Accounting and Auditing Update

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Foreword

The merger of a Special Purpose Acquisition Company (SPAC) and the target company, commonly referred to as a de-SPAC transaction may pose several challenges related to accounting and financial reporting in addition to the issues encountered in a traditional IPO transaction. For instance, determination of the appropriate Generally Accepted Accounting Principles (GAAP) while preparing pre and post-merger financial statements, identification of the entity in the merger that should be treated as the acquirer for accounting purposes and accounting of share-based payment arrangements and complex financial instruments. Continuing our discussion, in this edition of Accounting and Auditing Update (AAU), we aim to cover some of the key accounting and financial reporting considerations for completion of the de-SPAC transaction.

In recent times, there has been a significant shift in focus on Indian companies' commitment towards Corporate Social Responsibility (CSR) including ensuring compliance with the relevant provisions as laid down under the Companies Act, 2013 (2013 Act) and related rules. To facilitate effective implementation of CSR provisions by companies in India, the Ministry of Corporate Affairs (MCA) has over the time made various amendments to these provisions and issued related guidance in the form of clarifications. Recently, MCA has issued certain clarifications in the form of Frequently Asked Questions (FAQs). In addition to their erstwhile clarifications, the FAQs cover recent amendments made to the CSR provisions pursuant to the Companies (Amendment) Act, 2019 and the Companies (Amendment) Act, 2020. Some of the key FAQs relate to eligible CSR activities, treatment of unspent CSR amount and surplus from CSR, impact assessment of specified projects and definition of an ongoing project. Our article summarises the key clarifications issued by MCA in this regard.

During the month, MCA has also notified amendments to the provisions relating to databank of independent directors and extended the exemption relating to mandatory online proficiency self-assessment test to certain specified individuals. For instance, individuals, who are or have been, for at least 10 years advocate of a court, in practice as a chartered accountant, cost accountant or company secretary have been exempt from the online test. Additionally, Accounting Standards Board (ASB) of Institute of Chartered Accountants of India (ICAI) through an Exposure Draft (ED) proposed certain amendments to Indian Accounting Standard (Ind AS) 1, *Presentation of Financial Statements*. The proposed amendments require companies to disclose their 'material accounting policy information' rather than their 'significant accounting policies'. Our regulatory updates section provides an overview of these and other relevant financial reporting developments in India and internationally.

We would be delighted to receive feedback/ suggestions from you on the topics we should cover in the forthcoming editions of AAU.

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Chapter 1

De-SPAC - Key accounting and financial reporting considerations

This article aims to:
Discuss key accounting and financial reporting considerations for completion of the de-SPAC transaction.

Introduction

In our previous edition, we discussed how Special Purpose Acquisition Companies (SPAC) are gaining momentum as an alternate mode of going public globally. We also covered how SPAC transactions are different from a traditional Initial Public Offer (IPO) including specific regulatory considerations in India.

The merger of a SPAC and the target company, commonly referred to as a de-SPAC transaction may pose several challenges relating to accounting and financial reporting in addition to issues encountered in a traditional IPO. This could range from determination of the appropriate GAAP while preparing pre and post-merger financial statements, identification of the entity in the merger that should be treated as the acquirer for accounting purposes and accounting of share-based payment arrangements and complex financial instruments.

Continuing our discussion, in this article we aim to cover some of the key accounting and financial reporting considerations for completion of the de-SPAC transaction. SPACs are predominantly listed in the U.S. and challenges could arise where the private operating company (target) is a foreign business historically reporting under the International Financial Reporting Standards (IFRS) or another locally accepted standard such as Indian Accounting Standards. Therefore, we will deliberate on the accounting and financial reporting issues arising in a de-SPAC transaction.

Accounting and valuation of financial instruments

A SPAC IPO is typically structured to offer investors units of securities comprising shares of common stock and warrants to purchase additional shares of common stock. The evaluation of the accounting for contracts in an entity's own equity, such as warrants issued by a SPAC, requires a careful consideration of the specific facts and circumstances for each entity and each contract.

An entity would need to assess the contractual arrangement to determine classification of the financial instrument issued in a SPAC as a financial liability or as an equity. For this purpose, it would need to consider all the terms and conditions of the financial instrument, including relevant local laws, regulations and the entity's governing charter in effect at the date of classification. Also, specific consideration would need to be given in cases where an instrument contains some contingent settlement provisions to determine whether such an instrument would qualify as a liability or as an equity.

The U.S. Securities and Exchange Commission (SEC) has issued a staff statement on 12 April 2021 regarding their evaluation of a fact pattern relating to the accounting for warrants issued in connection with a SPAC's formation. In accordance with the guidance, if the warrants include conditions that could change the settlement amount, then such a condition would preclude the warrants from being indexed to the entity's stock. Thus, in such cases, the warrants would be classified as a liability measured at fair value, with changes in fair value in each period reported in earnings.

Accordingly, careful assessment of warrant arrangements will be required to ascertain if there are terms or conditions which can cause changes in settlement amount or can impact how the settlement is calculated.

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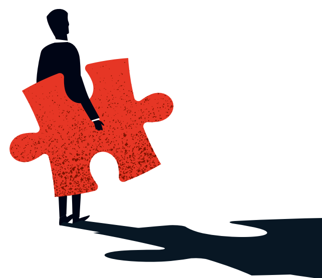
Accounting for the acquisition, reverse acquisition, or recapitalisation

In a SPAC transaction, determination of which entity is the accounting acquirer involves significant judgement. An accounting acquirer is the one which obtains control of the acquiree. Further, it may also need to evaluate whether the SPAC merger would qualify as a 'reverse acquisition'. In a reverse acquisition, the legal acquirer - i.e. the entity that issues the securities - becomes the acquiree for accounting purposes and the legal acquiree becomes the acquirer for accounting purposes. The reverse acquisition is reflected in the consolidated financial statements of the legal acquirer, but not in any consolidated financial statements of the legal acquiree. If the target is a variable interest entity, then the primary beneficiary of the variable interest entity could be considered as the acquirer. This is especially important as typically SPACs are set up to evaluate and acquire a single or multiple operating businesses and usually these businesses fold into the SPAC to survive as the continuing listed entity. The determination of the accounting acquirer requires judgement and impacts the eventual purchase price allocation and valuation of the assets of the accounting acquiree vs the legal one. This can become more complicated when a SPAC acquires multiple entities with different businesses.

In certain cases, a reverse acquisition may fall in the scope of IFRS 2, *Share Based Payments*. For example, an unlisted operating entity that meets the definition of a business may want to obtain a stock exchange listing but want to avoid a public offering. The unlisted entity arranges for a non-operating listed entity (that does not meet the definition of a business) to acquire its equity interests in exchange for the equity interests of the listed entity. In this example, the listed entity is the legal acquirer because it issued its equity interests, and the unlisted entity is the legal acquiree because its equity interests were acquired. In such a case, the guidance in IFRS 3, *Business Combinations* on identifying the acquirer applies by analogy and would result in identifying the listed entity as the accounting acquiree and the unlisted entity as the accounting acquirer. However, because the listed entity is not a business, once the acquirer has been identified, IFRS 2 applies in accounting for the transaction, instead of IFRS 3[1].



Presentation issues

- **Change in capital structure:** A typical SPAC transaction could result in the change in the capital structure. In accordance with the SEC Staff Accounting Bulletin (SAB) – Topic 4.C dated 7 March 2011, changes in capital structure after the date of the latest reported balance sheet but before the release of the financial statements must be given retroactive effect in the balance sheet. An appropriately cross-referenced note should disclose the retroactive treatment, explain the change made and state the date the change became effective.
- **Reverse acquisitions and reverse recapitalisations:** The SEC staff, in its Financial Reporting Manual – Topic 12 considered a public shell reverse acquisition to be a capital transaction in substance, rather than a business combination i.e., the transaction is equivalent to the issuance of stock by the private company for the net monetary assets of the shell corporation accompanied by a recapitalisation. The accounting could be similar to that resulting from a reverse acquisition, except that no goodwill or other intangible assets would be recorded.

  In accordance with IFRS 3 (provided the definition of business is met), consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer), with one adjustment, which is to adjust retroactively the accounting acquirer's legal capital to reflect the legal capital of the accounting acquiree. Accordingly, the consolidated financial statements reflect the following:

- The assets and liabilities of the legal subsidiary (the accounting acquirer) recognised and measured at their pre-combination carrying amounts.
- The assets and liabilities of the legal parent (the accounting acquiree) recognised and measured in accordance with IFRS 3.
- The retained earnings and other equity balances of the legal subsidiary (accounting acquirer) before the business combination.
- The amount recognised as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree).
- The non-controlling interest's proportionate share of the legal subsidiary's (accounting acquirer's) pre-combination carrying amounts of retained earnings and other equity interests.

1. Para 4.5.2360, Insights into IFRS, 17th Edition 2020/21, KPMG IFRG Limited.

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Financial reporting complexities for SPAC IPOs involving foreign operating targets including which GAAP to apply

The financial reporting requirements pre- and post-merger differ depending on whether the registrant qualifies as a US domestic registrant or as a Foreign Private Issuer (FPI). US domestic registrants present their financial statements under the US GAAP. FPIs benefit from reduced reporting obligations, compared to the US domestic registrants. For instance, FPIs can choose among US GAAP, IFRS standards, as issued by the International Accounting Standards Board (IASB), or home country GAAP (with a reconciliation to US GAAP) when preparing financial statements to be provided in SEC filings.

Some of the pre- and post-merger financial reporting issues that may arise when the target is a foreign operating company are as follows:

Merger of a US-domiciled SPAC and a foreign target: When the proxy/registration statement is filed, the merger has not yet occurred, and may not occur at all if the SPAC's shareholders do not approve. Therefore, target's financial statements can be presented under IFRS standards as issued by the IASB, or a home country GAAP with a reconciliation to the US GAAP, in the proxy/registration statement.

A foreign target may avoid converting historical US GAAP financial statements for purposes of the proxy/registration statement, but it would still need US GAAP financial statements within four business days of completing the SPAC merger. Additionally, US GAAP adjustments are needed for the Article 11 proformas. Registrants (with the support of the target's management) should be prepared to address the need to convert the foreign target's financial statements to the US GAAP, generally shown in the Article 11 proformas, as a transaction accounting adjustment. This could pose challenge considering the short start-to-finish timeline of SPAC transactions.

US GAAP conversions may significantly affect finance processes, internal controls, system configurations, and other business processes. Therefore, it is critical to identify potential US GAAP conversion requirements before or during negotiations to avoid delays during the SPAC merger process and adequately prepare the target for life as a public company and US GAAP preparer.

Merger of a foreign-domiciled SPAC and a foreign target: In certain situations, the SPAC is a foreign-domiciled company with predominantly US shareholders; therefore, it reports to the SEC as a US domestic registrant pre-merger. After a merger with a foreign target, the post-merger registrant may be able to qualify as an FPI as a result of the shareholder composition and/or its foreign nexus.

FPI status would allow the foreign target to use IFRS Standards, as issued by the IASB, in its financial statements included in both the proxy/registration statement and ongoing reporting requirements. Also, the post-merger registrant would benefit from reduced financial reporting obligations, including the option to report under IFRS Standards on an ongoing basis.

While the regulations play an important role in determining the choice of GAAP to be followed, due consideration should also be paid to the GAAP followed by the listed peer companies. In a number of instances it may be beneficial to align with the peer companies choice of GAAP even though the regulation may allow the use of IFRS or home country GAAP in order to ensure better comparability with such peer companies.

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Disclosure considerations

The SEC through its guidance dated 22 December 2020 highlighted certain disclosure considerations for SPACs, in connection with their IPOs and subsequent business combination transactions.

Some of the key disclosure considerations while presenting a business combination transaction to shareholders are as follows:

- Terms of additional financing necessary to complete the business combination and how the terms may impact the public shareholders.
- Approach taken to evaluate and decide to proceed with the identified transaction including how alternative targets may have been considered.
- Material factors that the board of directors considered in approving the identified transaction and the price paid to acquire the target operating company.
- Conflicts of interest of the sponsors, directors, officers and affiliates in presenting the opportunity to the SPAC, and how the SPAC addressed such matters.
- Qualitative and quantitative information about the consideration that the sponsors, directors, officers and their affiliates will receive upon completion of the transaction and the retained ownership they will have in the combined entity.
- Underwriting fees payable upon the completion of the business combination and the additional services the underwriter provided.

Auditing and other related considerations

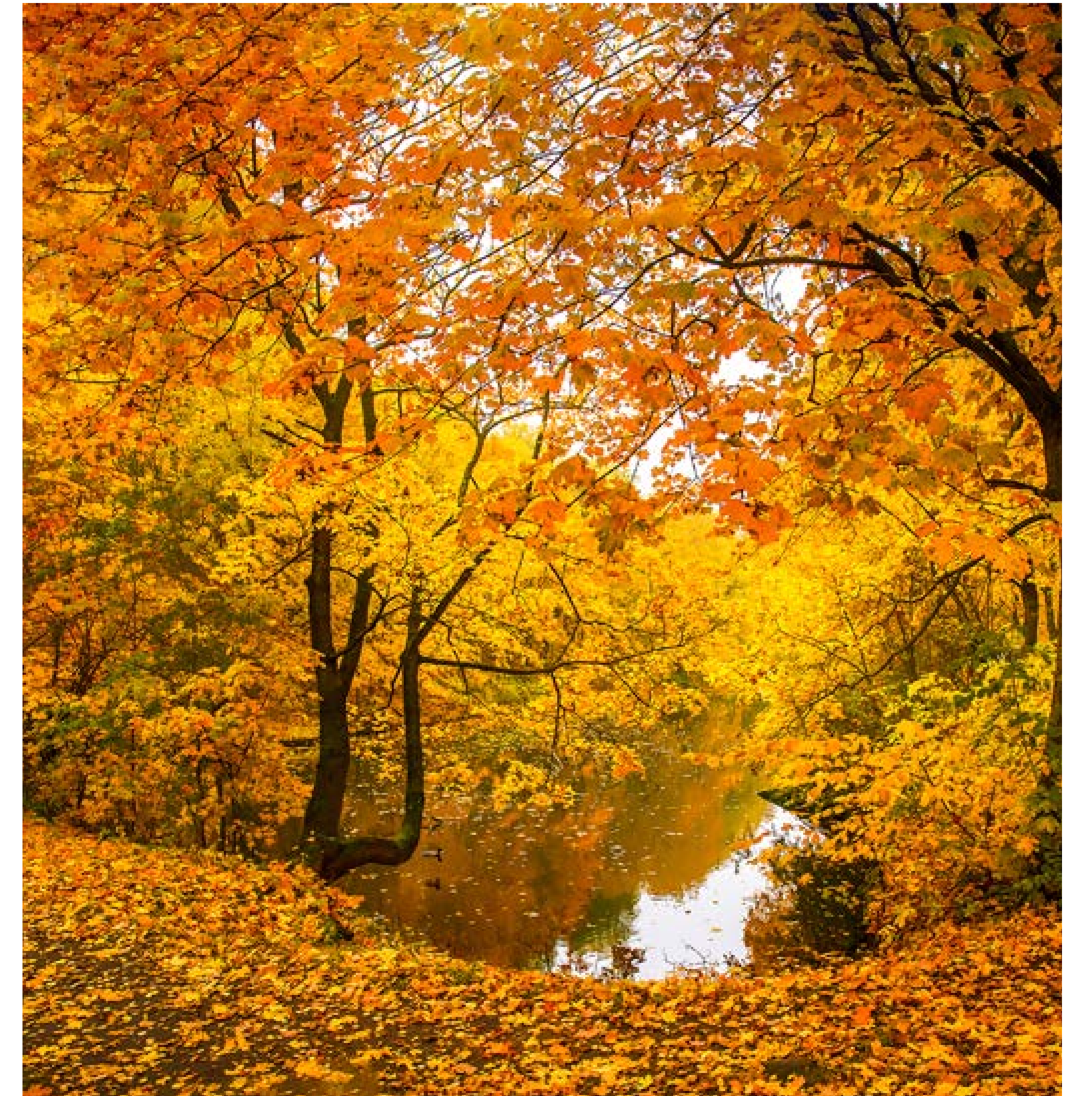
The financial statements of the target included in the proxy/registration statement must be audited under PCAOB auditing standards and by considering PCAOB[2] and SEC independence requirements. This requires careful planning and an assessment of the auditor's independence.

Auditors would need to change or augment the audit engagement team to include members with the appropriate experience in audits of operating company's financial statements.

Additionally, an auditor would also need to evaluate whether appropriate acceptance and continuance procedures have taken place when a formerly private audit client prepares to go public through a SPAC merger. Some of the other areas to be considered include reporting on critical audit matters/key audit matters, reduced materiality, enhanced risk assessment, scoping and process understanding and incremental audit quality control review procedures. To facilitate timely reporting and auditing, the combined public company should have finance and accounting professionals with sufficient knowledge of the relevant reporting requirements, including the applicable accounting requirements.

Next steps

Entities should consider the risks, complexities and challenges relating to SPAC mergers including careful consideration of the financial reporting considerations. Needless to say, quality and reliability of financial reporting and quality of audits of financial statements depends upon financial reporting participants including management, auditors and audit committee fulfiling their professional responsibilities by providing high quality information to the investors and other stakeholders.



2. Public Company Accounting Oversight Board

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Chapter 2

MCA issued FAQs on CSR provisions

This article aims to:

Summarise key clarifications issued by MCA with respect to implementation of the CSR provisions under the Companies Act, 2013.

Introduction

Corporate Social Responsibility (CSR) activities play a significant role in the nation building. The Companies Act, 2013 (2013 Act) along with the Companies (CSR Policy) Rules, 2014 (CSR Rules) governs the provisions relating to applicability and implementation of CSR activities for companies in India. In accordance with the framework laid down under the 2013 Act, companies meeting the prescribed criteria[1] are required to mandatorily contribute two per cent of their profits for the purpose of CSR. Further, Schedule VII to the 2013 Act prescribes eligible activities which can be covered in CSR policy by companies.

From the time CSR provisions have been made effective[2], significant amendments have been made to these provisions through issuance of various notifications and clarifications to streamline its implementation by companies. On 22 January 2021, the Ministry of Corporate Affairs (MCA) notified certain amendments relating to CSR under the 2013 Act and the CSR Rules pursuant to amendments made vide the Companies (Amendment) Act, 2019[3] and the Companies (Amendment) Act, 2020[4]. The amendments are aimed to strengthen the CSR ecosystem, by improving disclosures and by simplifying compliances.

Accordingly, to facilitate effective implementation of these amendments and relevant provisions of CSR by companies, on 25 August 2021, MCA has issued certain clarifications in the form of Frequently Asked Questions (FAQs). The recent FAQs supersedes the erstwhile FAQs and clarifications issued by MCA relating to CSR[5]. In this article, we will discuss the key issues relating to CSR in light of the clarification issued by MCA.

1. Every company with a net worth of INR500 crore or more, turnover of INR1,000 crore or more or a net profit of INR5 crore or more during the immediately preceding Financial Year (FY) should contribute at least two per cent of its average net profits (made during the three immediately preceding FYs) for the purpose of CSR in pursuant to its policy in this regard. (Section 135(1) of the 2013 Act)
2. CSR provisions became effective from 1 April 2014.
3. Companies (Amendment) Act, 2019 received the assent of the President of India on 31 July 2019.
4. Companies (Amendment) Act, 2020 received the assent of the President of India on 28 September 2020.
5. FAQs issued vide general circular no. 21/2014 dated 18 June 2014, general circular no. 36/2014 dated 17 September 2014, general circular no. 01/2016 dated 12 January 2016, general circular no. 05/2016 dated 16 May 2016, clarification issued vide letter dated 25 January 2018 and general circular no. 06/2018 dated 28th May 2018),

Applicability of CSR provisions

MCA through its previous notification dated 12 January 2016 has provided certain clarifications relating to the applicability of CSR provisions which have been also incorporated in the revised FAQs. These are clarifications regarding applicability of CSR provisions to a holding or subsidiary company of a CSR eligible company and Section 8 company.

In addition to these, MCA has clarified applicability of CSR provisions to a company which has not completed three years since its incorporation. Currently, Board of Directors (BoD) of every company that falls within the specified threshold[1] is required to ensure that the company spends at least two per cent of the average net profits of the company made during the three immediately preceding FYs, in every FY as per its CSR policy.

As per the clarification, if a company has not completed three FYs since its incorporation, but it satisfies any of the criteria mentioned under Section 135(1) of the 2013 Act, then also CSR provisions including spending of at least two per cent of the average net profits made during immediately preceding FY(s) would be applicable.

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CSR Framework

- **Responsibilities of the board of directors:** CSR is a board-driven process. In accordance with the clarifications, the responsibilities of the BoD of a CSR-eligible company, *inter alia*, include the following:

  a. Approve the CSR policy

  b. Disclose contents of such policy in its report and also place it on the company's website, if any

  c. Ensure that the activities included in the CSR policy are undertaken by the company

  d. Ensure that the company spends, in every FY, at least two per cent of the average net profits of the company made during the three immediately preceding FYs

  e. Satisfy itself regarding the utilisation of the disbursed CSR funds and

  f. If a company fails to spend at least two per cent of the average net profits of the company, then the board of directors shall specify the reasons for not spending the amount in the board's report. Also, it should transfer the unspent CSR amount in accordance with the provisions of Section 135(5) and 135(6) of the 2013 Act.

- **Role of the government in the approval and implementation of the CSR programmes:** The FAQs clarifies that the government has no direct role in the approval and implementation of the CSR programmes/projects of a company. BoD of a company is empowered to plan, approve, execute, and monitor the CSR activities of the company based on the recommendation of its CSR committee.

- **CSR monitoring mechanisms:** The CSR architecture is disclosure-based, and CSR-mandated companies are required to file details of CSR activities annually in MCA21 registry. Further, companies are required to make necessary disclosures in the financial statements regarding CSR including non-compliance. Therefore, as per the clarification, the existing legal provisions such as mandatory disclosures, accountability of the CSR committee and the BoD, and provisions for audit of accounts of the company provide sufficient mechanisms for monitoring the CSR process.

  It is to be noted that the government monitors the compliance of CSR provisions through the disclosures made by the companies in the MCA21 portal. Accordingly, in case of any violation with the CSR provisions, an action can be initiated by the government against such non-compliant companies as per the provisions of the 2013 Act after due examination of records and following due process of law.

  Further, non-compliance of CSR provisions has been notified as a civil wrong effective 22 January 2021 i.e. following penal provisions will be applicable in case of non-compliance with the CSR provisions:

  a. A company would be liable to a penalty of twice the amount required to be transferred by the company to the fund specified in Schedule VII of the 2013 Act or the unspent CSR account or INR1 crore, whichever is less.

  b. Every officer of the company who is in default would be liable to a penalty of one-tenth of the amount required to be transferred by a company to the fund specified in Schedule VII of the 2013 Act or the unspent CSR account or INR2 lakh, whichever is less.

CSR Expenditure

- **Administrative overheads:** In terms of Rule 7 of the CSR Rules, the board of directors of an eligible CSR company are required to ensure that the administrative overheads shall not exceed five per cent of total CSR expenditure of the company for the FY.

  Administrative overheads have been defined as the expenses incurred by a company for 'general management and administration' of CSR functions in the company. It should not include the expenses directly incurred for the designing, implementation, monitoring and evaluation of a particular CSR project or programme.

  For instance, salary and training for the employees working in the CSR division of a company, stationery cost, travelling expenses, etc. may be categorised as administrative overheads. However, salary of school teachers or other staff, etc. for education-related CSR projects shall be covered under education project cost.

  Additionally, expenses incurred by implementing agencies on the management of CSR activities shall not amount to administrative overheads and cannot be claimed by a company.

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- **Surplus from CSR activities:** In accordance with the amendments to Rule 7 of the CSR Rules notified on 22 January 2021, any surplus arising out of the CSR activities should not form part of the business profit of a company and should be ploughed back into the same project or should be transferred to the unspent CSR Account and spent in pursuance of CSR policy and as per the annual action plan of a company. It can also transfer the surplus amount to a fund specified in Schedule VII to the 2013 Act within a period of six months of the expiry of the FY.

  The FAQs define surplus as an income generated from the spend on CSR activities, e.g., interest income earned by the implementing agency on funds provided under CSR, revenue received from the CSR projects, disposal/sale of materials used in CSR projects, and other similar income sources. It further, clarifies that the surplus arising out of CSR activities should be utilised only for CSR purposes.

- **Eligible CSR activities and expenditure:** Schedule VII to the 2013 Act lays down a list of activities which are eligible for the CSR expenditure and could be included by companies in their CSR policies. MCA clarified that CSR expenditure cannot be incurred on activities beyond Schedule VII to the 2013 Act. However, it reiterated that the items enlisted in Schedule VII to the 2013 Act are broad-based and are intended to cover a wide range of activities. Thus, these prescribed activities must be interpreted liberally to capture the essence of the subjects enumerated.

  Some of the other clarifications relating to eligible CSR expenditure are as follows:

  - **Contribution to corpus of any entity:** It is not an admissible CSR expenditure in accordance with the amendments to Rule 7 of the CSR Rules notified on 22 January 2021.
  - **Creation/acquisition of a capital asset:** CSR amount may be spent by a company for creation or acquisition of a capital asset, which should be held by:

    a. A company established under Section 8 of the 2013 Act, or a registered public trust or registered society with charitable objects and CSR registration number

    b. Beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities, or

    c. A public authority[6].

    It has been clarified that expenses relating to transfer of a capital asset such as stamp duty and registration fees, will qualify as admissible CSR expenditure in the year of such transfer.

  - **Contribution to any other fund not specified in Schedule VII:** The 2013 Act does not recognise any contribution to any other fund, which is not specifically mentioned in Schedule VII, as an admissible CSR expenditure. Additionally, CSR should not be interpreted as a source of financing the resource gaps in government schemes. Accordingly, CSR funds cannot be utilised to fund government schemes. However, the board of directors of the eligible company may undertake similar activities independently subject to fulfilment of CSR Rules.
  - **Employee participation in CSR:** Involvement of employees in CSR projects of a company cannot be monetised. However, companies should be encouraged to involve their employees in CSR activities.
  - **CSR activities for benefits of employees:** Any activity benefitting employees of a company is an ineligible CSR activity in accordance with Rule 2(1)(d)(iv) of the CSR Rules. In this regard, the FAQs further clarified that any activity designed exclusively for the benefit of employees should be considered as an 'activity benefitting employees' and will not qualify as permissible CSR expenditure. However, any activity which is not designed to benefit employees solely, but the public at large, and if the employees and their family members are incidental beneficiaries, then, such an activity would not be considered as an 'activity benefitting employees'. Thus, it will qualify as an eligible CSR activity.
  - **Sponsorship activities deriving marketing benefits for a company's products or services:** Activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services are ineligible CSR activities in terms of Rule 2(1)(d)(v) of the CSR Rules.

    MCA further clarified that the intent of CSR is to encourage companies to undertake the activities in a project or programme mode rather than as a one-off event. Accordingly, companies should not use CSR purely as a marketing or brand building tool for their business, however, brand building as a collateral benefit does not vitiate the spirit of CSR.

  - **CSR expenditure in kind:** The BoD of every company shall ensure that it spends amount earmarked for CSR. Therefore, CSR contribution cannot be in kind and monetised.

6. Public authority means 'public authority' as defined in Section 2(h) of the Right to Information Act, 2005.

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- **Local area preference for CSR spend:** A company is required to give preference to local areas and the areas around where it operates for spending the amount earmarked for CSR activities in accordance with the first proviso to Section 135(5) of the 2013 Act. MCA observed that there are challenges in determination of local area in particularly with the advent of Information and Communication Technology (ICT) and emergence of new age businesses like e-commerce companies, process-outsourcing companies, and aggregator companies.

  Therefore, MCA clarifies that the preference to local area in the 2013 Act is only directory and not mandatory in nature and companies need to balance local area preference with national priorities.

- **Set-off of excess CSR amount:** The amendments made to the CSR Rules dated 22 January 2021 permits a company which spends an amount in excess of the prescribed amount of two per cent on CSR activities, to set-off excess amount against the requirement to spend up to immediately succeeding three FYs. This is subject to the fulfillment of following conditions:

  a. The excess amount available for set-off should not include the surplus arising out of the CSR activities, if any and

  b. The BoD of a company should pass a resolution to that effect.

  The MCA clarified that the provision is applicable from 22 January 2021 and has a prospective effect. Accordingly, no carry forward would be allowed for the excess amount spent, if any, in FYs prior to FY2020-21.

  Also, in case a company cannot take the benefit of set-off of excess amount spent in the previous FY because of non-applicability of CSR provisions, the excess amount will lapse at the end of immediately succeeding three FYs. For instance, a company had spent an excess CSR amount of INR2 crore in FY2020-21 and sets-off INR50 lakh in FY2021-22. However, from FY2022-23, the company is no longer subject to CSR provisions under Section 135(1) of the 2013 Act. In such a case, the company may continue to retain the remaining excess CSR amount of INR1.50 crore up to FY2023-24 and thereafter the same shall lapse.

CSR Implementation

- **Eligible implementation agencies:** A company may undertake CSR activities, *inter alia*, through eligible implementation agencies. Those are as follows:

  a. A company established under Section 8 of the 2013 Act, or a registered public trust or a registered society, registered under Section 12A and 80G of the Income Tax Act, 1961 (IT Act), established by the company, either singly or along with any other company

  b. A company established under Section 8 of the 2013 Act or a registered trust or a registered society, established by the Central Government (CG) or State Government

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

  d. A company established under Section 8 of the 2013 Act, or a registered public trust or a registered society, registered under Section 12A and 80G of the IT Act with an established track record of at least three years in undertaking similar activities.

  As per the clarification, all three types of entities i.e. a company established under Section 8 of the 2013 Act, a registered public trust, or a registered society are required to have income-tax registration under Section 12A as well as Section 80G of the IT Act to act as an implementing agency, except for any entities established by CG or State Government.

  Further, an international organisation cannot act as an implementing agency. A company can engage international organisations for the limited purposes of designing, monitoring, and evaluation of the CSR projects or programmes, or for capacity building of personnel of the company involved in CSR activities.

- **Mandatory registration of implementation agencies:** Pursuant to the amendments to the CSR Rules dated 22 January 2021, every entity (covered in point (a) to (d) under 'Eligible implementation agencies' section of this article) that intends to undertake any CSR activity should register itself with the CG by filing the Form CSR-1 electronically with the Registrar of Companies (ROC) with effect from 1 April 2021. In this regard, MCA clarified that any ongoing project which has been approved between 22 January 2021 and 31 March 2021 may be carried out by an implementing agency which is not registered on MCA21 portal.

  However, the unregistered implementing agency is required to register on MCA21 portal before undertaking any new project after 1 April 2021.

- **Disbursal of funds to implementation agencies:** The MCA clarified that mere disbursal of funds for implementation of a project to the implementation agency does not amount to spending unless the implementing agency utilises the whole amount. The CSR committee and BoD should ensure that CSR fund to be disbursed to implementing agencies, partially or wholly, in such a manner so that they can be utilised by them during the FY.

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Ongoing project

- **Definition of an ongoing project:** Rule 2(1)(i) of the CSR Rules defines an 'ongoing project' to mean a multi-year project undertaken by a company in fulfilment of its CSR obligation with timelines not exceeding three years (excluding the FY in which it was commenced). It should also include such a project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the BoD based on reasonable justification.

  MCA clarified the following with respect to an eligible 'ongoing project' for the purposes of CSR:

  a. The project should have commenced within the FY. The intent is to include a project which has an identifiable commencement and completion dates.

     After the completion of any ongoing project, the BoD of the company are free to design any other project related to operation and maintenance of such completed projects in a manner as may be deemed fit on a case-to-case basis.

  b. An ongoing project would 'commence' when a company has either issued the work order pertaining to the project or awarded the contract for execution of the project.

  c. Under no circumstances, the time period of an ongoing project should be extended beyond its permissible limit (i.e. three FYs excluding the FY in which it is commenced).

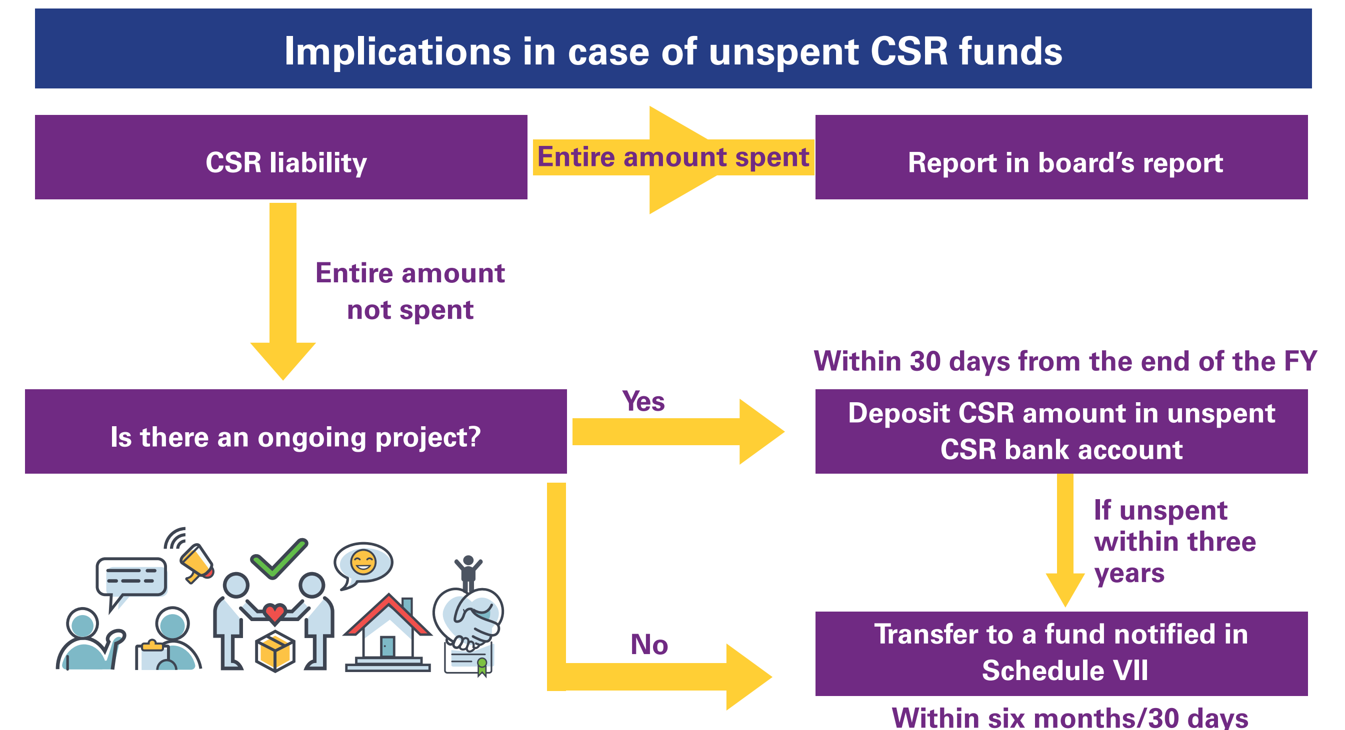
- **Ongoing project of previous FY:** The provisions relating to ongoing projects have come into effect from 22 January 2021, i.e., from FY2020-21 onwards. Therefore, an ongoing project initiated by a company in any previous FY (e.g., in FY2019-20) cannot be classified as an ongoing project under Section 135(6) of the 2013 Act.

- **Implementation of an ongoing project through an implementation agency:** Once the BoD of a company approve a project as an ongoing project, then it can choose to implement the project either itself, or through any of the eligible implementing agencies.

- **Usage of funds in another project:** As per the clarification, the budget outlay dedicated for one project can be used against another project. While doing so, the BoD and the CSR committee should appropriately record the alteration in the target spending and modify the same in accordance with the actuals.

Unspent CSR amount

In accordance with the amendments notified on 22 January 2021, a company is mandatorily required to utilise the unspent amount earmarked for CSR activities, failing which it would be transferred to a fund specified in Schedule VII to the 2013 Act as explained in the diagram below:



(Source: KPMG in India's analysis, 2021 basis the provisions notified by MCA)

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Clarifications

- When there is no ongoing project, the unspent amount should be transferred to a fund specified in Schedule VII of the 2013 Act within a period of six months from the expiry of the FY. As per the clarification, companies are not permitted to spend the unspent CSR amount on any CSR activity during the intervening period of six months after the end of the FY.
- A company is not required to open a separate 'unspent CSR account' for each ongoing project but is required to open for each FY to transfer the unspent amount with respect to ongoing project(s) of that FY.
- The unspent CSR account cannot be used by a company as collaterals or creating a charge or any other business activity. It can be used only for meeting the expenses of ongoing projects, and not for other general purposes of the company.
- The BoD of the company are free to decide the treatment of the unspent CSR amount of previous FYs prior to FY2020-21. It can either transfer the amount to 'unspent CSR account' or continue as per the previous accounting practices adopted by the company.

Impact assessment

Amendments to CSR Rules dated 22 January 2021 require every company with an average CSR obligation of INR10 crore or more (in the three immediately preceding FYs) to undertake an impact assessment of their CSR projects which meets both the conditions given below:

a. It has an outlay of INR1 crore or more and

b. It has been completed not less than one year before undertaking the impact study.

The assessment should be done through an independent agency. The impact assessment reports should be placed before the BoD and should be annexed to the annual report on CSR.

Clarifications

- **Applicability:** The company is required to undertake impact assessment of the CSR projects completed on or after 22 January 2021. However, as a good practice the BoD may undertake impact assessment of completed projects of previous FYs (i.e. prior to FY2020-21).
- **Project-wise assessment:** Impact assessment should be carried out project-wise only in cases where both the above conditions are fulfilled. In other cases, it can be taken up by the company on a voluntary basis.
- **Expenditure on impact assessment:** A company undertaking impact assessment may book the expenditure towards CSR for that FY not exceeding five per cent of the total CSR expenditure for that FY or INR50 lakh, whichever is less. Expenditure incurred on impact assessment is over and above the specified administrative overheads of five per cent.
- **Collaborative CSR implementation:** In case two or more companies choose to collaborate for the implementation of a CSR project, then the impact assessment carried out by one company for the common project may be shared with the other companies for the purpose of disclosure to the BoD and in the annual report on CSR.

  The sharing of the cost of impact assessment may be decided by the collaborating companies subject to the maximum limit specified for impact assessment (i.e. five per cent of the total CSR expenditure for that FY or INR50 lakh, whichever is less).

CSR disclosures

The board's report of a CSR eligible company pertaining to any FY should include an annual report on CSR containing specified details[7]. Also, in terms of Rule 9 of the CSR Rules, the BoD of the company is mandatorily required to disclose the following on their website, if any:

a. Composition of the CSR committee

b. CSR policy and

c. Projects approved by the BoD.

In this regard, the FAQ clarifies that in case of a CSR-eligible foreign company, the balance sheet filed under Section 381(1)(b) of the 2013 Act should include an annual report on CSR containing specified details.

Additionally, all CSR projects approved by the BoD are required to be disclosed on the website of the company, if any, for public access, irrespective of outlay and percentage to the total CSR expenditure of the company.

Conclusion

The MCA clarifications addresses various important issues, in particular those notified recently relating to eligible CSR activities, determination of an ongoing project, impact assessment, treatment of unspent CSR amount and eligibility of implementation agency. These are expected to streamline the implementation of the CSR provisions by companies in India.

7. Annexure I - Format for the annual report on CSR activities to be included in the board's report for FY commenced prior to 1 April 2020 or Annexure II - Format for the annual report on CSR activities to be included in the board's report for FY commencing on or after 1 April 2020 of the CSR Rules, as applicable.

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Chapter 3

Regulatory updates

Clarification on spending CSR funds on COVID-19 vaccination programme

The Ministry of Corporate Affairs (MCA) through a circular dated 30 July 2021 has clarified that spending funds earmarked for Corporate Social Responsibility (CSR) on COVID-19 vaccination for persons other than employees and their families, is an eligible CSR activity under the provisions of the Companies Act, 2013 (2013 Act). This will be covered under item no. (i) relating to promotion of health care including preventing health care and item no. (xii) relating to disaster management of Schedule VII to the 2013 Act.

Companies may undertake the activity subject to the fulfilment of requirements of the Companies (CSR Policy) Rules, 2014 and circulars related to CSR issued by MCA from time to time.

(Source: MCA general circular no. 13/2021 dated 30 July 2021)

Exemption from provisions relating to foreign companies

Background

Chapter XXII of the 2013 Act governs provisions relating to companies incorporated outside India. Further, the Central Government (CG) may exempt certain companies from any of the provisions of Chapter XXII of the 2013 Act in accordance with Section 393A of the 2013 Act. The exempted companies would be any class of:

a. Foreign companies

b. Companies incorporated or to be incorporated outside India, whether the company has or has not established, or when formed may or may not establish, a place of business in India.

New development

Exemption from provisions relating to a foreign company

MCA through a notification dated 5 August 2021 has exempted certain companies from compliance with the provisions of Sections 387 to 392 (both inclusive) under Chapter XXII of the 2013 Act in so far as they relate to the offering of subscription in the securities, requirements related to the prospectus, and all matters incidental thereto in the International Financial Services Centres (IFSC) set up under Section 18 of the Special Economic Zones Act, 2005 (SEZ Act). The exempted companies would be

a. Foreign companies

b. Companies incorporated or to be incorporated outside India, whether the company has or has not established, or when formed may or may not establish, a place of business in India.

Definition of a 'foreign company'

Related amendment has been made to the definition of a foreign company. Currently, Section 2(42) of the 2013 Act defines a 'foreign company' as any company or body corporate incorporated outside India which:

a. Has a place of business in India whether by itself or through an agent, physically or through an **electronic mode** and

b. Conducts any business activity in India in any other manner.

The term 'electronic mode' has been further defined under the Companies (Specification of Definitions Details) Rules, 2014 and the Companies (Registration of Foreign Companies) Rules, 2014. It means carrying out electronically based activities (whether main server is installed in India or not) including, but not limited to specified transactions which, *inter alia*, include offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India.

MCA through notifications dated 5 August 2021 has clarified that electronic based offering of securities, subscription thereof or listing of securities in the IFSC set up under Section 18 of the SEZ Act shall not be construed as an 'electronic mode' for the purpose of Section 2(42) of the 2013 Act.

Effective date: The provisions are effective from the date of their publication in the official gazette i.e. 5 August 2021.

(Source: MCA notification no. S.O. 3156(E), G.S.R. 538(E) and G.S.R. 539(E) dated 5 August 2021)

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Provisions relating to databank of independent directors

Annual report on capacity building of an independent director

The MCA through a notification dated 19 August 2021 has issued an amendment to the Companies (Creation and Maintenance of databank of Independent Directors) Rules, 2019 (Databank Rules) which inserted a new provision in the Databank Rules. In accordance with the newly inserted provision, the Indian Institute of Corporate Affairs (institute) will send an annual report on the capacity building of an independent director within 60 days from the end of every financial year to the following:

- Every individual whose name is included in the databank and
- Every company in which such individual is appointed as an independent director.

The format of annual report has been enclosed in the notification. The format requires the institute to report on e-learning models, training programmes and workshops/events that have been attended by the independent directors registered with the institute during the financial year and total participation till date.

Effective date: The amendment is effective from the date of its publication in the official gazette i.e. 19 August 2021.

(Source: MCA notification no. G.S.R.580 (E) dated 19 August 2021)

Persons exempt from online proficiency self-assessment test

Rule 6(4) of the Companies (Appointment and Qualification of Directors) Rules, 2014 requires every individual whose name is included in the databank of independent directors to pass an online proficiency self-assessment test conducted by the institute within a period of two years from the date of inclusion of his/her name in the databank, failing which his/her name would be removed from the databank. However, certain individuals are exempt from the online proficiency self-assessment test.

Those, *inter alia*, include persons who have served for a total period of three years or more as on date of inclusion of name in databank as a director or above **in the MCA, the Ministry of Finance, Ministry of Commerce and Industry or the Ministry of Heavy Industries and Public Enterprises with experience in handling the matters relating to corporate laws or securities laws or economic laws.**

Amendment

MCA through a notification dated 19 August 2021 has amended Rule 6(4) of the Companies (Appointment and Qualification of Directors) Rules, 2021. As per the amendments, following persons are exempt from passing the online proficiency self-assessment test conducted by the institute:

a. Individuals who have served for a total period of three years or more as on date of inclusion of name in databank in the pay scale of director **or equivalent** or above in **any Ministry or Department of the CG or any State Government,** with experience in handling:

- **The matters relating to commerce, corporate affairs, finance, industry or public enterprises or**
- **The affairs related to government companies or statutory corporations set up under an Act of Parliament or any State Act and carrying on commercial activities.**

(Emphasis added to highlight the changes)

b. Individuals, who are or have been, for at least 10 years (newly inserted):

- An advocate of a court
- In practice as a chartered accountant
- In practice as a cost accountant or
- In practice as a company secretary.

Effective date: The amendments are effective from the date of its publication in the official gazette i.e. 19 August 2021.

(Source: MCA notification no. G.S.R.579(E) dated 19 August 2021)

SEBI board meeting

SEBI in its board meeting dated 6 August 2021 took some key decisions pertaining to the following:

- **Merger of SEBI (Issue of Sweat Equity) Regulations, 2002 and SEBI (Share Based Employee Benefits) Regulations, 2014 into a single regulation - SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021:** Some of the key provisions of the new regulations are as follows:

  a. Companies will be allowed to provide share-based employee benefits to employees who are exclusively working for such company or any of its group companies including its subsidiary or its associate.

  b. Minimum vesting period and lock-in period for all share benefit schemes in the event of death or permanent incapacity (as defined by the company) of an employee to be dispensed with.

  c. Companies will have flexibility in switching the administration of their schemes from the trust route to the direct route and vice-versa with the approval of the shareholders, subject to the condition that the switch is not prejudicial to the interest of the employees.

  d. Maximum yearly limit of sweat equity shares that can be issued by a listed company has been prescribed at 15 per cent of the existing paid-up equity share capital within the overall limit not exceeding 25 per cent of the paid-up capital at any time.

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- **Review of regulatory framework for promoter, promoter group and group companies:** SEBI has agreed in-principle to the proposal for shifting from the concept of promoter to 'person in control' or 'controlling shareholders' in a smooth, progressive and holistic manner. In this regard, SEBI will undertake following measures:

  a. Engage with other regulators to ascertain and resolve regulatory hurdles, if any.

  b. Prepare draft amendments to securities market regulations and analyse impact of the same.

  Further, it will deliberate at the Primary Market Advisory Committee (PMAC) and develop a road map for implementation of the proposed transition.

(Source: SEBI press release PR No. 24/2021 dated 6 August 2021)

Amendments to SEBI Regulations

Listing Regulations

SEBI through its notifications made certain amendments to the relevant provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations). The key amendments relate to the following:

Independent Directors (IDs)

- **Eligibility of IDs:**

  a. *Cooling-off period for IDs with pecuniary relationship:* SEBI has extended the cooling-off period for a material pecuniary relationship between an ID and the related entities to three years (earlier two years).

  b. *Restriction on being a KMP in a company belonging to promoter group:* An individual or his/her relative should not hold or have held the position of a Key Managerial Personnel (KMP) or be or have been an employee of the listed entity, its holding, subsidiary or associate company or **any company belonging to the promoter group.**

- **Appointment, re-appointment and resignation:**

  a. *Special resolution for appointment, re-appointment and removal of IDs:* Appointment, re-appointment or removal of an ID of a listed entity would be subject to the approval of the shareholders by way of a special resolution.

  b. *Transparency in the appointment process:* Nomination and Remuneration Committee (NRC) is required to perform the following while selecting a candidate for the role of an ID.

     i. Evaluate the balance of skills, knowledge and experience on the board of directors and on the basis of such evaluation, prepare a description of the role and capabilities required of an ID. The person recommended to the board of directors for appointment as an ID should have the capabilities identified in such description.

     ii. For the purpose of identifying suitable candidates, NRC may use the services of an external agency, if required, consider candidates from a wide range of backgrounds, with due regard to diversity, and consider the time commitments of the candidates.

     iii. The notice for appointment of a director to be sent to the shareholders should, *inter alia*, include skills and capabilities required for appointment of the ID and how the proposed person meets the requirement of the role.

  c. *Timelines for filling vacancy and approval of IDs appointed by board of directors:* Vacancy of an ID, as a result of resignation or removal from the board of directors to be filled **within three months from the date of such vacancy** (earlier later of immediate next meeting of the board of directors or three months from the date of such vacancy).

- **Composition of an audit committee:** Currently, listed entities are required to constitute a qualified and an independent audit committee subject to the prescribed conditions which, *inter alia*, include a requirement to appoint two-third of the members of audit committee as IDs. In case of a listed entity with outstanding SR equity shares, the audit committee should only comprise of IDs.

  The amendment has clarified that at least two-third of the members of audit committee should be IDs.

- **Amendment in composition of NRC:** Currently, board of directors of listed entities are required to constitute the NRC which should comprise of:

  a. At least three directors

  b. All directors should be non-executive directors and

  c. At least 50 per cent of the directors should comprise of IDs. In case of a listed entity with outstanding SR equity shares, two-thirds of the NRC should comprise of IDs.

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As per the amendment, at least two-thirds of the directors of the NRC should be IDs.

- **Related Party Transactions (RPTs):** All RPTs are required to be approved by only IDs on the audit committee.
- **Directors and Officers (D&O) insurance:** Top 1,000 listed entities by market capitalisation are required to undertake D&O insurance for all their IDs.

Effective date: These amendments will be applicable to listed entities effective 1 January 2022.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2021/35 dated 3 August 2021)

Disclosure of shareholding pattern of promoters and promoter group entities

A listed entity is required to submit a statement showing holding of securities and shareholding pattern separately for each class of securities to the stock exchange(s) in accordance with Regulation 31 of the Listing Regulations. Further, all entities falling under promoter and promoter group should be disclosed separately in the shareholding pattern appearing on the website of stock exchanges, in accordance with the format(s) specified by SEBI.

Currently, the shareholdings of promoter(s) and promoter group entities are collectively disclosed under 'Table II - Statement showing shareholding pattern of the promoter and promoter group' of the format specified by SEBI through its circular dated 30 November 2015.

Amendment

SEBI through a circular dated 13 August 2021 has issued revised format of 'Statement showing shareholding pattern of the promoter and promoter group'. As per the revised format, all listed entities will be required to provide such shareholding, segregated into promoter(s) and promoter group.

(Source: SEBI circular no. SEBI/HO/CFD/CMD/CIR/P/2021/616 dated 13 August 2021)

Amendments to provisions relating to debt listed entities

SEBI through a notification dated 13 August 2021 has made certain amendments with respect to an entity which has listed its Non-Convertible Debt Securities (NCDS) or Non-Convertible Redeemable Preference Shares (NCRPS) or both (debt listed entity). The key amendments are as follows:

- **Disclosure with financial results:** The amendments have omitted the requirement of making following disclosures by a debt listed entity along with the half-yearly/annual financial results as required under Regulation 52 of the Listing Regulations:
  a. Credit rating and change in credit rating, if any
  b. Asset cover available in case of NCDS
  c. Previous due date for the payment of interest/dividend for NCRPS/repayment of principal of NCRPS/NCDS and whether the same has been paid or not
  d. Next due date for the payment of interest/dividend of NCRPS/principal along with the amount of interest/dividend of NCRPS payable and the redemption amount.
- **Other submissions to stock exchanges:** The requirement of submitting an undertaking to the stock exchange(s) on an annual basis stating that all documents and intimations required to be submitted to debenture trustees in terms of trust deed and SEBI (Issue and Listing of Debt Securities) Regulations, 2008 have been complied with, has been omitted.

Effective date: The amendments are effective from the date of its publication in the official gazette i.e. 13 August 2021.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2021/42 dated 13 August 2021)

ICDR Regulations

On 13 August 2021, SEBI issued certain amendments to the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations). Key amendments are as follows:

- **Revised definition of a 'promoter group':** Currently, Regulation 2(1)(pp) of the ICDR Regulations define promoter group to, *inter alia*, include:
  a. The promoter
  b. An immediate relative of the promoter
  c. In case promoter is a body corporate then any body corporate in which a group of individuals or companies or combinations thereof acting in concert, which hold 20 per cent or more of the equity share capital in that body corporate and such group of individuals or companies or combinations thereof also holds 20 per cent or more of the equity share capital of the issuer and are also acting in concert.

  Amendment

  The amendment omitted the requirement of including entities specified in point (c) above from the definition of promoter group.

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- **Reduction in lock-in period:**
  a. *Minimum promoters' contribution:* Lock-in period of minimum promoters' contribution has been reduced from three years to 18 months from the date of allotment in an IPO.

     However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be utilised for capital expenditure[1], then the lock-in period shall be three years from the date of allotment in an IPO.

  b. *Promoters' holding in excess of minimum promoters' contribution:* Lock-in period of promoters' holding in excess of minimum promoters' contribution has also been reduced from one year to six months from the date of allotment in an IPO.

     However, in case the majority of the issue proceeds excluding the portion of offer for sale is proposed to be utilised for capital expenditure[1], then the lock-in period shall be one year from the date of allotment in an IPO.

  c. *Specified securities held by persons other than promoters:* The entire pre-issue capital held by such persons should be locked-in for a period of six months (earlier one year) from the date of allotment in an IPO.

- **Streamlining disclosures of 'group companies':** As per the amendments, following disclosures are not required to be made by an issuer in respect of group companies in the offer document:
  a. Refusal of listing of any securities of the issuer during last 10 years by any of the stock exchanges in India or abroad.
  b. Failure of the issuer to meet the listing requirements of any stock exchange in India or abroad and the details of penalty, if any, including suspension of trading, imposed by such stock exchanges.
  c. Existence of a large number of pending investor grievances.

  Further, only names and registered office address of all the group companies should be disclosed in the offer document. Also, following information based on the audited statements in respect of top five group companies (based on market capitalisation for listed/based on turnover in case of unlisted) for the preceding three years shall be hosted on the website of the respective group company (listed/ unlisted):
  a. Reserves (excluding revaluation reserve)
  b. Sales
  c. Profit after tax
  d. Earnings per share
  e. Diluted earnings per share and
  f. Net asset value.

  The offer document shall refer the website where the details of the group companies shall be available.

Effective date: The amendments are effective from the date of its publication in the official gazette i.e. 13 August 2021.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2021/45 dated 13 August 2021)

Prohibition of Insider Trading Regulations

Informant mechanism

SEBI through a notification dated 5 August 2021 has issued certain amendments to the SEBI (Prohibition of Insider Trading) Regulations, 2015 (Prohibition of Insider Trading Regulations). The amendments mainly relate to informant reward under the Prohibition of Insider Trading Regulations.

In accordance with the informant mechanism, SEBI may declare an informant eligible for reward and intimate the informant or his/her legal representative to file an application for claiming such reward. The amount of reward shall be 10 per cent of the monetary sanctions and shall not exceed **INR1 crore.**

Amendments

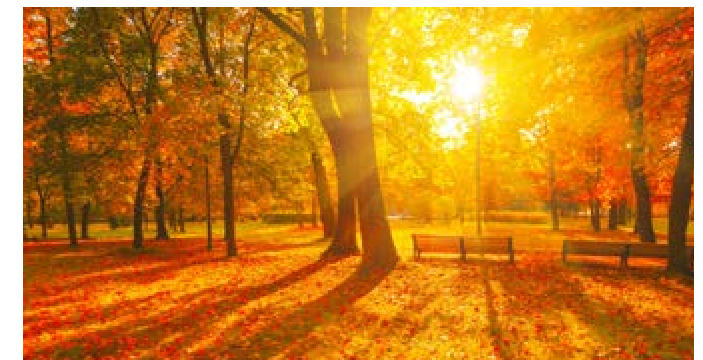
The amendments have increased the maximum amount of reward to **INR10 crore.** Additionally, as per the amendments:

- If the total reward payable is *less than or equal to INR1 crore,* SEBI may grant the said reward upon the issuance of the final order.
- In case the total reward payable is *more than INR1 crore,* SEBI may grant an interim reward not exceeding INR1 crore upon the issuance of the final order by SEBI and the remaining reward amount shall be paid only upon collection or recovery of the monetary sanctions amounting to at least twice the balance reward amount payable.

An illustrative table of the reward payable has also been given in the notification.

Effective date: The amendments are effective from the date of its publication in the official gazette i.e. 5 August 2021.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2021/37 dated 5 August 2021)



1. Capital expenditure shall include civil work, miscellaneous fixed assets, purchase of land, building and plant and machinery, etc.

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Automation of continual disclosures

Background

Currently, Regulation 7(2) of the Prohibition of Insider Trading Regulations requires a promoter, an employee and a director of a listed company to disclose about the transaction relating to acquisition or disposal of securities to the company within two trading days, if the value of such transaction exceeds INR10 lakh over any calendar quarter. Also, a listed company is required to notify the particulars of such trading to the stock exchange within two trading days of receipt of the disclosure of such information.

SEBI through a circular dated 9 September 2020 had decided to implement System Driven Disclosures (SDD) for member(s) of promoter group and designated person(s) in addition to the promoter(s) and director(s) of company (referred to as entities) under Regulation 7(2) of the Prohibition of Insider Trading Regulations.

Under SDD framework, listed companies are required to provide the information including Permanent Account Number (PAN) of their promoters, designated person(s) and director(s) to the designated depository in the format and manner prescribed by the depositories. Any subsequent update in the details of the entities, need to be updated by a listed company on the same day.

Stock exchanges and depositories have confirmed to SEBI that they have implemented SDD in line with the circular dated 9 September 2020 and the same is live from 1 April 2021.

New development

SEBI through a circular dated 13 August 2021 has clarified that manual filing of disclosures as required under Regulation 7(2)(a) and (b) of the Prohibition of Insider Trading Regulations is no longer mandatory for listed companies who have complied with the requirements of SEBI circular dated 9 September 2020.

(Source: SEBI circular no. SEBI/HO/ISD/ISD/CIR/P/2021/617 dated 13 August 2021)

Amendment to the Securities Contracts (Regulation) Rules, 1957

Currently, Rule 19A of the Securities Contracts (Regulation) Rules, 1957 requires every listed company to maintain minimum public shareholding of at least 25 per cent in terms of continuous listing requirement.

Amendment

The Ministry of Finance through a notification dated 30 July 2021, has provided that the Central Government may, in the public interest, exempt any listed public sector company from any or all of the provisions of Rule 19A of the Securities Contracts (Regulation) Rules, 1957.

Effective date: The amendment is effective from the date of their publication in the official gazette i.e. 30 July 2021.

(Source: Ministry of Finance notification no. G.S.R 520(E) dated 30 July 2021)

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

On 9 August 2021, SEBI notified SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations). NCS Regulations merges following two erstwhile regulations relating to issuance and listing of debt securities and Non-Convertible Redeemable Preference Shares (NCRPS)

- SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (ILDS Regulations)
- SEBI (Issue and Listing of NCRPS) Regulations, 2013 (NCRPS Regulations).

NCS Regulations aim to harmonise with the provisions of the 2013 Act and maintain consistency with the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, SEBI (Debenture Trustees) Regulations, 1993 (DT Regulations) and circulars issued thereunder. Further, NCS Regulations also include certain provisions issued through circulars under ILDS Regulations and NCRPS Regulations.

Key features of the NCS Regulations are as follows:

- **Disclosure of parameters for identification of risk factors:** The NCS Regulations have introduced comprehensive parameters to provide for identification of risk factors such as risks intrinsic to the issuer, security, other risk factors which may have an impact on the issue, security, etc. in line with the ICDR Regulations.
- **Minimum subscription of 75 per cent for public issue of debt securities and NCRPS:** The NCS Regulations has introduced a requirement of minimum subscription of 75 per cent for public issue of debt securities and NCRPS.
- **Applicability of the Electronic Book Provider (EBP) platform:** EBP platform has been made mandatory for issuance of eligible securities proposed to be listed amounting to INR100 crore or above in a financial year.
- **Harmonisation of provisions on creation of charges with the 2013 Act:** The creation of charge on the assets and properties of the issuer under the NCS Regulations has been aligned with the provisions of the 2013 Act.
- **Format of application for public issue of NCRPS:** The NCS Regulations introduced a format of application form for public issue of NCRPS in line with the format existing for an issue of debt securities.

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Operational circular for issue and listing of NCS, securitised debt instruments, security receipts, municipal debt securities and commercial paper

On 10 August 2021, SEBI issued an operational circular which provides a chapter-wise framework for the issuance, listing and trading of NCS, securitised debt instruments, security receipts, municipal debt securities or commercial paper. Some of the key guidance relates to:

- Application process in case of public issues of securities and timelines for listing
- Additional disclosures by a Non-Banking Finance Company (NBFC), Housing Finance Company or public financial institution
- Standardisation of timelines for listing of securities issued on a private placement basis
- Green debt securities
- Operational framework for transactions in defaulted debt securities post maturity date/ redemption date
- Fund raising by issuance of debt securities by large corporate.

Effective date: The NCS Regulations and provisions of the circular are effective from 16 August 2021.

(Source: SEBI notification no. SEBI/LAD-NRO/ GN/2021/39 dated 9 August 2021 and circular no. SEBI/HO/DDHS/P/CIR/2021/613 dated 10 August 2021)

The Limited Liability Partnership (Amendment) Act, 2021

The Limited Liability Partnership (LLP) (Amendment) Act, 2021 (Amendment Act) has received the assent of the President of India on 13 August 2021. The Amendment Act amends the LLP Act, 2008. The amendments convert certain offences into civil defaults and changes the nature of punishment for these offences. It also defines small LLP, provides for appointment of certain adjudicating officers, and establishment of special courts.

Some of the key amendments are as follows:

- **Introduction of small LLPs:** In accordance with the Amendment Act, a small LLP means a LLP whose:
  a. Contribution from partners is up to INR25 lakh (may be increased up to INR5 crore) and
  b. Turnover as per the Statement of Accounts and Solvency for the immediately preceding financial year is up to INR40 lakh (may be increased up to INR50 crore).
- **Standards of accounting and auditing:** The Central Government may, in consultation with the National Financial Reporting Authority (NFRA) prescribe the standards of accounting and standards of auditing as recommended by the Institute of Chartered Accountants of India (ICAI) for a class or classes of LLPs.
- **Compounding of offences:** The Amendment Act allows Regional Director (RD) or any other officer not below the rank of RD to compound any offence under the LLP Act which is punishable with a fine only.
- **Establishment of special courts:** The Amendment Act empowers Central Government to establish or designate special courts to facilitate speedy trial of offences under the LLP Act.
- **Punishment for fraud:** The amendments have increased the term of imprisonment from two years to five years if an LLP or its partners carry out an activity to defraud their creditors, or for any other fraudulent purpose.

Effective date: The Amendment Act shall come into force on such date as the Central Government may, by notification in the official gazette, appoint. Different dates may be appointed for different provisions of the Amendment Act and any reference in any such provision to the commencement of the Amendment Act shall be construed as a reference to the coming into force of that provision.

(Source: The Limited Liability Partnership (Amendment) Act, 2021 issued by the Ministry of Law and Justice on 13 August 2021)

2. Earnings Before Interest, Tax, Depreciation and Amortisation

Revised timelines for compliance under resolution framework for COVID-19 related stress

Background

In August 2020, the Reserve Bank of India (RBI) had issued a resolution framework for COVID-19 related stress (the framework) to mitigate the impact of the pandemic on the ultimate borrowers. In accordance with the framework, corporate borrowers were required to maintain certain ratios by 31 March 2022. The ratios were specified by the expert committee formed under the resolution framework, and consisted of following key operational ratios namely:

a. Total debt/EBITDA[2]
b. Current ratio
c. Debt Service Coverage Ratio (DSCR)
d. Average Debt Service Coverage Ratio (ADSCR) and
e. Total Outside Liabilities/Adjusted Tangible Net Worth (TOL/ATNW) representing the debt-equity mix of the borrower post implementation of the resolution plan.

New development

In view of the resurgence of the COVID-19 pandemic in 2021 and recognising the difficulties it may pose for the borrowers in meeting the operational parameters, RBI has decided to defer the target date for meeting the specified

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thresholds in respect of the four operational parameters, viz. Total Debt/EBIDTA, Current Ratio, DSCR and ADSCR, to 1 October 2022.

The target date for achieving the ratio TOL/ATNW shall remain unchanged as 31 March 2022.

(Source: RBI notification no. RBI/2021-22/80 dated 6 August 2021)

Restructuring of derivative contracts due to LIBOR transition

Background

On 13 October 2008, RBI issued Prudential Norms for Off-balance Sheet Exposures of Banks which, *inter alia*, specified that where a derivative contract is restructured, the mark-to-market value of the contract on the date of restructuring should be cash settled. For this purpose, any change in any of the parameters of the original derivative contract would be treated as a restructuring.

New development

RBI through a notification dated 6 August 2021 has further clarified that change in the terms of a derivative contract on account of change in reference rate necessitated due to transition from

LIBOR to an alternative reference rate shall not be treated as restructuring of the derivative contract provided all other parameters of the original contract remain unchanged.

(Source: RBI notification no. RBI/2021-22/81 dated 6 August 2021)

Update to master direction for HFCs – Revised criteria for notification of HFC as a financial institution

Background

RBI, through a notification dated 17 February 2021 had issued Master Directions-NBFC-Housing Finance Company (HFC) (Reserve Bank) Directions, 2021 (Master Directions) which included guidelines on asset classification and provisioning requirements for HFCs along with matters to be included in the auditor's report of HFCs.

Paragraph 105 of the Master Directions specified certain criteria for notification of HFCs as 'financial institution' under Section 2(1)(m)(iv) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

On 17 June 2021, the Government of India through a notification has provided that a HFC registered under Section 29A(5) of the National Housing Bank Act, 1987 with assets worth INR100 crore and above would be considered as a 'financial institution' under Section 2(1)(m)(iv) of the SARFAESI Act.

New development

Consequently, RBI through a notification dated 25 August 2021 has withdrawn the criteria prescribed for notification of HFCs under paragraph 105 of the Master Direction with immediate effect.

(Source: RBI notification no. RBI/2021-22/91 dated 25 August 2021)

Disclosures of accounting policies – Proposed amendments to Ind AS 1

Recently, the Accounting Standards Board (ASB) of ICAI through an Exposure Draft (ED) proposed certain amendments to Ind AS 1, *Presentation of Financial Statements.* The proposed amendments to Ind AS 1 requires companies to disclose their 'material accounting policy information' rather than their 'significant accounting policies'. In this regard, the proposed amendments further clarifies that:

- Accounting policy information may be material because of its nature, even if the related amounts are immaterial
- Accounting policy information is material if users of an entity's financial statements would need it to understand other material information in the financial statements
- If an entity discloses immaterial accounting policy information, such information shall not obscure material accounting policy information.

The amendments have been proposed to be made effective for annual reporting periods beginning on or after 1 April 2023.

Comments on the proposed amendments are invited up to 31 August 2021.

(Source: Exposure Draft on Disclosures of Accounting Policies ED/Ind AS 1/2021/7 issued by ICAI on 30 July 2021)

Comparative information on initial application of IFRS 17 and IFRS 9 – Exposure draft issued by IASB

The International Accounting Standards Board (IASB) has published an Exposure Draft (ED) on 'Initial application of IFRS 17 and IFRS 9 - Comparative information (Proposed amendments to IFRS 17)'.

The ED proposes a narrow-scope amendment to the transition requirements in Appendix C of IFRS 17, *Insurance Contracts* for entities that initially apply IFRS 17 and IFRS 9, *Financial Instruments* at the same time. The proposed amendment relates to financial assets for which comparative information presented on initial application of IFRS 17 and IFRS 9 has not been restated for IFRS 9. Applying the proposed amendment, an entity would be permitted to present comparative information about such a financial asset as if the classification and measurement requirements of IFRS 9 had been applied to that financial asset. The ED proposes no change to the transition requirements in IFRS 9.

ICAI has invited comments on the ED up to 3 September 2021.

(Source: Exposure Draft on Initial Application of IFRS 17 and IFRS 9 – Comparative information ED/2021/8, ICAI announcement dated 3 August 2021)

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The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

First Notes

Ind AS amendments including inter-bank offered rate reforms and extension of COVID-19 related rent concession

29 July 2021

In view of the recent amendments to IFRS, and in order to keep the Ind AS converged with IFRS, on 18 June 2021, the Ministry of Corporate Affairs (MCA) issued certain amendments to Ind AS (the 2021 amendments). These amendments have been issued in the following areas:

- Inter-bank Offered Rate (IBOR) related reforms (phase 2 reforms)
- Extension of practical expedient for rent concession
- Amendments consequent to issue of Conceptual Framework for financial reporting under Ind AS
- Other minor/clarificatory updates.

The amendments are effective from annual reporting periods beginning on or after 1 April 2021.

This issue of First Notes aims to provide an overview of the 2021 amendments.

Voices on Reporting (VOR) - Special session on technology sector

On 29 July 2021, KPMG in India organised a special session of VOR focussed on the accounting issues in the technology sector. Some of the topics that were discussed in this session are as follows:

1. Accounting for software development cost under the waterfall method and agile method
2. Key implementation issues arising from the Companies (Auditor's Report) Order, 2020 (CARO 2020)
3. Clarifications on recent amendments to Schedule III of the Companies Act, 2013.

To access the presentation and recording, please click here.

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