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Table of
Content

03

07

12

16

20

23

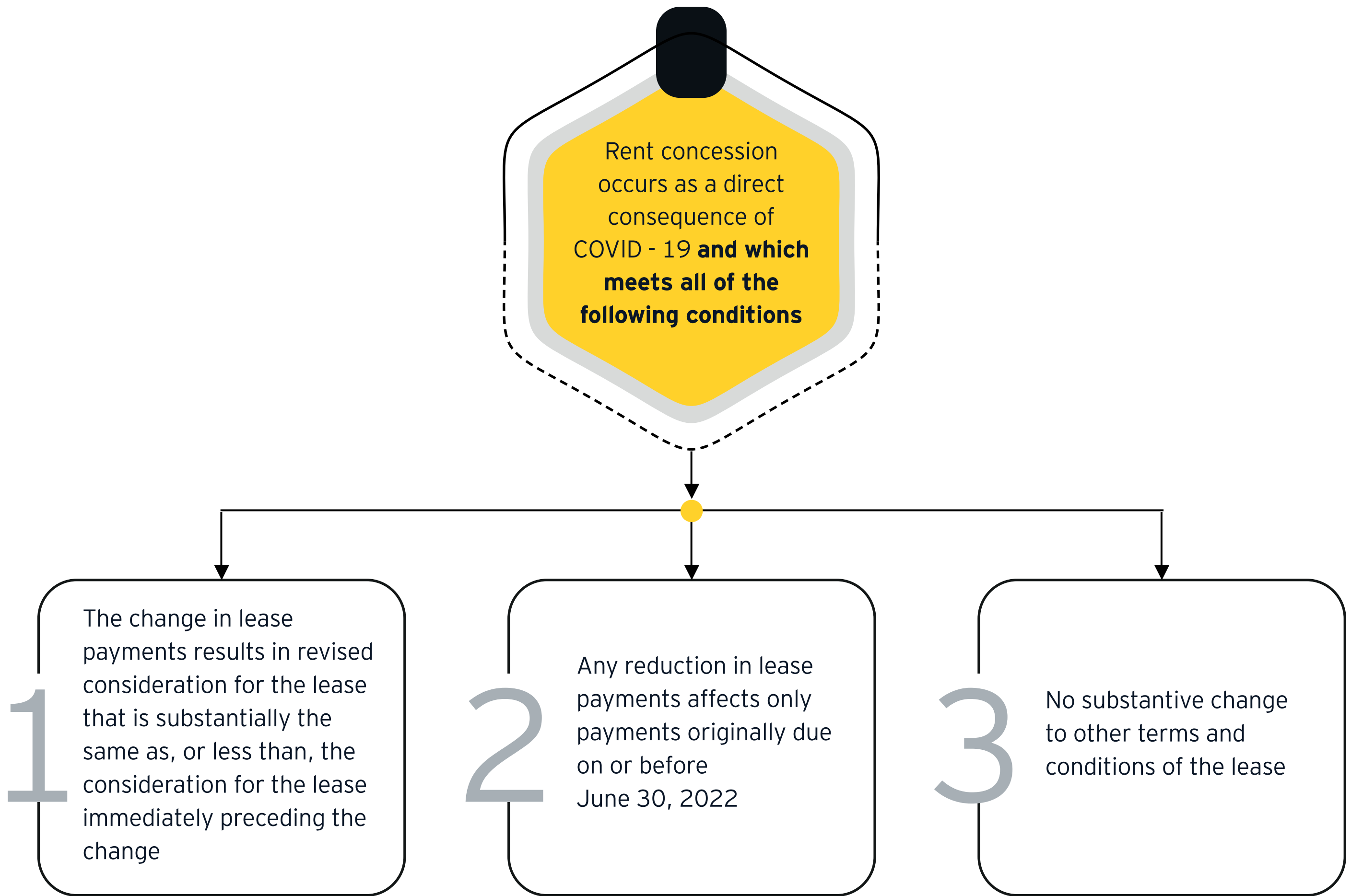
Lease concessions consequent to outbreak of COVID 19

A large number of lessees have obtained some form of rent concessions from lessors due to the ongoing COVID-19 pandemic. Rent concessions can take many forms e.g. a rent payment holiday; a reduction in lease payments for a period of time; and a deferral of payments to a later date. A concession might also include a change to the lease term. When there is a change in the scope of a lease or the consideration for a lease (that was not part of the original terms and conditions of the lease) such changes are known as lease modifications under Ind AS 116, Leases ('Ind AS 116'). The assessment for lease modification (if material) involves the application of judgement and depends on a number of factors which generally involves remeasuring the lease liability using the revised lease payments and a revised discount rate. Lessees could find it challenging to assess whether a large volume of the pandemic-related rent concessions are lease modifications and to apply the accounting requirements, especially in the light of the many challenges lessees face during the pandemic.

To mitigate these challenges faced by the lessees, Ind AS 116, Leases was amended in July 24, 2020 ('2020 amendments') to provide a temporary optional relief to lessees from applying the requirements of lease modification for rent concessions arising as a direct consequence of the COVID – 19 pandemic. This practical expedient was available for lease rent due on or before June 30, 2021. Due to the continued effects of the pandemic, Ind AS 116 was further amended on June 18, 2021 ('2021 amendments') to extend the availability of the practical expedient by one year – other terms and conditions remained unchanged. The 2021 amendments are effective for annual periods beginning on or after 1 April 2021.

Prior to the 2020 amendments, when a rent concession is granted by a lessor, the lessee would assess whether the rent concession represents a lease modification. If the concession meets the definition of a lease modification, it will apply the requirements for accounting for lease modifications. However, if a pandemic-related rent concession granted by a lessor meets the prescribed conditions, a lessee may elect not to assess whether the COVID-19 rent concession is a lease modification and, therefore, account for the concession as if it was not a lease modification. This article provides an overview about certain aspects of lease concessions provided due to the continuing effect of pandemic.

Conditions for availing the practical expedient related to rent concession:



A direct consequence of COVID – 19

The practical expedient applies only to those rent concessions that are received as a direct consequence of the effects of the COVID-19 pandemic. Companies should assess specific facts and circumstances in this regard such as the underlying reason for negotiations, timing of negotiation of rent concession, reason for providing rent concessions as stated in the revised rent agreement/ addendum to rent agreement, etc.

Revised consideration - substantially the same as or less than the original consideration

One of the conditions for application of the practical expedient is that the change in lease payments that results in revised consideration for the lease that is substantially the same as (or less than) the consideration for the lease immediately preceding the change i.e. original consideration. Accordingly, if rent concession leads to increases in total payments for the lease then such increase would not be considered a direct consequence of the COVID-19 pandemic, except where such increase reflects only the time value of money. For example, pursuant to deferral of rent payment the lessor demands additional rental of Rs. 100 per month to compensate him for time value of money. In such case the practical expedient is available to the lessee if other conditions are met.

Payments originally due on or before June 30, 2022

The practical expedient applies only to rent concessions for which any reduction in lease payments affects payments originally due on or before June 30, 2022. Hence, rent payments which are due after June 30, 2022 would remain unaffected. This criterion means that the practical expedient is strictly time limited.

In developing this condition, the standard setters felt that if the practical expedient were not limited to a particular time frame, a lessee could conclude that many future changes in lease payments would be a consequence of the COVID-19 pandemic. Restricting the time limit of the practical expedient provides relief to lessees when they are expected to need

it most, while being responsive to concerns from users of financial statements about comparability. It was also expected that this condition would be easy to apply and would also help lessees in identifying rent concessions occurring as a direct consequence of the COVID-19 pandemic.

No substantive change to other terms and conditions

The practical expedient applies only to rent concessions that have no other substantive changes to other terms and conditions of the lease. Qualitative and quantitative factors should be considered in assessing whether there are no substantive changes to other terms and conditions of the lease. Other substantive changes beyond providing a COVID-19 pandemic related rent concession, such as introducing or withdrawing extension, termination, or purchase options, would make the entire modification to the lease ineligible to qualify for the relief provided by the practical expedient. Conversely, a change in the lease term, such as a 3-month rent holiday followed by 3 additional months of substantially equivalent payments at the end of the lease, would not constitute a substantive change to other terms and conditions of the lease.

The term 'substantive' has not been defined in the amendments. A lessee should make the judgement about whether other changes are substantive based on its understanding of those changes.

Applying the practical expedient

A lessee accounts for any change in lease payments resulting from the COVID-19 pandemic related rent concession in the same way it would account for the change under Ind AS 116 if the change were not a lease modification. The practical expedient does not alter the standard's existing requirements for lease changes that are not accounted for as lease modifications. For example, if changes in lease payments do not arise from a lease modification then they are generally accounted for as variable lease payments. A lessee recognizes the variable lease payments in profit or loss in the period in which the event or condition that triggers those payments occurs.

Accounting for rent concession that are not lease modification

There are several potential approaches for accounting for a rent concession which is not accounted for as a lease modification, including:

Accounting for concession in the form of forgiveness or deferral of lease payments as a negative variable lease payment (Approach 1)

- When a lessor grants a concession that contractually releases a lessee from certain lease payments or defers lease payments the lessee would remeasure the remaining consideration in the contract at the original discount rate. If the contract contains multiple lease and non-lease components, reallocate the revised consideration to the lease and non-lease components (using unchanged allocation percentages). The lessee would also not update the discount rate used to measure the lease liability. Impact of the forgiven payments is accounted as a negative variable lease expense in the profit and loss account in the period when changes in facts and circumstances on which the variable lease payments are based occur. This approach is similar to that used by the lessor to recognize variable lease income.

Accounting for a concession in the form of forgiveness or deferral of lease payments as a resolution of a contingency that fixes previously variable lease payments (Approach 2):

A lessee may account for a rent concession in the same manner as it would account for a resolution of a contingency that fixes previously variable lease payments. In this case, the lessee would account for the rent concession in a manner similar to Approach 1 except that the lessee would remeasure its lease liability, using the remeasured consideration (e.g. reflecting the lease payment reduction or lease payment deferral provided by the lessor), with a corresponding adjustment to the right-of-use asset.

Accounting for concession in the form of a deferral of lease payments as if the lease is unchanged (Approach 3)

When a lessor permits a lessee to defer a lease payment, the lessee may account for the concession by continuing to account for the lease liability and right-of-use asset using the rights and obligations of the existing lease and recognizing a separate lease payable (that generally does not accrue interest) in the period that the allocated lease cash payment is due. In this case, the lessee would reduce the lease payable when it makes the lease payment at the revised payment date.

Transition challenges

Transition date accounting

Lessees opting for the relief in the 2021 amendment pertaining to previous year must apply the practical expedient retrospectively, recognizing the cumulative effect as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the practical expedient. The comparatives are not required to be adjusted.

Rent concessions: practical expedient availed previously

A lessee is required to apply the relief consistently to contracts with similar characteristics and in similar circumstances. Therefore, lessees that have already applied the relief to certain types of contracts under the 2020 amendment are required to apply the 2021 amendment retrospectively to eligible contracts with similar characteristics and in similar circumstances, irrespective of whether the contract became eligible for the relief as a result of the lessee applying the 2020 or the 2021 amendment.

Enhanced disclosures

A lessee that applies the optional practical expedient discloses that it has applied the practical expedient to all rent concessions that meet the conditions for it or, if not applied to all such rent concessions, information about the nature of the contracts to which it has applied the practical expedient. In addition, a lessee discloses the amount recognized in profit or loss to reflect changes in lease payments that arise from such rent concessions to which the lessee has applied the practical expedient. Disclosure of the cash flow effects of rent concessions would also be relevant regardless of whether a lessee applies the practical expedient.

Lessees are specifically exempted from the requirement to disclose the following information as prescribed in Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors when a company changes an accounting policy due to the rent concession. Ind AS 8 requires company to disclose for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

- For each financial statement line item affected; and
- If Earnings per Share applies to the entity, for basic and diluted earnings per share.

Lessor accounting

Lessor accounting for rent concessions is based on existing guidance. The 2020 and 2021 amendments do not apply to lessors. Whilst there are no specific disclosure requirements related to lease modifications, lessors will need to disclose information that is sufficient to enable users of financial statements to understand the impact of COVID-19 pandemic related changes in lease payments on the entity's financial position and financial performance.

How we see it

- There are many different forms of rent concessions obtained by lessees. Therefore, lessees need to evaluate the details of the rent concession granted carefully to determine an appropriate accounting approach. Electing to apply the practical expedient may involve re-configuring systems and updating existing processes.
- As well as providing the specific disclosures required in the amendment, companies should be mindful of the disclosure objectives of Ind AS 116 which require lessees to provide adequate disclosure that gives a basis for financial statement users to assess the effect that leases have on balance sheet, financial performance and cash flows of the lessee. In addition, lessees need to consider the presentation and disclosure requirements in other standards such as those in Ind AS 1 Presentation of Financial Statements when accounting for rent concessions. Ultimately, the extent of additional disclosure is company-specific and should communicate useful information to investors and other stakeholders.
- Lessors need to carefully evaluate the requirements of impairment and derecognition of lease receivables under Ind AS 109, Financial Instruments and its interaction with Ind AS 116 when rent concessions are granted.

Key considerations arising from amendments to Corporate Social Responsibility norms

Corporate Social Responsibility (CSR) has evolved in India over the last few years from being voluntary and philanthropic to organizations instituting strategic programs to contribute toward causes that enable the welfare of the society. CSR awareness and CSR consciousness has grown dramatically among companies, which now look at CSR to build a strategic fit with the community and environment in which they operate. The CSR norms has been strengthened over the years basis recommendations of various committees. With an intent to facilitate implementation of CSR in a more efficient and transparent manner, amendments were made to Section 135 of the Companies Act, 2013 ('2013 Act') and Companies (Corporate Social Responsibility Policy) Rules, 2014 ('CSR Rules'). These amendments are effective from January 22, 2021 and require close review as they directly impact implementation of a company's CSR initiatives. These amendments have also introduced concepts like a specific negative list in the CSR definition, mandatory treatment of CSR underspend, mandatory impact assessment, mandatory registration of CSR agencies, etc. These changes are likely to trigger impact across regulatory, accounting and finance domains.

With these changes significantly affecting the financial statements for year ended March 31, 2021 and onwards, we have summarized the key changes, their impact, and key points to be considered by companies in ensuring their compliance with these amendments. Reference should also be made to revised FAQs on CSR released by MCA on August 25, 2021 in response to the amendments to CSR norms ('MCA FAQs').

Definition of CSR

Negative list has been introduced in the definition of CSR with an aim to ensure promotion of public good and regulate spending of the CSR fund for their own benefit by Companies. Companies are required to re-assess whether their CSR policy is in compliance with amended definition of CSR in light of detailed negative list. The guiding principle for CSR is to prescribe permissible CSR activities and also to prescribe activities which are specifically restricted e.g. statutory obligations, political donation, activities undertaken on sponsorship basis to derive marketing benefits for products/ services. Further, any activities benefitting the employees of the company is not to be treated as CSR (Reference may also be to FAQs issued by MCA to deal with COVID 19 specific considerations)[1] .

[1] MCA circular General Circular No. 15/2020 dated April 10, 2020, COVID-19 related Frequently Asked Questions (FAQs) on Corporate Social Responsibility (CSR).

Administrative overheads

The CSR Rules were amended to introduce the definition of Administrative overheads. These are expenses incurred by the Company for 'general management and administration' of CSR functions. Administrative overheads do not include the expenses directly incurred for designing, implementation, monitoring and evaluation of a particular CSR project/ program and threshold of such expenses is limited to 5% of total CSR expenditure in a financial year of the company.

Mandatory registrations for CSR agencies

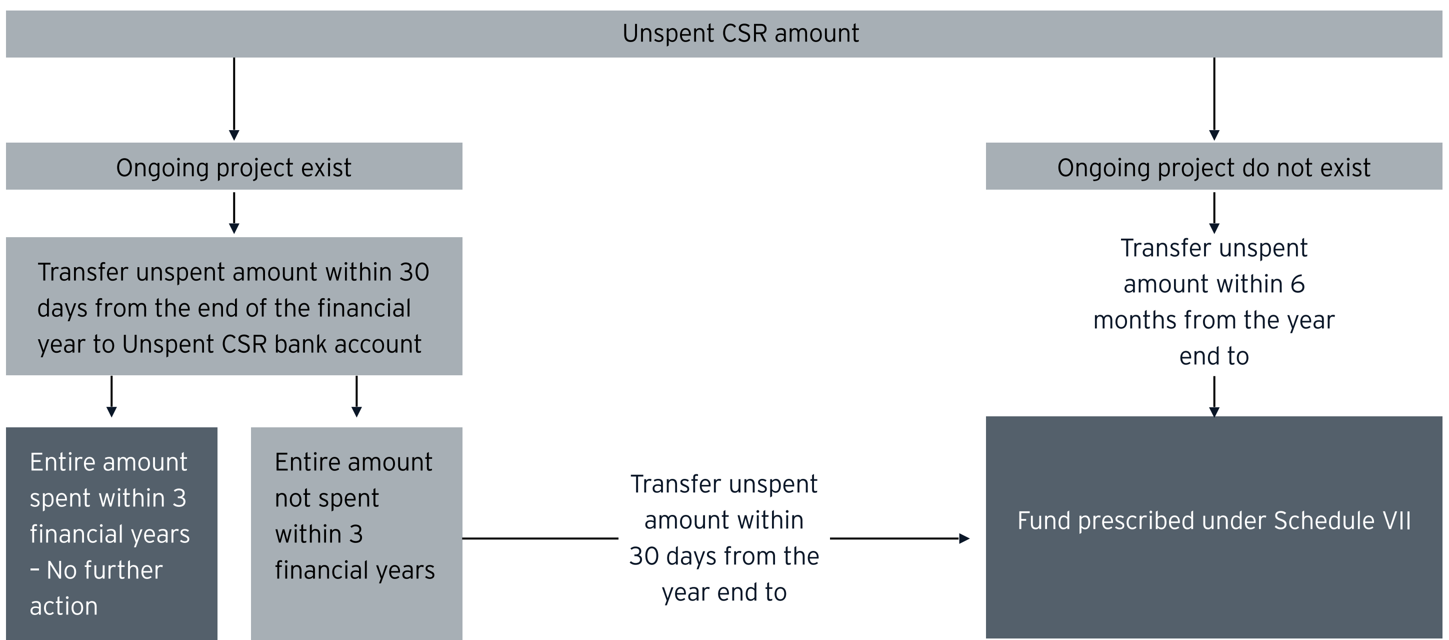
CSR Rules prescribes the criteria for agencies eligible to implement CSR such as a company established under section 8 of the 2013 Act, or a registered public trust or a registered society, registered under section 12A and 80 G of the Income Tax Act, 1961 , established by the company, either singly or along with any other company. Such CSR agencies intending to undertake any CSR activity, should register themselves with Central Government with effect from April 1, 2021. CSR projects or programmes approved prior to April 1, 2021 are not affected due to this amendment. Boards need to set-up a process to ensure that CSR agencies associated with the companies are registered as prescribed under the CSR Rules. Further, controls should be established around receiving and verifying the registration certificates at the time of disbursement of funds and such verification may be carried out at periodic intervals to ensure continued compliance by the CSR agencies. Company may frame a well-defined due diligence policy and establish underlying procedures in place to identify any potential 'Red Flag'.

One issue that arises is whether disbursal of funds to a CSR implementing agency will be considered as spend under CSR provision. The Board of directors should satisfy itself that the funds so disbursed have been utilized for the purposes and in the manner so approved.

Recognition of Unspent CSR amount in the financial statements

Section 135 of the 2013 Act require compulsory spending of at least 2% of average net profits of immediately preceding three years towards CSR activities of a company. Further as per Section 135, unspent CSR amount should be transferred to a Fund prescribed under Schedule VII to the 2013 Act within a prescribed time period – which depends on whether the company has an ongoing project or not. The CSR Rules clarify that till the time a Fund is prescribed, the unspent amount can be transferred to any Fund prescribed under Schedule VII.

Under the CSR Rules, an ongoing project means a multi-year project undertaken in fulfilment of its CSR obligation having timelines not exceeding 3 years (excluding the financial year in which it was commenced), and would include such project that was initially not approved as a multi-year project but whose duration has been extended beyond 1 year by the Board based on reasonable justification.



The Institute of Chartered Accountants of India has issued a Technical Guide on Accounting for Expenditure on Corporate Social Responsibility ('Technical Guide') which provide the following manner of recognition and measurement of unspent CSR expense in the financial statements:

- Ongoing projects: There is an obligation to transfer the unspent amount to a separate bank account within 30 days of the end of financial year and eventually any unspent amount out of that to a Fund specified in Schedule VII. Accordingly, a provision for liability for the amount representing the extent to which the amount is to be transferred within 30 days of the end of the financial year needs to be recognized in the financial statements.
- Other than ongoing project: The company would have an obligation to transfer the unspent amount of to a specified Fund. Accordingly, a provision for liability for the amount representing the extent to which the amount is to be transferred, needs to be recognized in the financial statements.

The applicability of this requirement is prospective and therefore the unspent amount for the financial year 2020-21 and onwards should be transferred to the Fund specified in Schedule VII within six months of the expiry of the said financial year, unless the same pertains to any ongoing project. Regarding unspent amount of years prior to financial year 2020-21, the MCA FAQ provides that the Board of the company is free to decide the treatment of such unspent CSR amount. The Board can either transfer the amount to 'Unspent CSR bank Account' or continue as per the previous accounting practices adopted by the company.

The Institute of Chartered Accountants of India has vide its FAQ dated May 10, 2021 has clarified that as per Ind AS 34/ AS 25, Interim Financial Statements, CSR obligation should be recognized based on the principles for recognition of the same in annual financial statements; the legal obligation for "unspent amount", whether relating to ongoing projects or not, which is determined as per the provisions of Section 135 arises only at the end of the financial year and hence the liability for the same is recognized at the end of the financial year.

Further, Companies (Auditor's Report) Order, 2020 also prescribes reporting responsibilities for auditors including whether any amount which remains unspent pursuant to any ongoing project, has been transferred in accordance with the applicable CSR provisions.

Carry forward and set-off of excess spend and surplus

CSR Rules provide for the carry forward of excess CSR spend during a financial year and such excess can be set-off from its obligation of next three years provided that the excess amount available for set off do not include the surplus arising out of the CSR activities and a Board resolution has been passed approving the set-off. As per the MCA FAQs, the amendment in CSR rules is applicable prospectively from January 22, 2021 i.e. from FY 2020-21 onwards. Thus, no carry forward would be allowed for the excess amount spent, if any, in financial years prior to FY 2020-21.

Company should put in place procedure and mechanism to identify surplus arising out of CSR activities and ensure that such surplus has been utilised for same project or transferred to the Unspent CSR bank Account and spent in pursuance of CSR policy without being accounted as income of a Company.

Creation/acquisition of capital assets

A capital asset created/ acquired out of CSR funds cannot be held by a company. It can be held by a Section 8 Company, Registered Public Trust or Registered Society (having charitable objects and CSR Registration Number) or beneficiaries of the said CSR project in the form of self-help groups; collectives, entities; or a public authority.

Companies need to establish a mechanism for transferring existing capital assets to prescribed entities and assess consequential implications as per applicable laws and regulations.

Impact assessment

The CSR Rules provide that Company having average CSR obligation of Rs 10 crore or more in the 3 immediately preceding financial years should mandatorily carry out Impact Assessment through an independent agency for projects having outlays of Rs. 1 crore or more than and which have been completed not less than 1 year prior to undertaking the impact study. This requirement has been introduced to identify areas where intervention is required for the benefit of marginalized communities. CSR Rules place limits on the amount spent towards the impact assessment that can be

considered as part of CSR expenditure during a financial year at Rs 50 lacs or 5% of total CSR expenditure for that financial year, whichever is lower.

Impact Assessments are to be executed based on viable and validated models such as Impact Reporting and Investment Standards, Log frame approach, Social returns on Investment and theory of change. These models help in assessing impact through tested approaches and scientific analysis. These Impact Assessment studies also aid in understanding the journey and effectiveness of a company's CSR agenda and goals and therefore, helps it take strategic decisions or corrective action where required.

Increasing responsibility of Board, CSR committee and Chief Financial Officer

The Amended CSR Rules have casted enhanced obligations on the Board, CSR Committee and Chief Financial Officer of the Company for monitoring, evaluation and reporting of CSR activities of the Company.

Key obligations of the Board includes

- The Board should ensure that the administrative overheads do not exceed 5% of total CSR expenditure of the company for the financial year.
- The Board of directors should pass resolution for carry forward and set off of excess CSR spend.
- Board's Report of the company should include an annual report on CSR containing particulars as specified in the CSR Rules.
- The impact assessment reports as discussed earlier should be placed before the Board and should be annexed to the annual report on CSR.

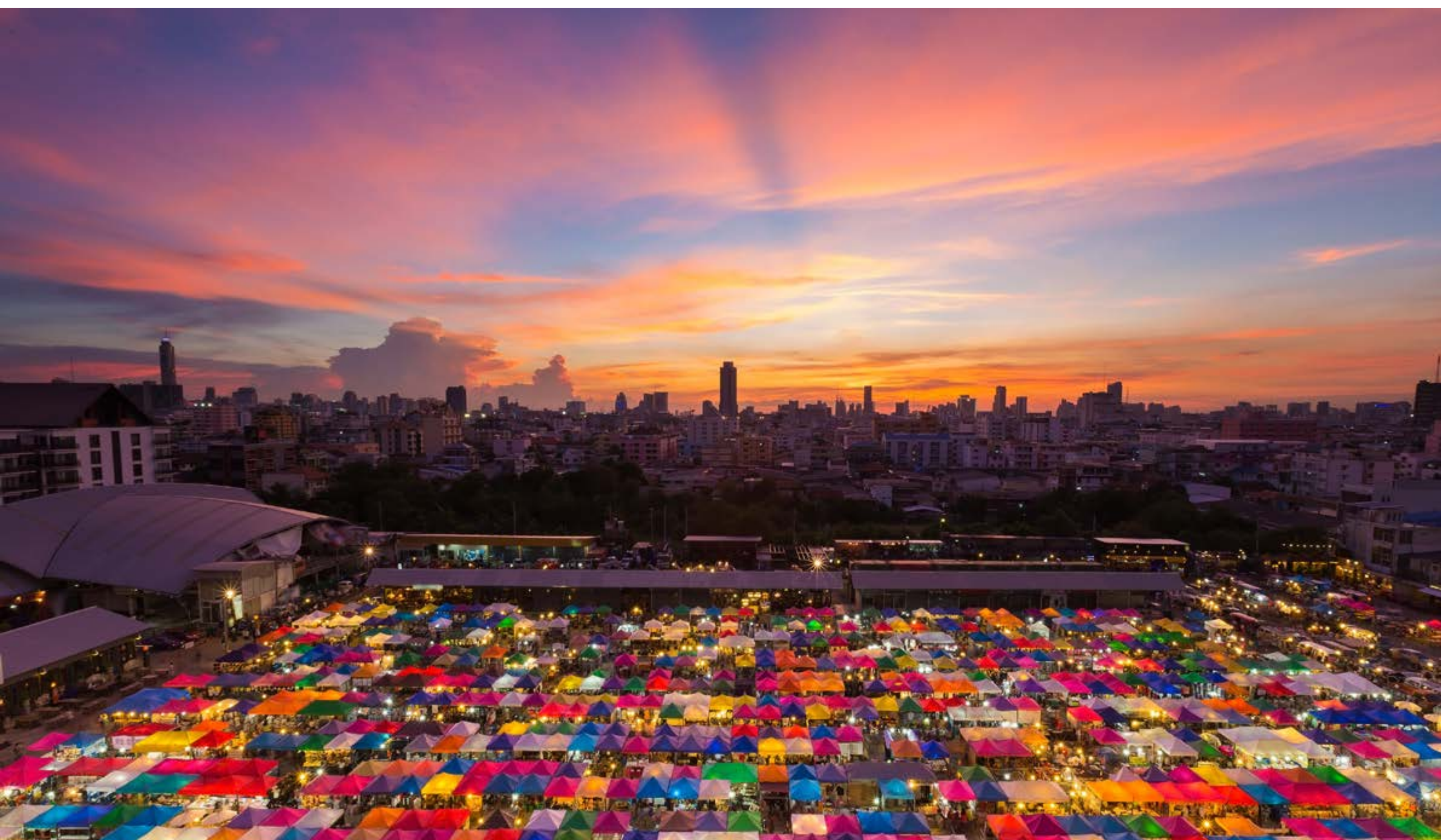
Key obligation of Chief Financial Officer

CSR Rules require CFO to certify that the funds disbursed for CSR have been utilized for the purposes and in the manner as approved by the Board of Directors of the Company.

Key obligations of the CSR Committee

The CSR Committee should formulate and recommend to the Board, an annual action plan in pursuance of its CSR Policy, which should include the following:

- List of CSR projects or programmes
- Manner of execution of CSR projects
- Modalities of utilisation of funds and implementation schedules for the CSR projects
- Monitoring and reporting mechanism for the projects or programmes and
- Details of need and impact assessment, if any, for the projects undertaken by the company.



Enhanced disclosures/ reporting

- CSR Rules mandatorily require impact assessment report to be placed before the Board and the reports to be annexed to the Annual Report on CSR. As clarified in the MCA FAQs a web-link to access the complete impact assessment reports and an executive summary of the impact assessment reports should be provided in the annual report on CSR.
- The Board of Directors of the Company should mandatorily disclose the composition of the CSR Committee, CSR policy and projects approved by the Board on the website, if any, for public access.
- Schedule III to the 2013 Act has been amended to include specific CSR related disclosures in the financial statements (which were earlier prescribed under the Technical Guide). Additional disclosures include reason for shortfall and nature of CSR activities.

Penalty provisions

Section 135 provides penalty for non-compliance with the CSR norms including non-disclosure of unspent amount in annual report on CSR, transfer of unspent amount to the Unspent CSR bank Account/ Fund prescribed under Schedule VII. In such cases:

- The company is liable to a penalty of twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent CSR Account or Rs 1 crore, whichever is less.
- Every officer of the company who is in default would be liable to a penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent CSR Account, as the case may be, or Rs 2 lakh, whichever is less.

How we see it

The CSR provisions were amended with an objective to reinforce compliance, anti-abuse and strengthen governance, transparency and flexibility. Companies will have to consider these changes holistically from the systems, processes, compliance and reporting perspective and may have to re-visit their existing policy and procedures to ensure that their CSR policy, procedures and systems are in compliance with these changes at all times. This will also require regular monitoring and checks for certain more onerous provisions such as last mile monitoring of funds spent by Companies or the CSR agencies of the Company. Companies will need to review the current CSR spend or potential shortfall or surplus and determine its treatment, ensure implementing agencies are duly registered and conduct a due diligence including reputational checks. Also, companies may refresh the roles of Board, CSR Committee, CFO and set up new standard operating procedures for the annual process including formulation of annual action plan. Further the MCA FAQs provides detailed guidance on key implementation challenges which companies should refer for compliance with the CSR norms.

03

Evolving landscape of expected credit losses post COVID-19 in financial services companies

Expected Credit Loss (ECL) has been around for three years in India (with first phase of implementation in FY 2018-19 for Non-Banking Financial Companies (NBFCs) with net worth of more than Rs.500 crore). However, it was put to a real test of relevance last year after the world was hit by the deadly pandemic. COVID-19 has not only impacted economies and businesses around the globe but has also significantly altered the very notions about "risk" especially for the financial services sector. When COVID-19 first broke out in FY 2019-20, most NBFCs elected to keep their base ECL model unchanged and factored in its impact in ECL only by way of a post model adjustment or through an additional layer of provisioning based on management's estimate of losses for specific events (commonly referred to as "management overlay"). This approach did make sense then as no one knew how long and severe COVID's impact was going to be, not to mention the lack of any empirical data to build a model around it. However, four quarters and two waves later, this notion may require a serious reconsideration.

The question is – now do we know enough to recalibrate our ECL models for the pandemic or whether this uncertainty is here to stay and we might need to get accustomed to the idea of not being able to reliably estimate the near future with a reasonable degree of confidence? The answer, however unsettling, lies somewhere in between meaning that the role of management's judgement in the ECL estimation process would further get enlarged. But before we delve deeper into this question, let's look at some of the factors which have changed the landscape of ECL post pandemic:

A. Loan Moratorium

The Reserve Bank of India ('RBI'), as part of the COVID-19 regulatory package, announced a moratorium of six months on all loan repayments between March 1, 2020 and August 31, 2020. The important question which arose was whether availment of moratorium is to be considered as a trigger for significant increase in credit risk ('SICR') requiring classification of the account as stage 2 (i.e. an account where credit risk has increased significantly from initial recognition).

The Institute of Chartered Accountants of India ('ICAI') in its guidance dated May 6, 2020[2] provided that

[2]COVID -19 : FAQs on Indian Accounting Standards (Ind AS)

a mechanistic approach should not be applied for determining SICR. Therefore, a temporary repayment moratorium granted as part of regulatory support measure need not be construed as an indicator for SICR. It prescribes consideration of more qualitative considerations of past events, current conditions and forecast of economic conditions including impact of COVID-19 and related regulatory actions.

Accordingly, companies excluded moratorium from the past-due status however, not many institutions were able to devise any objective criteria for a qualitative assessment of increased credit risk during such period especially in the retail loan portfolio. It will be fair to say that distinguishing the stressed exposure when a blanket moratorium was offered across the board was not practically feasible, especially when the moratorium itself was causing the credit discipline to dilute in some pockets. This was evident from the significant flows in stage 2 soon after the expiry of the moratorium period contrary to what one might have expected.

While the regulatory moratorium period has elapsed a year ago, the data gathered on the behavioural pattern of customer segments during and post moratorium will serve as a key ingredient for ECL remodelling for upcoming periods.

B. One-time restructuring (OTR)

OTR was another regulatory relief measure announced on August 6, 2020 wherein the RBI permitted lending institutions to restructure/ reschedule loans of eligible customers stressed due to COVID-19 without downgrading them to substandard. RBI has clarified that the eligible borrowers' accounts should continue to be classified as Standard till the date of invocation of resolution under this framework. Once again, the imminent question was whether such restructuring should result in a stage 2 classification.

In this instance, although ICAI did not provide any specific guidance on treatment of OTR, most companies considered OTR as a SICR event primarily due to the following reasons:

- Unlike moratorium, OTR was not granted across the board but only to specific customers who were experiencing COVID-19 related stress
- OTR was granted to customers after they were already provided a repayment moratorium of six months, which indicated of a higher degree of stress
- Past-due status is not a conclusive evidence of increased credit risk especially when an asset is restructured
- The credit risk of a restructured account cannot be said to be same as what it was at the time of inception of loan

While the view on classification has been broadly consistent, there have been different positions taken as regards the extent of provision to be recognized on such accounts.

C. Industry-specific concessions

The unprecedented scenario last year had adversely impacted retail borrowers especially from the economically weaker sections. As a result, companies catering to this section resorted to means such as pre-closing existing loans of the borrower and issuing a fresh loan of a higher amount with renewed terms and conditions. This helped the borrowers to reduce their cash outflows and secure a longer repayment tenure as well as receive some additional cash to restart their small businesses or regularise their working capital cycles.

Irrespective of the intent behind such measures which is usually to bail the borrowers out of an imminent default (which could spoil their credit history impairing their future ability to borrow), not many have been able to acknowledge or fully grasp the implications of this from an ECL standpoint.

In most cases the new loan issued gets serviced by the borrower without any immediate defaults. Thus, as on a particular date it may appear to be fully performing but what needs be taken into consideration is that the customer had already demonstrated an inability to repay (notwithstanding that such inability was induced by external factors). Such inability was forborne / regularised by the lending institution by offering a new loan at beneficial terms. Thus, it would be inappropriate to disregard such credit event and only look at the past-due status of the new loan in isolation and delay the recognition of credit risk.

D. Management overlay

Over the past one year, all lending institutions have not only been grappling with business and operational challenges posed by the pandemic but also in figuring out the best way to incorporate its effect in their loan loss provisioning. With unprecedented spikes in delinquencies, all eyes have been on credit costs with little attention towards profitability. This task has been particularly difficult under the ECL regime due to the fluidity of the situation, lack of any past data or trends to base the model upon and the pressure of getting the balance

between over and under provisioning right.

As a result, managements have resorted to creating an addition layer of provisioning towards expected losses on account of COVID-19, over and above their base ECL figures. Such overlays have been computed in numerous ways, but the primary theme has been to stress the existing probability of default (PD) or loss given default (LGD) factors for higher flows and greater losses. However, there has been a general sense of opacity around it due to the unavailability of objective parameters to derive the overlay as well as due to constantly changing scenarios requiring the management also to improvise.

E. Structural changes in credit risk profile

Another major aspect which could impact ECL models going forward is that post pandemic, certain institutions have revisited their business models and credit policies. In the process of tightening the screws on whom to lend, companies believe that they have become much more stringent in credit appraisals and thus the new segment of customers acquired post pandemic have greater resilience to the impact of pandemic. Therefore, they believe that the extent of losses on these new sets of customers would be lower than the losses witnessed in the past one year. Ironically, in some cases this has resulted in an unexpected situation of declining ECL estimates in the most stressful times.

Having discussed some of the issues which have had an impact on the ECL modelling, **let us look at some aspects which will be important in redesigning the ECL models:**

A. Identification of stress

One of the key aspects of remodelling the ECL going forward would be how effectively the institutions are able to segregate the loan portfolio impacted due to COVID-19 so as to enable them to develop separate ECL estimates for this cohort. While the existing pre-COVID-19 ECL estimates can be applied for the portfolio which continued to perform through the pandemic, special rates, which would take into consideration the abnormal delinquencies induced by an extra-ordinary event, can be developed for the COVID-19 impacted portfolio. The premise of this concept is that the normal pre-COVID ECL rates were based on a business-as-usual scenario where loan losses used to arise primarily due to borrower-specific credit events. Thus, applying those rates during such times of heightened stress may be counter intuitive.

This may be more complex than it sounds, as it will require a lot of objectivity from the management to set out the criteria for such bifurcation. Companies can look at specific geographies, demographic patterns, loan products, nature of underlying security and other similar factors to bifurcate the loan portfolio. One of the key indicators would be to look at the pool of borrowers that availed moratorium for most part of the six-month window provided under the RBI's package. Higher the extent of objectivity in the segmentation process, better the quality of ECL estimation would be.

It may also be relevant to revisit or reassess the definition of what constitutes a default and significant increase in credit risk. However, any exceptions to or rebuttal of the thresholds prescribed in the standard shall have to be approved by the audit committee (as required by the RBI circular on Ind AS implementation).

B. Performance post moratorium

The delinquencies increased significantly after moratorium period elapsed and by end of Q3 – FY 2021, substantial portfolio had migrated to stage 3. By end of FY 2021, these figures had further deteriorated requiring companies to write-off large amount of their portfolio. While it can be debated whether such write-offs were an outcome of an objective assessment of ultimate recoverability or were influenced by the need to keep the NPA ratios under check, such accelerated write-offs automatically led to the consideration of the post-pandemic performance into the ECL (although not by way of provisioning).

Thus, if the companies are able to analyze the post-moratorium flows, it could serve as a proxy for the near-term probability of default (PD) factor. In addition to this, companies may also analyze the collections made from written off portfolio to adjust the loss given default (LGD) factor. An effective back-testing mechanism will be very essential in these times to recalibrate the model.

C. Impact of regulatory packages

As discussed above, a minimum of stage 2 classification of loans under OTR has been considered by entities as a fair reflection of the stress in the portfolio. It is therefore essential to recognize this stress in the ECL estimation also. While application of the existing estimates of lifetime ECL may not be essential, carrying only a stage 1 provisioning would also be inappropriate as it will result in placing a stressed customer in the same bracket as those who have been genuinely performing through the pandemic.

Thus, the answer would lie somewhere in between the existing stage 1 and 2 ECL rates. Companies should take into consideration the extent of concessions granted (rate reduction, tenure elongation, additional moratorium, etc.) and performance post restructuring (provided the length of the period is reasonable) to determine whether the provisioning estimates need to lean towards the normal life-time (stage 2) rates or can be lowered.

Another important question that looms is how long should be the performance period post restructuring to upgrade the loan to stage 1. While Ind AS 109 is silent, reference may be drawn from RBI's Master Directions (which indicate a period of one year of satisfactory performance for upgradation). In the context of Ind AS 109 read with RBI's guidance on Implementation of Ind AS (dated March 13, 2020), this should be governed by the Board approved policy.

D. Moving away from overlays

A complete elimination of management overlays may not be feasible as the situation still remains highly uncertain and dynamic, however, there shall be a need to gradually move away from the overlays. Over reliance on overlays not only undermines the ECL methodology of the entity but also hinges primarily on management's judgement rather than objectivity and data.

Non-recurring one-off events such as COVID-19 are usually not considered for ECL modelling but the current fact pattern suggests that the impact of the pandemic could be relevant for at least 12-18 months from now.

Thus, to reduce the proportion of overlay, the impact of post-pandemic delinquencies may be factored in the base PDs itself. While integrating the past year's default data into base PDs will surely lead to a spike in the ECL rates but the same shall have to be rationalised by applying appropriate weights.

How we see it

As uncertainty still looms with an imminent third wave fear, institutions will need find order from the chaos and develop objective models based on unbiased and independent data. These models may hinge upon external macro-economic data such as GDP growth, inflation, unemployment, etc. or data specific to entity's borrower profile such as customer vintage, repayment bounce ratio, credit bureau score, etc. This may also require companies to apply various data mining techniques in order to analyze the trends appropriately and integrate the results into the model.

There would also be a need to revisit the model more frequently (say each quarter) rather than at annual intervals to enable early course correction. More importantly, it will be essential for those charged with governance to lay down a framework prescribing the qualitative criteria for determination of ECL. This will provide the required flexibility to the management and also keep excessive judgement and subjectivity under check.

Strengthening the framework of Independent Directors

Background

Independent directors ('IDs') are an important feature of the corporate governance. Regulators are increasingly relying on them to protect interest of the stakeholders especially the minority shareholders.

Over the years, the institution of IDs has been strengthened basis recommendations received from various stakeholders. With an intent to further strengthen the overall framework of IDs for entities having listed specified securities i.e. equity shares and convertible securities and to enhance their effectiveness in protection of the interest of the minority shareholders, Securities and Exchange Board of India (SEBI) amended SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations').

These amendments would come into effect from January 1, 2022. The Listing Regulations were amended further on September 7, 2021 to empower IDs of 'high value debt listed entity[3]' and 'other matters'. The amendments relating to IDs applies on a 'comply or explain' basis until March 31, 2023 and on a mandatory basis thereafter. In this article, we provide an overview of the key changes.

Definition of an ID

Regulation 16(1)(b) of the Listing Regulations set out certain objective conditions for determination of independence of an ID. These conditions include areas of relationship of self and of relatives (including material pecuniary relationship) with the listed entity, its promoter, or directors, etc. An ID is also defined under section 149(6) of the Companies Act, 2013 (2013 Act) which provides that proposed ID cannot have any pecuniary relationship apart from remuneration as prescribed therein. SEBI observed that scope exists to further strengthen the criteria for independence of IDs and harmonization of certain requirements with 2013 Act. Accordingly, SEBI amended the Listing Regulations to align with relevant requirements and also to insert additional criteria as follows:

- Existing Regulation 16(1)(b)(iv) of the Listing Regulations provides that the ID, apart from receiving director's remuneration, should not have/ had any material pecuniary relationship with the listed entity, its holding, subsidiary, associate company, or their promoters, or directors during the 2 immediately preceding financial years or during the current financial year. These requirements are largely similar to the requirements prescribed under Section 149(6)(c) of the 2013 Act. Regulation 16(1)(b)(iv) of the Listing

[3]Listed entity which has listed its non-convertible debt securities and has an outstanding value of listed non-convertible debt securities of Rs. 500 Crore and above.

Regulations has been amended to extend the cooling off period to 3 immediately preceding financial years.

- Existing Regulation 16(1)(b)(v) of the Listing Regulations provides that ID is a person whose relatives do not have/ had pecuniary relationship or transaction with the listed entity, its holding, subsidiary or associate company, or their promoters or directors beyond prescribed threshold during the 2 immediately preceding financial years or the current financial year. Similar requirement exists under Section 149(6)(d) of the 2013 Act as well.

  SEBI has amended this Regulation to align with the requirements prescribed under the Section 149(6)(d) of the 2013 Act to a large extent - however certain differences still exist e.g. the period for determining pecuniary relationship is stated as 3 immediately preceding financial years (under 2013 Act: 2 immediately preceding financial years), retention of lower threshold for determining pecuniary relationship of relatives as provided under the Listing Regulations.

- Existing Regulation 16(1)(b)(vi) of the Listing Regulations and Section 149(6)(e)(i) of the 2013 Act provides that a ID is a person who (neither himself nor whose relatives) holds or has held the position of a key managerial personnel or is or has been an employee of the listed entity or its holding, subsidiary or associate company in any of the 3 financial years immediately preceding the financial year in which he is proposed to be appointed. Amended Regulation 16(1)(b)(vi) of the Listing Regulations extends the restriction to employment in any company belonging to the promoter group.

  Proviso under this Regulation has been inserted to provide that the cooling off period will not apply to relatives in employment of the stated entities, provided they do not hold the position of a key managerial personnel.

- Existing Regulation 16(1)(b)(viii) of the Listing Regulations provide that ID is a person who is not a non-independent director of another company on the Board of which any non-independent director of the listed entity is an ID. An explanation has been inserted under this Regulation to provide that in case of a 'high value debt listed entity' which is a body corporate mandated to constitute its board of directors in a specific manner in accordance with the law under which it is established, the non-executive directors on its Board would be treated as IDs. Similar requirement has also been prescribed for 'high value debt listed entity' which is a Trust.

Appointment, re-appointment and removal of IDs

Appointment of an ID is permitted through an ordinary resolution in the general meeting of a company as prescribed under section 152(2) of the 2013 Act. However, reappointment of an ID requires passing of a special resolution by the company. SEBI felt that the present system of appointment of IDs may be influenced by the promoters – in recommending the name of ID and in the approval process by virtue of shareholding. This may hinder the independence of IDs and undermine their ability to differ from the promoter, especially in cases where the interests of promoter and of minority shareholders are not aligned. Additionally, considering that the role of IDs includes protecting the interest of minority shareholders, there is a need for minority shareholders to have greater say in the appointment/ re-appointment process of IDs.

Accordingly, in order to give more say to the minority shareholders in the simplest manner possible, SEBI introduced Regulation 25(2A) in the Listing Regulations to provide that the appointment, re-appointment or removal of an ID should be subject to the approval of shareholders by way of a special resolution.

Shareholders' approval for appointment of IDs

The existing Listing Regulations do not prescribe any time gap between the appointment of ID by the Board of Directors and approval by the shareholders. In the past, SEBI had observed a significant time gap between the appointment (including that arising from causal vacancy) of an ID and approval of shareholders, which is not in the best interest of especially the minority shareholders. Hence, SEBI intended to reduce such time. Further, SEBI also felt that such approach should also be followed for other category of directors as well e.g. Executive Directors, Non-Executive Directors in order to bring consistency and ease of compliance.

Accordingly, Regulation 17(1C) was introduced in the Listing Regulations to provide that approval of shareholders for appointment of any person on the Board of Directors should be taken at the next general meeting or within 3 months from the date of appointment, whichever is earlier.

Enhancing and bringing in more transparency in the role of Nomination and Remuneration Committee (NRC)

At present, the Regulation 19(1)(c) of the Listing Regulations provide that NRC should comprise of atleast 50% of IDs and for listed companies having outstanding superior rights equity shares, 2/3rd of the NRC should comprise of IDs. Regulation 19(1)(c) has been amended to provide that atleast 2/3rd of the directors in NRC of all listed companies (including listed companies having outstanding superior rights equity shares) should comprise of IDs.

Clause A to Part D to Schedule II of Listing Regulations, interalia prescribe that the role of the NRC includes formulation of the criteria for determining qualifications and positive attributes of a director. SEBI felt that there is a need to strengthen the composition of IDs in NRC. Further, SEBI observed that due to lack of transparency, there is a need to prescribe disclosures regarding the process followed by NRC for selection of candidates for the post of an ID.

SEBI introduced Clause 1A in Part D to Schedule II of Listing Regulations to provide that for every appointment of an ID, the NRC should evaluate the balance of skills, knowledge and experience on the Board of Directors. On the basis of such evaluation, NRC should prepare a description of the role and capabilities of an ID. The person recommended to the Board for appointment should have the capabilities identified in such description. NRC may use the services of an external agency, if required, consider candidates from a wide range of backgrounds (having due regard to diversity) and consider the time commitments of the candidates.

Resignation of IDs

Current provisions prescribed under Schedule III(Part A)(A)(7B)(i) require the resigning ID (within 7 days from date of resignation) to disclose to the stock exchanges, detailed reasons for the resignation along-with a confirmation that there is no other material reason for resignation other than those already provided. In order to improve transparency and enhance disclosures, Schedule III has been amended to provide for disclosure of the resignation letter of an ID along with names of listed entities in which the resigning director holds directorships, indicating the category of directorship and membership of board committees, if any.

SEBI also observed instances where IDs have resigned and have joined the same company as an Executive Director. In such cases where an ID is aware that he/ she may move to a larger role in the company in the near future, may practically lead to a compromise in independence. Accordingly, Regulation 25(11) was introduced in the Listing Regulations to provide that an ID (who resigns from a listed entity) should not be appointed as an Executive / Whole time Director on the Board of the listed entity, its holding, subsidiary or associate company or on the Board of a company belonging to its promoter group, unless a period of 1 year has elapsed from the date of resignation as an ID.

Composition of the Audit Committee

At present, the Regulation 18(1)(b) of the Listing Regulations provide that 2/3rd of the members of the Audit Committee should comprise of IDs and for listed companies having outstanding superior rights equity shares the Audit Committee should comprise only of IDs. In order to ensure a balance between independence and efficiency of the Audit Committee the existing composition of "2/3rd of IDs" as prescribed in the above Regulation has been replaced with "atleast 2/3rd of IDs". The amendment prescribes for a minimum requirement of 2/3rd of the Audit Committee to be comprised of IDs, thus requiring companies to appoint more IDs as members of the Audit Committee.

Regulation 23(2) of the Listing Regulations provide that all related party transactions require prior approval of the Audit Committee. SEBI felt the need to further enhance the scrutiny around related party transactions. Accordingly, a proviso has been added to Regulation 23(2) which provide that only those members of the Audit Committee, who are IDs, should approve related party transactions.

Insurance for IDs

Top 500 listed entities by market capitalization are required as per Regulation 25(10) of the Listing Regulations to undertake Directors and Officers insurance ('D and O insurance') for all IDs of such quantum and for such risks as may be determined by its Board of Directors. SEBI considered that the requirement of mandatory D and O insurance should be extended to a wider group of listed entities. Accordingly, SEBI has decided that with effect from January 1, 2022 the requirement of undertaking D and O Insurance would be extended to the top 1000 companies by market capitalization.

Further, the Listing Regulations have also been amended to provide that a 'high value debt listed entity' should undertake D and O insurance for all its IDs for such sum assured and for such risks as may be determined by its Board of Directors.

How we see it

- The amendments to the Listing Regulations have been made with an objective of raising the corporate governance standards in India. These amendments will certainly nudge the Board of Directors and IDs to take suitable actions to enhance governance standards.
- The amendments have increased the number of IDs that are required to form the NRC. The listed entities would need to assess whether the NRC would need to be reconstituted.
- SEBI has provided sufficient time to the listed entities for seamless implementation of these amendments. As true for any change, these amendments will also raise implementation challenges such as whether existing IDs can continue and complete their remaining tenure (considering that the definition of an ID has undergone a change), and impact on the related party transactions approved by the Audit Committee prior to the effective date of the amendments (since as per the amendments only those members of the Audit Committee who are IDs can approve the RPTs). Hence it is important for entities to engage with the relevant stakeholders to conclude on these emerging issues.
- Apart from the above amendments, SEBI has also decided in its Board meeting that IDs can be given ESOPs. At present ESOPs to IDs are prohibited under the Listing Regulations and 2013 Act. Listed companies should watch out for any future development since this would require further amendments to the Listing Regulations and 2013 Act.

05

Accounting solutions

This section provides practical application issues with reference to business combinations and consolidation

1 Measurement of the investment in associate acquired in a business combination

Fact pattern

Entity A acquired Entity B. Included in the identifiable assets of Entity B is an investment in an associate.

Issue

When an associate is acquired as part of an acquisition of a subsidiary, what does the acquirer measure at fair value? Is it:

i. the investment in the associate

ii. the identifiable assets, liabilities and contingent liabilities of the associate, similar to the approach for subsidiaries?

Viewpoint

Paragraph 18 of IND AS103 requires the acquirer to measure the identifiable assets acquired at their acquisition-date fair values. IND AS 113 specifies how to measure fair value. Paragraph 14 of IND AS 113 requires that the unit of account (for the asset or liability to be measured at fair value) be determined by the IND AS that requires or permits the fair value measurement.

For the purposes of recognizing and measuring an identifiable asset acquired in a business combination, there is no difference between an investment that is an associate or an investment that is a trade investment because we have acquired the investment not the underlying assets and liabilities. This is different from an investment in a subsidiary in which the underlying assets and liabilities are acquired and, as a result, the assets and liabilities are individually fair valued.

Considering above, the acquirer measures the fair value (in accordance with IND AS 113 Fair Value Measurement) of the investment in the associate acquired in the business combination. The acquirer does not measure the fair value of the underlying assets and liabilities of the associate, as these assets and liabilities are not controlled in the same way that a subsidiary is. This means that any "goodwill" relating to the associate is subsumed in the associates balance and not within goodwill arising on the acquisition.

Although the investment in the associate is measured at fair value, the entity will need to know the underlying fair values of the identifiable assets, liabilities and contingent liabilities in order to apply equity accounting going forward. Subsequent to acquisition of the subsidiary, the fair value measured in accordance with IND AS 113 at the date of the acquisition is

effectively the "cost" to the group to which equity accounting is then applied.

If the fair value exercise results in negative goodwill on acquisition, in accordance with paragraphs 34 to 36 of IND AS 103 Business Combinations, the acquirer would challenge the fair value placed on the associate as it re-challenges the values placed on all assets and liabilities of the acquiree to ensure this has not been overstated.

2 Accounting for reverse acquisition in standalone financial statements

Fact pattern

Entity A and Entity B (a listed company) undertake a business combination whereby:

i. Entity B issues new shares in exchange for all of the shares in Entity A; and

ii. Immediately following the share issue, Entity A is dissolved and the net assets of Entity A are merged into Entity B.

For the purposes of the consolidated financial statements, Entity A is the acquirer in accordance with paragraphs 6 and 7 of IND AS 103 Business Combinations and reverse acquisition accounting has been applied.

Issue

Considering acquisition will be accounted using reverse acquisition principles in consolidated financial statements, how should Entity B account for acquisition of Entity A in its separate financial statements?

Viewpoint

Reverse acquisition accounting should be applied in the separate financial statements of Entity B where the acquisition and merger occurs simultaneously. This reflects the substance of the transaction, i.e., that there has been a combination of Entity A and Entity B and that Entity A is, in substance, obtaining control of B. Therefore, in B's separate financial statements, B's identifiable assets and liabilities should be fair valued at the date of the merger.

This viewpoint does not necessarily apply if the legal merger of Entity A and Entity B (step 2) occurs in a later period than the period in which step 1 took place.

The merger of Entity A and Entity B meets the definition of a business combination for both the consolidated and the separate financial statements where a merger immediately follows the acquisition. As the acquirer is the party that, in substance, obtains control of the other it is not possible to arrive at inconsistent conclusions for, essentially, the same transaction. Therefore, Entity A must also be identified as the acquirer for the purpose of the separate financial statements.

3 Accounting for acquisition of Non-controlling interest in a common control business combination

Fact pattern

Parent A controls Entity B and Entity C. From the group's perspective, there is a 40% non-controlling interest in Entity C that is held by an unrelated party, Entity Z. Entity B obtains control of Entity C by issuing additional shares on the same date to:

i. acquire Parent A's 60% interest in Entity C; and

ii. acquire Entity Z's 40% interest in Entity C.

Issue

As per appendix C to IND AS 103, common control business combination is accounted using pooling of interest method. Previous year comparative also needs to be restated. Considering this requirement, how should acquisition of NCI be accounted and from which year?

Viewpoint

There are two separate transactions to be accounted for: (1) the acquisition of the NCI and (2) the reorganization of entities under common control. Accordingly, the acquisition of the NCI by the subsidiary is accounted for from the date the acquisition of these interests. It is not appropriate to reflect the acquisition of the non-controlling interest as if it occurred as of any prior date, even if the acquisition occurs simultaneous with a common control transaction.

An entity should apply the pooling of interests method to account for a common control transaction, as per Appendix C to IND AS 103. The basic principle of accounting for common control transactions using the pooling of interests method is that the movement of controlled businesses within the control group is discretionary and from the perspective of the controlling party without economic substance. Since the controlling party generally can dictate the structure of ownership within the group at anytime, restatement of previous periods presented to reflect the transaction as if it had occurred at an earlier date is mandated.

It is inconsistent with the principles of the pooling of interests method to reflect ownership of a portion or all of businesses that were not owned by the control group prior to the date the control group obtained the ownership interest.

The acquisition of non-controlling interest is a transaction with economic substance. IND AS does not include a principle that a transaction with a third party (e.g. acquisition of non-controlling interest) may be accounted for as of a date earlier than when the transaction is actually consummated. It should also be noted that IND AS specifically requires the presentation of income available to common shareholders (excluding the interest of non-controlling shareholders) and earnings per share based on common shareholder income.

Paragraph 23 of IND AS 110 Consolidated Financial Statements states:

"Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners)."

Paragraph B96 of IND AS 110 states:

"When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognize 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."

Considering above, acquisition of NCI should be accounted in the period in which it is acquired. It should be accounted for as an equity transaction. Gain or loss on acquisition should be accounted for in equity.

Therefore, Entity B should account for the acquisition of Entity Z's 40% interest in Entity C at the actual date of transaction. Thus, Entity B restates in its consolidated financial statements comparatives on the basis of a historical 60% interest. The change in ownership interest resulting from the acquisition of Entity Z's 40% interest will be accounted for as an equity transaction at the date of acquisition of the non-controlling interest.

Key regulatory updates

This section provides the key regulatory updates for the period July 01, 2021 to September 30, 2021

SEBI updates

SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2021

SEBI has amended SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to interalia provide that the requirements prescribed under Chapter V would apply to listed entity having listed non-convertible securities[4] instead of listed entities having listed non-convertible debt securities or non-convertible redeemable preference shares or both or perpetual debt instrument and perpetual non-cumulative preference share. Following are the key aspects:

- Listed entities having listed non-convertible securities should submit un-audited/ audited quarterly and year to date standalone financial results on a quarterly basis in the format specified by SEBI, except last quarter. These un-audited financial results should be accompanied by limited review/ audit report (as applicable) prepared by the statutory auditors, in the format specified by SEBI.

  SEBI vide circular dated October 5, 2021 has issued the format of financial results and has also provided certain guidance in preparation of financial results. The circular provides that In case the listed entity does not have corresponding quarterly financial results for the four quarters ended September 2020, December 2020, March 2021 and June 2021, the column on corresponding figures for such quarters will not be applicable.

- The annual audited standalone and consolidated financial results for the financial year should be submitted to the stock exchange within 60 days from the end of the financial year along with the audit report.

- The listed entity should submit as part of its standalone/ consolidated financial results for the half year, by way of a note, a statement of assets and liabilities and statement of cash flows as at the end of the half year.

Further the Amendment Regulations has extended the provisions stated in Regulation 16 to 27 to 'high value debt entities' i.e. listed entity which has listed its non-convertible debt securities and has an outstanding value of listed non-convertible debt securities of Rs. 500 Crore and above. Following are the key aspects:

- Regulation 16 to 27 relates to corporate governance requirements such as composition and functioning of Board of Directors, setting up of committees including Audit

[4]Non-convertible debt securities means debt securities as defined under SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021

Committee, Nomination and remuneration committee and Risk Management Committee, approval of related party transactions and corporate governance requirements with respect to subsidiary of the listed entity.

- The 'high value debt entities' would be determined on the basis of value of principal outstanding of listed debt securities as on March 31, 2021.
- These provisions are applicable to a 'high value debt listed entity' on a 'comply or explain' basis until March 31, 2023 and on a mandatory basis thereafter.

These amendments come into force from the date of publication in the Official Gazette i.e. September 7, 2021. To access these amendments, click here.
To access the SEBI circular click here

SEBI (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2021

SEBI has amended SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to primarily omit disclosure of following matters [as prescribed under Regulation 52(4)] in the half yearly/ annual financial results:

- Credit rating and change in credit rating (if any);
- Asset cover available, in case of non-convertible debt securities;
- Previous due date for the payment of interest/ dividend for non-convertible redeemable preference shares/ repayment of principal of non-convertible preference shares ('NCPS')/ non-convertible debt securities and whether the same has been paid or not; and,
- Next due date for the payment of interest/ dividend of NCPS/ principal along with the amount of interest/ dividend of NCPS shares payable and the redemption amount.

Further, the half yearly communication of prescribed matters to holders of non-convertible debt securities and non-convertible preference shares as stated under Regulation 58(1)(d) has also been omitted.

These amendments come into force from the date of publication in the Official Gazette i.e. August 13, 2021. To access these amendments, click here.

SEBI (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2021

SEBI has amended SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 to primarily reduce lock in period of minimum promoters' contribution to 18 months from the date of allotment in IPO (instead of 3 years from the date of commencement of commercial production or date of allotment in the IPO, whichever is later as per existing provisions) and exclude disclosure of financial information in the Offer Document relating to top 5 group companies (based on market capitalization for listed companies/ based on turnover in case of unlisted companies). These disclosures will continue to be made available on the website of the respective group companies. These amendments come into force from the date of publication in the Official Gazette i.e. August 13, 2021. To access these amendments, click here.

SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021

SEBI has issued SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 which comes into force on the 7th day from the date of its publication in the Official Gazette (i.e. From August 16, 2021). This new Regulation merges SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and SEBI (Non-Convertible Redeemable Preference Shares) Regulations, 2013 and provides a framework for issuance of debt securities and non-convertible redeemable preference shares (by public issuance), non-convertible securities (on private placement basis) and listing of commercial paper. Further, SEBI has consolidated related existing circulars and issued a single operational circular, with consequential changes. To access the new Regulations, click here. The operational circular can be accessed here.

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

SEBI vide notification dated August 13, 2021 has issued SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021. This new Regulation merges SEBI (Issue of Sweat Equity) Regulations, 2002 and SEBI (Share Based Employee Benefits) Regulations, 2014 and modifies certain existing provisions e.g. companies are permitted to provide share based employee benefits to employees, who are exclusively working for such company or any of its group companies including its subsidiary or its associate. The new Regulation comes into force from the date of publication in the Official Gazette i.e. August 13, 2021. To access the new Regulations, click here.

Standard Operating Procedure for listed subsidiary company desirous of getting delisted through a Scheme of Arrangement

SEBI on July 6, 2021 has issued a Standard Operating Procedure for listed subsidiary company desirous of getting delisted through a Scheme of Arrangement wherein the listed parent holding company and the listed subsidiary are in the same line of business. The circular prescribes the criteria to be followed for defining 'same line of business' and also requires the Statutory Auditor and SEBI Registered Merchant Banker to certify these criteria. To access the Standard Operating Procedure, click here.

SEBI Board Meeting

SEBI in its Board Meeting on September 28, 2021 has approved amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, in relation to provisions on related party transactions (RPTs). The amendments will come into force with effect from April 1, 2022 unless otherwise specified. Key amendments are as follows:

- Definition of related party to include:
  - All persons or entities forming part of promoter or promoter group irrespective of their shareholding.
  - Any person/ entity holding equity shares in the listed entity (as below) either directly or on a beneficial interest basis at any time during the immediately preceding financial year to the extent of:
    - 20 % or more
    - 10% or more w.e.f. April 1, 2023.
- Definition of RPT shall include transactions 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.
  - 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.
- Prior approval of the shareholders of the listed entity shall be required for material RPTs having a threshold of lower of Rs. 1000 crore or 10% of the consolidated annual turnover of the listed entity.
- Approval of the Audit committee shall be required for:
  - All RPTs and subsequent material modifications as defined by the Audit committee;
  - RPTs where subsidiary is a party but listed entity is not a party subject to threshold of:
    - 10% of the consolidated turnover of the listed entity
    - 10% of the standalone turnover of the subsidiary w.e.f. April 1, 2023
- Enhanced disclosure of information related to RPTs to be:
  - Placed before the audit committee,
  - Provided in the notice to shareholders for material RPTs, and
  - Provided to the stock exchanges every six months in the format to be specified with the following timelines:
    - within 15 days from the date of publication of financials;
    - simultaneously with the financials w.e.f. April 1, 2023.

Other key decisions include creation of the Social Stock Exchange for fund raising by social enterprises, amendment to the existing regulatory framework for delisting of equity shares pursuant to open offer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and relaxation in the eligibility requirements related to Superior Voting Rights Shares framework. To access the SEBI Board meeting decision click here.

MCA updates

Extension of time for holding Annual General Meeting ('AGM')

MCA (Registrar of Companies of various States) vide its Order dated September 23, 2021 has extended the timeline of AGM for the companies by two months beyond the due date within which the companies ought to have conducted their AGM for the FY 2020-21 ended on March 31, 2021. The Order also provides clarifications on certain matters which are arising consequent to the extension of time for holding AGM. To access the Orders issued by the Registrar of Companies of various States, click here

ICAI has issued an announcement in this regard which can be accessed here.

MCA FAQs on CSR

MCA vide circular dated August 25, 2021 has issued FAQs to clarify on various issues relating to CSR pursuant to amendments to the CSR norms prescribed under the Companies Act, 2013. To access the FAQs, click here.

MCA clarification on spending of CSR funds for COVID-19 vaccination

MCA vide circular dated July 30, 2021 has clarified that spending of CSR funds for COVID-19 vaccination for persons other than the employees and their families, is an eligible CSR activity under Schedule VII of the Companies Act, 2013. To access the circular, click here. ICAI has also issued an announcement in this regard, which can be accessed here.

RBI updates

RBI Master Direction on Financial Statements - Presentation and Disclosures

RBI on August 30, 2021 has issued the above Master Direction to incorporate, update and to harmonize across the banking sector the extant guidelines/ instructions/ directives relating to presentation and disclosure of financial statements. The Master Direction interalia provide that half yearly review of accounts is applicable for all commercial banks irrespective of whether such banks are listed or not. Banks are required to follow the format to be prescribed by the Department of Supervision, Reserve Bank of India (or National Bank for Agriculture and Rural Development for Regional Rural Banks) for the purpose. To access the Master Direction, click here.

RBI advisory on transitioning away from London Interbank Offered Rate (LIBOR)

Reserve Bank of India on July 8, 2021 has issued an advisory to banks and other RBI regulated entities emphasizing the need for preparedness for the transition away from LIBOR. One of the key steps to be taken in this regard include cessation from entering into new financial contracts that reference LIBOR as a benchmark and instead use any widely accepted alternative reference rate, as soon as practicable and in any case by December 31, 2021. To access the advisory, click here.

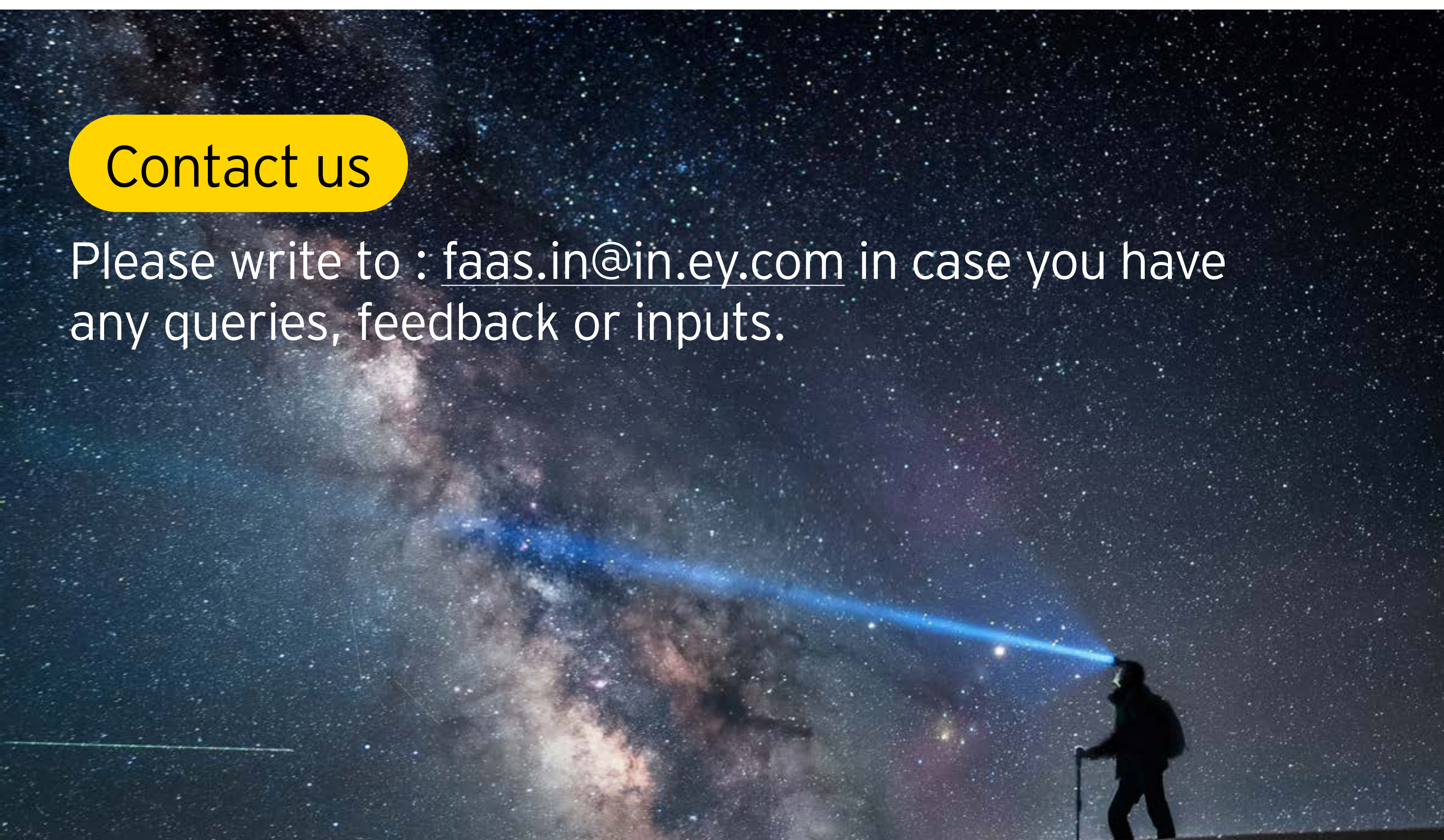
Other key updates

Guidance Note on Accounting for Derivative Contracts (Revised 2021)

ICAI has issued the revised Guidance Note on accounting for derivative contracts in view of global developments in respect of Interbank Offered Rates. This Guidance Note applies to all entities that do not apply Ind AS. To access the Guidance Note, click here.

Limited Liability Partnership (Amendment) Act, 2021

The Limited Liability Partnership (Amendment) Act, 2021 was assented by the President of India and published in the Official Gazette on August 13th, 2021 to amend the Limited Liability Partnership Act, 2008. The amendments include that standards of accounting and auditing for a class of limited liability partnerships would be prescribed by the Central Government in consultation with National Financial Reporting Authority and amendment of certain sections so as to convert offences into civil defaults and to convert the nature of punishment provided in the said sections from fines to monetary penalties. To access the Amendment Act, click here. ICAI has also issued an announcement in this regard, which can be accessed here.



Contact us

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

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