Year-end considerations

Updates of standards, interpretations and regulatory considerations affecting financial statements

April 2021

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Foreword

Financial year 2020-21 brought an unprecedented challenge for companies across the globe. The impact of pandemic was felt in all aspects of organizations. Companies took various measures to overcome impact of pandemic, e.g., cost rationalization, adoption of digital, restructuring, liquidity support, etc. Government came out with various measures to support companies to overcome these challenges. Resilience, agility, innovation and adaptability shown by organizations have yielded positive results across many sectors – many companies are showing lot of buoyancy and are back to growth trajectory. However, there are a few sectors which continue to be under stress and may take longer to return to a path of growth.

Financial reporting for financial year 2020-21 will be a reflection of how companies have fared in mitigating the effect of the pandemic and their resilience. As companies prepare for their annual results, it is critical for them to ensure that readers of financial statements adequately understand the impact of the pandemic on the financial results of the company. Hence assessment of the impact on significant estimates and judgment, and appropriate COVID-19 disclosures will be key focus areas for companies while preparing their financial results. Whilst there are no new accounting standards issued in current year, there have been few amendments to the existing standards. Also, there are a slew of regulatory measures which may have a bearing on accounting and reporting. Consequently, there is a need for companies to proactively understand the changes, assess their impact on financial statements and prepare their systems and processes to ensure a smooth transition to changes in accounting standards and regulatory changes.

As companies prepare for closing the financial year, we have summarized the key changes and their impact to assist companies in ensuring compliance with these developments while finalizing their annual financial statements.

Purpose of this publication

This publication provides an overview of the changes in accounting and auditing standards and interpretations as well as regulatory changes relevant for financial year 2020-21 and beyond. It does not attempt to provide an in-depth analysis or discussion on the changes. Rather, it aims to highlight the key aspects of these changes. Reference should be made to the text of the pronouncements before taking any decisions or actions.

This publication consists of three sections:

Section 1 provides an overview of the key accounting changes as at 31 January 2021 and certain key amendments that are applicable for financial statements ended 31 March 2021 and beyond.

Section 2 summarizes key hot topics which may have a significant impact on the reporting for the financial year ended 31 March 2021 and beyond.

Section 3 provides a glance at the regulatory and other changes that have been issued. There have been a significant number of regulatory updates during this year which have consequential impact on accounting, disclosures and compliance with regulations.

Sandip Khetan
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SECTION 1:

New accounting pronouncements relevant for financial statements of FY 2020-21 or thereafter

1 Overview of key amendments to Ind AS

During the financial year (FY) 2020-21, there have been certain amendments in the existing Indian Accounting Standards (Ind AS). Various committees/ board of the Institute of Chartered Accountants of India (ICAI) have rolled out additional guidance. The following section covers a summary of the key changes and the potential impact that these changes may have on the financial statements of companies.

On 24 July 2020, the Ministry of Corporate Affair (MCA) vide notification dated 24 July 2020 made the rules to amend the Companies (Indian Accounting Standards) Rules, 2015. Some of these amendments have been made to alleviate practical challenges faced by companies due to pandemic. Summary of key changes is given below:

A. Ind AS 103, Business Combinations- Definition of a business

Key requirements

An entity shall determine whether a transaction or other event is a business combination by applying the definition of business as given in Ind AS 103, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.

Following amendments have been made with respect to business combination:

Definition of business

The definition of business and related guidance included in the standard for the purposes of identifying where an acquisition is a business, to apply business combination accounting, has been amended.

Previous definition of business	Amended definition of business
"An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing **a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants**".	"An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing **goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities".**

Note: (emphasis added to highlight the change)

Previously, outputs were defined as the result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits provided directly to investors or other owners, members or participants. As part of the amendments to Ind AS 103, the definition of outputs is narrowed to focus on goods or services provided to customers, investment income (such as dividends or interest) or other income from ordinary activities. The definition of a business in Appendix A of Ind AS 103 has been amended accordingly. According to the standard setter, the previous reference to lower costs and other economic benefits provided directly to investors did not help to distinguish between an asset and a business. For example, many asset acquisitions may be made with the motive of lowering costs but may not involve acquiring a substantive process. Therefore, the reference to an ability to reduce costs and other economic benefits was excluded from the definition of outputs and the definition of a business.

Relevant amendment has been made to the definition of "output" as an element of business.

Elements of business

The three elements of business as defined under Ind AS 103 include, input(s), processes applied to those inputs and output. Although businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business.

In order to be considered as a business, the amendments have clarified that an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. Further, if an acquired set of activities and assets has outputs, continuation of revenue does not on its own indicate that both an input and a substantive process have been acquired.

Assessing whether an acquired process is substantive

The Post-Implementation Review (PIR) of IFRS 3 revealed difficulties

in assessing: whether the acquired processes are sufficient to constitute one of the elements of a business; whether any missing processes are so significant that an acquired set of activities and assets is not a business; and, how to apply the definition of a business when the acquired set of activities and assets does not generate revenue. In response, the IASB added guidance to help entities assess whether an acquired process is substantive. That guidance requires more persuasive evidence when there are no outputs, because the existence of outputs already provides some evidence that the acquired set of activities and assets is a business. Consequent amendments were also made in Ind AS 103.

The Board also reasoned that, although itself an input, the presence of an organized workforce is an indicator of a substantive process. This is because the "intellectual capacity" of an organized workforce having the necessary skills and experience following rules and conventions may provide the necessary processes (even if not documented) that are capable of being applied to inputs to create outputs.

The amendments to Ind AS 103 specify that if a set of activities and assets does not have outputs at the acquisition date, an acquired process shall be considered substantive only if:

a) it is critical to the ability to develop or convert acquired inputs into outputs; and

b) the inputs acquired include both an organized workforce with the necessary skills, knowledge, or experience to perform that process and other inputs that the organized workforce could develop or convert into outputs.

In contrast, if a set of activities and assets has outputs at that date, an acquired process shall be considered substantive if, when applied to acquired inputs:

a) it is critical to the ability to continue producing outputs and the acquired inputs include an organized workforce with the necessary skills, knowledge, or experience to perform that process; or

b) it significantly contributes to the ability to continue producing outputs and either is considered unique or scarce, or cannot be replaced without significant cost, effort or delay in the ability to continue producing outputs.

The amendments also added some clarifications to Ind AS 103 to support these above requirements, including that an acquired contract is an input and not itself a substantive process. An acquired contract, such as a contract for outsourced property management or outsourced asset management, may however give access to an organized workforce. An entity shall assess whether an organized workforce accessed through such a contract performs a substantive process that the entity controls, and thus has acquired. Factors to be considered in making that assessment include the duration of the contract and its renewal terms.

Optional concentration test

Whilst applying the definition of a business might involve significant judgement, many noted that there was little or no guidance to identify situations where an acquired set of activities and assets is not a business. To address those concerns, amendment introduced an optional fair value concentration test. The purpose of this test is to permit a simplified assessment of whether an acquired set of activities and assets is not a business. Entities may elect whether or not to apply the concentration test on a transaction-by-transaction basis.

The concentration test is met if substantially all the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. The test is based on gross assets, not net assets, because a set of activities and assets includes a substantive process does not depend on how the set is financed. In addition, certain assets are excluded from the gross assets considered in the test, i.e., cash and cash equivalents acquired, deferred tax assets and goodwill resulting from the effects of deferred tax liabilities. If the test is met, the set of activities and assets is determined not to be a business and no further assessment is needed. If the test is not met, or if an entity elects not to apply the test, a detailed assessment must be performed applying the normal requirements in Ind AS 103. As such, the concentration test never determines that a transaction is a business combination.

The outcome of the concentration test is as follows:

- If the test is met: The entity can elect to treat the transaction as an asset acquisition.
- If the test is not met or not applied: An entity carries out further assessments to determine whether a business is acquired.

Jigar Parikh
Partner, Financial Accounting Advisory Services (FAAS), EY India

The changes to the definition of a business will likely result in more acquisitions being accounted for as asset acquisitions across all industries, particularly real estate, pharmaceutical and oil and gas.

Impact

Determining whether an acquired set of activities and assets is a business or not, could result in significantly different accounting outcomes, both at the date of acquisition (i.e., at initial recognition) and subsequently. The previous guidance on the definition of a business created some diversity in practice. And the change will bring more alignment in interpretation of definition of business go forward.

Key change is that the definition of business is narrowed to focus on providing goods or services to customers, generating investment income or generate other income from ordinary activities instead of the earlier wider focus of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

The amendments also provide that an entity can apply a concentration test that, if met, eliminates the need for further assessment. Under this optional test, where substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets), the assets acquired would not represent a business which in erstwhile scenario could have been accounted as business combination. Substantially all is not defined under the standard and this could require one to exercise judgment while applying the optional concentration test.

Since the amendments apply prospectively to transactions or other events that occur on or after the date of first application, most entities will likely not be affected by these amendments on transition. However, entities considering the acquisition of a set of activities and assets after first applying the amendments should update their accounting policies on a timely basis.

The changes to the definition of a business will likely result in more acquisitions being accounted for as asset acquisitions across all industries, particularly real estate, pharmaceutical and oil and gas.

Entities need to apply judgement to determine whether assets should be combined. Ind AS 103 is premised on a market participant's perspective when determining whether a particular set of assets and activities is a business. The assessment of whether assets can be aggregated into the same group, should also be based on a market participant's perspective.

If entities assess transaction as an asset acquisition, it should not account for same using principles of Ind AS 103. Assets acquired will need to be recorded at cost. If more than one asset is acquired, consideration should be allocated to various assets using relative fair value method. In assets acquired in business combination, companies will generally recognize deferred tax on temporary differences arising on initial recognition of asset. However, in case transaction is accounted as an asset acquisition, deferred tax may not be required to be recognized due to application of initial recognition exemption.

B. Ind AS 116, Leases-COVID-19 related rent concessions

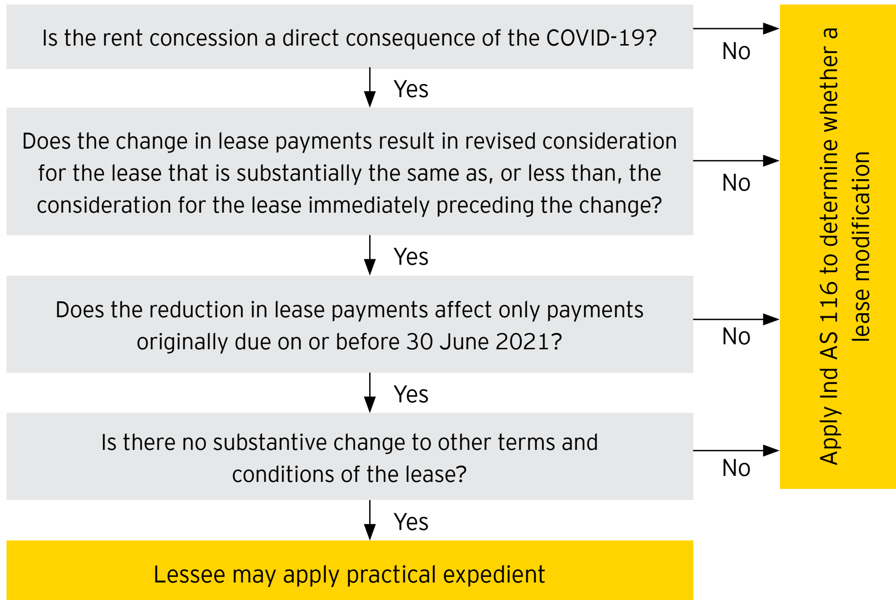
Key requirements

On 24 July 2020, the Ministry of Corporate Affairs (MCA) issued amendment to Ind AS 116, provides relief for lessees in accounting for rent concessions granted as a direct consequence of COVID-19. The accounting for lessor remains unchanged.

The amendment applies to annual reporting periods beginning on or after 1 April 2020. Earlier application is permitted for annual reporting periods beginning on or after the 1 April 2019, in case the financial statements are not approved for issue before the issuance of this amendment.

Ind AS 116 defines a lease modification as change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and condition of the lease. If a change in lease payments results from a lease modification, then unless the change meets criteria to be accounted for as a separate lease, a lessee is required to remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The accounting for lease modification can be complex. To address this challenge, as a practical expedient, a lessee may elect not to assess whether a COVID-19 related rent concession from lessor is lease modification. A lessee that makes this election accounts for any change in lease payments resulting from the COVID-19 related rent concession the same way it would account for the change under Ind AS 116, if the change were not a lease modification.

The criteria for application of practical expedient is as follows:



The lessee should apply the amendment retrospectively and recognize the cumulative effect of initially applying them in 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 amendment.

Disclosures requirements:

An entity that applies the practical expedient must disclose:

1. That it has applied the practical expedient to all rent concessions that meet the conditions or if not applied to all such rent concessions, information about, the nature of the contracts to which it has applied the practical expedient; and
2. The amount recognized in the statement of profit and loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient.

Disclosure of the cash flow effects of rent concessions would be relevant regardless of whether a lessee applies the practical expedient or not.

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Though the practical expedient simplifies accounting for lessee, significant work efforts may still be required for lessee with large portfolio of leases. Companies should make relevant disclosures about accounting policy adopted by them to account for lease concession. Appropriate disclosures as required in the standard should be made in the financial statements.

Impact

Many lessors have provided rent concessions to lessees as a result of the COVID-19 pandemic. Applying the requirements in Ind AS 116 for changes to lease payments, particularly assessing whether the rent concessions are lease modifications, and applying the required accounting, could be practically difficult in the current environment.

The amendment to Ind AS 116 provided relief to lessees for accounting for rent concessions arising from the COVID-19 pandemic. Entities will be required to exercise judgements to determine eligibility of practical expedient.

While lessees that elect to apply the practical expedient do not need to assess whether a concession constitutes a modification, lessees still need to evaluate the appropriate accounting for each concession, as the terms of the concession granted may vary. The amendment does not specify explicit guidance about how a lessee accounts for a rent concession when applying the practical expedient. In absence of specific guidance, we believe, changes in lease payments may be accounted using following approaches:

Approach 1 – Accounting for a concession in the form of forgiveness or deferral of lease payments, as a negative variable lease payment	**Approach 2** – Accounting for a concession in the form of forgiveness or deferral of lease payments, as a resolution of a contingency that fixes previously made variable lease payments	**Approach 3** - Accounting for a concession in the form of a deferral of payments as if the lease is unchanged
Lessee would remeasure the remaining lease liability using the remeasured consideration in contract	Lessee would remeasure the remaining lease liability using remeasured consideration in contract	The lessee would continue to account for the lease liability and right-of-use asset using the rights and obligations of the existing lease
No change in discount rate to remeasure lease liability	No change in discount rate to remeasure lease liability	The lessee would recognize a separate lease payable (that generally does not accrue interest) in the period that the 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
The lessee would recognize the corresponding adjustment in statement of profit and loss as a negative variable lease expense	The lessee would recognize the corresponding adjustment to the right-of-use asset	

Though the practical expedient simplifies accounting for lessee, significant work efforts may still be required for lessee with large portfolio of leases. Companies should make relevant disclosures about accounting policy adopted by them to account for lease concession. Appropriate disclosures as required in the standard should be made in the financial statements.

C. Ind AS 109 Financial Instruments & Ind AS 107 Financial Instruments - Disclosure: modification to hedge accounting

Key requirements

a) Modification to some specific hedge accounting requirements to provide relief to potential effects of uncertainty caused by the interest rate benchmark reform (IBOR).

b) In order to determine whether the hedged future cash flow are expected to occur, an entity should assume that the interest rate benchmark, on which hedged cash are based is not altered as a result of IBOR.

c) Requires entities with hedges affected by IBOR to apply the separately identifiable requirement only at the inception of the hedging relationship. A similar exception is also provided for redesignation of hedged items in hedges where dedesignation and redesignation takes place frequently.

d) Additional disclosure pertaining to interest rate benchmark reforms.

e) The amendments are expected to affect entities with foreign currency exposures who have also adopted hedge accounting for such exposures.

f) Disclosures relating to IBOR:

   (i) The significant interest rate benchmarks to which the entity's hedging relationships are exposed;

   (ii) The extent of the risk exposure that is directly affected by the IBOR;

   (iii) How the entity is managing the process to transition to alternative benchmark rates;

   (iv) A description of significant assumptions or judgements the entity made in applying these paragraphs and

   (v) The nominal amount of the hedging instruments in those hedging relationships

Impact

Refer to Section 2 Topic 3 for detailed discussion on Interest Rate Benchmark Reforms (IBOR).

2 Expert Advisory Committee (EAC) Opinions

A. EACs covering issues relating to classification in statement of cash flow:

1. EAC-1 Classification of grant related to assets in the statement of cash flows

Background

The Government of India (GOI) has entrusted with the company the task to execute Gas Pipeline Project connecting certain states of the country to the National Gas Grid. The project work was under progress as per phase-wise schedule. The Cabinet Committee on Economic Affairs (CCEA), GoI approved a capital grant and first instalment was disbursed to company. The company had classified the amount of capital grant under "Cash flows from financing activities" in the cash flow statement

Whether the capital grant should be presented in cash flow statement under financing or investing activity?

EAC view

For classification as financing activity, the receipt of the grant should result in change in the size and composition of contributed equity and borrowings. Although there can be equity contribution otherwise than by way of subscription to equity shares, in the extant case, the receipt of the grant does not represent equity contribution from the government and neither it is borrowing from the government. As per paragraph 6 of Ind AS 7, only acquisition and disposal of long-term assets and other investments not included in cash and cash equivalents should be classified as investing activities. Hence, at first sight, it may appear that receipt of the grant does not meet the definition of investing activity, since the resulting cash inflow does not arise from disposal of any asset. However, in substance, to the extent of the grant, cost of the pipeline project is borne by the government. In effect, the cash outflow on the long-term asset, i.e., pipeline, is reduced by the amount of the grant and hence the same should be classified as part of cash flows from Investing activities.

2. EAC-2 Disclosure/ classification of late payment interest charges collected from customers in statement of cash flows

Background

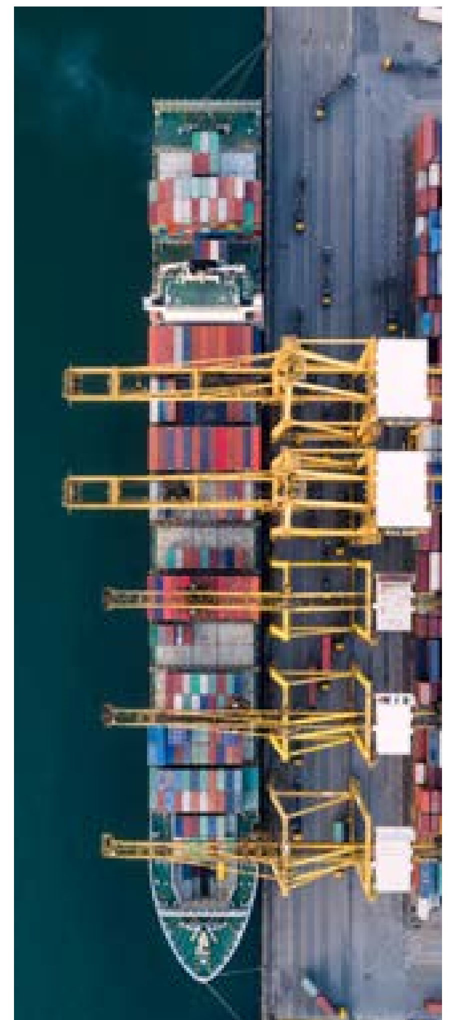
The company engaged in business of distribution of natural gas and it charges delayed interest charge on overdue balances to the customers who have not paid the bill within due date. The late payment charges are fixed amount in case of domestic customers (irrespective of the days of delay) and variable percentage in case of other categories of customers on overdue amount for delayed days.

The company has classified such interest income in the statement of cash flows as income from investing activities as per para 31 of Ind AS 7, in the case of entities (other than financial institution), cash flows arising from interest and dividends received should be classified as cash flows from investing activities.

Whether the classification done by company in cash flow statement is correct?

EAC view

- As business of company is distribution of natural gas and it is not a financial institution/ NBFC. late payment interest/charge in case of customers other than domestic customers in the extant case should be presented as "cash flows from investing activities", since the amount of consideration varies due to difference in timing of payments (as the consideration will increase with increase in timing of payment) and therefore, it appears that the late payment interest/charge in such a case is directly linked to the timing of payment by the customers and are in nature of finance income.



- As far as domestic customers are concerned, the late payment interest/ charge, to the extent, it represents time value of money, should be presented as "cash flows from investing activities", otherwise, if it is compensation for some other element, such as penalty, it should be considered and presented as "cash flows from operating activities".

Classification should be governed by substance of arrangement. Companies must consider all facts / circumstances in making such evaluation.

Impact

Classification should be governed by substance of arrangement. Companies must consider all facts / circumstances in making such evaluation. Users of financial statement analyzes cash flow statement from various perspectives and hence appropriate classification is critical.

B. EACs covering issues relating to classification in statement of profit and loss:

3. EAC-3 Accounting for surcharge on delayed payment

Background

The company has entered into power purchase / sale agreement with different electricity boards and DISCOMs. As per the Tariff Regulation of Central Electricity Regulatory Commission (CERC), in case the purchaser fails to pay the power bill within the allowed 45 days' period, delayed payment surcharge is applicable at a specified rate, i.e., 1.5% per month. Similarly, if the purchaser pays the bill within 45 days' period, graded rebate is also allowed based on the date of payment of the bill.

According to the querist, when the product pricing guidelines are issued by a regulator allowing provisions both for early payment and late payment of the billed amount, whether the late payment surcharge (billed / received) from the Electricity Boards should be considered under the head "Operating Revenue" or as "Other Income" as per applicable Accounting Standards (Ind AS).

EAC view

The EAC noted that the amount of consideration varies due to difference in timing of payments, for example, if customer paid within the prescribed period, which is 45 days from the day of presentation of bills, no late payment surcharge would be charged from the customers, whereas if the customer pays beyond the prescribed period, late payment surcharge would be levied. Thus, it appears that the late payment surcharge in the extant case is directly linked to the timing of payment by the customers and is to compensate the entity for the time value of money. Therefore, the Committee has opined that the late payment surcharge is of the nature of finance income in the extant case and should be accounted for and presented accordingly in the financial statements.

The Committee also noted that the company is not an NBFC (Non-banking Financial Company) and thus, the Division III of Schedule III to the Companies Act, 2013 is not relevant. Therefore, as far as presentation of the late payment surcharge is concerned; Ind AS 107, para 20(b) requires total interest revenue calculated using the effective interest method for financial assets that are measured at amortized cost and that are measured at FVOCI, to be shown separately. Accordingly, 'Interest Income' for financial assets measured at amortized cost and for financial assets measured at FVOCI, calculated using effective interest method, should be presented in separate line items under "Other Income".

4. EAC-4 Presentation of gain or loss on account of mark to market valuation of derivative contracts resulting from movements in exchange rates and interest rates of underlying currencies

Background

A company is engaged into business of exploration and production of oil and gas and other hydrocarbon related activities outside India. In order to finance its overseas operations, the company arranges external commercial borrowings including but not limited to debentures and bonds denominated in external currencies. The company currently has: (i) Euro (EUR) denominated bonds, (ii) Indian Rupee (INR) denominated debentures and (iii) Japanese Yen (JPY) denominated long term bank loan besides bonds and debentures in the company's functional currency, i.e., USD. The company measured its derivative contracts at FVTPL by recognizing net gain/loss in the statement of profit and loss. The said mark to market gain/loss was disclosed under "Finance Cost" in the notes to the statement of profit and loss as a separate line item with heading "Net loss (gain) on fair value of derivative contracts mandatorily measured at fair value through profit or loss". Also, company is not following hedge accounting as per Ind AS 109.

Whether the presentation of the gain/loss on mark to market valuation of derivative contracts taken to hedge the currency fluctuations on long term foreign currency borrowings by the company under "finance cost" is appropriate or it should be presented under "Other income"

EAC view

The EAC opined that it may not be inappropriate to present and disclose the net gain or net losses arising on fair valuation of the derivative contracts/financial instruments in the extant case, entered into to hedge the foreign currency external commercial borrowings, as "other borrowing cost" under the head "Finance costs". However, as per the requirements of paragraph 20(a) and 20(b) of Ind AS 107, separate disclosure of the net gain or loss on the said derivative contracts and the interest expense on the foreign currency external commercial borrowings (being financial liabilities not measured at fair value through profit or loss) should be made within the "Finance costs" schedule in the financial statements. Further, as per the requirements of paragraph 21 of Ind AS 107, a disclosure in respect of the same should be given by the company in its significant accounting policies.

5. EAC-5 Presentation of the grant receivable from the Government of India in statement of profit and loss

Background

The Company is engaged in logistic business and operates as a carrier, inland port operator, terminal services provider. Under the Foreign Trade Policy (FTP) 2015-20 of the Government of India, various incentives are being provided to the trade and one of such benefit to service sector in which the company operates is Service Export from India Scheme (SEIS).. As the Companies services are related to Export & Import trade of the country and are provided to Foreign Shipping Lines or their Indian agents, the company is entitled to claim SEIS benefit. As the SEIS income is derived out of the operations of the company, the same has been considered by Company as part of revenue from operations (sub-head "Other operating income", "Separate line as "Export incentive").

The querist has requested the EAC to opine on whether the income recognized on accounting for grant receivable under SEIS has been correctly presented by company in statement of profit and loss or as stated by CAG in its comments, it has to be shown under "Other Income".

EAC view

EAC considered that as per Ind AS 20, grants related to income are presented as part of profit or loss, either separately or under a general heading such as "Other income". Alternatively, they are deducted in reporting the related expense. Further, the Committee noted that as per Guidance Note on Division II- of Ind AS Schedule III to the Companies Act, 2013 (revised July, 2019), revenue from operations needs to be disclosed separately as revenue from:

a) sale of products

b) sale of services and

c) other operating revenues

It is important to understand what is meant by the term "other operating revenues" and which items should be classified under this head vis-à-vis under the head "Other Income". The term "other operating revenue" is not defined. This would include revenue arising from a company's operating activities, i.e., either its principal or ancillary revenue generating activities, but which is not revenue arising from sale of products or rendering of services. Whether a particular income constitutes "other operating revenue" or "other income" is to be decided based on the facts of each case and detailed understanding of the company's activities."

Dilpesh Chouhan
Director, Financial Accounting Advisory Services (FAAS), EY India

Principles laid down by EAC puts to rest the issue of classification of Government Grant as operating revenue in many sectors like fertilizer industry, cement industry etc.

The Committee noted that the objective of SEIS is to encourage and maximize export of notified Services from India and the eligibility criteria of the scheme is based on the net free foreign exchange earnings by the service provider. In this context, the Committee noted from the facts of the case that the querist has specifically stated that major portion of the revenue of the company arises from export of services and thus, exports is a key revenue generating activity of the company.

The EAC opined that keeping in view the activities of the company, it may be appropriate to present the duty credit scrips/entitlement under Service Export from India Scheme (SEIS) as "other operating revenue" under "Revenue from Operations" in the statement of profit and loss. The company should also give adequate disclosures (including the accounting policy for recognition of such income) so as to appropriately explain the nature of the item.

6. EAC-6 Disclosure of feedstock subsidy

Background

The Cabinet Committee on Economic Affairs (CCEA) in December 2019 accorded approval of feedstock subsidy to the Company for 15 years of plant operation to maintain minimum internal rate of return (IRR) of 10% (post-tax). To bring the IRR to 10%, the Company has estimated certain amount of feedstock subsidy for the project for 15 years of plant operation as per the approved methodology. The Company has submitted its claim of certain amount for FY 2015-16 (3 months), 2016-17 and 2017-18 and accounted for the same as an "exceptional item".

The company had sought the EAC's opinion whether the feedstock subsidy claims for previous years (till 31st March 2019) is to be presented as an "Exceptional Item" in the statement of profit and loss for the FY ended 31st March 2020. Alternatively, whether the above transaction can be considered as "Other Income" as a separate line item and recognized in the financial statements accordingly.

EAC view

The Committee noted that material items need to be presented as separate line items and/or disclosed in financial statements, which includes the notes. As per Ind AS 1, materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. Further, as per the requirements of paragraphs 85 and 86 of Ind AS 1, events and transactions which differ in frequency should be presented as additional line items/ headings when such presentation is relevant to understanding of the entity's financial performance having regard to factors including materiality and the nature and function of the items of income and expense.

Therefore, the Committee has opined that exceptional items are those items which meet the test of "materiality" (size and nature) and the test of "incidence"; and that all material items are not exceptional items. The Committee has further opined that "incidence" refers to frequency of occurrence and the meaning of the term "material" should be construed as per paragraph 7 of Ind AS 1. Thus, the Committee was of the view that for an item to be classified as an "exceptional item", it has to be both "material" as well as infrequent/nonrecurrent in nature.

The EAC opined that the feedstock subsidy claims of previous years cannot be classified as "exceptional item" since feed stock subsidy of past years is only previous years' accumulated subsidy, which without the approval of CCEA could not be processed earlier and accounted for. Further, considering the requirements of Ind AS 20, the feedstock subsidy in the extant case may be presented as a part of the statement of profit and loss either separately or under the general head of "other income" considering the materiality of the item. However, whether this item is material or not and accordingly whether or not it requires separate disclosure, is a matter of judgement and the same should be decided by the Company in its own facts and circumstances and accordingly, if it is material, the Company should comply with the disclosure requirements of Ind AS 1.

Impact

Principles laid down by EAC puts to rest the issue of classification of Government Grant as operating revenue in many sectors like fertilizer industry, cement industry etc. EAC laid down principles which one should use to decide whether appropriate classification of government grant should be "operating revenue" or "other income"

Appropriate classification between operating revenue, other income is relevant not only from perspective of compliance with Ind AS, but it may also have impact on certain ratios relating to operating revenue or other income.

C. EACs covering issues relating to classification in statement of financial position:

7. EAC-7 Classification of spares

Background

A manufacturing Company procures stores and spares from time to time and is maintaining the stock of spares in anticipation of requirement at any time during operation of the plant. Up to the FY 2016-17 till the adoption of Ind AS, these spares were classified as "Inventory". During the FY 2017-18, a technical committee was constituted to

examine all the stores and spares and to recommend about their usability, retention as "Inventory" etc. The Committee after reviewing all the items of stores and spares, recommended that the spares which are directly attributable to any particular plant & machinery should be classified as "capital spares", thereby segregating these from normal inventories, towards better disclosure. Based on the said technical assessment, spares usable only for any particular plant & machinery were categorized as "capital spares" and were disclosed in the financial statements separately under the head "Inventory". The total value of spares consumed during the financial year were charged off as expenses.

The querist has sought the opinion of the EAC on the following issues:

a) Whether the practice followed by the company to classify such spares as "capital spares" and disclosed as separate line item under "Inventories" under the head "Current Assets" is correct. or

b) Such capital spares should be classified under "Property, Plant and Equipment (PPE)"

EAC view

Spare parts are recognised as an item of PPE only if they meet the definition of property, plant and equipment otherwise, these are classified as Inventory. As per Ind AS 16, for the purpose of classification of spares as "inventory" or "PPE", one has to determine the nature of the spares and the purpose for which these are held; and the useful life of the spare.

The EAC opined that the company should evaluate in its own facts and circumstances, the nature of the spares and the purpose for which these are held; and determine the useful life of the spares. On the basis of such evaluation, if these spares are not for day-to day servicing or repairs and maintenance and if they meet the definition of "PPE", these should be classified as "PPE", assuming that their cost can be measured reliably. Further, the company should also evaluate whether in the facts and circumstances of the company, it is appropriate to aggregate these spares which are not individually significant (considering the aggregate value in relation to the overall related assets for which these are to be used) and apply the recognition criteria to the aggregate value.

Impact

Appropriate classification as inventory or PPE will have impact not only in balance sheet, but also in statement of profit and loss account, since if classified as PPE, it will be charged as depreciation and if classified as inventory, it will be charged to consumption of inventory.

D. EACs covering issues related to recognition of cost:

8. EAC-8 Accounting treatment of certain indirect administrative overheads (i.e., salary of the KMPs, directors sitting fees, audit fees, statutory and other levies) incurred during construction phase of power plant

Background

A power generating company was setting up a power plant and had incurred capital expenditure, various indirect administrative overheads (i.e., salary of key management personnel (KMPs), directors' sitting fees, audit fees, statutory and other levies). It was the only plant under construction and all the concerned staff were deputed at construction site including the company secretary and other related sections. All expenditure incurred till March 2018 were booked under capital work in progress in balance sheet except the pre-incorporation expenditures.

Whether indirect administrative overheads incurred during construction phase of power plant could be capitalized along with the cost of the project or charged to statement of profit and loss, even though there is no income generated by company during construction phase.

EAC view

The capitalization of an item of cost to a plant depends upon the nature of such expenses in context of requirements in this regard laid down in applicable Ind AS. Just because the company is engaged in construction of a single plant at present does not mean that all the costs incurred by company are directly attributable costs to construction of the plant in accordance with the requirements of Ind AS 16.

As per Ind AS 16, basic principle to be applied while capitalizing an item of cost to a property, plant and equipment is that it is directly attributable to bringing the asset to location and condition necessary for it to be capable of operating in manner intended by management. Committee was of the view that "directly attributable" costs are generally such costs which are necessary to enable the construction activity, i.e., these costs are directly related to the construction activity and without the incurrence of which the asset cannot be brought to location and condition necessary for it to be capable of operating in manner intended by management.

Committee opined that the employee benefit expenses relating to key management personnel, directors' sitting fee, audit fees are not directly attributable to the construction of project; rather are of the nature of administration and general overheads and therefore, should not be capitalized. Statutory and other levies, to the extent, these are directly attributable to construction, e.g., fees/charges paid for obtaining license or seeking mandatory approvals/clearances for construction etc. should be capitalized and rest should be recognized as expense.

9. EAC-9 Accounting treatment of expenditure incurred for rejuvenation of petrochemical plant

Background

A company is engaged in manufacture and marketing of fertilizers and petrochemicals; engineering design and consultancy services, fabrication and erection of equipment. The company had closed down one of its plants known as caprolactam plant in the year 2012 due to uneconomic realization and was in shutdown condition for the last seven years.

The assets of the plant were already substantially depreciated, and no reassessment of life or value were conducted. Considering favorable LNG market conditions, the company reviewed the financial viability and it was decided to rejuvenate the plant.

The Company incurred expenditure during the FY 2019-20 for rejuvenation of plant in form of replacement / purchase of major equipment and other expenditure like fuel, power and labor. These additional investments provided an additional life to the plant for about 10 to 15 years.

The opinion of the EAC was sought on the following issues:

a) How the expenditure incurred for modernization of a closed plant so as to make it productive and to increase the expected lifetime to 10 to 15 years, can be accounted?

b) Whether the expenditure incurred on rejuvenation / modernization of the caprolactam plant, as detailed above, can be capitalized or to be treated as revenue expenditure.

c) Whether the total amount incurred can be written off over the remaining useful life of the asset as assessed by the technical team and in line with the accounting policy of the company.

EAC view

The EAC considered that for issue no (a) and (b), all major subsequent expenditure incurred including cost of replacing various assets of the caprolactam plant should be capitalized provided it is probable that the future economic benefits will flow to the Company and the cost of the asset to the Company can be measured reliably, as per Ind AS 16. Further at the same time, the carrying amount of those assets that are replaced should be derecognized as per the derecognition provisions. However, if there are any expenditure on regular repairs and maintenance as afore mentioned, the same should not be capitalized. Further, as far as the costs relating to labor and power and fuel are concerned, same can be capitalized only if these are directly attributable to bringing the various assets / plant to the location and condition necessary for it/them to be capable of operating in the manner intended by management. Thus, any fuel and power consumed for checking the serviceability of existing plant and equipment should not be capitalized as this expenditure is not required for bringing the plant to an operating condition.

For issue no (c), EAC opined that depreciation should be provided in accordance with the principles enunciated in Ind AS 16.

Impact

Companies should carefully evaluate criteria for recognition of cost as PPE or expense in statement of profit and loss considering whether it will lead to probable future economic benefit and whether cost can be measured reliably.

3 Key financial reporting considerations relevant for annual financial statements relating to impact of COVID -19

A. Classification of income and expenses as exceptional item:

Key requirements

Due to the outbreak of coronavirus, entities may have incurred various losses, including liquidated damages, fixed cost during factory shut down, impairment of financial / non- financial asset etc. Some of these losses may be material in nature. Companies are facing challenges in the classification of losses/ expenses as exceptional item. This is because an item of expense or loss may arise from COVID-19 or non-COVID-19 factors or combination of both and therefore such segregation may not be easy.

Further, neither Ind AS nor Schedule III to the Companies Act, 2013 define the term "exceptional item". However, Schedule III (Division II and III) to the Companies Act, 2013 requires presentation of exceptional items on the face of the statement of profit and loss. Further, SEBI requires the listed company to follow Schedule III format for presentation of financial results.

As per Ind AS 1, when items of income or expense are material, an entity shall disclose their nature and amount separately. Entities are permitted to present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance. Additionally, Ind AS 1 allows expenses to be subclassified in the statement of profit and loss on the basis of frequency, potential for gain or loss and predictability.

The two aspect which may lead to the conclusion that whether an item can be considered as an exceptional item are materiality and its predictability.

Given the specific requirement of SEBI and Schedule III, it may not be inappropriate to disclose a material and non-recurring item as an exceptional item on the face of statement of profit and loss. However, as it would also result into mixed presentation, i.e., nature wise as well as functional classification, preferred option is to disclose such items in notes to the financial statements in detail.

Impact

Companies should carefully assess the nature of income and expenses before classifying the same as exceptional. It requires exercise of significant judgement. Companies are advised to proactively discuss with their auditors on their assessment of expenses as exceptional.

Sandip Khetan
Partner and National Leader
Financial Accounting Advisory Services (FAAS), EY India

Companies should carefully assess the nature of income and expenses before classifying the same as exceptional. It requires exercise of significant judgement. Companies are advised to proactively discuss with their auditors on their assessment of expenses as exceptional

B. Expected credit losses- COVID-19 scenario:

Key requirements

Ind AS 109, Financial Instruments requires expected credit losses to be measured as an unbiased, probability weighted amount using reasonable and supportable information that is available without undue cost or effort. It basically requires a company to incorporate forward looking information about past events, current conditions and the forecast of future economic conditions while assessing expected credit losses (ECL) for financial assets not measured at fair value through profit or loss.

COVID-19 has resulted in major disruptions to businesses thereby increasing the volatility across markets worldwide. The scale of COVID-19 impact globally has been severe enough to compare it to a Black-Swan event (a one in a hundred year event with the last such event being the Spanish Flu in 1917). Various government institutions have provided both financial and non-financial assistance to help the affected industries and businesses to deal with the impact of this pandemic.

COVID-19 has impacted many areas of accounting and financial reporting but one of the most crucial impacts has been on the computation of impairment allowance based on ECL model.

The unfolding of events post the outbreak and all associated forecasted information needs to be considered while assessing the ECL.

The implications on ECL could vary depending upon company-specific situation and its current methodology. Companies should consider disclosing qualitative and quantitative information to help users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. This includes use of inputs, assumptions and estimation techniques, and how forward-looking information has been incorporated.

The IASB document dated 27 March 2020 on accounting for expected credit losses applying IFRS 9, Financial Instruments in light of the current uncertainty resulting from the COVID-19 pandemic provides the following guidance:

IFRS 9 requires the application of judgement and both requires and allows entities to adjust their approach to determining ECLs in different circumstances. Several assumptions and linkages underlying the way ECLs have been implemented to date may no longer hold in the current environment. Entities should not continue to apply their existing ECL methodology mechanically. For example, the extension of payment holidays to all borrowers in particular classes of financial instruments should not automatically result in all those instruments being considered to have suffered a significant increase in credit risk (SICR).

Both the assessment of SICRs and the measurement of ECLs are required to be based on reasonable and supportable information that is available to an entity without undue cost or effort.

Entities are required to develop estimates based on the best available information about past events, current conditions and forecasts of economic conditions. In assessing forecast conditions, consideration should be given both to the effects of COVID-19 and the significant government support measures being undertaken.

Changes in economic conditions should be reflected in macroeconomic scenarios applied by entities and in their weightings. If the effects of COVID-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered. The environment is subject to rapid change and updated facts and circumstances should continue to be monitored as new information becomes available.

Although current circumstances are difficult and create high levels of uncertainty, if ECL estimates are based on reasonable and supportable information and IFRS 9 is not applied mechanistically, useful information can be provided about ECLs. Indeed, in the current stressed environment, IFRS 9 and the associated disclosures can provide much needed transparency to users of financial statements.

ICAI has published certain COVID-19 related FAQs on Ind AS (dated 6 May 2020):

Some of the key aspects from the FAQs on ECL computation are summarized below:

1. It would be imperative to reassess and re-evaluate the original provision matrix employed by the entity for any changes and considerations required to be made in regard to the changes in the current economic environment and forward looking information (including macroeconomic information) for the entity in light of COVID-19 outbreak.
2. With respect to the type and number of macroeconomic factors to be considered, Ind AS 109 being a principle-based standard, does not set any bright lines nor mandates minima-maxima thresholds in this area. However, paragraph B5.5.52 quotes a few macroeconomic indicators, e.g., unemployment rate, property prices, commodity prices, etc. in the context of ensuring directional consistency between estimation of expected credit losses and these factors. It may be noted that following macroeconomic factors are commonly used in the estimation of expected credit losses in general. It is important to ensure correlation between the macroeconomic factors used in Ind AS 109 ECL estimates and the credit risk profile of the entity.

Gross domestic product (GDP) growth	Inflation rate or Consumer Price Index	Unemployment rates
Interest rates	Foreign exchange rates	Real estate prices
Household consumption/ savings	Industrial production	Crude oil prices
Equity prices	Purchasing Power Index	Investment in fixed assets

3. According to Ind AS 109, Financial Instruments, while estimating the expected cash shortfalls for measuring the expected credit losses the entity should consider the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognized separately by the entity. (Paragraph B5.5.55 of Ind AS 109). Therefore, an important aspect to note is that the collateral or credit enhancement should be part of the contractual terms of the loan.

Economic reliefs provided by the government or prudential regulatory authority may take a variety of forms such as mandating the entities to grant loan repayment moratoriums, giving repayment guarantees on the financial obligations of the industries or providing liquidity facilities and so on. The treatment of these economic reliefs depends upon specific facts and details of those particular schemes and entities need to apply judgment.

Key requirements

1. Incorporation of macroeconomic factors:

In practice, many entities use a provision matrix to calculate the impairment allowance on trade receivables. However, in order to comply with the requirements of Ind AS 109, an entity would need to consider how current and forward-looking information might affect the historical default rates and consequently, how such information would affect their estimates of ECL.

The assessment of the impact of the pandemic on ECL will require significant judgement, especially as it is not directly comparable with any recent similar events and the impact will depend on government measures as much as the spread of the virus. Entities will have to update their macroeconomic scenarios and consider the use of top-down "management overlays" to embed in the ECL risks not yet fully captured by their models.

Further, entities would have to develop additional internal controls on their computation and develop robust models so that the impairment computation is reflective of the management judgement of the impact and is revised on a regular basis.

2. Impact of time value of money:

As per the requirements of Ind AS 115, Revenue from Contracts with Customers, trade receivables without a significant financing component are measured on initial recognition at the transaction price and do not have a contractual interest rate. This implies that the effective interest rate for such receivables is zero. Accordingly, discounting of cash shortfalls to reflect the time value of money when measuring ECL is generally not required.

However, if a trade receivable becomes overdue and is subsequently modified in order to incorporate a significant financing component, then further analysis and judgement may be required, because using an effective interest rate of zero may not be appropriate. There may be more renegotiations of trade receivables given the economic impacts of the pandemic.

3. Scope of impairment requirements:

Financial instruments within the scope of impairment requirements of Ind AS 109 include trade and other receivables, loan receivables and other debt investments not recognized at fair value through profit or loss contract assets, lease receivables, financial guarantees and loan commitments.

While, for many corporate entities the main balances subject to ECL will be trade receivables, it is important to assess the credit risk and a need for impairment provision for other financial instruments (such as debt instruments at amortized cost or at FVOCI, intercompany loans and deposits, financial guarantee, etc.) specifically in light of the pandemic since there may be a substantial delay in repayment or factors that indicate a deterioration in the creditworthiness of the counter-party.

4. ECL on intercompany transactions:

Financing arrangements between entities within the same group can take various forms. Intercompany loans and financial guarantees issued on behalf of the group companies would fall within the scope of ECL requirements of Ind AS 109. Such exposures may be considered to have low credit risk if the borrower has a strong capacity to meet its contractual cash flow obligations in the near term, and adverse changes in economic and business conditions in the longer term might, but will not necessarily, reduce the ability of the borrower to fulfil its obligations.

While many corporates consider intercompany exposures to have a low credit risk and recognized little or no impairment allowance assuming the same to be insignificant, a detailed assessment of the same would be required in light of the potential impact of the COVID-19 outbreak.

5. Evaluation of "low risk" credit exposures:

It is generally observed that companies do not evaluate in detail the significant increase in credit risk criteria for "low credit risk" exposures such as exposure in instruments having high ratings and no default history. However, the COVID-19 situation has been responsible for putting severe pressure on business enterprises across various industries which may thus lead to an impact on the credit risk of these exposures. The companies should ensure that they have a robust mechanism to track the significant increase in credit risk on a periodic basis and the same is adequately documented. The chances of significant increase in credit risk is high for those exposures which are probably at the lower end of the investment rating grade.

6. Climate related matters:

IASB in its document "Effects of climate-related matters on financial statements" released in the month of November 2020 states the following in respect of expected credit loss computation:

Climate-related matters may also affect a lender's exposure to credit losses. For example, wildfires, floods or policy and regulatory changes could negatively affect a borrower's ability to meet its debt obligations to the lender. Further, assets could become inaccessible or uninsurable, affecting the value of collateral for lenders. In recognizing and measuring expected credit losses, IFRS 9 requires use of all reasonable and supportable information that is available without undue cost or effort. Climate-related matters may therefore be relevant—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.

Similarly, it is critical for an entity to evaluate the impact of climate-related matters in the computation of impairment allowance for trade receivables.

Manan Lakhani
Director, Financial Accounting Advisory Services (FAAS), EY India

Companies need to be mindful about the internal controls and aspects around governance pertaining to ECL computation

Impact on disclosures:

The uncertainty associated with COVID-19 pandemic affects the assumptions and estimation in respect of measurement of assets and liabilities. Therefore, entities should carefully consider whether additional disclosures are necessary in order to help users of financial statements understand the judgements applied in the financial statements.

Under Ind AS 107.35G(b), an entity must disclose how forward-looking information has been incorporated into the determination of ECL, including the use of macroeconomic information. Entities are expected to provide more detailed information if the forward-looking information has a significant impact in the calculation of ECL. Given the level of uncertainty and the sensitivity of judgements and estimates, disclosures of the key assumptions used, and judgements made in estimating ECL, as well as the impact of any relief measures, is going to be important.

The impact of COVID-19 requires an entity to consider disclosing the following quantitative and qualitative information:

- How credit risk management practices have been affected;
- How the segmentation of trade receivables has been affected
- Revisions to the entity's definition of default or write-off policy;
- How forward-looking information has been incorporated.

Entities that have identified concentrations of activities in areas or industries affected by the pandemic (e.g., the airline, hospitality and tourism industries) and have not previously disclosed the concentration because they did not believe that the entity was vulnerable to the risk of a near-term severe impact, should, under the current circumstances, consider making such a disclosure.

Impact

- Determine suitable macroeconomic scenarios and evaluate the same on a periodic basis
- Determine whether any suitable adjustments are required in the existing ECL model
- Significant judgements and assumptions considered in the ECL computation to be adequately disclosed
- A robust ECL methodology to be in place and the same to be updated and reviewed on a periodic basis
- Determine and develop robust ECL mechanism not just for "trade receivables" but also for investment in debt securities classified at either "amortised cost" or "fair value through other comprehensive income" and intercompany loans and receivables
- Companies need to be mindful about the internal controls and aspects around governance pertaining to ECL computation:
  - Whether adequate internal controls are in place specifically in respect of the overlays and assumptions considered in the working?
  - Does the company hold focused meetings (such as audit committee) to discuss the approach and methodology used for ECL computation and whether the decisions and deliberations on economic scenarios are adequately documented for future reference?

C. Moratorium in COVID-19 scenario:

Key requirements

The economic fallout on account of the COVID-19 pandemic led to a significant financial stress for borrowers across the board. The total and prolonged lockdown affected supply and demand as investment plans derailed, corporate and household spending reduced, and multiple sectors are facing job losses. Certain sectors including micro, small & medium enterprises (MSMEs), tourism, hospitality, aviation, automotive, real estate and textiles have been particularly vulnerable to the shock.

India's policymakers responded swiftly to the crisis with proactive steps taken and provided policy support to ensure survival, solvency and stabilization in these times of radical uncertainty.

The RBI has given certain waivers to the borrowers which include moratorium to pay principal and interest on term loans and deferment of interest payment for working capital facilities to help borrowers tide over temporary financial difficulties.

Applicability and period of moratorium

The RBI permitted lenders to grant a moratorium on loan repayment instalments falling due between 1 March 2020 and 31 May 2020 which was subsequently extended till 31 August 2020. The repayment schedule and the residual tenor for such loans was shifted across the board by up to six months. Recently, the Supreme Court pronounced its judgment whereby no further extension has been granted to borrowers.

Applicability of "Resolution Framework for COVID-19-related Stress"

In addition to the relief provided through moratorium, RBI also decided to allow a one-time restructuring of loans for eligible borrowers facing stress on account of COVID-19 through the "Resolution Framework for COVID-19-related Stress". Only those borrower accounts which were classified as standard, but not in default for more than 30 days with any lending institution as of 1 March 2020 and those accounts with stress due to COVID-19, were eligible for resolution under the framework.

The resolution plans under this framework involved any of the mechanisms under the prudential framework (e.g., the sale of exposure, the change in ownership or the restructuring or rescheduling of debt). Lenders could also extend the tenor of the facilities by up to two years. The plan may also involve sanctioning additional facilities.

Accounting implication on borrowers

Affected entities may have opted for moratorium / restructuring relief provided by the RBI. In such cases, they will need to consider the guidance provided in Ind AS 109 to determine whether any changes to existing contractual arrangements represent a substantial modification or potentially a contract extinguishment, which would have accounting implications in each case.

For financial liabilities, an entity should derecognize the liability if the cash flows are extinguished (i.e., when the obligation specified in the contract is discharged, cancelled or expires) or if the terms of the instrument have substantially changed.

Ind AS 109 provides guidance on determining if a modification of a financial liability is substantial, which includes a comparison of the cash flows before and after the modification, discounted at the original effective interest rate (EIR), commonly referred to as the "10% test". If the difference between these discounted cash flows is more than 10%, the instrument is derecognized. However, other qualitative factors could lead to derecognition irrespective of the 10% test (e.g., if a debt is restructured to include an embedded equity instrument). The new debt will be measured at fair value and any gain or loss between the carrying value of existing debt and the fair value of new debt will be accounted for in statement of profit and loss.

If, following the guidance above, a modified financial asset or liability does not result in derecognition, the original EIR is retained and there is a catch-up adjustment to statement of profit and loss for the changes in expected cash flows discounted at the original EIR. For floating rate instruments, a change in the market rate of interest is accounted for prospectively. However, any other contractual change (e.g., the spread applied above the interest rate) would also result in a catch-up adjustment at the date of modification.

Impact

- Companies need to assess appropriate accounting for moratorium and loans.
- Appropriate disclosures should be made in the financial statements if moratorium is availed by the company.
- Debt covenants should be analyzed. If there are any breaches, then company should evaluate the impact on classification of loans.

4 Clarification on tax deductibility of goodwill

Key requirements

While moving the Finance Bill for approval by the Lok Sabha, the Finance Minister introduced amendments to Finance Bill 2021 (Amended Finance Bill) which includes the mechanism for exclusion of goodwill from block of assets.

The brief impact of the same is summarized below:

Definition of "intangible asset" to exclude goodwill of business or profession thereby making the goodwill ineligible for depreciation from FY 2020-21 onwards - both for existing goodwill as on 31 March 2020 and new goodwill acquired on or after 1 April 2020. Finance Bill 2021 also proposed to amend capital gains provisions to provide that cost of acquisition of self-generated goodwill acquired in tax neutral transfer will be NIL.

However, Finance Bill 2021 missed to provide for similar amendment to the definition of "written down value" of block of assets to deny depreciation on goodwill acquired prior to 1 April 2020 and forming part of block of "intangible assets" on that date.

Amended Finance Bill 2021 now proposes to adjust closing Written Down Value (WDV) of intangible asset as on 31 March 2020 by reducing the standalone tax WDV of goodwill computed as difference between actual cost of goodwill and depreciation allowable on such goodwill till 31 March 2020. The reduction shall, however, not exceed the closing WDV of intangible assets as on 31 March 2020.

Impact

Companies need to revisit deferred tax balances recognized on goodwill in their financial statements. If the goodwill was treated as tax deductible at initial recognition, the non-deductibility of goodwill as a result of the amended provisions, would in most cases require additional creation of deferred tax liability. In addition, the entity will have to review, whether its claim for goodwill deduction in past years, will be challenged by the tax authorities. This is an uncertain tax position, and the entity will have to review, if any provision is required with respect to the same.

These adjustments will impact the Statement of Profit and Loss for the period 31st March 2021 and will have impact on the effective tax rate reconciliation of the entity.

Jigar Parikh
Partner, Financial Accounting Advisory Services (FAAS), EY India

Companies need to revisit deferred tax balances recognized on goodwill in their financial statements. If the goodwill was treated as tax deductible at initial recognition, the non-deductibility of goodwill as a result of the amended provisions, would in most cases require additional creation of deferred tax liability.

SECTION 2:

Key hot topics

1 Impact of Code on Social Security (2020) on gratuity and other employee benefits

Key requirements

The Code on Social Security, 2020 was passed by the Parliament on 23 September 2020 and shall come into force once the same is notified by the Central Government. Once notified, the Code on Social Security, 2020 will replace nine existing labor laws, including the following:

- The Payment of Gratuity Act, 1972
- The Employees' Provident Fund and Miscellaneous Provisions Act, 1952
- The Employees' Compensation Act, 1923
- The Employees' State Insurance Act, 1948

As at 26 March 2021, the code is not yet made effective and likely to be effective from 1 April 2022.

Enhanced coverage

The Code has widened coverage by including the unorganized sector, fixed term employees and gig workers, platform workers, inter-state migrant workers, etc. in addition to contract employees. It is, therefore, important for establishments to assess the implications and revisit the compliance requirements under the Code.

Definition of Wages - Section 2(80):

Uniformity in determining wages for the purpose of social security benefits is the main highlight of the re definition "Wages" means all remuneration whether by way of salary, allowances or otherwise, expressed in terms of money or capable of being so expressed which would, if the terms of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment, and provided that; for calculating the wages under this clause, if payments made by the employer to the employee under clauses (a) to (i) of the Section 2(80) exceeds one-half, or such other per cent as may be notified by the Central Government, of all remuneration calculated under this clause, the amount which exceeds such one-half, or the per cent so notified, shall be deemed as remuneration and shall be accordingly added in wages under this clause: Provided further that for the purpose of equal wages to all genders and for the purpose of payment of wages, the emoluments specified in clauses (d), (f), (g) and (h) of the Section 2(80) shall be taken for computation of wage.

Once implemented, the new Code will impact most companies in some way or the other. In particular, the requirement for Basic Salary and Dearness Allowance to be at least 50% of the total compensation may necessitate most companies to align their compensation structures with the requirements of the Code. Such realignment may also impact the value of liabilities carried in the books in respect of post-employment and other long-term employee benefits such as gratuity, leave encashment, etc.

If the code became effective from 1 April 2022, then for the March 2022 quarter, the entities would need to evaluate if the changes are a plan amendment or change in actuarial assumption. If it is treated as a plan amendment, then the impact will be a past service cost and statement of profit and loss will be debited. If the change is treated as a change in actuarial assumption, the impact will be taken to Other Comprehensive Income. Most situations would qualify as a plan amendment, impacting statement of profit & loss. In few cases, the impact would be considered as a combination of change in actuarial assumption and past service cost; for example, when the entity increases the total final salary, beyond what was assumed as salary growth rate in previous filings, as well as changes the salary structure

Ajith Thambi
Director, Financial Accounting Advisory Services (FAAS), EY India

Employers are required to assess the impact of change in definition of wages on their organizations. A change in the definition of wage has a large impact due to enhanced provision for gratuity/leave, net pay of employees, possible enhanced provision for PF and other employee benefits dependent on the wages.

However , the government decided to defer the decision to notify the date of implementation of the code, so the companies are advised to include a disclosure about the impact on transition to the new code in their financial statements. There shall be no impact on the financials for the year ending 31 March 2021.

Impact

Employers are required to assess the impact of change in definition of wages on their organizations. A change in the definition of wage has a large impact due to enhanced provision for gratuity/leave, net pay of employees, possible enhanced provision for PF and other employee benefits dependent on the wages.

2 Corporate Social Responsibility (CSR) amendments and frequently asked questions (FAQs)

The Companies (Amendment) Act, 2020 and Companies (Corporate Social Responsibilities Policy) Rules, 2014:

The Companies (Amendment) Act, 2020 has amended section 135 and the Ministry of Corporate Affairs has amended the Companies (Corporate Social Responsibility Policy), Rules, 2014 (CSR Rules) vide Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 notified on 22 January 2021. The significant updates are as follows:

i) Definition of CSR – Negative list:

Companies (Corporate Social Responsibility Policy) Rules, 2014 have amended the definition of CSR and have excluded:

- Activities undertaken in pursuance of normal course of business of company; except for the company engaged in research and development activity of new vaccine, drugs and medical device in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for FY 2020-21, 2021-23, 2022-23 subject to the conditions that;
  - a) Such research and development activities shall be carried out in collaboration with any of the institutes or organization mentioned in item (ix) of Schedule VII to the Act;
  - b) Details of such activity shall be disclosed separately in the annual report on CSR included in the Board's Report;
- Any activity undertaken by the company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level;
- Contribution of any amount directly or indirectly to any political party under section 182 of the Act;
- Activities benefitting employees of the company as defined in clause (k) of section 2 of the Code on Wages, 2019 (29 of 2019);
- Activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services;
- Activities carried out for fulfilment of any other statutory obligations under any law in force in India;

Impact

Companies (Corporate Social Responsibility Policy) Rules, 2014 has introduced the exclusion list, amount spent on such activities would not be qualified as CSR Spends, hence the Companies would require to re-assess their CSR Policy and planned activities in line with the requirement of new definition of CSR. While evaluation there are certain key question the management is required to consider:

a) When can an activity be treated as being in the "normal course of business" and subject to disqualification?

b) Whether an activity incidentally benefiting "employees" can also be disqualified?

c) When can a sponsorship be treated as deriving "marketing benefits" for a company's products or services and be subject to disqualification?

(ii) Mandatory registration under the Income Tax Act,1961 (Section 12A and 80G) and Companies Act, 2013 (Form CSR-1)

The Board shall ensure that the CSR activities are undertaken by the company itself or through:

a) Company established under section 8 of the Act, or a registered public trust or a registered society, registered under section 12A and 80 G of the Income Tax Act, 1961 (43 of 1961), established by the company, either singly or along with any other company, or

b) A company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government; or

c) Any entity established under an Act of Parliament or a State legislature; or

d) A company established under section 8 of the Act, or a registered public trust or a registered society, registered under section 12A and 80G of the Income Tax Act, 1961, and having an established track record of at least three years in undertaking similar activities.

Every entity, covered under sub-rule (1), who intends to undertake any CSR activity, shall register itself with the Central Government by filing the form CSR-1 electronically with the Registrar, with effect from the 1 April 2021.

Provided that the provisions of this sub-rule shall not affect the CSR projects or programs approved prior to the 1 April 2021.

Impact

The amended rules are applicable to every entity who undertakes any CSR Activity and is effective from 1 April 2021. Pursuant to the amendment the companies are required to assess following key issues:

a) Who needs to register and by when?

b) Would sums paid to IAs registered under Section 10(23C) and Section 80G of the ITA be disregarded as CSR expenditure? [Provisions seem to recognize only Section 12A and Section 80G registered entities as CSR vehicles]

c) Will IAs registered under Section 12A and Section 80G of the ITA be treated as CSR vehicles pursuant to the mandatory re-registration under Section 12AB of the ITA w.e.f. 1 April 2021?

(iii) Surplus arising out of CSR activities

The surplus arising out of CSR Activities shall not form part of the business profit of a company and

- Shall be ploughed back into the same project; or
- Transfer the unspent amount to CSR Unspent Account and spent in pursuance of CSR policy and annual action plan of the company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the FY.

Impact

The surplus arising out of CSR activities shall not be considered as business profit of the company. The rules require to ploughed back the surplus amount into the same project. This would mean, any surplus arising out of CSR activities cannot be accounted as income and would be required to be reduced from the expense relating to the same project.

(iv) Excess spends

Where a company spends an amount in excess of requirement provided under 135(5), such excess amount may be set off against the requirement to spend under 135(5) up to immediate succeeding three FY subject to the conditions that:

(i) The excess amount available for set off shall not include the surplus arising out of the CSR activities if any; and

(ii) The Board of the company shall pass a resolution to that effect.

Impact

The excess amount spent by the company for CSR activities over and above the obligation for the year is eligible for carry forward for three FY and setoff against the obligation. The amount eligible for carry forward subject to the board resolution is in nature of pre-paid expense and the company would be entitled to create the pre-paid asset for the setoff in subsequent year up to three years. Upon utilization/setoff of excess spend, the company would recognize the expense in statement of profit and loss.

(v) Transfer of unspent CSR amount:

The amended rules requires, until a fund is specified in Schedule VII for the purposes of sub-section (5) and(6) of section 135 of the Act, the unspent CSR amount, if any, shall be transferred by the company to any fund included in Schedule VII of the Act.

Impact

The rule mandates transfers of Unspent CSR amounts to prescribed Funds or Unspent CSR Account depending on nature of project i.e. Ongoing and other projects. There are certain key considerations which would need assessment includes:

a) Treatment of underspend of FY 2019-20 and prior years

b) Classification of projects as "Ongoing"

c) Whether mere transfer of funds to IAs qualifies as spend or actual spend by IAs is necessary to meet the CSR spend requirement?

d) Do separate Unspent CSR Accounts need to be opened for each project?

e) If the unspent amounts are proposed to be spent prior to the prescribed date of transfer, do they still need to be transferred to a prescribed Fund or Unspent CSR Account?

f) Are transferred Unspent CSR amounts on an Ongoing project only permitted to be spent on the same project?

(vi) Increased liability for non-compliance with Section 135:

Section 135, subsection 7 has been amended to provide the higher penalty on non-compliance with section 135 (5) or (6), with the revised provision, the company shall be 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 Corporate Social Responsibility Account, as the case may be, or one crore rupees, whichever is less, and every officer of company who is in default shall 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 Corporate Social Responsibility Account, as the case may be, or two lakh rupees, whichever is less.

Impact

The penal provision reinforces the mandatory nature of CSR obligations. The penalties introduced for noncompliance are not compoundable.

(vii) Administrative expense:

The board shall ensure that the administrative overheads shall not exceed five percent of total CSR expenditure of the company for the FY.

Impact

The amount incurred in excess of the five percent shall be borne by company from its profit and no CSR benefit shall be available.

(viii) Acquisition of Capital Asset:

The amendment rules allow to spend the CSR amount on creation or acquisition of capital asset. However, the capital asset shall be held by:

- Section 8 Company or a registered public trust or registered society, having charitable objectives and CSR registration number; or
- Beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities;
- A public authority;

Provided that any capital asset created by a company prior to the commencement of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, shall within a period of one hundred and eighty days from such commencement comply with the requirement of this rule, which may be extended by a further period of not more than ninety days with the approval of the Board based on reasonable justification.

Impact

The amended rules provide Restrictions on ownership of CSR capital assets by companies and mandated transfers of CSR assets created prior to 22 January 2021, to prescribed entities. There are certain key considerations which would required to be focused while implementation of amended rules;

- What are the tax considerations associated with transfer of assets forming part of block of assets of the company to IAs, beneficiaries or public authorities (i.e., the impact on depreciation claim, trigger of capital gains/ losses, etc.)?
- What are the tax/ accounting/ stamp duty considerations associated with transfer to, and receipt of CSR assets by, IAs (by way of voluntary / corpus donations, etc.)?

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Increase in corporate governance and transparency through display of CSR committee, CSR policy and CSR projects in website and enhanced disclosure in Annual CSR Report.

(ix) CSR reporting - impact assessment

The amended rules mandates impact assessment for qualifying companies (with average CSR obligation of INR 10 crores or more in last three FY) with respect to projects of minimum INR 1 crore size and completed at least one year prior to the date of impact assessment. The impact assessment is required to be carried through independent agency. The impact assessment reports shall be placed before the Board and shall be annexed to the annual report on CSR. A company undertaking impact assessment may book the expenditure towards corporate social responsibility for that FY, which shall not exceed five percent of the total CSR expenditure for that FY or INR 50 lakh rupees, whichever is less.

Impact

Certain qualifying companies have been mandated to perform the impact assessment. The impact assessment is required to be performed by independent agency. CSR rules places limit on the amount which can be spent towards the impact assessment to be considered as part of the CSR expenditure during a FY. Companies having multiple projects and having need of multiple impact assessments for such projects shall exceed this limit. This leads to question how this excess expense shall be recorded. The amount incurred in excess of the threshold shall be borne by company from its profit and no CSR benefit shall be available.

There are certain key issues to be addressed for implementing the amended rules:

a) Who can be engaged to undertake an impact assessment?

b) What should be the basis for identifying the projects?

c) How would impact assessment be done in case the CSR project is undertaken jointly by the company or the impact assessment consolidates the funds received from various companies for one project?

(x) Display of CSR activities on its website:

The board of directors of a company shall mandatorily disclose the composition of the CSR committee, CSR policy and projects approved by the board on the website, if any, for public access.

Impact

Increase in corporate governance and transparency through display of CSR committee, CSR policy and CSR projects in website and enhanced disclosure in Annual CSR Report.

(xi)Annual report on CSR activities:

A new format has been prescribed for annual report on CSR activities to be included in the board's report for FY commencing on or after 1 April 2020. This would result in enhanced reporting requirements and include the disclosure for:

- Brief outline on CSR policy of the company;
- Composition of CSR committee;
- Provide web-link where composition of CSR committee, CSR policy and CSR projects approved by the board are disclosed on the website of the company;
- Provide details of impact assessment of CSR projects carried out in pursuance of sub-rule (3) of rule 8 of Companies (Corporate Social responsibility policy) Rules 2014, if applicable (attach the report);
- Details of amounts available for set-off in pursuance of sub-rule (3) of rule 7 of the CSR rules and amount required to be set off for FY, if any;
- Average net profit as per section 135(5);
- (a) Two percent of average net profit of the company as per section 135(5), (b) surplus arising out of the CSR projects or programs or activities of the previous FY; (c) amount required to be set-off for the FY, (d) total CSR obligation for the FY;
- (a) CSR amount spent or unspent for the FY, (b) details of amount spent against the ongoing projects for the financial year, (c) details of amount spent against other than ongoing projects for the FY, (d) amounts spent for administrative overheads, (e) amount spent on impact assessment, if applicable (f) total amount spent for the FY, (g) excess amount for set off, if any;
- (a) Details of unspent CSR amount for preceding three FY, (b) details of amount spent in the FY for ongoing projects of the preceding FY;
- In case of creation or acquisition of capital asset, furnish the details relating to the asset so created or acquired through CSR spent in the FY : (a) date of creation or acquisition, (b) amount of CSR spent for creation or acquisition of capital asset, (c) details of the entity or public authority or beneficiary under whose name such capital asset is registered, their addresses;
- Specify the reasons, if the company has failed to spend two percent of the average net profit as per section 135(5).

Reasons why the company has failed to spend two per cent of the average net profit as per section 135(5) the enhanced reporting requirements are likely to involve additional time and effort to fully comply with the same. Developing structured formats for enabling rereporting will help create a more efficient process for enabling transparency and clarity to any stakeholder accessing the information.

Impact

Entities should evaluate and prepare themselves for disclosing the required information as part of the board's report. FY 2020-21 will be first year of disclosing such information. Entities are also required to disclose the amount of average net profit computed for the purpose of Section 135(5) of the Companies Act, 2013.

(xii) Amendments to the Schedule VII of Companies Act, 2013:

The MCA has added following activities:

- Funds may be spent for various activities related to COVID-19 under item nos. (I) and (ix) of Schedule VII relating to the promotion of health care, including the preventive health care and sanitation and disaster management.
- Company engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for FY 2020-21, 2021-22 and 2022-23 subject to the conditions specified in rules.
- Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the central government or state government or public sector undertaking or any agency of the central government or state government;
- Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defence Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).

Impact

The Companies may consider spending their amounts dedicated for CSR towards the new activities added in Schedule VII from the publication of notification in official gazette. The Pharma companies engaged in research and development of new vaccine as a normal business can undertake research and development activity of new vaccine.

FAQ on CSR

Ministry of corporate affairs have issued FAQ on COVID-19 related CSR expenditure on 10 April 2020

S.no.	Frequently asked questions (FAQs)	Reply
1.	Whether contribution made to "PM CARES Fund" shall qualify as CSR expenditure?	Contribution made to "PM CARES Fund" shall qualify as CSR expenditure under item no (viii) of Schedule VII of the Companies Act, 2013 and it has been further clarified vide Office memorandum F. No. CSR-05/1/2020-CSR-MCA dated 28 March 2020.
2.	Whether contribution made to "Chief Minister's Relief Funds" or "State Relief Fund for COVID-19" shall qualify as CSR expenditure?	Chief Minister's Relief Fund" or "State Relief Fund for COVID-19" is not included in Schedule VII of the Companies Act, 2013 and therefore any contribution to such funds shall not qualify as admissible CSR expenditure.
3.	Whether contribution made to State Disaster Management Authority shall qualify as CSR expenditure?	Contribution made to State Disaster Management Authority to combat COVID-19 shall qualify as CSR expenditure under item no (xii) of Schedule VII of the 2013 and clarified vide general circular No. 10/2020 dated 23 March 2020.
4.	Whether spending of CSR funds for COVID-19 related activities shall qualify as CSR expenditure?	Ministry vide general circular No. 10/2020 dated March 23, 2020 has clarified that spending CSR funds for COVID-19 related activities shall qualify as CSR expenditure. It is further clarified that funds may be spent for various activities related to COVID-19 under items nos. (i) and (xii) of Schedule VII relating to promotion of health care including preventive health care and sanitation, and disaster management. Further, as per general circular No. 21/2014 dated 18th June 2014, items in Schedule VII are broad based and may be interpreted liberally for this purpose.

S.no.	Frequently asked questions (FAQs)	Reply
5.	Whether payment of salary/wages to employees and workers, including contract labor, during the lockdown period can be adjusted against the CSR expenditure of the companies?	Payment of salary/ wages in normal circumstances is a contractual and statutory obligation of the company. Similarly, payment of salary/ wages to employees and workers even during the lockdown period is a moral obligation of the employers, as they have no alternative source of employment or livelihood during this period. Thus, payment of salary/ wages to employees and workers during the lockdown period (including imposition of other social distancing requirements) shall not qualify as admissible CSR expenditure.
6,	Whether payment of wages made to casual /daily wage workers during the lockdown period can be adjusted against the CSR expenditure of the companies?	Payment of wages to temporary or casual or daily wage workers during the lockdown period is part of the moral/ humanitarian/ contractual obligations of the company and is applicable to all companies irrespective of whether they have any legal obligation for CSR contribution under section 135 of the Companies Act 2013. Hence, payment of wages to temporary or casual or daily wage workers during the lockdown period shall not count towards CSR expenditure.
7.	Whether payment of ex-gratia to temporary /casual /daily wage workers shall qualify as CSR expenditure?	If any ex-gratia payment is made to temporary / casual workers/ daily wage workers over and above the disbursement of wages, specifically for the purpose of fighting COVID-19, the same shall be admissible towards CSR expenditure as a one-time exception provided there is an explicit declaration to that effect by the board of the company, which is duly certified by the statutory auditor.

3 Understanding the reporting consideration for Interest Rate Benchmark Reforms (IBOR)

Key requirements

What is changing and why is this change

Benchmark interest rates are a core component of financial markets, influencing borrowing and lending for all types of market participants funds across a myriad of financial instruments. Retail and commercial loans, corporate debt, securitized products and the derivatives markets all rely on these benchmark reference rates for the pricing and hedging of interest rates and other risks.

The London Interbank Offered Rate, or LIBOR, is one of the most common series of benchmark rates referenced by contracts measured in the trillions of dollars across global currencies. About USD350 trillion worth of contracts across the globe are pegged to LIBOR which is the key interest rate benchmark for several major currencies like JPY, EUR, CHF and GBP. The maturities on financial products based on LIBOR ranges from overnight to a year and the entire rate setting mechanism is administered by Intercontinental Exchange (ICE). Following the global financial crisis of 2008, calls grew to reform the process used to price LIBOR due to the way the rate was developed based on professional judgment by contributing banks, the lack of transactional data from which to derive such rates, and the potential for the rate-setting process to be manipulated as seen by regulatory enforcement and litigation in recent years.

As a result, global regulators collectively from the developed capital markets decided that the publication of the LIBOR will cease after December 2021 and will be replaced by Alternative Reference Rates (ARR) also known as Risk Free Rates (RFR). However as recently as 30 November 2020, ICE had announced its intention to extend the use of USD LIBOR till June 2023 for almost all maturity tenors except for one week and two-month tenors that will cease by December 2021. While ICE has issued a consultation to this effect, it seems to have in principle support from the UK and US regulators for the extension. The shift away from the most widely used interest rate benchmarks is an immense change to global finance that will have far-reaching impacts.

ARRs are being developed in key markets to replace current LIBOR currency rates: US dollar, Euro, British pound, Swiss franc and Japanese yen.

Designated ARR/RFR for major five LIBOR currencies

Jurisdiction	Working group sponsor	Currencies	Replacement ARR
US	Federal Reserve Bank of New York	USD LIBOR	Secured Overnight Financing Rate (SOFR)
UK	Bank of England	GBP LIBOR	Sterling Overnight Index Average (SONIA)
EU	European Central Bank	EUR LIBOR	Euro Short-Term Rate (ESTER)
Switzerland	Swiss National Bank	CHF LIBOR	Swiss Average Rate Overnight (SARON)
Japan	Bank of Japan	JPY LIBOR	Tokyo Overnight Average Rate (TONA)

The transition to ARRs would affect the entities with foreign currency exposures in the form of loans, borrowings and derivative financial instruments referenced to the IBORs. It may impact several operational functions such as treasury, lending, accounting and legal. Internal controls may have to be updated along with financial and accounting process. In order to mitigate the uncertainties surrounding the IBOR reform and address the accounting challenges successfully initiated and completed the two-phase project. These targeted standard setting has helped to avert the unintended consequences on companies' financial statements due to shift in benchmark rate.

Accounting and reporting implications for IASB IFRS (subject, of course, to any local endorsement procedures)

Phase 1 of the project addressed the pre replacement issues affecting financial reporting in the period before the reform particularly in the context of hedge accounting. It means even though there are uncertainties on the amount and timing of cash flows indexed to IBOR, due to the reform the entity must assume that the benchmark on which hedged cash flows are based is not altered, as long as uncertainty remains. This would help to comply with the existing hedge accounting requirement of hedged future cash flows indexed to IBOR being "highly probable". The reliefs will generally cease to apply at the earlier of:

- Absence of uncertainty with respect to the timing and amount of the cash flows arising from IBOR reform, or
- Discontinuance of the hedging relationship

In the absence of phase 1 relaxation, hedge accounting relationships may need to be terminated because of difficulty in declaring that the future hedged cash flows are highly probable, if the cash flows are indexed to a benchmark rate like LIBOR that is expected to go away, e.g., an IBOR-indexed borrowing.

However along with providing relief on hedge accounting, phase 1 requires entities to disclose the following:

- The significant interest rate benchmarks to which the entity's hedging relationships are exposed
- The nominal amount of the hedging instruments in those hedging relationships
- The extent of the risk exposure the entity manages that is directly affected by the interest rate benchmark reform
- How the entity is managing the process to transition to ARRs
- A description of the significant assumptions or judgements the entity had to make in applying the exceptions

The effective date of the Phase 1 amendments is for annual periods beginning on or after 1 January 2020, although earlier application was permitted.

Phase 2 of the project addresses the post IBOR reform issues and primarily focuses on the accounting issues with respect to classification, measurements, hedge accounting, key disclosure requirements and effects of IBOR reform on financial reporting. These amendments enable (and require) entities to continue hedge accounting in circumstances when changes to hedged items and hedging instruments arise as a result of changes required by the reform. Entities are required to amend their hedging relationships to reflect:

- Designating an alternative benchmark rate as the hedged risk;
- Changing the description of the hedged item, including the designated portion, or of the hedging instrument; or
- Changing the description of how the entity would assess hedge effectiveness (IAS 39 only).

Since entities would need to make changes required by the reform to the hedged items and hedging instruments at various times, companies may need to amend a hedging relationship more than once. Hence without the relief from specific requirements in IFRS 9 and IAS 39, entities would have been required to discontinue hedge accounting solely due to changes required by the IBOR reform.

IFRS 9 and IAS 39 require the cash flow hedge reserve to be reclassified to profit or loss when the hedged cash flows are no longer highly probable. Entities need to reclassify to profit or loss the amount accumulated in the cash flow hedge reserve in the period that the hedged cash flows affect profit or loss. In the absence of relief provided in phase 2 when the entity changes the description of the hedged item, the IBOR-hedged cash flows on which the cash flow hedge reserve was based will no longer affect profit or loss. Hence amendment provides that when entity changes the description of the hedged item to reflect changes required by the reform, the amount accumulated in the cash flow hedge reserve is deemed to be based on the alternative benchmark rate. Therefore, the company reclassifies the cash flow hedge reserve to profit or loss only when the cash flows of the amended hedged item affect profit or loss. Similarly, amounts accumulated in the cash flow hedge reserve for discontinued hedge are deemed to be based on alternative benchmark reforms.

Similarly, entities apply the qualifying criteria in IFRS 9 and IAS 39 for groups of items to be eligible hedged items to the hedging relationship in its entirety. For groups of items designated as hedged items in a fair value or cash flow hedge, the hedged items could consist of items that refer to IBOR as well as items that refer to the new alternative benchmark rate. Therefore, an entity could not amend the description of the hedged risk or the hedged item to refer to only an alternative benchmark rate for the group as a whole. Hence the amendment enables entities to allocate hedged items to subgroups within the hedging relationship based on the benchmark rate being hedged. The qualifying criteria for hedged items in IFRS 9 and IAS 39 are separately applied to each subgroup.

There are certain other reliefs provided for group of items designated as hedged items and retrospective effectiveness assessment (IAS 39). However, the key elements of phase 2 amendments are that the effective interest rate on financial instruments must be adjusted. The hedge accounting will continue on transition to alternative reference rates , but only to the extent that the modifications made to financial instruments are those necessary to implement IBOR Reform and that the new basis for calculating cash flows is "economically equivalent" to the previous basis. This means as a practical expedient or changes to cash flows that relate directly to the Reform to be treated as changes to a floating interest rate, i.e., the EIR is updated to reflect the change in an interest rate benchmark from IBOR to an ARR without adjusting the carrying amount. In effect, the change is treated as akin to a movement in the market rate of interest. IASB regards "economic equivalence" to be principles-based. However, as an example the economically equivalent changes would mean addition of a fixed spread to compensate for the basis difference between an existing IBOR and the alternative RFR, e.g., variable rate instrument with LIBOR + 100 basis points may be replaced with a coupon that is based on RFR plus 120 basis points, when the basis spread between IBOR and the RFR is 20 basis points. The basis difference arises mainly because the RFRs are overnight rates whereas LIBOR is a term rate, such as 3-month USD LIBOR.

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Entities need to identify and inventory all contracts that contain interest reference rates to IBOR and perform impact assessment of this transition from IBOR to ARR

There are significant disclosure requirements as a part of phase 2 to enable users of financial statements to understand the effect of interest rate benchmark reform on an entity's financial instruments and risk management strategy. An entity shall disclose the following:

- How the entity is managing the transition to alternative benchmark rates, its progress at the reporting date and the risks to which it is exposed arising from financial instruments because of the transition;
- Quantitative information about financial instruments indexed to rates yet to transition due to benchmark reform at the end of the reporting period, disaggregated by significant interest rate benchmark and showing non-derivative financial assets, non-derivative liabilities and derivatives separately; and

- the extent to which changes to an entity's risk management strategy have occurred due to the risks identified in the transition.

The Phase 2 Amendments are effective for annual periods beginning on or after 1 January 2021, with earlier application permitted. Application of the Phase 2 Amendments is mandatory, to ensure comparability.

IBOR developments in India and reporting considerations

In India, Reserve Bank of India has been participating in and monitoring global developments related to LIBOR transition and has tasked the Indian Banks' Association (IBA) to consult on relevant issues. The IBA has formed three workstreams on (i) LIBOR transition arrangements, (ii) rates and methodology and (iii) outreach to market participants. The working group is represented by participants from IBA, Fixed Income Money Market and Derivatives Association of India (FIMMDA), Foreign Exchange Dealers' Association of India (FEDAI), Financial Benchmarks India Pvt Ltd (FBIL), Domestic banks, Foreign Banks, Legal firms, etc.

Further, IBA has also conducted survey with Mumbai Interbank Forward Offer Rate (MIFOR) market players and circulated a guidance note among its member banks to enable them assess their preparedness for LIBOR transition on various parameters, viz., exposure assessment and assessment of the accounting, tax, information technology (IT) related implications.

Accounting and reporting considerations Indian context

Like the initiative taken by IASB to ensure smooth accounting transition from IBOR to RFR. The Ministry of Corporate Affairs (MCA) amended the Companies (Indian Accounting Standards) Amendment Rules, 2020 through notification G.S.R. 463 dated 24 July 2020 to address the accounting challenges due to Uncertainty arising from interest rate benchmark reform. The reliefs are like those provided by IASB through Phase 1 for pre replacement issues. The amendments are effective for annual reporting periods beginning on or after 1 April 2020. Entities need to identify and inventory all contracts that contain interest reference rates to IBOR and perform impact assessment of this transition from IBOR to ARR. Globally we have observed that entities have disclosed the notional value of derivatives (e.g., Interest Rate Derivatives) impacted by IBOR reform but which are not used in designated hedge accounting relationships. Similarly hedge accounting relationships that are affected by phase 1 and phase 2 amendments are presented on balance sheet in the respective captions separately. Generally, the amounts disclosed are nominal value of the transactions outstanding at the balance sheet date and they do not represent amount at risk.

Like IASB the Ind AS amendment under Ind AS 8 provides exemption for disclosure required below as per paragraph 28(f).

When initial application of an Ind AS has an effect on the current period or any prior period, paragraph 28(f) of Ind AS 8 requires an entity to disclose, in respect of current period and each prior period presented, to the extent practicable, the amount of adjustment;

a) For each financial statement line item affected; and

b) If Ind AS 33, Earnings per share, applies to the entity, for basic and diluted earnings per share.

As per the amendment, an entity is not required to present the quantitative information required by paragraph 28(f) on Ind AS 8, in the reporting period in which it first applies interest rate benchmark reform.

However, following disclosures are required as per amendments to Ind AS 107 are to be made by an entity in respect of hedging relationships to which it applies the exceptions provided under Ind AS 109 Interest Rate Benchmark Reforms:

a) The significant interest rate benchmarks to which the entity's hedging relationships are exposed

b) The extent of the risk exposure the entity manages that is directly affected by the interest rate benchmark reform

c) How the entity is managing the process to transition to alternative benchmark rates

d) a description of significant assumptions or judgements the entity made in applying these paragraphs (for example, assumptions or judgements about when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows); and

e) The nominal amount of the hedging instruments in those hedging relationships

Impact

Entities need to identify and inventory all contracts that contain interest reference rates to IBOR and perform impact assessment of this transition from IBOR to ARR. If they are availing practical relief given in Ind AS 107, they should ensure appropriate disclosures as required by Ind AS 107 are given.

4 MCA releases report on Business Responsibility and Sustainability Reporting

Since FY 2019-20, SEBI has mandated the top 1000 listed companies by market capitalization to file their Business Responsibility Reports (BRR) annually to the stock exchanges as part of their annual reports. The BRR is required to be prepared as per SEBI prescribed format, which is based on business responsibility principles defined under the "National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business" (NVGs) framed by the Ministry of Corporate Affairs (MCA) in 2011.

In March 2019, the MCA revised and released the NVGs in the form of the "National Guidelines on Responsible Business Conduct" (NGRBC) in order to align them with emerging global concerns such as the Sustainable Development Goals (SDGs) and the United Nations Guiding Principles on Business & Human Rights (UNGPs) and also to incorporate an Environmental, Social and Governance (ESG) perspective. Subsequently, in August 2020, the MCA Committee released a report recommending the adoption of new format of BRR by listed and unlisted companies. The new format is termed as Business Responsibility and Sustainability Report (BRSR) and comprises of two versions – Comprehensive format and Lite format, along with their corresponding guidance notes.

In light of the SEBI Board Minutes and MCA Committee report, the Securities and Exchange Board of India (SEBI) issued a consultation paper on 18 August 2020, proposing the implementation of BRSR format for top 1000 listed companies by market capitalization.

Key requirements

- The SEBI press release said the BRSR will be applicable to the top 1000 listed entities (by market capitalization), for reporting on a voluntary basis for FY 2021 – 22 and on a mandatory basis from FY 2022 – 23. SEBI has proposed to make the BRSR Comprehensive format applicable to the top 1000 listed entities by market capitalization. It has further proposed that to begin with, the new format will be adopted by such listed entities on a voluntary basis for the FY 2020 – 21 (for those who choose not to adopt the new format, the existing BRR format will apply) and mandatorily from the FY 2021-22.
- The BRSR Comprehensive format contains significantly enhanced reporting requirements over the existing BRR format. New questions pertain to both quantitative performance data as well as descriptive elements related to management approach, strategy and governance around ESG issues and the nine principles of NGRBC.
- The MCA Committee report has recommended that BRSR reporting requirement be extended by the MCA to unlisted companies in a phased manner. A BRSR Lite format has been proposed for smaller companies would need time to adapt to these reporting requirements. Unlisted companies below a specified threshold of turnover or paid-up capital (to be specified by MCA) may adopt the Lite version of the format, on a voluntary basis. No timeframe or applicability threshold have been announced yet.

Chaitanya Kalia
Partner and National Leader
Climate Change and Sustainability Services (CCaSS), EY India

For companies who are already publishing sustainability disclosures using other global frameworks (e.g. Global Reporting Initiative Standards) in a voluntary manner, the new BRSR format may not pose significant reporting challenges. Their mature sustainability governance and processes should largely be able to help meet the proposed reporting requirements

- Annual BRSR reporting is proposed to be integrated with reporting under the Companies Act, 2013 on the MCA21 portal, preferably in XBRL format.
- It is proposed that BRSR will form the basis of a Business Responsibility and Sustainability Index, providing stakeholders with comprehensive assessment and relative ranking of companies based on their performance on ESG issues and principles of responsible conduct.

Impact

- For companies who are already publishing sustainability disclosures using other global frameworks (e.g. Global Reporting Initiative Standards) in a voluntary manner, the new BRSR format may not pose significant reporting challenges. Their mature sustainability governance and processes should largely be able to help meet the proposed reporting requirements.
- However, for companies whose sustainability disclosures are limited to the existing format of BRR, and smaller entities who are yet to systematically implement sustainability measures may require significant preparatory work in order to fulfil proposed BRSR requirement. Such companies should consider adopting a comprehensive sustainability strategy and interventions that will support them in declaring adherence to ESG issues and principles of responsible business conduct.
- On account on continually widening coverage of ESG / sustainability issues and corresponding key performance indicators on which nonfinancial performance is now expected by investors and other stakeholders, it is critical for companies to adopt and/or strengthen internal reporting and data management processes, including use of digital tools which can support better analytics, accuracy and real-time decision-making on ESG issues.
- Proposed integration of BRSR with the MCA21 portal in an XBRL format, including pre-filling of certain information already reported by companies to MCA, will help in reducing duplication and effort needed by companies.
- There is currently no provision for assurance of BRSR, however getting the disclosures externally validated will help ensure that the reporting is accurate and reliable, especially in light of increased use of such information by investors and analysts as well as growing focus on ESG ratings in the capital markets.

SECTION 3:

Other regulatory changes

1 The Companies (Amendment) Act, 2020

On 28 September 2020, the Ministry of Law and Justice had issued the Companies (Amendment) Act, 2020 and made certain amendments to the provisions of Companies Act, 2013 (the Act). The amendments are based on the Company Law Committee recommendations which was set up under the Chairmanship of Mr. Injeti Srinavas on 18 September 2019. The following are the significant amendments which were introduced:

A. Financial results of the Company on a periodical basis

A new section 129A is inserted under Companies Act, under which the Central Government may, require such class or classes of unlisted companies, as may be prescribed:

(i) To prepare the financial results of the company on such periodical basis and in such form as may be prescribed;

(ii) To obtain approval of the board of directors and complete audit or limited review of such periodical financial results in such manner as may be prescribed; and

(iii) File a copy with the registrar within period of 30 days of completion of the relevant period with such fees as may be prescribed.

Impact

The listed companies are required to prepare the financial results as per the Listing Obligation and Disclosure requirements on periodic basis (quarterly/ half yearly). Pursuant to Section 129A, in addition to the annual financial statement, certain unlisted companies would be required to prepare financial results on periodic basis and get audited or limited review for submission to registrar. The criteria for deciding the class of unlisted companies and periodicity is yet to be notified by the central government. Unlisted companies will need to gear up their financial statements to enable interim reporting.

B. Definition of listed company

Section 2, Subsection 52 of Companies Act 2013 is amended to include that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

Impact

Pursuant to amendment in Companies Act, 2013 for definition of listed company, certain companies may not be considered as listed Companies. SEBI also defines the listed entity in the SEBI LODR. Change in definition would have impact in certain compliances as to be prescribed by Central Government and SEBI.

C. Rationalization of penalties and re-categorization/ decriminalization of certain compound offences:

The Companies (Amendment Act) 2020 has multiple amendments to decriminalize and rationalize certain offences under the Companies Act, 2013 in case of defaults which can be determined objectively and which otherwise lack any element of fraud or do not involve larger public interest. Based on recommendations made by CLC Committee significant amendments have been made to compoundable offences under Companies Act 2013. The amendments are relating to:

- Reduction of amount of monetary penalty
- Omitting punishment with imprisonment
- Penal provisions removed
- Re-categorizing of offences from compoundable offences to inhouse adjudication framework
- Amendment relating to adjudication, compounding and others

Impact

The amendments would help in reducing the amount of penalties based on rationalization of offences, this would also reduce the burden on the special courts of India by recategorization of offences and related penalties.

2 The Companies (Share Capital and Debentures) Amendment Rules, 2020

As per Rule 8 of the Companies (Share Capital and Debentures) Rules 2014, a company cannot issue sweat equity shares beyond 25% of its paid-up equity capital at any time. However, a start-up company enjoys an exemption, whereby a start-up is allowed to issue sweat equity shares up to 50% of its paid-up equity capital up to five years from the date of its incorporation or registration. The MCA on 5 June 2020 amended the provisions of Companies (Share Capital and Debentures) Rules, 2014 and provided further relief to start-ups by extending the time period from 5 years to 10 years from date of incorporation or registration.

Impact

The Start-up companies can issue sweat equity shares up to 10 years from the date of its incorporation or registration.

3 Deferment of the Companies (Auditor's Report) Second Amendment Order, 2020

In exercise of the powers conferred by sub-section (11) of section 143 of the Companies Act, 2013 (18 of 2013), the Central Government on 17 December 2020 have deferred the applicability of Companies (Auditor's Report) 2020 for one year and the order is now applicable from 1 April 2021.

(Refer Annexure A for the summary of the changes)

Impact

The Companies (Auditor's Report) 2020 would be applicable for Company from 1 April 2021, i.e., for FY ended March 2022 onwards, company should gear up their financial reporting process and internal financial control to ensure compliance with requirements of CARO 2020.

Dilpesh Chouhan
Director, Financial Accounting Advisory Services (FAAS), EY India

The government's announcement to defer CARO 2020 is a big relief for Indian corporates and auditors since all companies are grappling with uncertainties due to the outbreak of Coronavirus. However, it is important for companies to focus on new requirements as CARO 2020 will apply to all transactions from 1 April 2021. They should stress-test their systems and processes to ensure that the requisite information is compliant with CARO 2020.

4 Key changes to Securities and Exchange Board of India (SEBI) Regulations

A. Disclosure of material impact of COVID-19 pandemic on listed entities under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations"/ "LODR")

Key requirements

SEBI has issued a circular encouraging listed entity to evaluate the impact of the COVID-19 pandemic on their business, performance and financials, both qualitatively and quantitatively, to the extent possible and disseminate the same.

SEBI circular provides an illustrative list of information that listed entities may consider disclosing, subject to the application of materiality. Such list is reproduced below:

- Impact of the COVID-19 pandemic on the business
- Ability to maintain operations including the factories/units/office spaces functioning and closed down
- Schedule, if any, for restarting the operations
- Steps taken to ensure smooth functioning of operations
- Estimation of the future impact of COVID-19 on its operations
- Details of impact of COVID-19 on listed entity's –
  - Capital and financial resources
  - Profitability
  - Liquidity position
  - Ability to service debt and other financing arrangements
  - Assets
  - Internal financial reporting and control
  - Supply chain
  - Demand for its products/services
- Existing contracts/agreements where non-fulfilment of the obligations by any party will have significant impact on the listed entity's business
- Other relevant material updates about the listed entity's business

The above list is only illustrative and not exhaustive. Further, to have continuous information about the impact of COVID-19 on operations, listed entities may provide regular updates, as and when there are material developments.

Additionally, while submitting financial statements under Regulation 33 of the LODR, listed entities may specify/ include the impact of the COVID-19 pandemic on their financial statements, to the extent possible.

The provisions of the circular are effective from 20 May 2020.

Impact

Company should ensure appropriate disclosures are furnished as required by SEBI circular. This may have consequential impact on disclosures for material changes in financial ratios as required by SEBI LODR.

B. Direct listing: opening overseas opportunities for Indian companies

Key requirements

On 4 March 2020, the Union Cabinet has approved the Companies (Second Amendment) Bill, 2019 to amend the Companies Act, 2013. These include as many as 72 changes in 65 sections of the act. Once these enabling provisions are enacted into law, it would allow Indian companies to directly list on certain foreign stock exchanges.

Veenit Surana
Director, Financial Accounting Advisory Services (FAAS), EY India

Overseas listing is expected to increase the competitiveness of Indian companies in terms of access to deeper and diversified pools of capital, lower cost of capital, broader investor base, better valuations and in turn, boost the India brand globally.

At present, Indian companies can access the foreign equity markets only through depository receipts (e.g., American Depository Receipts or Global Depository Receipts regime) or by listing their debt securities (such as, foreign currency convertible bonds, masala bonds, etc.) on foreign markets.

These enabling provisions are all directed towards enhancing the ease of doing business and providing access to global capital.

In December 2018, the Securities and Exchange Board of India (SEBI) Expert Committee, in its report, made recommendations for a suitable framework for listing equity shares incorporated in India on foreign stock exchanges and companies incorporated outside India on Indian stock exchanges. It referred to a list of 10 permissible jurisdictions and specified stock exchanges. These include the US, China, Japan, South Korea, the UK, Hong Kong, France, Germany, Canada and Switzerland.

Further in October 2019, SEBI also issued a circular outlining the framework for issue of depository receipts.

Historically, many companies might have chosen to incorporate overseas with an intention to list directly on foreign exchanges. The proposed amendments now encourage companies to incorporate domestically and reduce their regulatory burden. Additionally, existing unlisted Indian companies, who may prefer listing only on overseas stock exchanges, for e.g., companies focusing on technology or innovation, may seek to further their readiness for listing.

While the details of the Indian framework for enabling such direct listing is awaited (to be finalized by the Ministry of Finance in consultation with the Ministry of Corporate Affairs, Reserve Bank of India and SEBI), it typically takes a company 18-24 months to prepare for the listing and the time is ripe now. Such enterprise-wide preparations need to include factors such as which market, strategy, governance, quality of financial information a company needs to be ready for public market scrutiny and long-term success. It also requires companies to enhance the existing systems, processes, taxation and compliances while preparing for an IPO.

Most of the overseas stock exchanges including the ones in the US, Singapore and London do permit or accept International Financial Reporting Standards (IFRS) as a framework for financial reporting. They instead focus on internal control over financial reporting. The markets in US provide certain relaxation for emerging growth companies which are typically defined as a company with a turnover of less than USD1 billion.

Impact

Overseas listing is expected to increase the competitiveness of Indian companies in terms of access to deeper and diversified pools of capital, lower cost of capital, broader investor base, better valuations and in turn, boost the India brand globally. It may also facilitate better benchmarking between peers, promote best practices and cross-border collaboration.

5 Amendment in Schedule III of Companies Act 2013

The Ministry of Corporate Affairs (MCA) has amended Schedule III of the Companies Act, 2013 on 24 March 2021. Schedule III provides general instructions for preparation of Financial Statement of a company classified under Division I (Indian GAAP) and Division II & III (Ind AS). Broadly, changes have been made to align the Schedule III with recent changes around CARO and CSR amendments.

Key changes with respect to presentation and disclosure of balance sheet are:

- Current maturities of long-term borrowings - shall be disclosed separately under "Short term borrowing" instead "Other current liabilities"
- Security deposits to be presented as "Other non-current assets" instead "Long term loans and advances" presently
- Promoters shareholding along with changes during the year (under "Share Capital")
- Ageing schedule of trade payables – with segregation between:]1) MSME and others; and 2) Disputed and undisputed
- Ageing schedule of trade receivables – with segregation between: 1) Considered good and doubtful; and 2) Disputed and undisputed receivables
- Ageing of CWIP (for tangible and intangible asset development), including completion schedule in case of delayed or overrun projects
- Information on immovable property whose title deeds are not held in name of the company
- Details of benami property held
- Loans and advances to related parties, promotors, directors and KMP's
- Capital WIP and intangible assets under development
- Utilization of Borrowed funds and share premium

Key changes with respect to presentation and disclosure of profit & loss are:

- Undisclosed income
- CSR expenditure
- Crypto currency or virtual currency

Key additional general disclosures are:

- Details by declared wilful defaulter
- Relationship and transactions by company with struck off companies
- Compliance with number of layers of companies
- Key financial ratios, including their definitions
- Compliance with approved scheme(s) of arrangements and accounting standards along with deviations, if any.

The above changes should be applicable from 1 April 2021 for the following reasons:

a) The amendments are made to align with CARO's requirement and CARO 2020 is going to be applicable for FY beginning on or after 1 April 2021

b) The amendments also align with Companies (Accounts) Rules, 2014 which are clearly applicable for FY commencing on or after 1 April 2021.

However, clarification from the MCA or ICAI are yet to be received in this regard.

Annexure

Annexure A: The Companies (Auditor's Report) Order, 2020

Key requirements

The Ministry of Corporate Affairs vide its notification dated 25 February 2020 issued the Companies (Auditor's Report) Order, 2020 (CARO 2020) in supersession of the existing the Companies (Auditor's Report) Order, 2016 (CARO 2016) after consultation with National Financial Reporting Authority (NFRA) constituted under section 132 of the Companies Act, 2013.

Every report made by the auditor under section 143 of the Companies Act, 2013 on the accounts of every company audited by them, to which this order applies, for the FY commencing on or after the 1 April 2021, must contain a report on matters specified in paragraphs 3 and 4 of the CARO 2020. This order is called the **Companies (Auditor Report) Order, 2020**.

Applicability:

It applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013 (18 of 2013).

Exceptions

(i) A banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949).

(ii) An insurance company as defined under the Insurance Act, 1938 (4 of 1938).

(iii) A company licensed to operate under section 8 of the Companies Act, 2013.

New reporting requirements	
Going concern	Auditor to consider financial ratios, ageing and expected dates of realization of financial assets/payment of financial liabilities, other information and their knowledge of Board of Directors and management plans; and Opine on whether any material uncertainty exists as on the date of audit report that a company is capable of meeting its liabilities existing at the balance sheet date as and when they fall due within a period of one year from the balance sheet date.
Cash losses	Has the company incurred any cash losses in the current FY and in the immediately preceding FY and the amount of such cash losses. This requirement has been reinstated from CARO 2003.
Default in repayment of loans	Increased reporting requirements on: ▶ Default in repayment of loans and interest thereon from any lender in the prescribed format, unlike only banks, financial institutions, government or debenture holders in CARO 2016. ▶ Declaration of willful defaulter by any bank or financial institution or other lender. ▶ Whether term loans were applied for the purpose for which it was obtained and the amount of diverted funds and the purpose for which such funds are used. ▶ Short-term funds utilized for long term purposes. This requirement has been reinstated from CARO 003. ▶ Any funds obtained from any entity/ person on account of or to meet the obligations of its subsidiaries, associates or joint ventures. ▶ Loans raised during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies; details to be reported and if the company has defaulted in repayment of such loans raised.
Working capital loans	New reporting on whether quarterly returns or statements filed with banks or financial institutions on the basis of current assets security for sanctioned working capital limits in excess of INR5 crores in aggregate are in agreement with the books of account, and if not, details to be reported.

New reporting requirements	
Investments, guarantees, loans and advances	If the company has made investments in, provided guarantees or security in addition to loans or advances in the nature of loans, secured or unsecured, to any entity (as against the parties covered under Section 189 of the Companies Act, 2013 in the erstwhile clause), additional reporting is required for: ▶ Loans or advances in the nature of loans granted, guarantees provided or security given to any other entity (applicable to all companies other than those who are in the principal business of giving loans). If so, the company is required to report the aggregate amount during the year and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security to (a) subsidiaries, joint ventures and associates and (b) other parties, separately. ▶ Whether investments made, guarantees provided, security given and the terms and conditions of the grant of all loans and advances in the nature of loans and guarantees provided are prejudicial to the company's interest. ▶ Any loan or advance in the nature of loan granted, which has fallen due during the year, has been renewed or extended or fresh loans granted to settle the overdues of existing loans given to the same parties, additional disclosure with respect of renewal of loans /extension of loans/ existing loans settled by granting fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year is required to be made (not applicable to companies whose principal business is to give loans). ▶ The company that has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, reporting on the aggregate amount and percentage, thereof on the total loans granted and their aggregate amount granted to promoters as well as related parties as defined in section 2(76) of the Act.
Property plant and equipment (PP&E)	▶ New reporting on maintenance of proper records showing full particulars of intangible assets. ▶ Additional disclosures and reporting requirements for revaluation of PP&E (including Right-of Use assets) and intangible assets undertaken during the year. Specific reporting on revaluation of 10% or more in aggregate net carrying value of each class of PP&E or intangible assets and reporting as to whether such revaluation is based on the valuation by a registered valuer. ▶ Proceedings initiated or pending against the company for holding any benami property defined under the Benami Transactions (Prohibition) Act, 1988.
Core investment companies, nonbanking financial companies and housing finance companies	▶ Any non-banking financial or housing finance activity conducted before obtaining a certificate of registration. ▶ Whether a company is a core investment company (CIC) or exempted or unregistered CIC and continues to fulfil such criteria. ▶ Total number of CICs which are part of a group, in case, the number of CIC is more than one.
Nidhi company	Reporting on default in payment of interest on deposits or repayment for any period.
Fraud	Whether auditor has reported under section 143(12) of the Companies Act, 2013 by filing Form ADT-4 with the Central Government. Whether whistle blower complaints received during the year by the company have been considered by the auditors.
Internal audit reports	New reporting on the internal audit system of the company being commensurate with the size and nature of the business of the company and whether reports of internal auditors considered by statutory auditor. This requirement has been reinstated from CARO 2003.
Resignation of statutory auditors	Incoming statutory auditors to report on consideration of concerns/objections raised by outgoing statutory auditor of the company.
Unrecorded income Subsequently recorded	Reporting on any transactions not recorded in the books of account but surrendered/disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 and if such unrecorded income has been recorded in the books of account during the year.

New reporting requirements	
Corporate social responsibility	▶ Compliance of second proviso to section 135(5) of the Act - transfer of unspent amount to a fund as specified in Schedule VII (other than on going project). ▶ Reporting on compliance with the provision of section 135(6) of the Act – any amount remaining unspent under section 135(5) of the Act, pursuant to any ongoing project, has been transferred to special account. It may be noted that second proviso to Section 135(5) and Section 135(6) of the Act are yet to be notified by the MCA.
Consolidated financial statements (CFS)	Qualification/adverse remarks in CARO in the audit report of companies which are consolidated in the CFS will be required to be reported.

Requirements with enhanced reporting from CARO 2016	
Loans and advances	▶ The ambit of reporting enhanced to include advances as well. In respect of loans and advances in the nature of loans, reporting on whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular. ▶ If the amount of loans and advances is overdue, the total amount that is overdue for more than 90 days has to be disclosed. Besides this, it is important to report whether reasonable steps have been taken by the company for recovery of the principal and interest.
Property, plant and equipment	▶ Aligned to the terminology used in Ind AS 16 and AS 10 on Property, Plant and Equipment instead of Fixed Assets. ▶ Clarification on reporting on title deeds of all the immovable properties (other than leasehold properties where the company is the lessee and the lease agreements are duly executed in favor of the lessee).
Inventory	Coverage and physical verification of inventory along with reporting whether discrepancies of 10% or more in the aggregate was noticed for each class of inventory and whether such discrepancies have been properly dealt in the books. Earlier, the clause required reporting with respect to only material discrepancies recorded in the books of account.
Fraud	Earlier, the reporting was restricted to fraud committed by the company or on the company by its officers or employees. Revised clause requires reporting on any fraud by the company or any fraud on the company, i.e., reporting on fraud is not limited to frauds committed by the officers or employees of the company while reporting under this clause.
Statutory dues	▶ Clarification on payment of undisputed Goods and Service Tax on account of introduction of Goods and Service Tax in India. ▶ Increase in reporting requirement with respect to all statutory dues which are disputed. Earlier the reporting was limited with respect to disputed income tax, sales tax or service tax or customs duty, excise duty or value added tax.
Deposits	▶ Slight modification has been made to the existing clause to include deemed deposits.
Preferential allotment or private placement of shares or debentures	▶ Slight modification has been made to the existing clause to provide more clarity. Previously, only specific reference to section 42 of the Companies Act, 2013 for private placement of shares or debentures and no reference made to section 62 of the Act which deals with preferential allotment.

Requirements carried forward with no modifications	
Reporting under section 185 and 186	▶ In respect of loans, investments, guarantees and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, it is important to provide the details thereof.
Cost records	▶ Whether maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained.
Nidhi company	▶ Whether the Nidhi company has complied with the net owned funds to deposits in the ratio of 1:20 to meet out the liability. ▶ Whether the Nidhi company is maintaining 10% unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability.
Related party transactions	Whether all transactions with the related parties are in compliance with section 177 and 188 of Companies Act, 2013, where applicable, and the details have been disclosed in the financial statements, as required by the applicable accounting standards.
Non-cash transactions	Whether the company has entered into any non-cash transactions with directors or persons connected with the directors and if so, whether the provisions of section 192 of the Companies Act, 2013 have been complied with.
Registration under section 45-IA of the RBI Act	Whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.
Public issue	Whether moneys raised by way of Initial Public Offer or further public offer (including debt instruments) during the year were applied for the purposes for which those were raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

Requirement not carried forward from CARO 2016	
Managerial remuneration	Subsequent to the amendment of section 197 of the Companies Act, 2013 in September 2018, the clause on reporting on managerial remuneration paid/provided in accordance with the requisite approvals mandated by the provisions of Section 197 is required to be reported under Other Legal and Regulatory Requirements section of the audit report along with CARO 2016, thereby leading to duplicity. CARO 2020 has removed the duplicity of this reporting requirement.

Impact

While CARO 2020 enhances reporting responsibilities for auditors, it has significant impact on the companies as well. Auditors will require significant information about the new clauses. In many cases, it will require reconciliation of information furnished with various lenders as well as regulators. Companies will need to beef up their internal control system so that information furnished to various regulators and lenders is subjected to the same rigor and controls as followed for financial statements. Companies need to realign their Financial Statements Close Process (FSCP) and internal control over financial reporting to ensure that information and data relating to clauses in CARO are compiled appropriately and on timely basis to avoid any adverse comments in the CARO report.

It should also be noted that new clause (xxi) in CARO 2020 will apply on the consolidated financial statements. It requires auditors of holding companies to include details of the companies and those paragraph numbers of CARO report that contain the qualification/adverse remarks by the respective auditors. Parent companies need to align the audit schedule of each of the group companies as any CARO qualification relating to subsidiary will also have impact on CARO report of parent companies.

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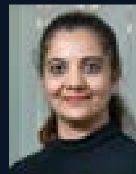

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