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Foreword

FinTech firms are redefining the way companies and consumers conduct transactions by offering a wide range of financial products and services and promotes financial inclusion. FinTech stands for 'Financial Technology' and is described as technologically enabled financial innovations. The Financial Stability Board (FSB) of the Bank of International Settlements (BIS) defines FinTech as 'technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services'.

Over the past few years, FinTech companies have had substantial impact on the financial services sector worldwide. The FinTech companies have capitalised on the rising demand for digitisation of financial services during COVID-19. With the primary focus of the FinTech entities in India being on raising

capital and accelerated growth through innovative solutions, it is important to understand some of the key financial reporting and accounting considerations for common transactions entered into by FinTech entities in India. This edition of Accounting and Auditing Update (AAU) carries an article which highlights key considerations for entities in FinTech sector.

The Reserve Bank of India (RBI) has been focussing its attention to the evolving and dynamic FinTech sector and has been developing guidelines and regulations relating to FinTech and digital banking. We have another article on FinTech sector that aims to provide an overview of RBI's recent circulars and guidelines in relation to the FinTech industry.

Central Bank Digital Currencies (CBDCs) are digital versions of a country's physical currency. Many countries across the globe are exploring CBDCs, few have

even implemented them. In October 2022, RBI issued a 'concept note' on Central Bank Digital Currency with an objective to create awareness about the planned features of the digital rupee. CBDC is aimed to complement, rather than replace, current forms of money and is envisaged to provide an additional payment avenue to users. Our article on this topic aims to discuss the key motivations and objectives for a CBDC, design and technology choices available and examine the policy and other implications of introducing CBDCs in India. Post issue of the concept note, RBI has commenced the pilot project of digital currency (e₹) for the wholesale segment from 1 November 2022 and is planning to start retail version soon.

Recently, the Securities and Exchange Board of India (SEBI) issued certain amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The amendments include introduction of alternate approval

mechanism for appointment and/or removal of independent directors, clarification regarding disclosure of ratios in the quarterly and annual financial results for the listed entities which have Non-Convertible Securities (NCS) and amendment regarding schemes of arrangements for debt listed entities. Further, the International Accounting Standards Board (IASB) has issued amendments to IAS 1, *Presentation of Financial Statements* relating to debt covenants. Our regulatory updates articles cover these and other important regulatory 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.



Sai Venkateshwaran
Partner - Assurance
KPMG in India



Ruchi Rastogi
Partner - Assurance
KPMG in India



CHAPTER 1

Accounting considerations for entities in FinTech sector

This article aims to:

Provide an overview of the key financial reporting and accounting considerations for the entities in the FinTech sector in India.



Introduction - FinTech in India

FinTech stands for 'Financial Technology' and is described as technologically enabled financial innovations.

The Financial Stability Board (FSB) of the Bank of International Settlements (BIS) has provided the following definition of FinTech.

'FinTech is technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services'

Indian FinTech sector is experiencing a strong exponential growth in recent times. The past decade has witnessed high growth in the payment system, which has fostered economic development and financial stability¹.

This sector has attracted massive investment from large venture capital and private equity firms. The FinTech companies have capitalised on the rising demand for digitisation of financial services during COVID-19.

The role of Reserve Bank of India (RBI), being the regulator, has transformed to create a platform for development of the payment ecosystem in India.

FinTech companies are redefining the way companies and consumers conduct transactions by offering a wide range of financial products and services and promoting financial inclusion. A majority of the FinTech companies have been focussed on enhancing the user experience through use of smart interface and Application Program Interface (APIs), which are linked to RBI's regulated entities such as banks, Non-Banking Financial Companies (NBFCs) and financial institutions. Such tie-ups between FinTech companies and the RBI's regulated entities are majorly governed by outsourcing guidelines issued by RBI.

With the primary focus of the FinTech entities in India being on raising capital and accelerated growth through innovative solutions, it is important to understand some of the key financial reporting and accounting considerations for common transactions entered into by FinTech entities in India:

1. Accounting for arrangements in the nature of First Loss Default Guarantees (FLDG)

FLDG is an arrangement whereby a third party compensates a lender if the borrower defaults. In an FLDG setup, the credit risk is borne by the Loan Service Provider (LSP) i.e. the FinTech company. The FLDG model was primarily introduced by

FinTech companies to tap into a market that traditional lenders would not be able to access.

An FLDG transaction, sometimes involves a 'guarantee' given by the FinTech entity to the partnering bank/NBFC. This quantum of guarantee is generally substantially higher than the actual loss that could be incurred by the bank/NBFC in case of a default by a customer. Therefore, the transaction would need to be carefully assessed under the principles of Ind AS 109, *Financial Instruments*. As per Ind AS 109, when an entity transfers a financial asset, it requires it to evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. Such arrangements would be evaluated under the derecognition principles of Ind AS 109.

Where the FinTech has retained substantially all the 'risks and rewards' of the portfolio of assets being guaranteed, the FLDG structure may warrant recognition on the balance sheet both a loan receivable from borrower (customer) and borrowing

from the RBI's regulated entity (partnering bank/ NBFC).

On recognition of the loan receivable from the borrower and related interest income, the FinTech company would also have to carefully evaluate its assets and the income pattern. The company could be considered and required to be registered as an NBFC, as per the press release issued by RBI vide No. 1998-99 1269 dated 8 April 1998 if its financial assets are more than 50 percent of its total assets (netted off by intangible assets) and income from financial assets is more than 50 per cent of the gross income.

The FinTech company would also be required to assess impairment under the principles of Ind AS 109 on the loan receivables recognised on the balance sheet.

1. RBI's vision document - Payments Vision 2025 dated 17 June 2022



2. Regulatory implications arising out of RBI's digital lending guidelines

RBI has issued the 'Guidelines on Digital Lending' on 2 September, 2022 (DL Regulations). These guidelines apply to all entities regulated by the RBI (regulated entities) and the FinTech platforms or lending service providers/Digital Lending Applications (DLAs) that have been engaged by regulated entities to offer digital lending products. The guidelines have significantly impacted the lending industry, particularly for models which leverage the use of pool/or pass-through accounts, Buy-Now-Pay-Later (BNPL), and co-lending models.

Consequential implications of the guidelines for FinTech companies

a. DL Regulations: The DL Regulations state that in case of financial products involving contractual agreements such as FLDG in which a third party guarantees (in this case FinTech company) to compensate up to a certain percentage of the default in a loan portfolio of the RBI's regulated entities, then it must comply with the securitisation guidelines. This means that a provision relating to synthetic securitisation (which means a structure where credit risk of an underlying pool of exposures is transferred, in whole or in part, through the use of credit derivatives or credit guarantees that serve to hedge the credit risk of the portfolio which remains on the balance sheet of the lender (bank/NBFC)).

As per the securitisation guidelines, the RBI's regulated entities are not permitted to undertake synthetic securitisation transactions. Where such transactions have been undertaken by the RBI's regulated entities, besides regulatory action, they are also subject to a 100 per cent capital charge².

While the restrictions are still unclear and additional clarity is expected on the topic, if the intention of the RBI is to restrict such FLDG transactions, the most impacted are expected to be new-to-credit borrowers which obtained loans from banks and NBFCs via the FinTech entity using the FLDG model. The FinTech company has the primary responsibility of evaluating the borrower and quality of the loan portfolio. Therefore, from the lender's perspective this model ensures that the lending service providers and FinTech companies have skin in the business. In simple terms, the credit risk is borne by the FinTech company with no requirement to maintain any regulatory capital and the RBI's regulated entity benefits from minimum cost incurred for the loan origination.

According to the RBI, regulation of FLDGs is still under consideration. However all FLDG structures are required to comply with Master Directions – RBI (Securitisation of Standard Assets) Directions, 2021.

2. Capital charge is more formally expressed as a Capital Adequacy Ratio (CAR) that is required by RBI to be maintained by lenders. The CAR is a measurement of a lender's available capital, shown as a percentage of a bank's risk-weighted credit exposures. The reason is to protect the depositors and make sure a bank or an NBFC can absorb a reasonable amount of loss without being at risk of insolvency.

b. Buy Now Pay Later (BNPL): BNPL is a short-term financing arrangement that allows consumers to buy a product or use a service, without paying for it upfront. BNPL arrangements are similar to an unsecured consumer loan where in many cases interest or fees are not charged and easier to get approved than other traditional lines of credit. This financing arrangement is usually given at the Point of Sale (PoS), or in other words when the consumer 'checks out' the shopping cart.

RBI in its DL Regulations has prescribed that all funds flowing that relate to loan servicing, disbursement and repayment must be done directly between the bank account of the lender and borrower, without any pass-through or pool account of any third party. However, the DL Regulations have provided the following exceptions for disbursements:

- i. Disbursals covered exclusively under statutory or regulatory mandate (of RBI or of any other regulator), flow of money between regulated entities for co-lending transactions; and
- ii. Disbursals for specific end use, provided the loan is disbursed directly into the bank account of the end-beneficiary.

Therefore, some digital lending structures may still be allowed including BNPL, supply-chain financings, consumer durable financing, etc. where the end use is specified and provided that the disbursal of the loan amount is made directly in the bank account of the end-beneficiary, and not routed through any third-party pass through or pool account, including the accounts of the LSPs and their DLAs. This area needs careful evaluation based on facts and circumstances of the arrangement.

BNPL models which were working on disbursal to Prepaid Payment Instruments (PPIs) like prepaid cards or mobile wallets are nevertheless impacted, given the DL guidelines require disbursals directly to the 'bank account' of the borrower. However, FinTech companies would need to evaluate new models and fund flow structures in line with the DL regulations.

Additionally, due to these guidelines, the role of financial intermediaries such as account aggregators, payment aggregators, marketplace lenders and LSPs is likely to undergo a significant change with regard to their business models and strategies. These guidelines are likely to lead to reassessment of the terms of the agreements between regulated entities and LSP, changes in group structures and reconsideration of revenue generating models.

3. Accounting for shareholders' transactions

Investors invest in FinTech companies using a variety of instruments and one of the most common ways to invest is equity shares or convertible preference shares. Generally, these convertible preference shares allow the investors to convert at a future date based on an agreed ratio. In certain cases, the conversion or settlement options are linked to future business performances, providing an exit to the investor e.g., an Initial Public Offering (IPO) event, or any other event agreed at the time of the investment. Such options may contain an unconditional obligation to deliver cash or another financial asset or contain rights to convert into variable number of equity shares.

Accounting for such instruments particularly from a classification perspective under Ind AS 32, *Financial Instruments: Presentation* can be quite complex. Features such as put options or buy back arrangements additionally add to the complexity.

The measurements of such instruments depend on their classification as either an equity instrument or a liability or potentially an embedded derivative. Many FinTech companies attract private equity/venture capital funding and therefore, it is important to understand the impact of accounting for instruments issued to them under Ind AS. FinTech companies should carefully assess detailed terms of each agreement relating to transactions with shareholders to evaluate the appropriate classifications and measurement.

4. Revenue recognition

FinTech companies generally have an online platform which is used to provide services of a wallet facility to the end user for purchasing goods or services of merchants such as spending on e-commerce apps/websites, shopping at physical retailers including mom & pop shops, paying electricity, mobile recharge, broadband and credit card bills, transferring money to the bank, etc.

In return for this facility, a FinTech company charges a percentage of commission on the transaction value from merchants. Further, as part of these arrangements, FinTech companies provide discounts, cash back, credits, price concessions, incentives as part of their promotional activities on using the wallet facility. On the other hand, a convenience charge fee may also be charged to end users for providing the wallet facility.

Such kinds of transactions need to be carefully evaluated under the principles of Ind AS 115, *Revenue from contract with customers*. Key areas of evaluation would include whether such cash back and incentives provided are to be assessed under variable consideration or consideration payable to a customer and therefore, reduced from revenue of the FinTech company; are these incentive transactions distinct from the commission revenue earned; would they be considered as promotional expense instead?

Taking into account the innovative incentive schemes introduced by the FinTech companies on a periodic basis, each transaction would need to be separately and carefully evaluated considering the respective terms and conditions.

Conclusion:

With the growing number of FinTech products in the market, level of innovations and change in regulations governing these entities, it is critical to assess and evaluate new business models that may potentially have a large impact on the statement of profit and loss on a timely basis. At the same time, the RBI has also initiated few steps in regulating this sector and it likely to help the digital lending ecosystem to continue to grow in a responsible and sustainable manner.



CHAPTER 2

Fintech - Regulatory interplay

This article aims to:

Provide an overview of RBI's regulatory considerations in the FinTech industry.



One of the products of FinTech companies is to issue Prepaid Payment Instruments (PPI). PPIs are instruments that facilitate purchase of goods and services, financial services, remittance facilities, etc., against the value stored therein. PPIs can be issued in the form of cards (prepaid cards) and wallets.

The Reserve Bank of India (RBI) has been regulating the business of issuance and operation of PPIs to essentially create a bankruptcy remote model coupled with customer protection.

While the exponential growth and changes brought in by FinTech companies has positive impact in the payment ecosystem, the same have also raised challenges emerging from enormous consumer data and potential risk in handling the same and the need to create regulatory landscape to prevent any impairment to the consumers.

Taking cognisance of this, the RBI has from time to time issued guidelines/circulars to regulate the inorganic growth of FinTech in payment and settlement space and has assumed supervisory powers over FinTech companies in the specific areas of payment settlement.

One such guideline issued was to regulate the business of Payment Aggregator (PA). PAs are a significant intermediary in the digital payments value chain. PAs are entities that facilitate e-commerce sites and merchants to accept various payment instruments from the customers for completion of their payment obligations without

the need for merchants to create a separate payment integration system of their own. PAs facilitate merchants to connect with acquirers. In the process, they receive payments from customers, pool and transfer them on to the merchants after a time period. Prior to March 2020, there were no detailed regulations for a PA. However, considering the vital role played by a PA in the entire settlement process, RBI has issued detailed guidelines. The guidelines have defined the term PA and also requires such companies to obtain license to undertake the business. The guidelines have also provided for base line technology recommendations which can be adopted by company providing payment gateways services.

On similar lines of PPI regulations, PA guidelines also require opening up an escrow account so as to safeguard the money collected from the public at large. The regulation provides various governance requirements to be adhered by a FinTech company which shall inter-alia include merchant on-boarding, storage of payment data, settlement management, Know Your Customer (KYC) conduct, customer grievance mechanism, etc.

Moving from the payment and settlement space to the lending business, RBI has been regulating this space by issuing detailed guidelines to banks and Non-Banking Financial Companies (NBFC). In the context of online business, there has been considerable surge in lending through digital means wherein the FinTech companies have been involved

to augment the lending business. In this regard, and to increase its footprint in the credit/lending facility, the companies have extensively created network of digital applications to create enhanced customer interaction and reach.

However, the recent damning events due to misuse by digital application companies and to address the systemic risk and breaching of data



privacy, which potentially could arise from lending through digital means, RBI on 2 September 2022 has issued detailed guidelines for digital lending¹. The guidelines provide for various customer protection measures such as issuance of key fact statement, disclosure of annual percentage rate, details pertaining to intermediary/recovery agents involved, non-storage of data by the intermediary, etc. The guidelines are aimed to bring the much-needed transparency and data privacy measures so as to protect the interest of the borrowers at large.

With respect to certain practice of providing First Loss Default Guarantee (FLDG) by the FinTech companies to the financial institution for offering specific financial products, the guidelines provide that the financial institution will have to adhere to the provisions of the Master Direction – Reserve Bank of India (Securitization of Standard Assets) Directions, 2021 dated 24 September 2021, especially, synthetic securitisation.

The report of the working group on digital lending released on 18 November 2021, also mentions about FLDG model, wherein a third party, such as FinTech companies guarantee to compensate up to a certain percentage of default in a loan portfolio of the regulated entities. Such FLDG arrangement could lead risk sharing arrangement with a non-registered entity. Considering the above risk, RBI through digital lending guidelines has asked the

regulated entities to adhere to the regulations provided to synthetic securitisation.

Peer-to-Peer (P2P) lending is another avenue in the FinTech sector. A P2P lending platform is referred to as an intermediary which provides services of loan facilitation via an online medium or otherwise. i.e. P2P lenders connect lenders and borrowers, using advanced technologies to speed up loan acceptance. These technologies are designed to increase the efficiency and reduce the time involved in access to credit. As the P2P lending industry has rapidly grown, RBI has provided detailed guidelines to regulate the business of P2P lending.

It shall be worthwhile to see how in future RBI shapes the regulations around ever-changing technology and its integration with the financial sector. Having regulations in these areas is likely to help with adequate supervision over such FinTech to curb malpractices. It shall be important for RBI to maintain a balance between various factors such as promoting growth of FinTech, customer protection, address systemic risk, etc.

1. RBI Notification no. RBI/2022-23/111 DOR.CRE.
REC.66/21.07.001/2022-23 dated 2 September 2022



CHAPTER 3

Central Bank Digital Currency (CBDC) - RBI concept note

This article aims to:

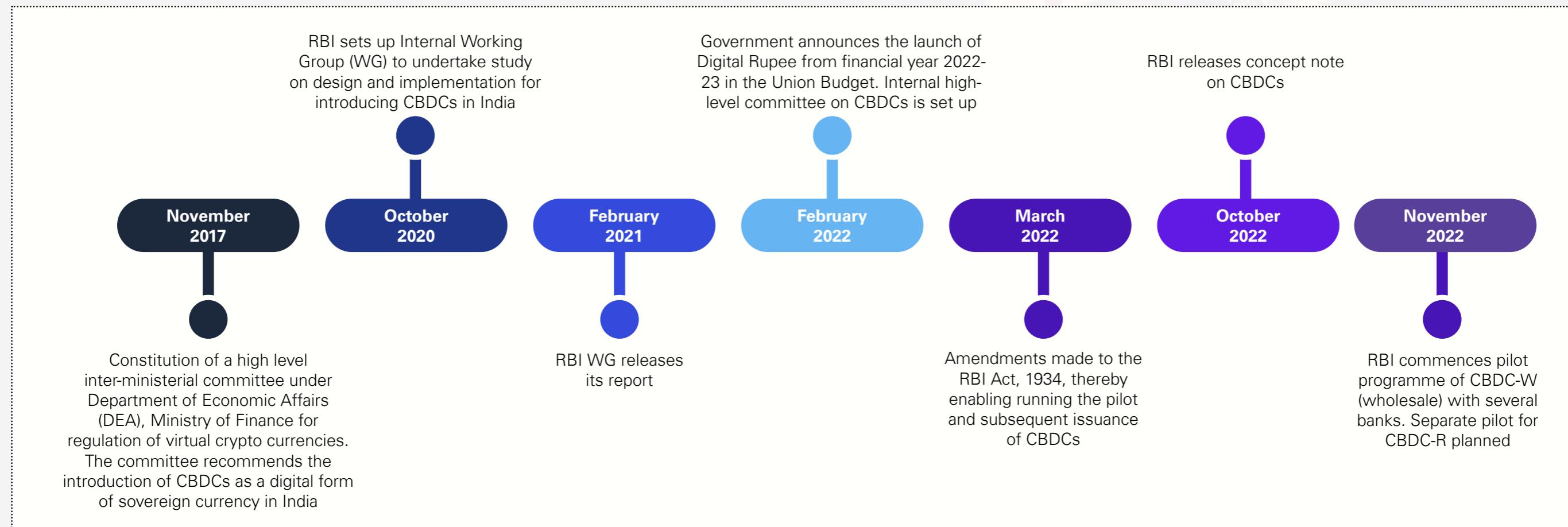
Highlight the CBDC concept note.



The Reserve Bank of India (RBI) has released a concept note on Central Bank Digital Currencies (CBDCs) on 7 October 2022. This concept note helps to create awareness about CBDCs. The concept note also discusses key considerations such as technology and design choices, possible uses of the Digital Rupee (e ₹), issuance mechanisms, etc.

The article discusses the key motivations and objectives for a CBDC, design and technology choices available and examine the policy and other implications of introducing CBDC in India.

A timeline of various events leading to this concept note is presented below:



(Source: KPMG in India's analysis, 2022 read with the RBI Concept Note on CBDCs dated 7 October 2022)

CBDC – What is it?

Current form of currency is essentially a debt instrument. It is a liability of the issuer (the central bank) and an asset of the holders. A currency note/coin represents this claim on the central bank. CBDC is a digital representation of this claim (for example, through a digital token issued by the central bank). It does not involve a printed currency note/coin, therefore, it will be a virtual currency.

RBI defines CBDC as a legal tender issued by a central bank, in a digital form. It will be akin to existing fiat currency issued by the central bank and would continue to perform the same functions i.e., as a safe store of value, a unit of measure and as a medium of payment. In terms of value, it would be exchangeable at par (1:1 ratio) with the existing 'paper' currency.

Many of us use digital wallets and online payments platforms to perform various purchase/sale transactions. The key difference between the money held in the current digital wallets/deposit accounts and CBDCs is that, whereas the present digital wallets/account balances represent a claim on a commercial bank (or a digital wallet service provider), CBDC represent a claim on the central bank. It will be direct liability of the central bank. As a result, unlike a commercial bank liability, there is no credit risk or liquidity risk associated with the CBDC. It is important to remember that

the proposed CBDC is not expected to replace or substitute the existing payment systems but act as another mode/platform through which users can hold and transact in central bank money.

Global scenario¹

Globally, more than 90 per cent of central banks are exploring the implementation of CBDC. It has been already launched in countries like the Bahamas, Nigeria and the East Caribbean Currency Union. Pilot projects/testing of CBDC is being undertaken in countries such as China, Sweden, Ukraine and Jamaica. China has also commenced a pilot of the e-yuan (e-CNY) in select cities and has launched a mobile app with a digital wallet for retail users. Further, France, Switzerland and Singapore have launched a joint trial of their experimental CBDC, a first cross-regional trial. Many other countries/regions are in the process of developing/designing CBDCs.

Motivations for issuing a CBDC in India

India has made significant progress in digital payment systems. There are various systems such as NEFT², RTGS³, IMPS⁴, UPI⁵ to enable online payments. Newer platforms like IMPS and UPI are available 24X7 and the related transaction costs are one of the lowest in the world. Despite this, there

are still various motivations for issuing CBDCs in India. These are discussed below:

- **Minimising use of cash and cash management expenses:**

RBI recognises that cash remains the most preferred mode for payment relating to regular, small value expenses. This preference can be redirected to CBDC if reasonable anonymity can be assured to the users, which would further facilitate digitisation process in the country to achieve a 'less-cash economy'.

Due to the large volume of cash in circulation, the cost of physical cash management (i.e., expenses relating to secure printing, storage, transportation and replacement of bank notes) continues to be significant. These costs can be reduced through introduction of CBDC. Although designing and establishing a CBDC (including related infrastructure) may require substantial costs upfront, the subsequent operating costs are expected to be lower. Additionally, CBDC may be also perceived to be environment friendly.

- **Promoting financial inclusion:** Another key motivation to implement CBDC is to promote financial inclusion. One would not need a bank account, to access and use the CBDC. The ability to perform offline transactions (peer-to-peer) is another key feature being

considered in the design of the CBDC. It is expected that these features would promote financial inclusion and enable more individuals (especially unbanked population in remote areas) in performing digital transactions and leave digital footprints in the financial system. This is likely to help the unbanked/underbanked population get easier access to credit facilities.

- **Cross border transactions:** While there are multiple payment systems for transactions within India, 'cross border transactions' is an area that could benefit from the new technology and innovations. Implementing such new technology in collaboration with other central banks could be beneficial for India, being the largest recipient of cross-border remittances. The RBI is proposing to collaborate and work with other central banks in this area.

1. Source: The Economist article dated 16 February 2021 titled "What is the fuss over central-bank digital currencies?" and Euronews article dated 9 March 2022 titled "Central Bank Digital Currencies: Which countries are using, launching or piloting CBDCs?"

2. National Electronic Funds Transfer

3. Real Time Gross Settlement

4. Immediate Payment Service

5. Unified Payments Interface

- Rapid rise of virtual private currencies:** In the last few years, many crypto-assets and cryptocurrencies have been launched. The proliferation of private virtual currencies and crypto assets (such as Bitcoin) can pose risks relating to money laundering and financing of terrorism. Use of crypto assets can also undermine the monetary policy transmission and the stability of domestic currency through creating a parallel economy. Also, since virtual private currencies are not backed by any central authority and are issued by private players, there is an added credit risk relating to the issuer.

On the contrary, creation of a CBDC would provide the public a risk-free virtual currency with legitimate benefits of a digital asset (such as reasonable level of anonymity and ease of performing online transactions). This would also enhance and restore trust in the central bank currency.



Design considerations for CBDC – the digital rupee (e₹)

Based on the usage and functions of the CBDC, the RBI has proposed issuing two versions of the CBDC - a general purpose, retail CBDC (CBDC-R) and CBDC-W for wholesale use.

CBDC-W	CBDC-R
CBDC-W could be used for improving the efficiency of inter-bank payments or securities settlement. It could also be used for transactions relating to instruments such as government securities, commercial papers and debentures etc. bypassing the bank account route.	CBDC-R would be an electronic version of cash primarily meant for retail consumption. It would provide an alternative medium for making digital payments (with direct access to central bank money).

The RBI has considered the following key design questions relating to the CBDC:

a. Role of the central bank and other entities – the concept note evaluates three models:

- Direct model:* The central bank will be responsible for managing all aspects of the CBDC system such as issuance, account keeping, transaction processing and verification etc.
- Indirect model:* Consumers would hold the CBDC in an account/wallet with a bank/service provider (an intermediary) and the transactions would be processed by the service provider. Transaction processing and customer interface, etc. is managed by the intermediary. The central bank would only track the wholesale balances with the intermediaries and the obligation to provide CBDC on demand to the customers would fall on the intermediary.
- Hybrid model:* This model is similar to the indirect model; Under this model, commercial intermediaries (payment service providers) provide retail services to end users. However, the central bank would maintain a ledger/record of all retail transactions (since it is a direct claim on the central bank).

RBI in its concept paper has highlighted that the indirect model is the most suitable architecture for introducing the CBDC in India. Under this

model, the RBI would create and issue tokens to authorised entities called Token Service Providers (TSPs) who in turn would distribute these to the end users. All customer facing activities including customer verification, Know Your Customer (KYC), Anti-Money Laundering (AML) checks, transaction verification will be performed by these TSPs.

b. Whether CBDC as an instrument should be interest bearing (deposit-like vs cash-like):

The concept paper highlights that an interest-bearing CBDC (remunerative CBDC) would be more attractive as it would serve as a store of value. It may also help in effective transmission of central bank's monetary policy, i.e., it would strengthen the pass through of the central bank rates to the financial system (for example – a central bank could even set a negative interest rate for CBDCs). However, a remunerative CBDC may make bank deposits less attractive. This would therefore increase borrowing costs for banks and could reduce credit supply in the market.

Further, since CBDC is an alternative to cash, the concept note argues that it should imbibe all elements of cash. Considering this, RBI highlighted that physical cash does not carry any interest and it would be logical to offer non-interest bearing CBDCs.

c. Token based or account based CBDC:

A CBDC can be structured as a 'token', an 'account' or a combination of both.

Token based CBDC would involve a type of digital token issued by the central bank with a unique token number (representing a claim on the bank) – like a bank note. It would be a bearer instrument (like bank notes), whoever holds the token would be presumed to be the owner. The token can be held and linked with an individual's mobile device, or a wallet provided by the TSP and exchanged/transferred electronically. On the other hand, an account-based system would require maintenance of records/accounts for all account holders to indicate the ownership of the monetary balances.

d. Level of anonymity:

Cash transactions can be performed without maintaining evidence of transacting parties, it has universality and has settlement finality. However, digital transactions usually leave a trail. Since CBDC is intended to provide an alternative to cash transactions, RBI argues that it should have the same characteristics that physical currency represents. Therefore, some level of anonymity would be incorporated in the design of the CBDC. However, it would be restricted to prevent illegal and shadow economy transactions, for example, by implementing transaction limits. This would be similar to the transaction limits and monitoring mechanism currently in place for large cash transactions.

Technology considerations

Since CBDC is a digital currency, technology considerations would always remain at its core to enable the translation of overall policy objectives into effective and smooth implementation across the country. In the context of the technology framework, the concept note discusses various functionalities that are desirable and can be considered for inclusion in the CBDCs. Some of these are discussed below:

- **Offline access:** Since major parts of rural and semi-urban areas of the country still face connectivity and internet issues, the concept note advocates for an offline capability in the CBDC architecture.
- **Integration with the existing payment systems and interoperability:** The aim of CBDC is to complement and integrate with the existing payment infrastructure available in the country and achieve co-existence, innovation and efficiency for the end users.
- **Cross border payments enabler:** RBI proposes to work together with other central banks and networks in designing an infrastructure that can facilitate easy and seamless international transactions.
- **Security considerations:** Security considerations have been given the center stage in the overall technological framework provided for the CBDCs. The concept note has suggested

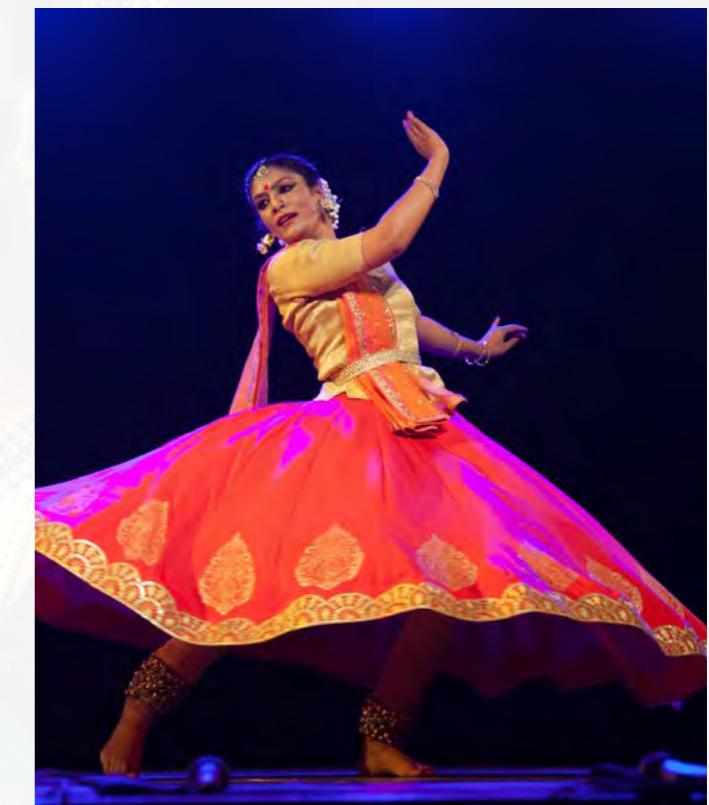
certain principles in this regard, including developing an enhanced risk management framework, rigorous testing of user interface, cryptography and quantum resistance, etc.

- **Data analytics:** The CBDC platform is expected to generate huge sets of data in real time. Thus, appropriate analytics can assist in evidence-based policy making, enforcing money laundering regulations, serve as a rich data source for service providers for financial product insights, among providing other benefits.

Having regard to the required functionality and the proposed design of the CBDC, the RBI has evaluated whether Distributed Ledger Technology (DLT), more commonly referred to as the blockchain technology, can be used as the platform for development of CBDC architecture.

Scalability has been identified as one of the key issues associated with the blockchain technology. In a DLT system, the ledger is usually managed jointly by multiple entities in a decentralised manner and each update (i.e., for each transaction) needs to be harmonised amongst the nodes of all entities. This limits number of transactions that can be processed using this system and it makes it slower than the conventional centrally controlled ledger.

Taking into consideration the vast geographical and demographic expanse of the country, concept note highlights that DLT, at this point of time, is not a suitable technology for the development of CBDC framework. However, depending upon future research and development activities, it could be evaluated for the indirect or hybrid CBDC architecture.



Next steps

Earlier this year, introduction of CBDCs was announced in the Union Budget and an appropriate amendment was also made to the RBI Act, 1934. Additionally, from 1 November 2022, RBI has commenced the pilot programme of CBDC-W (wholesale) and is soon planning to launch the first pilot for the retail segment as well⁶. CBDC holds a lot of promise and potential to expand the existing payment systems and address the needs of a wider category of users, in addition to supporting cross-border transactions. However, in the absence of relevant international benchmarks, extensive stakeholder consultation along with iterative technology design must take place to develop a solution that meets the envisaged requirements. As this is an evolving area, it will be important to watch how this implementation progresses in India and worldwide.

Some of the areas where there would be substantial impact is discussed below:

- User friendliness and impact on existing payment infrastructure:** With the presence of sound payment infrastructures ranging from RTGS and NEFT to UPI, the concept note argues that the CBDCs can provide an alternative medium of making digital payments (and it is not a substitute to the existing payment platforms). However, due care must be exercised that the

proposed framework offers seamless integration with the existing financial ecosystem and doesn't lead to unnecessary ambiguity for the users.

- Anonymity of transactions:** Since one of the key objectives of introducing CBDCs is to minimise the use of physical cash in the economy, as this would help in promoting the aim of digitisation of economy. In this regard, the provisions with respect to incorporating the programmability⁷ feature for keeping a check on the end use of funds may need to be deliberated upon, as it is likely to discourage people from switching to CBDCs from the present cash system.

- Comparison with virtual cryptocurrencies:** The concept note has discouraged the use and application of private cryptocurrencies, accusing them of being highly volatile and disrupting the traditional financial system. The various central banks globally have considered the rise of crypto-currency as one of key reasons to CBDC (to address the need of the users to perform digital transactions with reasonable anonymity). However, since CBDCs would be issued in the form of a digital currency and would not be tradable on any exchange or other similar platforms, it may not be directly comparable to these crypto-currencies. It will be of interest to

see how the behavioural patterns relating to use of crypto-currencies evolve and change with the issue of CBDCs.

- Impact on financial statement audits:** For entities that hold and transact in digital/virtual assets (including CBDCs), auditors would need to factor additional risks relating to such assets while performing audit engagements. Auditors would have to carefully assess the risks, evaluate the relevant internal controls relating to the performance of such transactions and perform specific substantive procedures to obtain adequate audit evidence relating to these balances. This will also include risks relating to cybersecurity and other relevant IT considerations.

6. The Economic Times article dated 9 November 2022 titled "RBI CBDC: Digital Rupee pilot starts from November 1; SBI, HDFC, 7 other banks to participate in wholesale launch"

7. CBDCs have the possibility of programming the money by tying the end use.



CHAPTER 4

Regulatory updates



Amendments to SEBI LODR Regulations

On 14 November 2022, the Securities and Exchange Board of India (SEBI) issued certain amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations) through SEBI LODR (Sixth Amendment) Regulations, 2022.

Some of the key amendments issued are as follows:

- **Appointment and removal of Independent Directors (IDs):** Currently under Regulation 25 of the LODR Regulation appointment, re-appointment, or removal of IDs is to be made through a special resolution. Regulation 25 has been amended to include an alternate method for appointment and removal of IDs.

As per the alternate method if a special resolution for the appointment of an independent director fails, then the following thresholds should be tested:

- i. The votes cast in favour of the resolution exceed the votes cast against the resolution, and
- ii. The votes cast by the public shareholders in favour of the resolution exceed the votes cast against the resolution.

If the above two thresholds are met then, the ID is deemed to be appointed. Further, the above threshold would also be applicable for removal of an ID appointed under this alternate mechanism.

- **Submission of financial results:** The SEBI introduced following amendments for listed entities which have Non-Convertible Securities (NCS).

i. Timeline for submission of results: As per the existing provisions of Regulation 52, every listed entity that issued NCS is required to prepare and submit un-audited or audited quarterly and year to date standalone financial results on a quarterly basis in the format specified by SEBI within 45 days from the end of the quarter other than for the last quarter. The SEBI introduced a new proviso to clarify the timeline for the submission of the financial results for the last quarter. It provides that the listed entity that issued NCS can submit its un-audited or audited quarterly and year to date standalone financial results within 60 days from the end of the last quarter to the recognised stock exchange.

- **ii. Disclosure of ratios:** Regulation 52(4) states that, listed entities are required to disclose certain ratios/financial information in the quarterly and annual financial results.

The SEBI through its recent amendments provided that the following ratios should be disclosed:

- Debt-equity ratio,
- Debt service coverage ratio,
- Interest service coverage ratio,
- Outstanding redeemable preference shares (quantity and value),
- Capital redemption reserve/debenture redemption reserve,
- Net worth,
- Net profit after tax,
- Earnings per share,
- Current ratio,
- Long term debt to working capital,
- Bad debts to account receivable ratio,
- Current liability ratio,
- Total debts to total assets,
- Debtors' turnover,
- Inventory turnover,
- Operating margin percent and
- Net profit margin percent.

In case these ratios or information is not applicable to a listed entity, it should disclose other ratio/equivalent financial information, as may be required under applicable law, if any.

iii. Timeline for submission of statement indicating the utilisation of the issue proceeds:

Currently, Regulation 52(7) and Regulation 52(7A) of the LODR Regulations require a listed entity that has issued NCS to submit to the stock exchange(s), a statement indicating the utilisation of the issue proceeds of non-convertible securities and statement disclosing material deviation(s) in the use of issue proceeds of non-convertible securities from the objects of the issue, in the format specified by SEBI within 45 days from the end of every quarter. SEBI has amended that a listed entity should submit such statements along with the quarterly financial results.



iv. Newspaper advertisement: Currently, Regulation 52(8) requires a listed entity to publish its financial results and provide the details of ratios and financial information, in at least one English national daily newspaper circulating in the whole or substantially the whole of India, within two working days of the conclusion of the board meeting. SEBI has clarified that a listed entity that has issued NCS and it submitted both standalone and consolidated financial results, then it shall publish the consolidated financial results along with the ratios and financial information in the newspaper.

• Scheme of Arrangement: The SEBI has issued new Regulations 59A to introduce following provisions relating to scheme of arrangements for entities which have NCS or Non-Convertible Redeemable Preference Share (NCRPS). The key provisions are:

- Every listed entity with NCS/NCRPS that intends to undertake a scheme of arrangement or is involved in a scheme of arrangement as per the provisions of the Companies Act, 2013 (2013 Act), should file the draft scheme of arrangement with the stock exchanges along with a non-refundable fees to obtain a no-objection letter. This letter would be valid for a period of six months within which the draft scheme of arrangement should be filed by the listed entity with the National Company Law Tribunal (NCLT).

- A listed entity should place the no-objection letter of the stock exchange(s) before the NCLT at the time of seeking approval for the scheme of arrangement. Upon sanction of the scheme by the NCLT, the listed entity would submit the prescribed documents to the stock exchange(s).

The above mentioned amendments are effective from 14 November 2022.

(Source: SEBI circular no. SEBI/LAD-NRO/GN/2022/103 dated 14 November 2022)

SEBI issues consultation paper on disclosure of material events or information

Regulation 30 of the SEBI LODR Regulations require every listed entity to provide disclosures of events or information which, in the opinion of the Board of Directors of the listed company, are material in accordance with the provisions of Part A of Schedule III of the LODR Regulations. However, SEBI received various complaints/references regarding inadequate/inaccurate/misleading/delayed disclosures provided by the listed entities. Further, listed entities have also expressed their concern that uniformity in the guidance is required for determining materiality of events or information.

With an aim to streamline the disclosure requirements for material events or information, SEBI has recently issued a consultation paper

'Consultation Paper on Review of disclosure requirements for material events or information'. Some of the key proposals provided by the consultation paper are:

a. Materiality threshold for disclosure: Para B of Part A of Schedule III of the LODR provides a list of events that are required to be disclosed as per the materiality policy framed by the listed entities. The consultation paper proposes to introduce a quantitative criteria of minimum threshold for disclosure of events specified under Para B. Accordingly, it is proposed that the listed entities should disclose an event or information specified under Para B whose threshold value or the expected impact in terms of value exceeds the lower of the following:

- i. Two per cent of turnover, as per the last audited standalone financial statements of the listed entity
- ii. Two per cent of net worth, as per the last audited standalone financial statements of the listed entity
- iii. Five per cent of three-year average of absolute value of profit/loss after tax, as per the last three audited standalone financial statements of the listed entity.

b. Materiality policy: It is proposed that listed entities should have an additional quantitative threshold or criteria for determining materiality of events in their materiality policy.

Therefore, it is proposed to specify the following in the Regulation 30(4):

- i. Materiality policy of the listed entity should not dilute any requirements specified under the LODR Regulation.
- ii. Materiality policy of a listed entity should be framed in a manner so as to assist employees in identifying potential material event or information which shall be escalated and reported to the relevant Key Managerial Personnel (KMP) for determining materiality of the event or information and for making disclosure to the stock exchange(s).

c. Timeline for disclosure: It has been proposed that, a listed entity should disclose all material events, as specified in Part A of Schedule III, or information which emanates from the listed entity, within 12 hours (*currently 24 hours*) to the stock exchange(s).

In case of events or information which emanate from a decision taken in board meeting, it is proposed that, the disclosure should be made within 30 minutes from the closure of such meeting. However, this proposal shall not apply for those events having specific timelines provided under Part A of Schedule III of LODR. Annexure II of the consultation paper prescribes the proposed timelines for disclosure of all the events specified under Part A of Schedule III of the LODR Regulations.

d. Verification of market rumours: The top 250 listed entities should necessarily confirm or deny any event or information reported in the mainstream media, whether in print or digital mode, which may have material effect on the listed entity under the LODR Regulations. The top 250 listed entities should be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

e. Disclosure of cyber security incidents or breaches and loss of data/documents: It is proposed that listed entities should provide disclosures in relation to 'cyber security incident'¹ or 'cyber security breaches'¹ or loss of data/documents of a listed entity in the quarterly corporate governance report in the format as prescribed by SEBI.

f. Addition and modification of events: The consultation paper has also proposed certain additions and modifications of events under Para A and Para B of Part A of Schedule III of LODR Regulations. The key additions and modifications are as follows:

- Details of the regulatory actions taken against listed entity, its directors, KMP, senior management, promoter, or subsidiary shall be disclosed. The name of the authority, nature and details of the action(s) taken or initiated, date of receipt of direction or order, details of the violation(s) committed and the impact on financial, operational or other activities of the listed entity should be disclosed.

- Delay or default in payment of fines, penalties, dues, etc. to any regulatory, statutory, enforcement or judicial authority should be disclosed.
- Details regarding voluntary revision of financial statements or the report of the board of directors of the listed entity shall be provided.
- At present, disclosure of change in directors, KMP, auditor and compliance officer are required to be provided. It has been proposed that change in senior management shall also be disclosed.
- In case of resignation of a KMP, a senior management, or a director other than independent director, the letter of resignation along with detailed reasons for the resignation as given by the KMP or the senior management or the director shall be disclosed to the stock exchanges by the listed entities within seven days from the date of resignation.
- If the Managing Director (MD)/Chief Executive Officer (CEO) is not available to perform his roles and responsibilities for a period of more than a month, the same should be disclosed to the investors.
- In case of acquisition of control by a listed entity, it has been clarified that acquisition would mean acquisition of shares in a newly incorporated entity as well as an existing entity. Further, a disclosure shall be provided

if the acquisition exceeds the materiality threshold limit as prescribed in consultation paper. Additionally, a disclosure should also be provided in case of sale of stake in an associate company and sale or disposal of the whole or substantially the whole of an undertaking as defined under Section 180 of the 2013 Act. It has been clarified that sale or disposal of subsidiary or stake in an associate shall include:

- i. Cessation of control in subsidiary, or
- ii. Sale or agreeing to sell more than two per cent of shares or voting rights in the subsidiary or associate company

- Disclosure shall be provided by the listed entity in case of any arrangements for strategic, technical, manufacturing, or marketing tie-up, adoption of new line(s) of business or closure of operation of any unit/division/subsidiary (in entirety or piecemeal).
- At present, disclosures were provided for loan agreements wherein the listed entity was a borrower. It has been proposed that material loan agreements in which the listed entity is a lender should also be disclosed. Therefore, a listed entity should provide disclosures with respect to all loan agreements entered/amended/revised/terminated which are binding and not entered into in the normal course of business.

Further, this disclosure shall not be provided by a bank or a non-banking financial company.

(Source: SEBI circular no. SEBI/LAD-NRO/GN/2022/103 dated 14 November 2022)

SEBI issues master circular for release of one per cent of issue amount in a public issue

As per the provisions of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations), the issuer, before the opening of the subscription list, is mandated to deposit with the Designated Stock Exchange (DSE), one per cent of the issue size available for subscription to the public. This amount deposited should be released to the issuer as per the manner specified by SEBI.

In this regard, SEBI has issued a master circular which states that, the amount of one per cent of the issue size deposited shall be released after obtaining a No Objection Certification (NOC) from SEBI. The master circular prescribes the manner for obtaining the NOC. All companies whose securities are listed on the stock exchanges and all registered merchant bankers are required to comply with the provisions of this master circular.

1. As defined in Information Technology (The Indian Computer Emergency Response Team and Manner of Performing Function and Duties) Rules, 2013.

The issuer is required to submit an application on its letter head to SEBI, after the expiry of 2 months from the date of listing on the latest stock exchange which permitted listing. The application for NOC should be filed by the Post Issue Lead Merchant Banker (PILMB), provided that all issue related complaints have been resolved by the PILMB/issuer. The master circular provides the format for submitting the applications.

SEBI shall issue the NOC after satisfying itself that the complaints arising from the issue received on SEBI Complaint Redress System (SCORES) against the issuer have been resolved to its satisfaction. The issuer has been submitting 'Action Taken Reports' on such complaints as per the format specified in master circular.

The above master circular is effective from 7 November 2022.

(Source: SEBI circular no. SEBI/HO/OIAE/IGRD/P/CIR/2022/0151 dated 7 November 2022)



SEBI introduces provisions on pre-filing of offer document for the purpose of Initial Public Offer (IPO)

On 21 November 2022, SEBI issued amendments to ICDR Regulations to prescribe the mechanism for pre-filing the draft offer document with the stock exchange in case of an IPO of specified securities. This pre-filing mechanism would allow issuers to carry out limited interaction without having to make any sensitive information public.

The key considerations for pre-filing of offer document are as follows:

- i. Prior to making an IPO, the issuer may file the following documents with SEBI and the stock exchange along with fees as specified in the ICDR Regulations:
 - a. Three copies of the draft offer document
 - b. Agreement that has been entered into between the issuer and the lead manager (s)
 - c. A due diligence certificate in the specified format
 - d. An undertaking from the issuer and the lead manager that they would not conduct marketing or advertisement for the intended issue.
- ii. The pre-filed draft offer document would not be available in the public domain. However, a public announcement would be made disclosing the fact of pre-filing of the draft offer document without providing any other details in relation to the intended issue, within two days of such pre-filing.
- iii. Provides guidance on resolution of the SEBI's observations with respect to the draft offer document and filing of updated draft red herring prospectus after complying with SEBI's observations. Further, guidance is also provided with respect to the observations of the public on the draft red herring prospectus and updation of the same.
- iv. The interaction with the Qualified Institutional Buyers (QIBs) will be permitted, provided such interaction is only to the extent of the information contained in the pre-filed draft offer document. The issuer must prepare a list of the QIBs who have participated in such interaction and obtain a confirmation of interaction from the QIBs to be submitted to SEBI.
- v. If the issue size exceeds INR100 crore, the issuer should make arrangements for appointing a credit rating agency to monitor the use of proceeds of the issue.
- vi. Further, the format and requirements for filing of

the following due diligence certificates has been prescribed in the regulations:

- To be filed along with pre-filed draft offer document
- At the time of filing the updated draft red herring prospectus
- In the event of disclosure of material events after the filing of the offer document.

The above mentioned regulations are effective from 21 November 2022.

(Source: SEBI notification no. No. SEBI/LAD-NRO/GN/2022/107 dated 21 September 2022)

Amendment to mutual fund regulations for transfer of dividend and redemption of proceeds

Regulation 53 of the SEBI (Mutual Funds) Regulations, 1996 (Mutual Fund Regulations) prescribed the procedure for dispatch of dividend warrants to the unitholders.

On 15 November 2022, SEBI issued SEBI (Mutual Funds) (Third Amendment) Regulations, 2022 to introduce new provisions on transfer of dividend to unitholders and redemption of proceeds replacing existing Regulation 53. Further on 25 November 2022, SEBI issued a circular

stipulating the timelines for transfer of such dividend and redemption of the proceeds to the unitholder. These regulations are applicable to every mutual fund and asset management company.

The key takeaways from the revised regulations are as follows:

- Payment of dividend:** The record date for payment should be two working days from the issue of public notice and dividend would be transferred to the unitholders within seven working days from the record date.
- Redemption or repurchase:** The proceeds should be transferred to the unitholders within three working days from the date of redemption or repurchase. In case of mutual fund schemes wherein 80 per cent of total assets are invested in permissible overseas investments², the timeline for transfer is within five working days from the date of redemption or repurchase.
- Delay in transfer of dividend, proceeds on redemption, or repurchase:** The interest would be payable to unitholders at the rate of 15 per cent per annum. The details of such payments shall be sent to SEBI as per the format prescribed in the SEBI's circular and investors should be informed about the rate of interest and the amount of interest.

The above amendment should be effective from 15 January 2023.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2022/106 dated 15 November 2022 and circular no. SEBI/HO/IMD/IMD-DOF2/P/CIR/2022/161 date 25 November 2022)

NFRA's circular on accrual of interest on borrowings classified as Non-Performing Asset (NPA) by the lender

The National Financial Reporting Authority (NFRA) issued a circular on accrual of interest on borrowings undertaken by companies.

Ind AS 109, *Financial Instruments*, prescribes the manner for recognition and recognition of financial assets and liabilities. As per the principles of Ind AS 109, borrowings and interest payable thereon are classified as financial liabilities and should be accounted at amortised cost as per the principles of Effective Interest Method and Effective Interest Rate (EIR).

Further, Ind AS 109 also states that a financial liability or a part of it should be derecognised only when it is extinguished i.e. when a borrower is legally released from the primary responsibility for the liability (or part of it) either by process of law or by the creditor.

In the case of defaults, a lender bank classifies certain borrowings as Non-Performing Asset (NPA) based on the prudential guidelines of RBI or write-off the borrowings for accounting purpose (termed as technical write-off'). The banks are required to maintain to a memorandum record of accrual interest on such NPAs which reflects the fact that

the bank has not legally released the borrowers from their contractual liability to pay the interest on the borrowings. In this scenario, if a company does not accrue or discontinues the recognition of interest expense on borrowings classified as NPA by the lender bank, such an accounting treatment followed by the company contravenes the principles of Ind AS 109.

In this regard, NFRA issued a circular clarifying that, discontinuation of interest expense recognition on financial liability solely based on borrowing company's expectation of waiver/concession of the loan/interest without evidence of legally enforceable contractual documents would result in a major non-compliance with the provisions of Ind AS 109.

(Source: NFRA circular no. NF-25011/5/2022-O/o Secy-NFRA dated 20 October 2022)

NFRA issues audit quality inspection guidelines

On 11 November 2022, the NFRA published its audit quality inspection guidelines. The overall objective of inspections is to evaluate compliance of the audit firm/auditor with auditing standards and other regulatory and professional requirements, and the sufficiency and effectiveness of the quality control system of the

audit firm/auditor including:

1. Adequacy of governance framework and its functioning
2. Effectiveness of firm's internal control over audit quality
3. System of assessment and identification of audit risks and mitigating measures.

The guidelines prescribe the criteria, scope and methodology of conducting the inspection.

(Source: NFRA press released id:1875275, dated 11 November 2022)

Framework for sovereign green bonds

With an ambition to significantly reduce the carbon intensity, the Hon'ble Finance Minister during the union budget for Financial Year (FY) 2022-23 announced the issue of Sovereign Green Bonds (SGB) in India. Accordingly, on 9 November 2022, the Department of Economic Affairs, Ministry of Finance published the draft Framework for Sovereign Green Bonds (Framework) as per the recommendations received from International Capital Market Association.

The framework sets forth the obligations of

2. SEBI Circular SEBI/IMD/CIR No.7/104753/07 dated September 26, 2007 issued a list of permissible investments was for the purpose of overseas investments

the GOI as a green bond issuer and it applies to all SGBs issued by GOI. The framework is designed to comply with the components and key recommendations of the International Capital Market Association (ICMA) Green Bond Principles, 2021. The four core components as outlined in the framework are as follows:

i. Use of proceeds: The proceeds should be utilised in the manner as prescribed in the Framework. The GOI will use the proceeds raised from SGBs to finance and/or refinance expenditure for eligible green projects described under the 'eligible categories' in the Framework.

ii. Project evaluation and selection – The Framework lays down the process for evaluating and selecting eligible green projects. A Green Finance Working Committee (GFWC), as set up by the Ministry of Finance, will provide support in the selection and evaluation of projects and other relevant work related to the Framework.

iii. Management of proceeds: In order to ensure transparency in the allocation and accounting of the proceeds, a separate account will be created and maintained by the Ministry of Finance. As per the Framework, the Public Debt Management Cell (PDMC) will track the proceeds and shall also monitor the allocation of funds to the eligible green projects. A

summary of the project details, allocation of proceeds to each project, expected climate impact and the extent of unallocated proceeds will be maintained in the 'Green Register'.

iv. Reporting: An allocation report will be maintained and updated annually until outstanding proceeds are fully utilised and allocated to the eligible projects. The report shall also be updated in case of any material changes. The allocation and utilisation of the green bonds will also be under the purview of the Comptroller and Auditor General of India (CAG)

(Source: Department of Economic Affairs, Ministry of Finance publication on framework for sovereign green bonds issued on 9 November 2022)

Study on compliance of financial reporting requirements

The Financial Reporting Review Board (FRRB) of the Institute Chartered Accountants of India (ICAI) conducts reviews of general-purpose financial statements and auditor's report of various entities to determine the compliance with generally accepted accounting principles, auditor's reporting obligations, disclosure requirements of applicable rules and regulations relevant to the reporting enterprise.

Recently, the FRRB has issued Volume II of the study on compliance of financial reporting requirements (Ind AS framework) which highlights the instances of non-compliance with the financial reporting requirements observed by the FRRB.

The observations have been categorised into following eight categories:

- Assets,
- Equity,
- Liabilities,
- Statement of Profit and Loss,
- Statement of Cash Flows,
- Other disclosures,
- Auditor's report,
- CARO, 2016.

(Source: ICAI publication on Study on compliance of financial reporting requirements issued in 2022)



Report on audit quality review

The Quality Review Board (QRB), established by the Government of India under the Chartered Accountants Act, 1949, has conducted reviews of audit quality of entities in India. For the financial year 2021-22, QRB completed 24 reviews of audit quality of 23 entities in India. The QRB has summarised key findings observed in the audit quality reviews, key trends, QRB's expectations and other focus areas in its recent report. The QRB's review involves assessment of the work of statutory auditors while carrying out the statutory audit of an entity.

The major focus of the covered in the review report are as follows:

- a. Standards on Auditing (SAs)
- b. Accounting Standards and Ind AS
- c. Compliance with relevant laws & regulations, quality of reporting,

(Source: QRB publication on report on audit quality review published on 18 October 2022)

IASB issues amendments on classification of liabilities as current or non-current

The International Accounting Standards Board (IASB) has issued amendments to IAS 1, *Presentation of Financial Statements* relating to debt covenants. The amendments are as follows:

- Classification and disclosure of liabilities with covenants:** As per current requirements of IAS 1, a company classifies a debt as non-current only if the company can avoid settling the debt within 12 months after the reporting date. This right may be subject to a company complying with conditions (covenants) specified in a loan arrangement.

The recent amendment has now removed this requirement and states that, covenants which are to be complied with after the reporting date (i.e. future covenants) do not affect the classification of debt as current or non-current at the reporting date. Therefore, only covenants with which a company must comply on or before the reporting date affect the classification of a liability as current or non-current.

Additionally, the amendment provides companies to disclose information regarding

non-current liabilities that are subject to future covenants to help users understand the risk that such liabilities could become repayable within 12 months after the reporting date.

- Classification of convertible debt:** The IASB has also issued amendments with respect to classification of a liability that can be settled in a company's own shares – e.g. convertible debt. When a liability includes a counterparty conversion option that involves a transfer of the company's own equity instruments, the conversion option is recognised as either equity or a liability separately from the host liability under IAS 32, *Financial Instruments: Presentation*.

The IASB has now clarified that when a company classifies the host liability as current or non-current, it can ignore those conversion options that are recognised as equity.

The aforementioned amendments apply retrospectively for annual reporting periods beginning on or after 1 January 2024, with early application permitted.

(Source: IASB announcement dated 31 October 2022 and KPMG IFRG Ltd's web article on *Classifying liabilities as current or non-current* dated 3 November 2022)

Considerations of professional ethics in sustainability reporting

In the recent years, as stakeholders are focusing on sustainability information, professional accountants play a major role in the preparation, presentation and assurance of such information on account of their professional capabilities. Professional accountants are required to comply with the code of ethics while performing their engagements. The International Ethics Board of Accountants (IESBA) develops and promotes the International Code of Ethics for Professional Accountants (the Code) by setting high-quality ethics standards for professional accountants.

In October 2022, IESBA issued a non-authoritative publication in the form of Questions and Answers (Q&A) which highlights the key principles in the Code that apply in preparing and presenting sustainability information. The publication highlights the challenges with respect to professional ethics faced by professional accountants involved in sustainability reporting and assurance, especially circumstances involving preparation and reporting of misleading or false sustainability information (also termed as 'greenwashing').

The publication aims to combat the ethical concerns with respect to greenwashing by stating that professional accountants should be

straightforward and honest and should refrain from being associated with information that is misleading or false, including in situations where they might experience pressure to do so. The publication also aims to assist other professionals involved in preparing sustainability reports or disclosures e.g.- regulators and audit oversight bodies, policy makers, investors, those charged with governance, national standard setters, professional accountancy organisations, and others working towards sustainability reporting and assurance.

(Source: IESBA announcement dated 21 October 2022)



IAASB issues guidance on the impact on the International Standards on Auditing (ISAs) due to the amendments made in IAS 1

On 12 February 2021, IASB had issued narrow-scope amendments to the International Financial Reporting Standards (IFRS) to help companies improve their accounting policy disclosures in order to provide more useful information to the stakeholders.

The narrow-scope amendments to IAS 1 requires entities to disclose their material accounting policy information, instead of significant accounting policies. The amendments are effective for annual reporting periods beginning on or after 1 January 2023, with early application permitted. When management prepares the financial statements of an entity in accordance with IFRS, the amendments to IAS 1 should also be factored in by the management while disclosing the accounting policies of the entity. The auditor is required to evaluate the appropriateness of management's disclosures.

The International Auditing and Assurance Standards Board (IAASB) considers financial reporting framework developments that may affect the ISAs, such as changes to the IFRS. Considering recent amendments IAASB has published a non-authoritative guidance to help users understand the impact on the ISAs due to narrow-scope amendments made in IAS 1.

As per the guidance issued, under circumstances wherein the management of the entity is preparing the financial statements in accordance with the IFRS, including the amendments to IAS 1, the amendments should be incorporated in the auditor's report as well. The terminology 'a summary of significant accounting policies' should be replaced with 'material accounting policy information'.

The IAASB will update the illustrations in the relevant standards on auditing and review engagements to align the relevant terminology with the amendments² to IAS 1. Such updates will be included in the 2022 edition of the IAASB Handbook.

(Source: IAASB announcement dated 16 November 2022)

3. ISA 510, Initial Audit Engagement—Opening Balances; ISA 570 (Revised), Going Concern; ISA 600 (Revised), Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors); ISA 700 (Revised); ISA 705 (Revised); ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report; ISA 710, Comparative Information—Corresponding Figures and Comparative Financial Statements; ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information. Appendix 1 of ISA 210, Agreeing the Terms of Audit Engagements, illustrations in Appendix 1 and Appendix 2 of ISRE 2400 (Revised), Engagements to Review Historical Financial Statements,



First Notes



Social Stock Exchange - A detailed framework issued by SEBI

On 25 July 2022, the Securities Exchange Board of India (SEBI) incorporated new chapters relating to the Social Stock Exchange (SSE) by amending the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations) and SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations).

On 19 September 2022, SEBI issued a detailed framework prescribing the minimum requirements to be followed by a Not for Profit Organisation (NPO) that desires to be registered/listed on an SSE. The main themes of the Framework are depicted below:

- a. (Registration of a Not for Profit Organisation (NPO)
- b. Disclosure to be provided by NPOs for raising funds through the issuance of Zero Coupon Zero Principal (ZCZP) Instruments
- c. Annual disclosures to be provided by an NPOs
- d. Disclosures forming part of the Annual Impact Report (AIR) submitted by Social Enterprises (SEs).
- e. The circular also prescribes the time limit for submission of statement of utilisation of funds by an NPO.

This issue of the First Notes provides an overview of the SSE framework issued by SEBI.

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000.

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Voices on Reporting – Special session on FEMA- New overseas investment framework

On 16 November 2022, KPMG in India organised a VOR webinar to discuss the updates regarding the new framework on overseas investment framework issued by the Central Government and Reserve Bank of India which includes the following regulations:

- Foreign Exchange Management (Overseas Investment) Rules, 2022 (OI Rules)
- Foreign Exchange Management (Overseas Investment) Regulations, 2022 (OI Regulations) and
- Foreign Exchange Management (Overseas Investment) Directions, 2022 (OI Directions).

To access the recording and presentation of the webinar, please [click here](#)

Introducing



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