

First Notes

SEBI amends provisions related to independent directors

8 September 2021

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Post six months

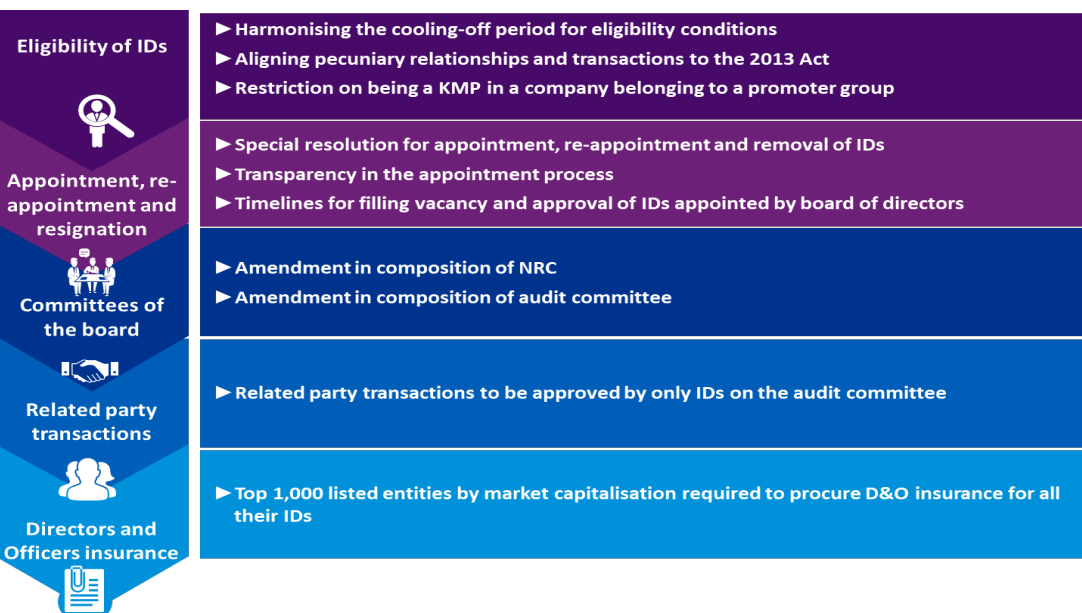
Forthcoming requirement

Introduction

The Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) lays down provisions for transparency and fair disclosures by all Indian listed companies. Amendments to the Listing Regulations have been made from time to time to reinforce compliances and protect the interest of investors.

SEBI has been working to strengthen the institution of Independent Directors (IDs) and has set up various committees over last few years to deliberate on this topic and implemented their recommendations. A need was felt to further bolster the independence of IDs and enhance their effectiveness in order to protect the interest of the minority shareholders, and other functions. In this regard, in March 2021, SEBI issued a consultation paper on review of regulatory provisions relating to independent directors on the boards of listed companies.

On 29 June 2021, SEBI, in its board meeting approved some of the proposals pertaining to IDs mentioned in the consultation paper. These decisions come into effect through SEBI's notification dated 3 August 2021 which amended the Listing Regulations pertaining to regulatory provisions relating to IDs. The amendments mainly pertain to the following areas:



(Source: KPMG in India's analysis, 2021 read with SEBI notification on regulatory provisions relating to IDs dated 3 August 2021)

Introduction (cont.)

These amendments will be applicable to all listed companies (however, requirement to procure D&O insurance for IDs is applicable to top 1,000 listed companies) effective 1 January 2022¹.

In this issue of First Notes, we aim to provide an overview of the key amendments made by SEBI in the Listing Regulations relating to IDs.

Overview of the amendments

Eligibility of IDs (Regulation 16)

Background

Regulation 16 of the Listing Regulations sets out certain objective conditions for determination of independence of an ID. These conditions include areas of relationship of self and of relatives (including material pecuniary relationship) with the listed entity, its holding, subsidiary or associate companies (related entities) or their promoters or directors, and shareholding in the listed entity. The SEBI has notified amendments in some of the eligibility conditions of IDs as given below:

Cooling-off period for directors with pecuniary relationship: The Listing Regulations prescribe a cooling-off period for persons to be eligible to act as IDs. Currently, the cooling-off period for a material pecuniary relationship between an ID and the related entities is two years.

Amendment

The SEBI has extended the cooling-off period for a material pecuniary relationship between an ID and the related entities to three years.

Relatives without pecuniary relationship or transaction: One of the eligibility conditions of an ID is that none of his or her relatives should have or had a pecuniary relationship or a transaction with the related entities, or their promoters, or directors, amounting to:

- i. Two per cent or more of its gross turnover or total income or
- ii. INR50 lakh or such higher amount as may be prescribed from time to time, whichever is lower.

The above condition needs to be evaluated during the two immediately preceding financial years or during the current financial year (i.e., a cooling off period of two years).

Amendment

The amendments provide:

- i. A **clarification of a pecuniary relationship or a transaction** by specifying certain relationships and transactions that would impact the independence of an ID², and
- ii. Extension of the **cooling-off period** for a material pecuniary relationship between the relative and the related entities from two years to three years.

Accordingly, as per the amendment, an ID will be considered independent if none of his or her relatives:

- i. Is holding securities of or interest in the related entities during the three immediately preceding financial years or during the current financial year of face value in excess of INR50 lakh or two percent of the paid-up capital of the related entities respectively or such higher sum as may be specified
- ii. Is indebted to the related entities or their promoters or directors, in excess of INR50lakh or two percent of gross turnover or total income, whichever is lower during the three immediately preceding financial years or during the current financial year
- iii. Has given a guarantee or provided any security in connection with the indebtedness of any third person to the related entities or their promoters or directors, for INR50 lakh or two percent of gross turnover or total income, whichever is lower during the three immediately preceding financial years or during the current financial year or
- iv. Has any other pecuniary transaction or relationship with the related entities amounting to two percent or more of its gross turnover or total income.

Additionally, the pecuniary relationship or transaction with the related entities or their promoters, or directors in relation to points (i) to (iv) above should not exceed:

- i. Two percent of its gross turnover or total income or
- ii. INR50 lakh or such higher amount as may be specified from time to time, whichever is lower.



1. Clarified by Corrigendum issued by SEBI dated 6 August 2021
2. By doing so, SEBI has essentially aligned the requirements of the Listing Regulations with the 2013 Act

Overview of the amendments

Eligibility of IDs (Regulation 16) (cont.)



Key Managerial Personnel (KMP): To be eligible as an ID, an individual should neither himself/herself, nor should his or her relatives hold or have held the position of a KMP or be or have been an employee of the related entities in any of the three financial years immediately preceding the financial year in which he/she is proposed to be appointed.

Amendment

SEBI has expanded the scope of 'related entities' to include any company belonging to the promoter group of a listed entity. Thus, an individual or his/her relative should not hold or have held the position of a 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.** *(Emphasis added to highlight change)*

The SEBI further clarified that the restriction under this clause would not apply for the employment of a relative who is an employee other than in the capacity of KMP.

Appointment, reappointment and resignation of IDs



Background

Various regulations in the Listing Regulations prescribe requirements for the appointment, re-appointment and removal of an ID, including the process of selection and appointment of the IDs. The SEBI has issued amendments to some of these provisions, as below:

Special resolution for appointment, re-appointment or removal of IDs (Regulation 25 (2A)):

Currently, the Companies Act, 2013 (2013 Act) governs the provisions of appointment, re-appointment and removal of IDs. As per the 2013 Act, IDs are appointed for their first term by passing an ordinary resolution in the general meeting, and they are re-appointed by passing a special resolution. Similarly, IDs can be removed from companies in their first term by way of an ordinary resolution and in their subsequent terms by way of a special resolution. The Listing Regulations were silent in terms of whether an ordinary or a special resolution is required for the appointment, re-appointment or removal of IDs.

Amendment

SEBI has now inserted Regulation 25(2A) in the Listing Regulations, which clarifies that the 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.

(Emphasis added to highlight change)

Information to shareholders while appointing/re-appointing directors (Regulation 36): When a listed entity appoints a new director or reappoints a director, the notice for appointment of director should include the following:

- i. A brief resume of the director
- ii. The nature of expertise in specific functional areas
- iii. Disclosure of relationships between directors inter-se
- iv. Names of listed entities in which the person also holds the directorship and the membership of committees of the board; and
- v. Shareholding of non-executive directors in the listed entity, including shareholding as a beneficial owner.

Amendment

In addition to the above requirements, listed entities should provide the following information:

- i. Names of listed entities from which the person has resigned in the past three years
- ii. In case of IDs, the skills and capabilities required for the role and the manner in which the proposed person meets such requirements.

Overview of the amendments

Appointment, reappointment and resignation of IDs (cont.)

Timeline prescribed for approval of shareholders for appointment of a person on the Board of Directors (Regulation 17): As per the current practice, companies appoint additional directors, subject to approval of the shareholders at the next general meeting³. There can be a significant gap between the appointment of a director and approval of shareholders, which may not be in the best interest of especially the minority shareholders.

Amendment

In view of this, **SEBI notified that listed entities should ensure that approval of shareholders for appointment of a person on the board of directors is taken at the next general meeting or within a time period of three months from the date of appointment, whichever is earlier.**

(Emphasis added to highlight change)

Transparency in appointment of IDs (Schedule II- Part D read with regulation 36):

The Nomination and Remuneration Committee (NRC) has the responsibility to propose a person as an ID, who is then appointed by the board of directors. Prior to proposing a person as an ID, the NRC is required to:

- i. Formulate the criteria for determining qualifications, positive attributes and independence of a director
- ii. Identify persons who are qualified to become directors in accordance with the criteria laid down, and recommend to the board of directors for their appointment and removal
- iii. Assess whether to extend or continue the term of appointment of the IDs, on the basis of the report of performance evaluation of IDs.

Though NRC is required to lay down the criteria of qualification and attributes for IDs, SEBI observed that there is a lack of transparency in the process followed by NRC. Accordingly, there is a need to prescribe disclosures, regarding the process followed by NRC for selection of candidates for the post of IDs.

Amendment

As per the amendment, 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, having 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.

Filling vacancy (Regulation 25(6)): As per the Listing Regulations, an ID who resigns or is removed from the board of directors of a listed entity should be replaced by a new ID at the earliest but not later than the immediate next meeting of the board of directors or three months from the date of such vacancy, whichever is later.

Amendment

The amendment now requires the 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.

(Emphasis added to highlight change)

Cooling off period for appointment as executive director (Regulation 25(11)): SEBI observed cases where IDs resigned and then joined the same company as an executive director.

Amendment

In order to prevent any compromise to the independence of IDs in these situations, SEBI has introduced a cooling-off period of one year for an ID from the date of resignation as an ID. Accordingly, **IDs who have resigned from the listed entity could be appointed as an executive or whole-time director on the board of the related entities or any company belonging to the promoter group only if a period of one year has elapsed from the date of resignation as an ID.** *(Emphasis added to highlight change)*



3. This is as per provisions of the 2013 Act. The Listing Regulations is currently silent in terms of period within which shareholders should approve the appointment of an additional director

Overview of the amendments

Appointment, reappointment and resignation of IDs (Cont.)



Resignation of IDs (Schedule III Part A.A.7B read with regulation 30⁴): Currently, when an ID resigns, listed entities are required to disclose the detailed reasons for the resignation as given by the ID along with a confirmation from the ID that there is no other material reason for resignation other than those already provided. Such disclosures should be provided by the listed company to the stock exchange(s) within seven days from the date of the resignation of an ID.

Amendment

In addition to the current requirement, listed entities are now required to provide the letter of resignation of the resigning ID to the stock exchanges. Further, the names of listed entities in which the resigning director holds directorships, indicating the category of directorship and membership of board committees, if any, should also be disclosed.

Committees of the Board



Background

The Listing Regulations prescribe the composition and duties and responsibilities of the various committees of the board. SEBI has prescribed amendments in the composition of certain committees of the board as below:

Composition of audit committee (Regulation 18): Currently, listed companies 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 having outstanding SR⁵ equity shares, the audit committee should only comprise of IDs.

Amendment

The amendment has clarified that at least two-third of the members of audit committee should be IDs⁶.

(Emphasis added to highlight change)

Composition of Nomination and Remuneration Committee (NRC) (Regulation 19): Currently, listing regulations require board of directors of listed entities to constitute the NRC. The NRC should comprise of:

- i. At least three directors
- ii. All directors will be non-executive directors, and
- iii. At least 50 per cent of the directors should comprise of IDs. In case of a listed entity having outstanding SR equity shares, two thirds of the NRC should comprise of IDs.

Amendment

The amendment has modified the composition requirement of NRC. As per the amendment, **at least two thirds of the directors** of the NRC should be IDs. Additionally, there is **no separate composition requirement** for the NRC for listed entities having outstanding **SR equity shares**.

Related Party Transactions (RPTs) (Regulation 23)



Background

The Listing Regulations cast specific responsibility on the Audit Committee with regard to financial matters, including RPTs. Accordingly, all RPTs require prior approval of the audit committee.

Amendment

Considering the importance of the audit committee with regard to related party transactions, SEBI now requires all RPTs to be approved by only IDs on the audit committee.

4. Regulation 30 requires listed entities to make disclosures of any events or information which, in the opinion of the board of directors of the listed entity, is material. Events mentioned in Part A of Schedule III are considered to be material events and should be disclosed.
5. Equity shares having superior voting rights compared to all other equity shares issued by that issuer
6. This requirement does not apply to listed entities having outstanding SR equity shares.

Overview of the amendments

Directors and Officers insurance (D&O) (Regulation 25(10))



Background

Currently, the top 500 listed entities by market capitalisation⁷ are required to undertake D&O insurance for all their IDs of such quantum and for such risks as may be determined by the board of directors.

Amendment

With effect from **1 January 2022**, the **top 1,000 listed entities** by market capitalisation would be required to undertake D&O insurance for all their IDs.

Our comments

Related party transactions

- One of the important change with regard to related party transactions is that all related party transactions will (effective 1 January 2022) be required to be approved by only IDs on an audit committee. While the proposal in the consultation papers was to not have any director related to the promoters on the audit committee to enhance independence in the review of financial reporting and RPT process, the amendments have essentially made the approval of the RPTs the prerogative of the IDs. The IDs would need to review both the qualitative and quantitative aspects of each of the RPTs and focus on ones that really impact the interests of minority shareholders and other stakeholders.

Committees of the Board

- **Audit committee:** The amendment in the provision relating to the constitution of an audit committee prescribes for a minimum requirement of two-third of the committee to be comprised of IDs. This will allow companies to appoint additional IDs as members of the audit committee, and companies are not required to reconstitute the audit committee.
- **NRC:** The composition of NRC under the Listing Regulations now prescribes for two-thirds of the members to be IDs. The same has been increased from the erstwhile requirement of 50 per cent of the members of the committee to be IDs. Therefore, in case the NRC of a listed company does not meet the prescribed requirement, the NRC would be required to be reconstituted effective 1 January 2022.

By increasing the minimum number of IDs to be appointed in the NRC to two-third of the total composition of the NRC, SEBI has harmonised the composition of directors in the NRC for listed entities that have issued SR equity shares with listed entities that have issued equity shares with equal voting rights. However, a similar harmonisation of composition of directors has not been directed for the audit committee. Thus, listed entities that have issued SR equity shares will have to ensure that their audit committees are entirely represented by independent directors. However, listed entities that have issued equity shares with equal voting rights may include non-independent directors in their audit committee to the extent of one-third of the audit committee's total composition.

- **Sourcing additional IDs:** With these amendment, many companies will now need to increase the number of IDs on the board. However, companies would need to consider how they will source the IDs, specially with the limitations on the number of directorships that is currently there for all directors as per the 2013 Act. Companies thus need to take action and draw up a road map for ensuring compliance with these provisions.
- **Equipping IDs for additional responsibilities:** The amendments in the Listing Regulations require IDs to take greater responsibility in terms of a structured and transparent process in the appointment of directors and approve related party transactions. It is essential that IDs are provided adequate training on the matters to be considered while performing these additional duties.

The above amendments pertaining to IDs provide greater voice to IDs in the NRC and audit committee.

Appointment, re-appointment and removal of IDs

- The SEBI's consultation paper proposed for dual approval which includes a vote of 'majority of minority'. While this proposal has not gone through, the amendments mandate special resolutions for the appointments and removals of IDs. In India, the trend of promoter shareholding slowly coming down, therefore, the requirement of a special resolution is likely to give greater voice to public shareholders, including institutional shareholders, who will now need to vote in favour of the resolutions relating to appointment, re-appointment and removal of IDs in many companies.

7. Market capitalization will be calculated as on 31 March of the preceding financial year

Our comments (cont.)

Appointment, re-appointment and removal of IDs (cont.)

- The SEBI has inserted additional disclosures required to be made by listed companies to shareholders at the time of appointment/re-appointment of directors. These additional disclosures *inter-alia* include the names of listed entities from which the person has resigned in the past three years. However, the reasons for resignation are not required to be provided. While disclosure of the names of companies from which the director has resigned would throw light on the experience of the director, providing the reasons that the ID resigned from those companies would further strengthen the disclosures around resignation.
- The SEBI has enhanced the role of the NRC by structuring and strengthening the appointment process of IDs and bolstering transparency in the selection of IDs. Companies will now be required to perform a critical assessment of their board of directors' skillsets and bring in the right set of complementary skills and competencies. While the NRC will be required to disclose to shareholders how a selected ID matches/fits the role required, additional disclosures in terms of persons who had been considered for the role, and were not selected, along with an appropriate reason for not selecting such persons would provide greater transparency in the selection process.

Review of remuneration to IDs

- As per the 2013 Act, apart from reimbursement of expenses, IDs are permitted to be paid sitting fees (max of INR1 lakh) and the profit linked commission⁸ with an overall limit. Further, in terms of both the 2013 Act and Listing Regulations, IDs cannot be given stock options.

While there are concerns that a large remuneration may compromise the independence of IDs, lesser compensation may also not attract competent IDs on the boards of the listed entities.

Accordingly, in its board meeting, SEBI agreed to make a reference to the Ministry of Corporate Affairs (MCA), for giving greater flexibility to companies while deciding the remunerations for all directors (including IDs), which may include profit linked commissions, sitting fees, ESOPs, etc. within the overall prescribed limit of the 2013 Act.

Companies should watch out this space for updates on remuneration provisions for IDs.

Eligibility of IDs

- Currently, the Listing Regulations prescribe a cooling-off period of three years in case a person has been an employee/KMP or his/her relative has been a KMP of the related entities. Similarly, the Listing Regulations prescribe (prior to the amendment) a cooling-off period of two years in case a person or his/her relative has or had a material pecuniary relationship with the related entities. By extending the cooling-off period in case of a material pecuniary relationship between a person or his/her relative and the related entities from two years to three years, SEBI has harmonised the cooling-off period in the eligibility conditions of IDs in the Listing Regulations.
- The Listing Regulations require IDs on the board of directors of listed entities to provide a revised declaration confirming his/her independence whenever there is change in circumstances which may affect the status of the ID. Pursuant to the current amendments in the eligibility conditions of IDs, there is a need for IDs to ascertain if they continue to meet criteria of independence. Thus, the listed entities should assess whether they are required to seek a revised declaration from the existing IDs confirming their independence.
- The SEBI has currently provided an exemption, wherein IDs, whose relatives are employees of a company, but are not KMPs, will meet the criteria of independence. There may be situations where corporates involve employees or consultants, who do not hold the position of a KMP, in taking key decisions of the company. With this amendment, relatives of such employees or consultants will be eligible to be appointed as IDs.

Inconsistencies with 2013 Act

- **Eligibility of IDs:** The SEBI has now defined 'pecuniary relationships or transactions' that may impair independence of IDs. By doing this, SEBI has tried to align the eligibility conditions pertaining to pecuniary relationships with IDs with those provided in the 2013 Act. However, the cooling-off period in the 2013 Act for IDs and his or her relatives is two years, while the cooling-off period for IDs and his or her relatives is three years in the Listing Regulations, thus resulting in inconsistencies in the two provisions.
- **Appointment, re-appointment and removal of IDs:** The SEBI vide its amendments to the Listing Regulations, now requires the appointment, re-appointment and removal of IDs by way of a special resolution. However, the 2013 Act still requires the initial appointment or removal of the ID for the first term by way of an ordinary resolution. Additionally, the appointment of additional directors (post 1 January 2022) is required to be ratified by the shareholders within three months of the date of appointment of an additional director or in the general meeting, whichever is earlier as per the Listing Regulations. However, the 2013 Act prescribes that an additional director appointed under section 161 of the 2013 Act holds office up to the date of the next AGM or the last date on which the AGM should have been held, whichever is earlier.

8. Provision of remuneration to IDs has now been permitted in certain cases by Section 197 read with Schedule V of the 2013 Act. This is vide notification issued by MCA on 18 March 2021.

Our comments (cont.)

Inconsistencies with 2013 Act (cont.)

The amendment of the aforementioned provisions in the Listing Regulations will result in a mis-match in the regulatory requirements as per the Listing Regulations and the 2013 Act. Regulators should take note of this and make the necessary amendments in the 2013 Act.

Timelines to implement amendments

- The amendments in the Listing Regulations require significant changes in the composition of committees of the board, including the audit committee and NRC. This may require reshuffling of IDs within the existing committees or appointment of additional IDs, so that companies are compliant with the new provisions of the Listing Regulations. Companies are required to ensure compliance by 1 January 2022, which is a stringent timeline, and thus need to take note of these amendments and prepare for compliance.



The bottom line

Though not all the proposals from the SEBI consultation paper have been accepted, the approved amendments will certainly help strengthen the corporate governance framework.

The companies should take note of these changes and gear up to implement from 1 January 2022.



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Issue no. 61– August 2021

The topics covered in this issue are:

- De-SPAC – Key accounting and financial reporting considerations
- MCA issued FAQ on CSR provisions
- Regulatory updates.



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

29 July 2021

Indian Accounting Standards (Ind AS) are largely converged with the International Financial Reporting Standard (IFRS) issued by the International Accounting Standards Board (IASB). In the recent past, IASB along with the IFRS Interpretations Committee (IFRIC) has issued various amendments to IFRS as part of their annual improvements process or as specific amendments.

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
- Extension of practical expedient for rent concession
- Amendments consequent to issue of Conceptual Framework for financial reporting under Ind AS
- Other minor/clarificatory updates



Voices on Reporting

VOR publication-29 July 2021

VOR publication for the month of July 2021 discusses about accounting for software development cost under waterfall and agile method, key implementation issues of CARO 2020 as well as clarifications on Schedule III of the Companies Act, 2013.

To access the publication, please click [click here](#)

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