken with seemingly unrelated parties but were intended to benefit related parties. The Amended Listing Regulations has broadened the coverage of RPTs to include transfer of resources, services, or obligations between the listed entity or any of its subsidiaries on one hand and:

- A related party of the listed entity or any of its subsidiaries on the other hand (w.e.f. April 1, 2022);
- Any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries (w.e.f. April 1, 2023).

Role of independent directors

The code for independent directors under Schedule IV to the 2013 Act puts significant responsibility on the independent directors regarding RPTs requiring them to pay sufficient attention and ensure that adequate deliberations are held before approving RPTs and assure themselves that the same are in the interest of the company. This put significant onus on independent directors and requires them to exercise higher degree of scepticism with due emphasis on evaluation of reasonableness of terms and conditions of such transactions.

Role of Audit Committee

Audit Committee plays a critical role in assessing the appropriateness of RPTs. Section 177 of the 2013 Act provides for approval or subsequent modification of transactions of the company with related parties except with respect to transactions with a wholly owned subsidiary. Regulation 18 of the Listing Regulations require prior approval of Audit Committee for all RPTs. Part C of Schedule II further requires the Audit Committee to review at periodic intervals the statement of significant related party transactions submitted by the management. The Listing Regulations also poses responsibility on the Audit Committee to review certain information of unlisted subsidiary e.g., Regulation 24(4) requires the unlisted subsidiary to periodically bring to the notice of the Board of Directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary. The Listing Regulations also provided that only those members of the Audit Committee, who are independent directors, should approve RPTs.

In order to further enhance the scrutiny of RPTs, the Amended Listing Regulations provides that subsequent material modifications of RPTs would require prior approval of the Audit Committee.

Further, prior approval of the Audit Committee would also be required for RPTs where subsidiary is a party, but listed entity is not a party subject to threshold of:

- 10% of the annual consolidated turnover as per the last audited financial statements of the listed entity (w.e.f. April 1, 2022).
- 10% of the annual standalone turnover as per the last audited financial statements of the subsidiary (w.e.f. April 1, 2023).

Further, the SEBI Circular has prescribed that from April 1, 2022, listed entities should provide wide ranging information to the Audit Committee for approval of proposed RPTs. Such information includes the following:

- Name of the related party and its relationship with the listed entity or its subsidiary including nature of its concern or interest (financial or otherwise).
- If the transaction relates to any loans, inter-corporate deposits, advances, or investments made or given by the listed entity or its subsidiary:
    - Details of the source of funds in connection with the proposed transaction.
    - Where any financial indebtedness is incurred to make or give loans, inter-corporate deposits, advances, or investments - listed entity to provide the nature of indebtedness, cost of funds and tenure.
- The purpose for which the funds will be utilized by the ultimate beneficiary of such funds pursuant to the RPT.
- Justification as to why the RPT is in the interest of the listed entity.

Similar information is also required to be included in the notice being sent to the shareholders seeking approval for any proposed RPT.

Increased disclosures to stock exchange

Regulation 27(2) of the Listing Regulations require listed entity to submit a quarterly compliance report on corporate governance in prescribed format to the stock exchange. The quarterly compliance report includes disclosures regarding compliance status of related party transactions e.g., prior approval of audit committee. The quarterly compliance format also requires half yearly disclosures around loans/ guarantees/comfort letters/ security provided by the listed entity, directly or indirectly to promoter/ promoter group entities or any other entity controlled by them.

Increased disclosures in financial statements

Disclosures of RPTs are prescribed under applicable accounting standards. Pre-revised Schedule III to the 2013 Act do not prescribe any specific disclosures in the financial statements

relating to RPTs. Schedule III has been amended and require that where the company makes any loan/ advances in the nature of loan to the promoters, directors, KMPs and other related parties (either jointly or severally) and such items are repayable on demand or without any specific terms or period of repayment, the details of such loans/ advances should be disclosed separately in the financial statements along with the amount of loan and percentage to total loans and advances.

Further, the Schedule III has been amended to prescribe detailed disclosures where outbound or inbound loans, advances and investments are intended to be routed through a conduit entity, masking the identity of the ultimate beneficiary. The disclosures include date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each intermediary, declaration that relevant provisions of the Foreign Exchange Management Act, 1999 and 2013 Act have been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering Act, 2002.

Increased auditors reporting responsibilities

Due to the revised regulatory framework for RPTs, the responsibilities of the auditors have also increased which includes critical assessment of compliance with laws and regulations and related party requirements so that the underlying objective of true and fair presentation is achieved. It might be noted that pursuant to amendment in Companies (Audit and Auditors) Rules, 2014 which is effective from April 1, 2021, auditors are required to obtain representations from management that (other than those disclosed in the financial statements) no funds have been provided to intermediaries with an understanding that the intermediaries would lend or invest or provide guarantee, etc on behalf of the ultimate beneficiaries. Similar reporting requirement has also been prescribed for receipt of funds from funding parties. Also, basis audit procedures, the auditor is required to comment that nothing has come to their notice that has caused them to believe that such representations contain any material mis-statement.

How we look at it

- Management will have to plan for approval of RPTs as per the new SEBI requirements which would include evaluation of monetary threshold, engaging with those charged with governance and planning for shareholder meetings to obtain approval for RPTs requiring their approval. This would include establishing robust internal control systems especially in identifying related parties, assessing the underlying terms and conditions and adherence to the approval requirements for such transactions.
- The additional reporting might require discussion with Audit Committee/ Board prior to submission of necessary information with the Stock Exchange. Also, listed entities will be required to provide wide ranging information to the Audit Committee and shareholders for approval of proposed RPTs.
- Amended Regulations require assessment of the purpose and effect of the transaction in order to evaluate the benefit of the RPT to the company, which may be financial or otherwise. Such assessment would be a significant focus area for independent directors and audit committee.
- The companies will have to evaluate the applicability of the amended SEBI regulations to existing transactions which are entered before April 1, 2022 and expected to continue beyond that date.
- The aforesaid amendments would also increase the auditor’s responsibilities regarding identification of related party relationships and transactions, appropriate accounting/ disclosure in financial statements accordance with financial reporting framework after considering the requirements of SA 550, Related Parties.

3 The changing paradigm of sustainability reporting

Climate change concerns and sustainable development have taken centre stage in global paradigm shift. The COVID-19 pandemic has further reinforced the need to redefine economic growth strategies. These developments have far reaching implications for corporates as they strive to move to a low carbon economy. Investors are noting that sustainability issues impact risk, return and value of companies over the long term. Investors are also realizing the implications of sustainability related risks and have started treating these as material to their investment decisions. This has resulted in investors wanting comparable, consistent, and reliable information about a company's sustainability performance.

Till now, regulators typically followed the "voluntary" or "comply-or-explain" approach towards ESG (Environment, Social and Governance) disclosures but now they are moving beyond their do-good ESG approach and there seems to be a shift to mandatory ESG disclosures with enhanced reporting requirements on quantitative social metrics. Such a shift is also being witnessed in Asian jurisdictions. Countries including Singapore and Japan, have already introduced or are in the process of introducing roadmaps for shifting to mandatory climate-related disclosures[2]. Currently with the heightened stakeholder activism, reporting is not only limited to disclosing positive opportunities, initiatives and minimal KPIs - but investors and other stakeholders are also interested to know the risks that are taken into consideration, the implications of those risks in future, the targets, and the roadmap and if there has been any hinderance in reaching those targets.

In the Indian context, the commonly used frameworks for such reporting are Business Responsibility and Sustainability Report and Integrated Reporting. This article focuses on the evolving reporting paradigms and how these reports may have different approaches but has the same vision- accelerate the disclosure around the world and help corporates develop a clear communication channel in their ESG space.

Business Responsibility and Sustainability Report (BRSR) by SEBI	Integrated Reporting by International Integrated Reporting Council

▶ Compliance driven for the top 1000 companies by market cap from FY 2022-2023 and voluntary in FY 2021-2022.
▶ A set of quantifiable and principle driven question to ascertain companies ESG performance.
▶ Keen focus on value chain partners.
▶ Leadership and essential indicators to highlight better practices companies are taking.
▶ Criteria like impact measurement, Life Cycle Assessments are part of BRSR.
▶ There is a prescribed format which companies have to comply with.
	▶ Voluntary and principle driven.
	▶ With the merger of International Integrated Reporting Council ('IIRC') and Sustainability Accounting Standards Board ('SASB') now the report:
	  ▶ Include Integrated Thinking Principle from IIRC - Value Creation Model.
	  ▶ Include Integrated Reporting Framework - Provide holistic view through business model, multiple capitals and detailed governance structure.
	  ▶ Provides industry wise KPI standards for investors to have information that are material for a particular industry[3] as pescribed by SASB.
	▶ The format of the report is not prescribed.

2 Source: SEBI Chairman speech FICCI's event on "Driving Climate Action through Disclosures: BRSR as Bedrock for ESG Action in India"
3 Value Reporting Framework: https://www.valuereportingfoundation.org/

The growing importance of ESG reporting in India - BRSR

The Companies Act, 2013 require a director of a company to act in the best interests of the company, its employees, the community and for the protection of the environment. SEBI[4] echoed similar expectation by introducing new requirements for sustainability reporting called the BRSR which replaces the existing requirements of Business Responsibility Reporting. BRSR is mandatory to top 1000 listed entities based on market capitalization from financial year 2022-2023 and is voluntary for financial year 2021 - 2022. Such companies are required to annually file information in a prescribed format to the stock exchanges as part of their annual reports.

A good way that companies can ensure they abide to the requirements of the BRSR is by obtaining an assurance report from an independent practitioner as per ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*. Many entities have voluntarily obtained assurance reports to enhance credibility of the underlying information for their sustainability reports in the past and can apply the same for BRSR.

The BRSR format is based on the principles that were first outlined by the Ministry of Corporate Affairs (MCA) under the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business' in 2011. It focusses on nine principles that largely relate to environmental, social and governance that ought to be demonstrated by all responsible corporates and excludes financial performance of companies. The key emphasis has been in the direction of making BRSR reporting format as a single source of sustainability information, enhancing comparability and consistency in the information which will benefit the users of information, and to also reduce duplication and compliance efforts by companies.

The disclosures in BRSR are not only limited to environment related metrics but also include reporting on quantitative social metrics such as workforce diversity, health and safety of employees, employee engagement and welfare measures, social impact assessment of projects undertaken by the entity, procurement from marginalized/vulnerable groups, CSR spending in aspirational districts and beneficiaries of CSR projects etc.

As compared to the existing requirements, the metrics on climate and social issues have been enhanced and made more granular. Disclosures relating to value chain partners have also been strengthened. The performance metrics are segregated into essential and leadership indicators. The essential indicators are required to be reported on a mandatory basis while the reporting of leadership indicators is on voluntary basis.

Effects of climate-related matters on financial statements

Indian Accounting Standards (Ind AS) do not refer explicitly to climate-related matters. However, companies must consider climate-related matters when the effect of those matters is material[5] in the context of the financial statements taken as a whole e.g., information about how management has considered climate-related matters in preparing a company's financial statements and which may be material with respect to the most significant judgements and estimates that management has made for preparation of financial statements. Further, Ind AS 1 requires a company to consider whether any material information is missing from its financial statements, which means that a company is required to consider whether to provide additional disclosures when compliance with the specific requirements in Ind AS is insufficient to enable investors to understand the impact of particular transactions, other events and conditions on the company's financial position and financial performance. Companies will therefore need to consider whether to provide additional disclosures. These overarching requirements in Ind AS 1 may be especially relevant for companies whose financial position or financial performance is particularly affected by climate-related matters.

Impact on key financial statements captions[6]

Ind AS	Key effects on financial statements
Presentation of Financial Statements (Ind AS 1)	▶ Disclosure of assumptions and judgements (apart from those involving estimations) about climate-related matters may be required such as: ▶ Matters creating uncertainties that affect assumptions used to develop estimates, such as best estimate of expenditure required to settle a decommissioning obligation. ▶ A company operating in an industry particularly affected by climate-related matters might test an asset for impairment but recognize no impairment loss. That company would be required to disclose judgements management has made such as in identifying the asset's cash-generating unit if such judgements are among those that have the most significant effect on the amounts recognised in the company's financial statements. ▶ If climate-related matters create material uncertainties related to events or conditions that cast significant doubt upon a company's ability to continue as a going concern, Ind AS 1 requires disclosure of those uncertainties.

4 Refer SEBI Circular SEBI/HO/CFD/CMD-2/P/CIR/2021/562 dated May 10, 2021

5 Information is material if omitting, misstating, or obscuring it could reasonably be expected to influence decisions that primary users of financial statements make on the basis of those financial statements, which provide financial information about a specific company.

6 Source: IASB document - Effects of climate-related matters on financial statements

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Ind AS	Key effects on financial statements
Inventories (Ind AS 2)	Climate-related matters may cause a company's inventories to become obsolete, their selling prices to decline or their costs of completion to increase thereby affecting recoverability of inventories and estimates of net realizable value.
Income Taxes (Ind AS 12)	Climate-related matters may affect a company's estimate of future taxable profits and may result in the company being unable to recognize deferred tax assets or being required to derecognize deferred tax assets previously recognised.
Property, Plant and Equipment (Ind AS 16) and Intangible Assets (Ind AS 38)	▶ Climate-related matters may prompt expenditure to change or adapt business activities and operations, including research and development. Ind AS 16 and Ind AS 38 specify requirements for the recognition of costs as assets (as an item of property, plant, and equipment or as an intangible asset). Ind AS 38 also requires disclosure of the amount of research and development expenditure recognized as an expense during a reporting period. ▶ Climate-related matters may affect the estimated residual value and expected useful lives of assets, for example, because of obsolescence, legal restrictions, or inaccessibility of the assets.
Impairment of Assets (Ind AS 36)	Climate-related matters may give rise to indications that an asset (or a group of assets) is impaired e.g., a decline in demand for products that emit greenhouse gases could indicate that a manufacturing plant may be impaired, requiring the asset to be tested for impairment.
Provisions, Contingent Liabilities and Contingent Asset (Ind AS 37)	Climate-related matters may affect the recognition, measurement, and disclosures for example, related to: ▶ regulatory requirements to remediate environmental damage. ▶ contracts that may become onerous (for example, due to potential loss of revenue or increased costs as a result of climate-related changes in legislation).
Financial Instruments (Ind AS 107 and 109) and Fair Value measurements (Ind AS 113)	▶ Climate-related matters may affect lender's exposure to credit losses. For example, they could affect the range of potential future economic scenarios, the lender's assessment of significant increases in credit risk, whether a financial asset is credit impaired and/ or the measurement of expected credit losses. ▶ Climate-related matters may expose a company to risks in relation to financial instruments For example, for lenders, it may be necessary to provide information about the effect of climate-related matters on the measurement of expected credit losses or on concentrations of credit risk. ▶ Climate-related matters may affect the fair value measurement of assets and liabilities in the financial statements For example, market participants' views of potential climate-related legislation could affect the fair value of an asset or liability.

Integrated Reporting - linking strategy, purpose, and value

The IIRC developed the Integrated Reporting Framework with a vision to embed integrated thinking within mainstream business practice as the corporate reporting norm. An integrated report aims to provide insight about the resources and relationships used and affected by an organization – these are collectively referred to as "the capitals" in the integrated reporting framework. It also seeks to explain how the organization interacts with the external environment and the capitals to create value over the short, medium, and long term. An integrated report is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or on a website); rather, it makes explicit the connectivity of information to communicate how value is created over time. Environmental matters continue to be a key focus area in the framework e.g., one of the fundamental concept enunciated in the framework is about natural capital – which covers all renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current, or future prosperity of an organization including air, water, land, minerals and forests biodiversity and eco-system health. The framework further provides that the value creation process should consider the effect of environmental challenges.

With an objective to improving disclosure standards, SEBI vide circular dated February 6, 2017 has provided that integrated reporting may be adopted on a voluntary basis by top 1000 companies which are required to prepare BRR[7]. In case the company has already provided the relevant information in any other report prepared in accordance with national/international requirement / framework, it may provide appropriate reference to the same in its Integrated Reports so as to avoid duplication of information.

How we look at it

Companies need to develop a clear vision for what ESG means for the company and have a well-defined roadmap. In order to drive maximum value from BRSR, companies would need to:

- Examine sections of the BRSR template and identify material aspects to their businesses (right from products and services, policies, patents, local and global reach, environmental footprint, cases, and penalties etc).
- Consider having a materiality assessment conducted periodically to assess the changing stakeholder needs, followed by a mock exercise of populating information against the essential indicators, to get a reflection of their present status.
- Consider declaring the following if they have been conducted in the present cycle:
  - Financial parameters linked with ESG.
  - Executive Compensation Linkage with ESG.
  - Investing Decisions linked with ESG Linkage.
  - Life Cycle Assessment conducted in the financial year.
  - Social Return on Investment / Social impact assessment conducted.
- Develop a comprehensive set of ESG risk and opportunities important for the business.
- Obtain assurance report from an independent practitioner so as to enhance trust and credibility of the underlying information. ISAE 3000 provides a solid foundation for consistent performance of quality assurance engagements relating to non-financial information reporting and is aimed at enhancing confidence in and improving the reliability of assurance reports for their intended users.

Over the years it became clear that financial statements on their own did not tell the whole story of a company's performance. Companies therefore started reporting on their environmental impacts, employee-related issues and corporate social responsibility issues in a separate report often referred to as a sustainability report, which accompanies the financial information distributed to shareholders. Globally, International Sustainability Standards Board has been set up which would develop global baseline of disclosure requirements designed to give investors high quality, globally comparable sustainability information that can be used by jurisdictions on a standalone basis or incorporated into requirements to meet broader, multi-stakeholder or public policy needs[8]. This shows how the non-financial disclosure is gradually merging with financial disclosure to provide stakeholder with unique comprehensive approach.

7 BRR is replaced by BRSR as per SEBI Circular dated May 10, 2021. BRSR is applicable to top 1000 companies under Regulation 34(2)(f) of SEBI LODR, 2015.
8 Source – IFRS Foundation

4 Accounting solutions

This section provides practical application issues with reference to accounting for income taxes.

A. Accounting for deferred tax on intra-group sales

Fact Pattern

Scenario 1 - Tax rate of the transferor is higher than rate of the transferee

A Parent entity taxed at 30%, has a subsidiary which is taxed at 34%. On 15 December 20X1, the subsidiary sells inventory with a cost of CU 100,000 to the Parent for CU 120,000, giving rise to a taxable profit of CU 20,000 and current tax at 34% of CU 6,800. On 31 January 20X2, the Parent sells the inventory to an unrelated third party for CU 150,000, giving rise to a taxable profit (at the entity level) of CU 30,000 and current tax of CU 9,000. In the consolidated financial statements of the Parent for the year ended 31 December 20X1, the profit made by a subsidiary on the sale to a parent is eliminated.

Scenario 2 - Tax rate of the transferor is lower than rate of the transferee

A Parent entity taxed at 34%, has a subsidiary which is taxed at 30%. On 15 December 20X1, the subsidiary sells inventory with a cost of CU 100,000 to the Parent for CU 120,000, giving rise to a taxable profit of CU 20,000 and current tax at 30% of CU 6,000. On 31 January 20X2, the Parent sells the inventory to an unrelated third party for CU 150,000, giving rise to a taxable profit (at the entity level) of CU 30,000 and current tax of CU 10,200. In the consolidated financial statements of the Parent for the year ended 31 December 20X1, the profit made by a subsidiary on the sale to a parent is eliminated.

Issue

How should deferred taxes on temporary differences arising from intragroup transfers be measured at the Group level? Should the Group use the tax rate as applicable in the transferor's or the transferee's jurisdiction for measuring the deferred tax?

Viewpoint

Where the carrying amount of an asset in consolidated financial statements is lower than the tax base of the transferred asset (for the transferee), this may result in a deductible temporary difference on which a deferred tax asset is recognized.

Ind AS 12 does not specifically address the measurement of such items. However, paragraph 51 of Ind AS 12 generally requires an entity, in measuring deferred tax, to consider the tax consequences from expected manner of recovery or settlement of the carrying amount of its assets and liabilities. It is consistent with the requirement to measure deferred tax on temporary differences arising from intragroup transfers at the tax rates and laws applicable to the transferee rather than those applicable to the transferor, since the transferee would be taxed when the asset or liability subject to the transfer is realised or sold. In other words, an intercompany transfer of assets (such as the sale of inventory or depreciable assets) between tax jurisdictions is a taxable event that establishes a new tax base for those assets in the transferee's jurisdiction. This new tax base is deductible in the transferee's tax return as those assets are consumed by the entity or sold to an unrelated party.

Analogy can be drawn from paragraph 11 of the Illustrative Examples B to IAS 12 Income Taxes which states:

"Unrealised profits resulting from intragroup transactions are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes."

Considering above guidance the tax base of the inventory held by the Parent is CU 120,000, while their carrying amount in the consolidated financial statements is CU 100,000.

Scenario 1 - Tax rate of the transferor is higher than rate of the transferee

A current tax expense / liability of CU 6,800 (being 34% of subsidiary profit of CU 20,000) should be recognized in the financial statements of the subsidiary jurisdiction. In the consolidated financial statements deferred tax asset for the

temporary difference of CU 20,000 (Carrying amount of CU 100,000 – Net tax base of CU 120,000) should be recognized. The new tax base of CU 120,000 is deductible in the Parent's (transferee's) tax return when the inventory would be sold to an unrelated party. Accordingly, Parent's tax rate should be used to calculate the deferred tax asset of CU 6,000 (being 30% of CU 20,000).

In summary, the net additional tax of CU 800 (Current tax liability of CU 6,800 - Deferred Tax credit of CU 6,000) payable by the subsidiary is recognised in the consolidated profit and loss for the year ended 31 December 20X1 which reflects the fact that, by transferring the inventory from one tax jurisdiction to another which have a lower tax rate, the Group has effectively exposed itself to additional tax of CU 800 (i.e. CU 20,000 at the tax rate differential of 4%) for the cost of the inventory to the transferee parent. The carrying amount of the asset in the consolidated financial statements is lower than the tax base of the transferred asset (for the transferee).

Scenario 2 - Tax rate of the transferor is lower than rate of the transferee

A current tax expense / liability of CU 6,000 (being 30% of profit of CU 20,000) should be recognized in the financial statements of the subsidiary. In the consolidated financial statements deferred tax asset for the temporary difference of CU 20,000 (carrying amount of CU 100,000 – net tax base of CU 120,000) should be recognized. Because the new tax base of CU 120,000 is deductible in the Parent's (transferee's) tax return when the inventory would be sold to an unrelated party. Accordingly, the Parent's tax rate is used to calculate the deferred tax asset of CU 6,800 (being 34% of CU 20,000).

In summary, a net additional tax income of CU 800 (Current tax liability of CU 6,000 - Deferred Tax credit of CU 6,800) is recognized in the consolidated statement of profit and loss for the year ended 31 December 20X1, which reflects the fact that, by transferring the inventory from one tax jurisdiction to another with a higher tax rate, the group has effectively increased the amount of the future tax deduction associated with the asset of CU 800 (i.e. CU 20,000 at the tax rate differential of 4%).

B. Accounting for current tax and deferred tax on gain or loss on sale of partial stake in subsidiary without losing control

Fact Pattern

A parent owns 100% of the shares of a subsidiary and presents the investment at a cost of CU1,000 in the parent's separate financial statements. At the end of the reporting period, the subsidiary's post acquisition profit and net asset value recognized in the parent's consolidated financial statements are CU500 and CU1,500, respectively. Previously, the parent had not recognised deferred taxation, as it considered it probable that the temporary difference would not reverse in the foreseeable future. The parent disposes 20% interest in the subsidiary for a cash consideration of CU1,400.

The tax base of the investment in the subsidiary is the same as the investment cost recognized in the separate financial statements of the parent. The taxable gain is calculated based on the same basis as gain recognized in the separate financial statements and the applicable tax rate is 25%.

The parent recognizes a gain of CU1,200 ((i.e. CU1,400 – (CU1,000 x 20%)) in its separate financial statements and is liable for a current tax of CU300 (i.e. CU1,200 x 25%).

The Transaction does not result in the parent losing control of the subsidiary and it is accounted for as an equity transaction in the consolidated financial statements of the parent. The parent recognizes non-controlling interests of CU300 (i.e. CU1,500 x 20%) and credits equity for CU1,100, being the difference between the consideration of CU1,400 and the non-controlling interests of CU300, in the consolidated financial statements of the parent.

Scenario 1- The Transaction is not yet completed at the end of the reporting period.

Scenario 2 - The Transaction is completed at the end of the reporting period.

Issue

How does a parent recognize the current tax and deferred tax in its consolidated financial statements when the parent disposes of a portion of its ownership interest in a subsidiary that does not result in the parent losing control of the subsidiary?

Viewpoint

Scenario 1- The Transaction is not yet completed at the end of the reporting period.

Paragraph 39 of IND AS 12 *Income Taxes* states:

"An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, except to the extent that both of the following conditions are satisfied:

a) the parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and

b) it is probable that the temporary difference will not reverse in the foreseeable future."

The carrying amount of the investment in the subsidiary included in the consolidated financial statements amounts to CU1,500 and the tax base is CU1,000. As the parent intends to dispose of 20% of its equity investment in the subsidiary, it is now probable that the related temporary difference will reverse in the foreseeable future. Accordingly, a deferred tax liability of CU25 (i.e., (CU1,500 – CU1,000) x 20% x 25%) is recognized at the end of the reporting

period. The deferred tax is recognized in profit or loss in the consolidated financial statements as the temporary difference arises from the post-acquisition profit of the subsidiary and it does not relate to an amount directly recognised in equity.

Scenario 2 - The Transaction is completed at the end of the reporting period.

Paragraph B96 of IND AS110 *Consolidated Financial Statements* states:

"…The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent."

Paragraph 58 of IND AS 12 states:

"Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from: (a) a transaction or event which is recognised, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity. …"

Paragraph 61A of IND AS 12 states:

"Current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period: … (b) directly in equity, shall be recognised directly in equity."

As the Transaction is accounted for as an equity transaction, which does not affect profit or loss in the consolidated financial statements, one might assume that the full amount of the tax charge of CU300 should also be recognized against equity. However, this is not the case as the gain recognized as equity in the consolidated financial statements only amounted to CU1,100 compared with the total gain subject to tax of CU1,200. By applying paragraph 58(a) of IND AS 12, the current tax of CU275 (i.e., CU1,100 x 25%) arising from this equity transaction is recognised directly in equity and the remaining current tax of CU25 is recognized as a current tax expense in profit or loss. The remaining current tax of CU25 (i.e., (CU1,500 – CU1,000) x 20% x 25%) relates to the post acquisition profit of the subsidiary, which was recognised in the consolidated statement of profit and loss.

5 Key regulatory updates

This section provides an overview of the key regulatory updates for the period October 1, 2021 to December 31, 2021.

MCA updates

Timelines for conducting AGM/ EGM through electronic means

MCA had prescribed the modalities for conducting EGMs and AGMs through electronic means (in accordance with a prescribed framework) upto December 31, 2021. MCA had further provided that this timeline to conduct AGM through electronic means should not be construed as conferring any extension of time for holding AGM and the companies which have not adhered to the relevant timelines would be liable to legal action under the appropriate provisions of the Companies Act, 2013.

MCA has extended the above timeline as follows:

- Companies whose AGMs are due in the year 2021, are allowed to conduct AGM through video conference or other Audio-Visual Means on or before June 30, 2022 as per the prescribed framework. To access the MCA circular *click here*. ICAI has also issued an announcement in this regard which can be accessed *here*.
- Companies who are proposing to organise AGMs in 2022 for the financial year ended/ ending anytime before/ on March 31, 2022, can conduct AGM through video conference or other Audio-Visual Means as per the respective due dates by June 30, 2022 as per the prescribed framework. To access the MCA circular *click here*.
- Companies are allowed to conduct EGMs through video conference or other Audio-Visual Means or transact items through postal ballot upto June 30, 2022 as per the prescribed framework. To access the MCA circular *click here*. ICAI has also issued an announcement in this regard which can be accessed *here*.

SEBI updates

SEBI Board meeting

SEBI in its Board Meeting dated December 28, 2021 has taken the following key decisions:

- Approved amendment to Mutual Fund Regulations to mandate Mutual Funds schemes to follow IND AS from FY 2023-24 onwards. Further, SEBI approved amendments to Mutual Fund Regulations with respect to accounting related regulatory provisions to remove redundant provisions and to bring more clarity.
- Amend SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to provide that appointment or a re-appointment of any person, including as a managing director or a whole-time director or a manager, who was earlier rejected by the shareholders at a general meeting, shall be done only with the prior approval of the shareholders.
- Amend various aspects of regulatory framework under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and consequential amendment to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, as applicable e.g. conditions for objects of the issue, Conditions for Offer for Sale to public in an IPO where DRHP is filed by issuer without track record.

To access the SEBI Board meeting *click here.*

FAQs on SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

SEBI has issued FAQs to provide guidance on certain provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The FAQs include guidance on submission of financial results for the last quarter, criterion for determining material subsidiary, disclosure of events and information with respect to material subsidiaries where parent and subsidiary are listed entities. To access the FAQs, *click here*.

FAQs on SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021

SEBI has issued FAQs which provide simplistic explanation/ clarification of terms/ concepts related to SEBI India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021. To access the FAQs, *click here*

SEBI amends general investment conditions for Category III AIFs

SEBI has amended the SEBI (Alternative Investment Funds) Regulations, 2012 to modify the concentration norms of Category III AIFs. As per the revised norms, Category III AIFs should invest:

- Not more than 10% (up to 20% in case of large value funds for accredited investors of Category III AIF) of the net asset value in listed equity of an Investee Company and
- Not more than 10% (up to 20% in case of large value funds for accredited investors of Category III AIF) of the investable funds in securities other than listed equity of an Investee Company directly or through investment in units of other AIFs.

These amendments were published in the Official Gazette on November 9, 2021 and come into force on the 30th day from the date of their publication in the Official Gazette. To access the notification, *click here*.

Further, SEBI vide Circular dated November 22, 2021 has interalia clarified certain matters relating to computation of concentration norm based on Net Asset Value of the fund for investment in listed equity of an investee company. To access the Circular, *click here*.

Quarterly reporting to SEBI by Category III AIFs

Category III AIFs are required to submit to SEBI reports on leverage undertaken in prescribed formats on a quarterly basis. This requirment was applicable from the quarter ended December 31, 2021 onwards. SEBI has decided that these requirements will now be applicable for the quarter ending September 30, 2022 onwards. To access the circular *click here.*

SEBI amends Takeover Regulations

SEBI vide notification dated December 6, 2021, has amended SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 to primarily modify the requirements relating to delisting offer as prescribed in the said Regulation. To access the notification, *click here*.

Non-compliance with provisions related to continuous disclosures

SEBI vide circular dated December 29, 2021 has prescribed the norms relating to levy of fine and action in case of non-compliances with continuous disclosure requirements specified under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 by the issuers of listed Non-Convertible Securities and/ or Commercial Papers. To access the SEBI Circular *click here*.

RBI updates

Scale Based Regulation (SBR): a revised regulatory framework for NBFCs

RBI vide notification dated October 22, 2021 has revised the regulatory framework for NBFCs. The SBR framework encompasses different facets of regulation of NBFCs covering capital requirements, governance standards, prudential regulation, etc. The SBR has been issued as an integrated regulatory framework providing a holistic view of the SBR structure, set of fresh regulations being introduced and respective timelines. These guidelines are effective from October 01, 2022 except for the instructions relating to ceiling on IPO funding which would come into effect from April 01, 2022. To access the notification, *click here.*

RBI notification on treatment of additional liability arising from enhancement in family pension

RBI vide notification dated October 4, 2021, has prescribed the following treatment in respect of additional liability on enhancement in family pension of employees of banks (which are covered in the 11th Bipartite Settlement):

- The liability for enhancement of family pension shall be fully recognized as per applicable accounting standards.
- The above expenditure may, if not fully charged to the Profit and Loss Account during the financial year 2021-22, be amortized over a period not exceeding 5 years beginning with the financial year ending March 31, 2022, subject to a minimum of 1/5th of the total amount involved being expensed every year.
- Appropriate disclosures of the accounting policy followed in this regard should be made in the 'Notes to Accounts' to the financial statements. The Notes to Accounts should also disclose the amount of unamortised expenditure and the consequential net profit if the unamortised expenditure had been fully recognized in the Profit and Loss Account.

To access the notification, *click here*.

RBI introduces Internal Ombudsman mechanism for select NBFCs

RBI vide notification dated November 15, 2021 has provided that Deposit-taking NBFCs (NBFCs-D) with 10 or more branches and Non-Deposit taking NBFCs (NBFCs-ND) with asset size of Rs.5,000 crore and above having public customer interface should appoint Internal Ombudsman (IO) unless specifically excluded by RBI. The notification covers inter-alia, appointment, tenure, role and responsibilities, procedural guidelines, and oversight mechanism for the IO. To access the notification, *click here*.

RBI clarifications on prudential norms on income recognition, asset classification and provisioning pertaining to advances

RBI vide notification dated November 12, 2021 has clarified/ harmonized certain aspects of the extant regulatory guidelines relating to income recognition, asset classification and provisioning pertaining to advances, which will be applicable mutatis mutandis to all lending institutions. All the instructions, except those prescribed, are effective immediately from the date of this notification. To access the notification, *click here*.

Revised Prompt Corrective Action (PCA) Framework for Scheduled Commercial Banks and NBFCs

RBI vide notification dated November 2, 2021 has revised the PCA Framework for Scheduled Commercial Banks. The revised PCA framework is effective from January 1, 2022. To access the revised framework, *click here*.

Further, RBI vide notification dated December 14, 2021 has issued PCA Framework for:

- All Deposit Taking NBFCs (excluding Government Companies),
- All Non-Deposit Taking NBFCs in Middle, Upper and Top Layers (excluding - (i) NBFCs not accepting/ not intending to accept public funds; (ii) Government Companies, (iii) Primary Dealers and (iv) Housing Finance Companies).

The PCA Framework for NBFCs shall come into effect from October 1, 2022, based on the financial position of NBFCs on or after March 31, 2022. A separate circular would be issued in due course with regard to applicability of PCA Framework to Government NBFCs.

To access the framework, *click here*.

RBI accepts certain recommendations of the Internal Working Group (IWG) formed to review extant ownership guidelines and corporate structure for Indian private sector banks

RBI vide press release dated November 26, 2021 has accepted 21 recommendations (some with partial modifications, where considered necessary) out of 33 recommendations of the IWG which was constituted to review the extant guidelines on ownership and corporate structure for Indian private sector banks. Some of the key recommendations include those relating to lock-in period for promoters' initial shareholding, limits on shareholding in long run, dilution requirement and voting rights, pledge of shares and eligibility of Promoters. The remaining recommendations are under examination.

The consequential amendments in instructions/ circulars/ master directions/ licensing guidelines following the acceptance of the recommendations (with or without modifications) are being carried out and will be notified in due course. To access the press release, *click here*.

We acknowledge contribution from

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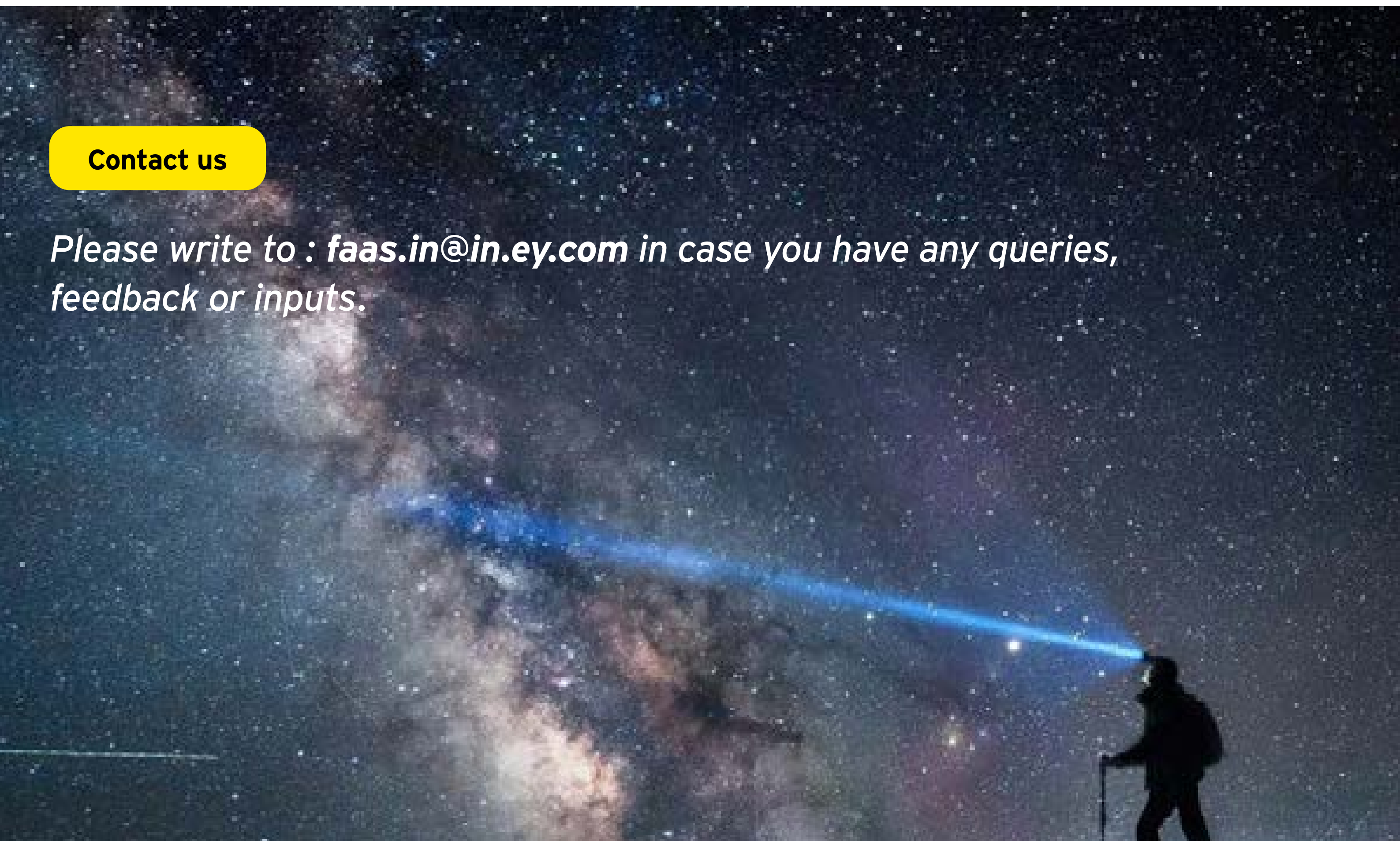

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