Accounting and Auditing Update

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Foreword

Distinguishing between accounting policies and accounting estimates is important because changes in accounting policies are generally applied retrospectively, while changes in accounting estimates are applied prospectively. The approach taken can therefore affect both the reported results and trends between periods. Therefore, the International Accounting Standards Board (IASB) issued amendments to IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* to clarify how companies should distinguish changes in accounting policies from changes in accounting estimates, with a primary focus on the definition of and clarifications on accounting estimates. The amendments introduce a new definition for accounting estimates: clarifying that they are monetary amounts in the financial statements that are subject to measurement uncertainty. The amendments also clarify the relationship between accounting policies and accounting estimates by specifying that a company develops an accounting estimate to achieve the objective set out by an accounting policy. However, the definition of accounting policies remains unchanged. The amendments are effective for periods beginning on or after 1 January 2023. Further, it is pertinent to note that the revised definition of accounting estimates in IAS 8 is similar to the definition in the existing Standard on Auditing (SA) 540, *Auditing Accounting Estimates*. This edition of Accounting and Auditing Update (AAU) contains an article on this topic which discusses the recent amendments to IAS 8 which are also expected in Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. Additionally, the article summarises the auditing guidance in relation to accounting estimates and discusses key considerations for management and auditors.

Our second article focusses on ethical considerations related to sustainable reporting. The disclosure and communication of Environmental, Social, and Governance (ESG) goals, as well as a company's progress toward them represent sustainability reporting. Over the past decade, sustainability reporting has gained prominence among the investors, regulators and other stakeholders. Many countries across the globe are adopting mandatory reporting and disclosure of sustainability related information. The accountancy profession plays a major role in sustainability reporting from the perspective of technical competency in preparing, presenting, and assurance. While global sustainability reporting standards will be essential to meet the information needs of investors and other stakeholders, it is critical to recognise the role of ethics in supporting public trust in sustainability reporting and assurance. 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 professional accountants' obligations and assist them in navigating ethics situations or challenges that might lead to reporting misleading or false sustainability information. Our article on this topic summarises guidance on the challenges with respect to consideration of professional ethics in sustainability reporting.

There have been various regulatory developments in India and internationally during the month. Recently, the Securities Exchange Board of India (SEBI) issued certain amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 such as expansion in the definition of senior management, approval requirement for re-appointment of a person on the board of directors, corporate governance disclosures in the annual report, etc. Further, the Reserve Bank of India (RBI) issued discussion paper on Expected Credit Losses (ECL) based approach for loan loss provisioning by banks which incorporates the more forward-looking ECL approach as against the extant 'incurred loss' approach. 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

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CHAPTER 1

Accounting estimates

This article aims to:

- Highlight changes to guidance on accounting estimates under IFRS and expected under Ind AS.
- Summarises the auditing guidance in relation to accounting estimates.

The current IAS 8 (Ind AS 8), *Accounting Policies, Changes in Accounting Estimates* and Errors does not define the term 'accounting estimate' instead it defines the term 'change in accounting estimate'.

The International Accounting Standards Board (IASB) observed that entities faced difficulties in distinguishing changes in accounting policies from changes in accounting estimates. This was due to the fact that definition of a change in accounting estimate in the standard was not sufficiently clear.

Distinguishing between accounting policies and accounting estimates is important because changes in accounting policies are generally applied retrospectively, while changes in accounting estimates are applied prospectively. The approach taken can therefore affect both the reported results and trends between periods.

Therefore, the IASB issued amendments to IAS 8 to clarify how companies should distinguish changes in accounting policies from changes in accounting estimates, with a primary focus on the definition of and clarifications on accounting estimates.

In response to change in IAS 8, the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) has issued an exposure draft which is proposed to be effective on 1 April 2023 corresponding to amendments in IFRS Standard IAS 8.

New definition

The amendments to IAS 8 are summarised below:

- The new definition of accounting estimate is that **'Accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty.'**
- Clarify the relationship between accounting policies and accounting estimates by specifying that a company develops an accounting estimate to achieve the objective set out by an accounting policy.
- Developing an accounting estimate includes both
  - Selecting a measurement technique (estimation or valuation technique)
  - Choosing the inputs to be used when applying the chosen measurement technique.

  The amended standard explicitly provides some examples of estimates to be developed by management based on the applicable financial reporting framework. These are:

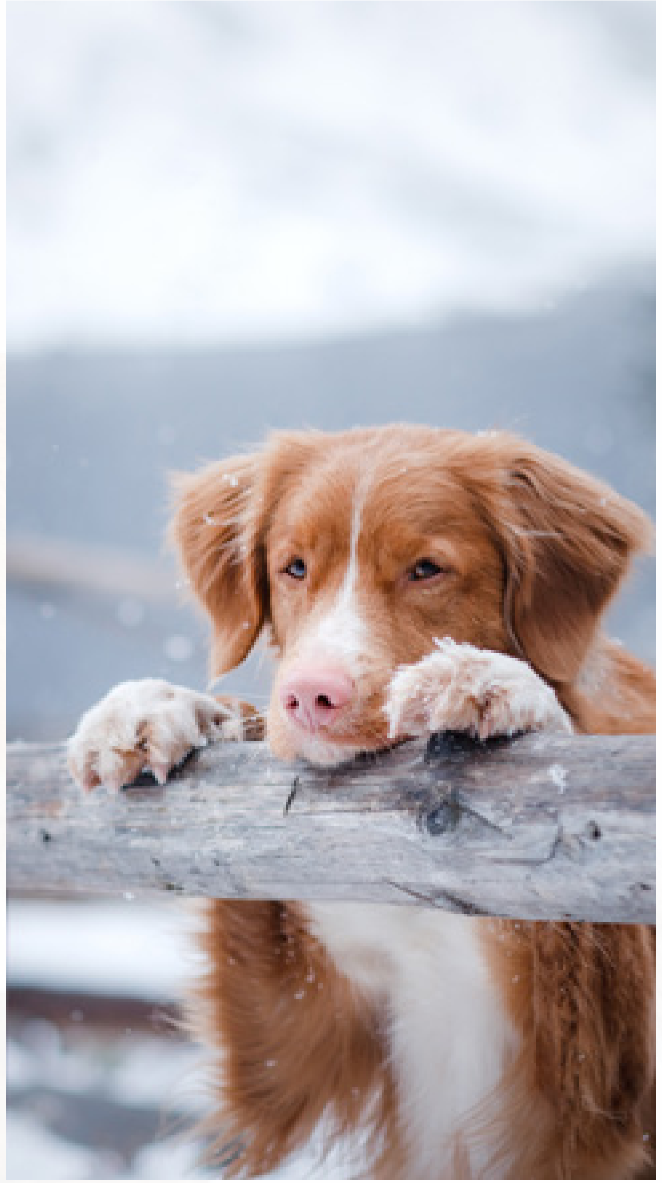
  a. Loss allowance for expected credit losses, applying IFRS 9, *Financial Instruments*
  b. The net realisable value of an item of inventory, applying IAS 2 *Inventories*
  c. The fair value of an asset or liability, applying IFRS 13, *Fair Value Measurement*
  d. The depreciation expense for an item of property, plant and equipment, applying IAS 16, *Property, plant and equipment*.

The definition of accounting policies remains unchanged.

It is pertinent to note that the revised definition of accounting estimates in IAS 8 is similar to the definition in the existing Standard on Auditing (SA) 540, *Auditing Accounting Estimates*.

As per SA 540, an accounting estimate is an approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation.

This SA deals with the auditor's responsibilities regarding accounting estimates, including fair value accounting estimates, and related disclosures in an audit of financial statements. It further expands on how SA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment* and SA 330, *The Auditor's Responses to Assessed Risks and* other relevant SAs are to be applied in relation to accounting estimates. The standard also highlights the responsibilities of management towards identifying, making, and disclosing an accounting estimate.



Management's responsibility

It is management's responsibility to identify those transactions, events and conditions that may give rise to the need for accounting estimates to be recognised or disclosed in the financial statements. These would be based on management's understanding of the business and industry.

Elements of an accounting estimate as per the auditing standard

Determination of an accounting estimate depends on few elements e.g. selection of an accounting policy, method, assumptions and data. Management will establish a process for making an accounting estimate, including internal controls. These would include:

a. Selecting appropriate accounting policies and prescribing estimation processes, including appropriate estimation or valuation methods, including, where applicable, models. Management is required to use measurement techniques and inputs as per the applicable financial reporting framework in order to develop an estimate, for example, the technique as mentioned in Ind AS 109, *Financial Instruments* to measure loss allowance for expected credit losses. However, there may be situations where there are no specific methods prescribed by the applicable financial reporting framework.

b. Developing or identifying relevant data and assumptions that affect accounting estimates. The assumptions made by management should be supported by external or internal information sources.

   There may be situations based on specialised, technical and/or unusual nature of an accounting estimate where management may need to engage an expert to make or assist in making the accounting estimate. Such assumptions, when used by management, become management's assumptions.

c. Periodically reviewing the circumstances that give rise to the accounting estimates and re-estimating the accounting estimates as necessary.

Estimation uncertainty

Accounting estimate and its related disclosure are susceptible to an inherent lack of precision in its measurement which is called as estimation uncertainty. Management may evaluate alternative assumptions or outcomes of the accounting estimates through a number of methods, depending on the circumstances. One possible method used by management is to undertake a sensitivity analysis.

Auditor's responsibility

While auditing an accounting estimate an auditor would be identifying and assessing the risk of material misstatement associated with an accounting estimate where there is likelihood of estimation uncertainty. Where there is an estimation uncertainty then an auditor shall further evaluate whether there is a significant risk. Therefore, SA 540 requires an auditor to perform procedures to obtain an understanding for the process of development of the accounting estimates (i.e. identification and assessment of risk of material misstatement). An auditor would understand on how management:

- Identifies accounting estimates
- Develops the accounting estimates basis the method, assumption and data used
- Whether appropriate controls are in place
- How management assesses the effect of estimation uncertainty.

After understanding the process of development of the accounting estimates (i.e. identification and assessment of risk of material misstatement), an auditor would need to perform certain audit procedures. These procedures may include the following :

- Audit evidence from events occurring up to the date of the auditor's report
- Testing how management made the accounting estimate and the data on which it is based
- Testing the operating effectiveness of management controls, together with appropriate substantive procedures
- Developing the auditor's point estimate or range.

In addition to the above procedures, for accounting estimates that give rise to significant risks, the auditor needs to further evaluate:

- How management has addressed estimation uncertainty
- Whether the significant assumptions used by management are reasonable.

ISA 540 revised?

The International Auditing and Assurance Standard Board (IAASB) based on its outreach activities realised that the accounting estimates is a key area where enhanced auditing standards are required to enable an auditor to deal with increasingly complex accounting estimates and the related disclosures. Accordingly, IAASB revised the International Standard on Auditing (ISA) 540, *Auditing Accounting Estimates and Related Disclosures*, (ISA 540 (Revised)). While the broad outline as mentioned in the earlier version of ISA 540 towards management and auditor's responsibilities remains same, there are certain key concepts that have been included and/or amended.

Since measurement of accounting estimates is subject to estimation uncertainty, it reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The ISA 540 Revised states that when management makes an accounting estimate it involves selecting and applying a method using assumptions and data, which requires judgement and can give rise to complexity in measurement.

Therefore, ISA 540 (Revised) provides guidance in relation to` the effects of complexity, subjectivity or other inherent risk factors on the measurement of these monetary amounts.

Key considerations

Indicators of management bias

An auditor shall review the judgements and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias.

Communication to those charged with governance

An auditor would communicate with those charged with governance regarding significant qualitative aspects of the entity's accounting practices and significant deficiencies in internal control, respectively.

CHAPTER 2

Ethics consideration in sustainability reporting

This article aims to:

- Provide guidance on the challenges with respect to consideration of professional ethics in sustainability reporting.

Background

Stakeholders are now focussing on information that provides a better understanding of an entity's long-term value creation goals. This helps them to allocate capital to businesses that are striving for sustainable rather than just focussing on financial metrics. This has led to an increase in demand for timely, accurate and relevant sustainability information[1]. Many countries across the globe are adopting mandatory reporting and disclosure of sustainability related information.

The accountancy profession plays a major role in sustainability reporting from the perspective of technical competency in preparing, presenting, and assurance. While global sustainability reporting standards will be essential to meet the information needs of investors and other stakeholders, it is critical to recognise the role of ethics in supporting public trust in sustainability reporting and assurance. 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 professional accountants' obligations and assists them in navigating situations relating to ethics or challenges that might lead to reporting misleading or false sustainability information. This document is also useful for other professionals involved in preparing sustainability reports or disclosures including regulators and audit oversight bodies, policy makers, investors, Those Charged with Governance (TCWG), national standard setters, professional accountancy organisations, and others working towards sustainability reporting and assurance.

1. The term 'sustainability' refers to Environmental, Social and Governance (ESG) matters and related considerations associated with the achievement of the United Nations Sustainable Development Goals (SDGs)

Key concepts

The key concepts highlighted in the publication are as follows:

Application of the code to financial and non-financial information

The Code provides that a professional accountant must act in public interest while accepting any engagement. Professional accountants should adhere to the ethical principles and professional standards, use business acumen, apply expertise on technical and related matters and should exercise professional judgment in order to provide advice or other output that meets the purpose of the intended users of such output.

The financial and non-financial information including sustainability information, may assist stakeholders in understanding and evaluating an organisation's state of affairs and in making decisions concerning an organisation. The professional accountants must comply with the fundamental principles[2] of the Code while preparing and presenting sustainability information.

2. Section 110 of the Code describes the five fundamental principles of ethics for professional accountants. These include:
   a) Integrity
   b) Objectivity
   c) Professional competence and due care
   d) Confidentiality
   e) Professional behaviour

Preparation, presentation and reporting of sustainability information

In the recent years, a number of sustainability reporting frameworks and standards have been developed, majority of which deal with disclosures on ESG matters. The multitude of voluntary reporting standards and the fact that these can have different target users and scope as well as different definitions, formats and metrics, could create challenges with regard to comparability across different voluntary frameworks.

The Code specifically requires professional accountants to prepare and present sustainability information in accordance with the relevant reporting framework, where applicable. In cases where a sustainability reporting framework is not applicable or when the reporting framework does not include specific industry-related guidance, there is a possibility that some companies may choose to disclose certain ESG-related matters (e.g., carbon emissions) while omitting others (e.g., human-rights-related issues or information about diversity, equity and inclusion) or selectively disclose the risks. Therefore, the Code states that, when disclosure of particular aspects of sustainability performance is not required or is not standardised, professional accountants should exercise discretion in making professional judgement to prepare and present sustainability information. A professional accountant should consider following key points from the Code[3]:

a. Understand the purpose for which the information is to be used and the context within which it is given

b. Aware of its intended audience

c. Relevant background, assumptions and other disclosures should be provided to enable the intended users to make their assessments.

d. Industry specific information should be considered

e. Not to omit anything with the intention of misleading the intended users

f. Represent the facts accurately and completely in all material respects, describe the true nature of business transactions or activities and classify and record information in a timely and proper manner

g. Discretion in making judgement should not be exercised with the intention of misleading others or influencing contractual or regulatory outcomes inappropriately.

Challenges and safeguards with regard to 'greenwashing'

The term 'greenwashing' has not been defined in the Code. The International Organisation of Securities Commissions' (IOSCO) publication on Sustainable Finance and the Role of Securities Regulators[4], defines greenwashing as practices that involve disclosing information which would result in misleading the intended users or intentionally giving them a false impression about how well an organisation or an investment is aligned with its sustainability goals. Greenwashing covers more specifically a range of behaviours, from omitting information to misrepresenting or falsifying it with an intent to mislead investors and other users. In some cases, greenwashing might result in non-compliance with laws and regulations.

The entities should develop well-functioning systems, processes and internal controls to accurately collect and report sustainability information. It is pertinent to note that, although obtaining an external assurance can reduce the risk of reporting misleading information, considering the nascent state of ESG (Environmental Social and Governance) reporting and assurance standards, assurance alone cannot prevent greenwashing or act as a safeguard against greenwashing.

The Code highlights that the professional accountants should disassociate themselves from misleading information as threats to compliance with the fundamental principles of objectivity, professional competence and due care and professional behaviour can be created.

3. As per paragraph R220.4 (b) and (c), R220.5, R220.6 and R220.6 A1 of the Code.
4. IOSCO publication no. FR04/2020 issued in April 2020

Other matters

Professional competence, expertise and experience

A professional accountant should be professionally competent and should have the relevant expertise and experience when dealing with sustainability reporting requirements, measurements and evaluations. A professional accountant should comply with the fundamental principles of professional competence and due care.

However, if a professional accountant does not have the relevant sufficient expertise, it would result in creation of self-interest threat. Obtaining assistance or training from someone with the necessary expertise might be an appropriate safeguard to address the self-interest threat. However, if the self-threat cannot be addressed, the Code requires a professional accountant to consider declining the performance of his/her duties in question. If the accountant determines that declining is appropriate, the reasons for such decline should be communicated.

Verification of sustainability information

Certain companies may make misleading or inaccurate claims about their sustainability performance without providing evidence for such claims. Professional accountants must not accept the sustainability information at face-value. The Code requires an accountant to have an inquiring mind to obtain an understanding of the known facts and circumstances. The professional accountant should take note of the following principles:

- Consider the source, relevance and sufficiency of information obtained
- Be alert and open for further investigation or other action, where required

The Code provides guidance to assist professional accountants in considering the source, relevance and sufficiency of information obtained. The matters to consider include new information that has emerged or any changes in the facts and circumstances, information or source should not be biased or possibility that potentially relevant information might be missing from the facts and circumstances, etc.

Communication with TCWG

TCWG, including audit committees, play a vital role in enhancing the quality of corporate reporting, and determining the strategy, risks and opportunities relating to sustainability. Effective communication with TCWG provides enhanced transparency and contributes to promoting an ethical culture in an organisation, especially when leaders within the organisation hold themselves and others accountable for demonstrating ethical values. When communicating with TCWG, a professional accountant should determine the appropriate individual(s) within the entity's governance structure with whom to communicate considering the nature and importance of the circumstance and the matter to be communicated. The Code states that, communication with TCWG would help in evaluating threats to compliance with the fundamental principles or in resolving specific issues pertaining to greenwashing risks, such as:

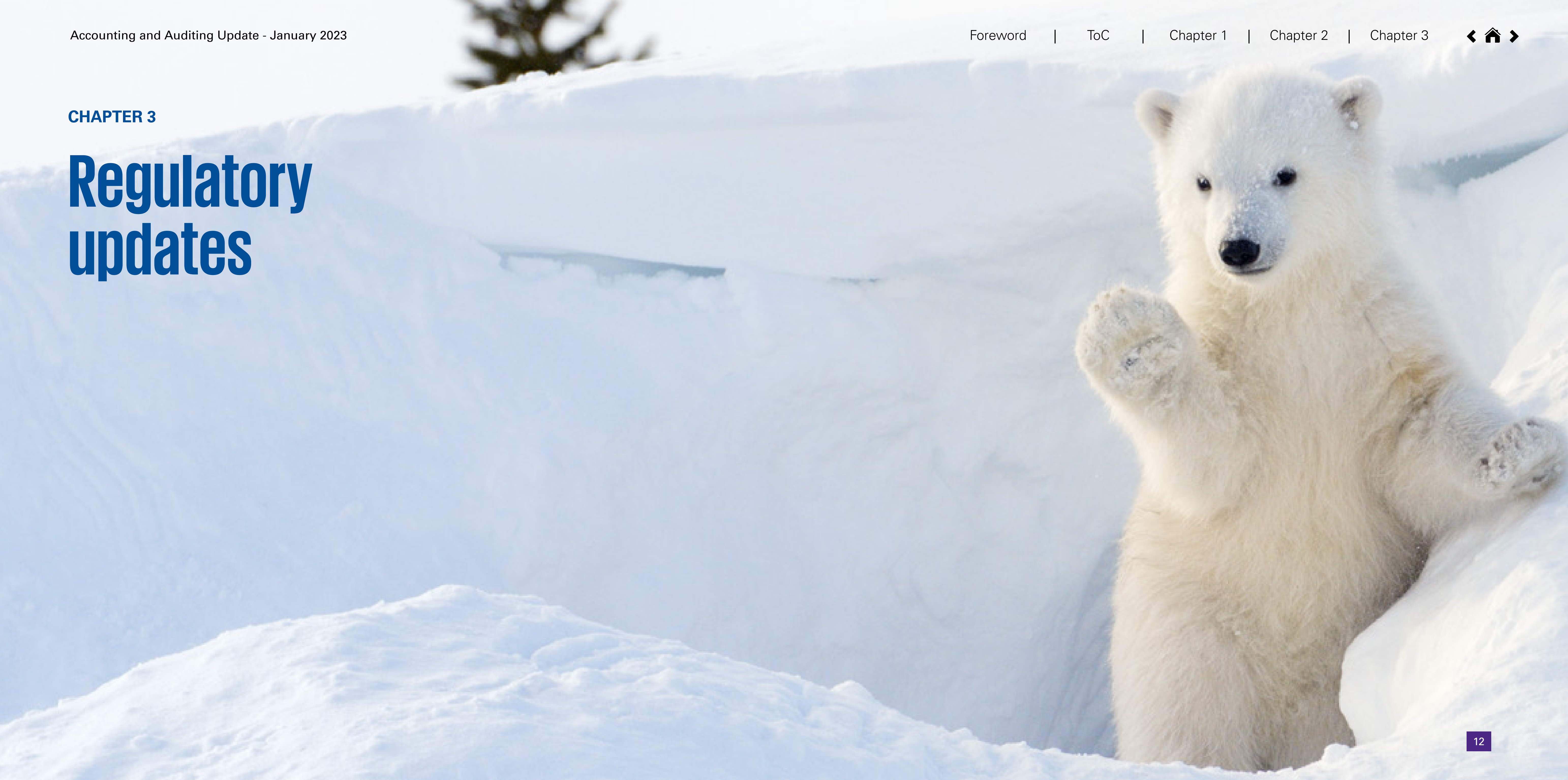
i. Pressures on individual involved in sustainability reporting to meet internal or external ESG targets, goals and expectations and the consequential risks

ii. Misleading information about sustainability should be communicated to the TCWG and they should be requested to take appropriate action to resolve the matter

iii. Non-Compliance with Law or Regulations (NOCLAR) related matters, including actual and suspected matters should be communicated to TCWG.

Bottom line

As sustainability reporting is an emerging area, there are many challenges regarding the quality of information being reported and information being reliable. This occurs because such information is often based on forward-looking data instead of historical trends and is subject to higher levels of estimation uncertainty and volatility. Further, organisations may lack mature systems, processes and internal controls to accurately collect and report the required information. Considering this, the IESBA Code sets out the fundamental principles of ethics, provides a robust ethical framework for sustainability reporting and assurance engagements. IESBA is now working towards a project plan for a timely delivery of profession agnostic ethics (and independence) standards so as to create an infrastructure for sustainability assurance engagements. In India, the Code of Ethics issued by Institute of Chartered Accountants of India (ICAI) is applicable, which is largely aligned with the provisions of IESBA's Code of Ethics



CHAPTER 3

Regulatory updates

Amendments to the SEBI LODR Regulations

On 17 January 2023, the Securities Exchange Board of India (SEBI) issued certain amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations). The key amendments are as follows:

Expansion in the definition of 'senior management'

Regulation 16 of the LODR Regulations defines 'senior management' as officers/personnel of a listed entity who are members of its core management team excluding board of directors and normally this should comprise all members of management one level below the chief executive officer/managing director/whole time director/manager (including chief executive officer/manager, in case they are not part of the board) and shall specifically include company secretary and chief financial officer.

As per the amendment, now the definition would also include functional heads of an entity as senior management. This revised definition is effective from 17 January 2023.

Approval for re-appointment of a person on the board of directors

Regulation 17 of the SEBI LODR Regulations requires an approval of shareholders for the purpose of appointment of a person on the board of directors or as a manager.

As per the amendment, with effect from 17 January 2023, the provision of this regulation would also be applicable for re-appointment of a person on the board of directors or as a manager.

Accordingly, an approval of shareholders would be required for appointment or re-appointment of a person on the board of directors or as a manager in the next general meeting or within a time period of three months from the date of appointment, whichever is earlier.

The amendment further provides that in case of a public sector company, the approval of the shareholders for appointment or re-appointment of a person on the board of directors or as a manager should be taken in the next general meeting.

Corporate governance disclosures in the annual report

As per LODR, a listed entity is required to provide corporate governance disclosures in the annual report to be submitted to the stock exchange in accordance with the requirements of Schedule V of the LODR Regulations.

A new requirement inserted to provide that, for annual reports to be filed for financial year 2022-23 and onwards, a listed entity should also provide details of material subsidiaries of the listed entity, including the date and place of incorporation and the name and date of appointment of the statutory auditors of such subsidiaries.

Compliance with corporate governance norms by REIT and InvIT

The amendments provide that Real Estate Investment Trust (REIT) or an Infrastructure Investment Trust (InvIT) should now comply with the governance norms stipulated under SEBI REIT Regulations, 2014 and SEBI InvIT Regulations, 2014, respectively, with effect from 1 April 2023 and would not comply with corporate governance provisions under the LODR Regulations.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2023/117 dated 17 January 2023).

SEBI extends relaxation from sending physical copies of annual reports

In accordance with the provisions of Regulation 36(1)(b) of the LODR Regulations, listed entities that have issued specified securities are required to dispatch a hard copy of the statement containing the salient features of all the documents prescribed in Section 136 of the Companies Act, 2013 (2013 Act) or rules made thereunder (i.e. financial statements, board's report, auditor's report etc.) to the shareholder(s) who have not registered their email address.

On 5 January 2023, SEBI has exempted listed entities from sending the hard copies of the statement till 30 September 2023 (earlier 31 December 2022). However, the listed entities should ensure the following conditions are satisfied:

i. The listed entities are required to send hard copy of full annual reports to those shareholders who request for the same.

ii. The listed entity should disclose the web-link to the annual report in the notice of Annual General Meeting (AGM) published in the newspaper advertisement to enable the shareholders to have access to the full annual report.

The provisions of the above circular are effective from 5 January 2023.

(SEBI circular no. SEBI/HO/CFD/PoD-2/P/CIR/2023/4 dated 5 January 2023)

SEBI approves certain proposals through its board meeting

On 20 December 2022, SEBI issued a press release summarising the decisions approved in its board meeting with respect to certain significant matters pertaining to the SEBI Regulations. Following are the key decisions from the board meeting:

a) Amendment to SEBI (Buy-back of Securities) Regulations, 2018

In order to streamline the buyback process, create a level playing field for investors and promote ease of doing business, the following amendments have been approved in the SEBI (Buy-back of Securities) Regulations, 2018:

- **Buyback through stock exchange route:** With respect to the buyback of shares or other specified securities through the stock exchange, the following has been approved:

  i. As per the existing provisions, a company may buy-back its shares or other specified securities through the stock exchange. It has now been decided to phase out this route of buyback in a gradual manner.

  ii. The minimum utilisation amount earmarked for buyback through the stock exchange route to be increased from 50 per cent to 75 per cent.

  iii. A separate window would be created on the stock exchanges for undertaking buyback till the time buyback through a stock exchange is permitted.

- **Buyback through tender offer route:** With respect to the buyback of securities through a tender offer, the following changes have been approved:

  i. The timeline for completion of buyback has been reduced by 18 days by removing the requirement of filing draft letter of offer with SEBI and its observations thereof, and reduction of the duration of the tendering period and period available for payment of consideration to the shareholders

  ii. Permitted upward revision of buyback price until one working day prior to the record date

  iii. A mandatory requirement has been introduced to place the relevant advertisements/documents with respect to buyback such as, copy of the public announcement, letter of offer, etc. on the respective website of the stock exchange(s), merchant banker and the company for better dissemination of information to shareholders.

b) Appointment of a nominee director and public issue timelines

The following proposals were approved with respect to the timelines for the corporate bond market in the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations):

i. In order to protect the interests of debenture holders, it has been decided that issuers of listed debt securities shall incorporate suitable provisions in their articles of association, to cast an obligation on the board of directors of the issuer to appoint the person nominated by its Debenture Trustee (DT) as a director in the event of a default. Further, corresponding amendments should be made in the debenture trust deed. The listed debt issuers are required to comply with this requirement by 30 September 2023.

ii. At present, there are no guidelines that stipulate the duration for which a public issue of debt securities or Non-Convertible Redeemable Preference Shares (NCRPS) should be kept open. Therefore, it has been decided that public issue of debt securities and NCRPS should be kept open for subscription for a minimum period of three working days and maximum period of 10 working days.

The abovementioned timelines are aligned with timelines provided for specified securities under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations).

c) Amendment to NCS Regulations to facilitate sustainable finance while safeguarding against 'greenwashing'

On account of the increasing interest in sustainable finance and with a view to align the extant framework for green debt securities with the updated Green Bond Principles (GBP) recognised by IOSCO[1], SEBI reviewed the regulatory framework for green debt securities. The following points have been approved:

i. It has been decided to enhance the scope of the definition of green debt security by including new modes of sustainable finance in relation to pollution prevention and control, eco-efficient products, etc.

ii. Introduction of the concept of blue bonds (related to water management and marine sector), yellow bonds (related to solar energy) and transition bonds as sub-categories of green debt securities

iii. The basic dos and don'ts with respect to green debt securities will be specified in order to address the concerns of the issuers against 'greenwashing' related risks.

(Source: SEBI Press Release No. PR No. 37 /2022 dated 20 December 2022)

1. International Organization of Securities Commissions.

NFRA to introduce Annual Transparency Report (ATR) by the Audit Firms

In order to enhance transparency about the management and governance of audit firms and their internal policy framework to ensure high quality audits and preventing conflict of interest by maintaining independence, on 16 January 2023, the National Financial Reporting Authority (NFRA) published a consultation paper on draft requirements for preparation and publication of the ATR by auditors/audit firm.

The proposal requires information about an auditor's operational activities, management, governance and ownership structures, policies and procedures necessary to deliver high-quality audits, etc. It is proposed that ATR will be implemented in a gradual manner for Public Interest Entities (PIEs) falling within the purview of NFRA, starting with the auditors/audit firms performing audit of top 1,000 listed companies (by market capitalisation) from the financial year ending 31 March 2023.

It also proposes that the ATR should be published within three months from the end of each financial year.

Public comments/suggestions on the contents of the ATR can be provided till 16 February 2023.

(Source: NFRA press release ID: 1891606 dated 16 January 2023)

Discussion paper on Expected Loss (EL)-based approach for loan loss provisioning by banks

In India, commercial banks determine the provision for loan losses on the basis of an 'incurred loss' approach which is prescribed in the Prudential norms on Income Recognition, Asset Classification, and Provisioning pertaining to Advances issued by the Reserve Bank of India (RBI).

However, it has been observed that the incurred loss approach results in a delay in recognition of the expected loss on financial assets resulted in banks having to make higher levels of provisions thereby affecting the resilience of banks and poses systemic risks. Recently, RBI issued a Discussion Paper on Expected Loss based approach. This approach for loan loss provisioning by banks (discussion paper), which incorporates a forward-looking Expected Credit Losses (ECL) approach as against the extant 'incurred loss' approach.

The key proposals in the discussion paper are as follows:

- **Applicability:** The ECL approach would be applicable to all scheduled commercial banks other than small co-operative banks[2] and regional rural banks.
- **Applicable financial assets:** The requirement for estimating loan loss provision (impairment losses) would apply to financial assets that meet both criteria as given below:
  a. They are **'applicable financial assets'**, which includes all loans and advances including irrevocable loan commitments (including sanctioned limits under revolving credit facilities), lease receivables, irrevocable financial guarantee contracts, and investments classified as held-to-maturity or available-for-sale, and
  b. The financial assets are **measured at amortised cost** (i.e. they are held with the business to collect contractual cash flows thereon and their contractual cash flows give rise to cash flows on specified dates that are solely payments of principal and interest on the principal amount outstanding.
- **Determining a Significant Increase in Credit Risk (SICR):** In order to determine whether there has been a significant increase in credit risk on a financial asset, banks need to compare the risk of default pertaining to a financial asset as on the reporting date with the risk of default as on initial recognition. The discussion paper has defined the term 'default' to be considered while performing the SICR assessment.

  Some of the key considerations that the discussion paper prescribes for assessing whether there has been a SICR are as follows:
  - SICR assessment should be done at a counterparty level (IFRS 9, *Financial Instruments* requires such an assessment to be done at an instrument level).
  - As a backstop, the credit risk of a counterparty would be considered to have increased significantly since initial recognition when it is overdue for more than 60 days.
  - Stressed exposures which are classified under a 'watch-list' or an equivalent classification for stressed exposures should also be assessed as exposures where there has been a SICR.
- **Determining 'default':** IFRS 9 does not define 'default', it instead requires entities to consider the criteria which are considered for internal credit risk management purposes for determining a default. The discussion paper has proposed a definition of default, which is as below:
  - The counterparty is classified as a Non-Performing Asset (NPA) under the extant guidelines of RBI
  - Restructured assets which are in the 'monitoring period'; or
  - The bank considers that the borrower is unlikely to pay[3] its existing debt.

(Source: ICAI announcement dated 14 January 2023)

2. The threshold for determining a 'small' co-operative bank would be prescribed by RBI based on comments received by it.
3. The RBI has provided a non-exhaustive list of indicators of unlikeliness to pay such as where bank puts the credit obligation on a non-accrued status, or sells the credit obligation at a material credit-related economic loss, etc.

- **Credit impairment:** The banks should measure the loss allowance for financial instruments as follows:
  a. **Lifetime ECL:** If the credit risk on a financial asset has increased significantly since initial recognition, the allowance should be an amount equal to the lifetime ECL. Further provisions on exposures which are in the nature of lease receivables or contractual guarantees, should always be measured at an amount equal to lifetime ECL.
  b. **12-month ECL:** If the credit risk on a financial asset has not increased significantly since initial recognition, banks should measure the loss allowance for that financial instrument at an amount equal to 12-month ECL.

  The practical expedient to compute a 12-month ECL on financial instruments that have a low credit risk at the reporting date would be restricted to certain instruments[4].
- **Measurement of ECL:** Similar to IFRS 9, the discussion paper does not prescribe any methodologies for estimating ECL. Accordingly, banks will be permitted to design and implement their own models for measuring loan loss provisions. However, RBI will issue detailed guidance for designing credit risk models which should be considered by banks while developing their ECL models.

  Since significant variability could arise on account of disparate models for assessment of credit losses, the following mitigants have been proposed:
  a. The ECL models proposed to be adopted by banks should undergo a process and validation either internally or by an external third party. The validation reports should be placed before the audit committees of the boards of banks.
  b. The credit loss estimates determined will be subject to a prudential floor prescribed by RBI as a regulatory backstop.
- **Classification of financial assets and income recognition:** Banks should classify the financial instruments into the following categories of financial assets based on whether there has been a significant increase in credit risk or whether they are credit impaired:
  - **Stage 1:** Financial assets for which there is no SICR, or financial assets that have low credit risk at the reporting date. For these assets, 12-month ECL are recognised. Interest income is recognised on an accrual basis by applying the effective interest rate to the gross carrying amount of the asset
  - **Stage 2:** Financial assets that have had a significant increase in credit risk since initial recognition (unless they have low credit risk at the reporting date) but that do not have objective evidence of impairment. For these assets, lifetime ECL are recognised. Interest income is recognised on an accrual basis by applying the effective interest rate to the gross carrying amount of the asset
  - **Stage 3:** All financial assets that are in 'default' as defined in the discussion paper should be classified as Stage 3 assets. For these assets, lifetime ECL is recognised. Interest income is recognised on an actual receipt basis.
- **Disclosures:** RBI would prescribe a non-exhaustive list of disclosures for banks adopting ECL approach for estimating loan loss provision.

The comments on the discussion paper can be provided till 28 February 2023. Based on the comments received, the draft guidelines and subsequently, the final guidelines will be formulated. Further, on account of the complexities involved in designing the models and the time required to test them, sufficient time would be provided for implementation of the framework after issue of the final guidelines. In order to enable a seamless transition, banks would be provided an option to phase out the effect of increased provisions on Common Equity Tier I capital over a maximum period of five years.

(Source: RBI press release no. 2022-2023/1558 dated 16 January 2023)

4. These instruments include:
   - SLR eligible investments;
   - Direct claims on central government (i.e., excluding claims that arise from exposures that are guaranteed by the central government);
   - Exposures that are guaranteed by the central government, provided that the guarantee contains suitable clauses mandating invocation within a specified period (say, 30 days) from the event of default and payment of the guarantee amount will be received within a reasonable period (say, 60 days) after the invocation.

ICAI issued standard on sustainability assurance engagement

On 10 January 2023, the Sustainability Reporting Standards Board (SRSB) of the Institute of Chartered Accountants of India (ICAI), issued Standard on Sustainability Assurance Engagements (SSAE) 3000, *Assurance Engagements on Sustainability Information*. The standard draws reference from International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* issued by the International Auditing and Assurance Standards Board (IAASB).

SSAE 3000 deals with assurance engagements on an entity's sustainability information. SSAE 3000 is an umbrella standard which is applicable for attestation of all assurance engagements on sustainability information. The standard should be read in conjunction with the 'Framework for Assurance Engagements' issued by ICAI. It deals with providing reasonable or limited assurance on sustainability information. Further, the standard is applicable to a practitioner being a professional accountant in public practice[5] conducting the assurance engagement on sustainability information.

The standard covers the following aspects:

- Conducting an assurance engagement in accordance with SSAEs
- Quality control
- Planning and performing the engagement
- Execution
- Completion and reporting.

The effective date for application of the standard is as follows:

i. Voluntary basis for assurance reports covering periods ending on 31 March 2023.

ii. Mandatory basis for assurance reports covering periods ending on or after 31 March 2024.

(Source: ICAI announcement dated 10 January 2023)

ICAI issued Social Audit Standards (SAS)

On 25 July 2022, SEBI introduced the regulations pertaining to Social Stock Exchange (SSE). As per the regulations, a social enterprise (i.e. either a Not for Profit Organisation (NPO) or a for profit social enterprise that meets the eligibility criteria specified in the regulations) shall be eligible to raise funds from an SSE provided such a social enterprise engages in social activity that is listed by the regulator. There are 16 broad categories have been specified for social activities. Further, an SE either registered with or that has raised funds through an SSE is required to submit an annual impact report to the SSE which is to be audited by a social audit firm employing a social auditor.

The ICAI has been entrusted with the responsibility of being the self-regulatory organisation for regulating the profession of social auditors. In this regard, on 14 January 2023, ICAI issued the SAS based on the 16 categories of social activities as specified by SEBI. The SASs contain essential procedures and related guidance/criteria for the performance of each area of the 16 categories. The SASs should be read in conjunction with the 'Preface to the Social Audit Standards' and 'Framework for the Social Audit Standards', issued by the ICAI and are effective from 14 January 2023.

The list of the SAS are as follows:

- **SAS 100:** Eradicating hunger, poverty, malnutrition and inequality
- **SAS 200:** Promoting health care including mental healthcare, sanitation and making available safe drinking water
- **SAS 300:** Promoting education, employability and livelihoods
- **SAS 400:** Promoting gender equality, empowerment of Women and LGBTQIA+ communities
- **SAS 500:** Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation
- **SAS 600:** Protection of national heritage, art and culture
- **SAS 700:** Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports
- **SAS 800:** Supporting incubators of social enterprises
- **SAS 900:** Supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building
- **SAS 1000:** Promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector
- **SAS 1100:** Slum area development, affordable housing, and other interventions to build sustainable and resilient cities
- **SAS 1200:** Disaster management, including relief, rehabilitation and reconstruction activities
- **SAS 1300:** Promotion of financial inclusion
- **SAS 1400:** Facilitating access to land and property assets for disadvantaged communities
- **SAS 1500:** Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection
- **SAS 1600:** Promoting welfare of migrants and displaced persons.

(Source: ICAI announcement dated 14 January 2023)

5. As per the ICAI's Code of Ethics, the term 'professional accountant in public practice' refers to the member of ICAI who is in practice in terms of section 2 of The Chartered Accountants Act, 1949. The term 'professional accountant in public practice' is also used to refer to a firm of professional accountants in public practice.

Implementation guide to SA 230, *Audit Documentation* issued by ICAI

Standard on Auditing (SA) 230 prescribes the basic principles of audit documentation. These principles are required to be complied by the auditors with respect to the documentation requirements. In December 2022, ICAI published an implementation guide on SA 230 which provides practical implementation guidance to auditors. The implementation guide contains summary of the standard, introduction to the standard, Frequently Asked Questions (FAQs) on SA 230, checklist and an illustrative working paper format. The guide aims to provide clarify on various aspects of SA 230 thereby enabling the auditors to effectively comply with the requirements of the standard.

(Source: ICAI announcement dated 15 December 2022)

ICAI issued technical guide on digital assurance

On 14 January 2023, ICAI published a technical guide on digital assurance. The guide would help members to adopt enhanced use of technology in an audit by implementing the use of digitally available audit evidence and information. The technical guide primarily focusses on sources of external audit evidence available and how it can be utilised by the members in their audit procedures. It also highlights the importance of reliability and relevance of the source from which the information is being obtained and also provides various illustrations of available sources of external audit evidence and how they can be used.

(Source: ICAI announcement dated 14 January 2023).

ICAI issued exposure drafts on the amendments to Ind AS 1 and Ind AS 116

The Ind AS are based on the IFRS Standards issued by the International Accounting Standards Board (IASB). As part of the convergence with the IFRS standards, in case IASB issues any amendments to IFRS Standards, the Accounting Standards Board (ASB) of the ICAI considers those amendments and other related aspects for amending the corresponding Ind AS.

In this regard, on 30 December 2022 the ASB issued Exposure Drafts (EDs) on the amendments to Ind AS 1, *Presentation of Financial Statements* and Ind AS 116, Leases, as follows:

- **Ind AS 1:** The ED has proposed amendments with respect to the classification of current and non-current liabilities. The key amendments proposed are as follows:
  i. The only covenants with which an entity is required to comply on or before the reporting date would affect the classification of a liability as current or non-current. Therefore, covenants which are to be complied with after the reporting date, do not affect the classification of debt as current or non-current at the reporting date, however, disclosures should be provided to enable the users of financial statements to understand the risk that such non-current liabilities with covenants could become repayable within 12 months.
  ii. At present, a carve out exists under Ind AS 1 from IAS 1, *Presentation of Financial Statements*. The carve out provides that in case of a long-term arrangement where there has been a breach of a material provision on or before the end of the reporting period but the lender has agreed to not demand payment after the reporting period, such a long-term arrangement would be classified as non-current as on the reporting date. It has been proposed to remove this carve out as it is not conceptually aligned with the abovementioned proposed amendment. Post the mentioned amendment, Ind AS 1 would be aligned with IAS 1.
- **Ind AS 116:** The proposed amendment prescribes the subsequent measurement requirements for sale and leaseback transactions particularly in a leaseback that includes variable lease payments that do not depend on an index or rate. The amendments require a seller lessee to subsequently measure lease liabilities arising from a leaseback in a way that it does not recognise any amount of the gain or loss that relates to the right of use it retains.

The time period to provide comments ended on 30 January 2023.

(Source: ICAI announcement on 'Exposure Drafts of Amendments to Ind AS 1 and Ind AS 116 for comments' dated 30 December 2022)

IASB issued exposure draft on International Tax Reform—Pillar Two Model Rules

In December 2021, the Organisation for Economic Co-operation and Development (OECD) published its Pillar Two model rules to address the tax challenges arising from the digitalisation of the economy. Accordingly, the Pillar Two model rules aim to ensure that large multinational groups pay a minimum amount of tax on income arising in each jurisdiction in which they operate by applying a system of top-up taxes that result in the total amount of taxes payable on excess profit in each jurisdiction representing at least the minimum rate of 15 per cent.

However, there was uncertainty over the accounting for deferred taxes arising from the rules and clarity was required with respect to the implementation of the rules in some jurisdictions. Considering this, on 9 January 2023, International Accounting Standards Board (IASB) issued an Exposure Draft (ED) to amend IAS 12, *Income Taxes*.

The key points considered in the ED are as follows:

- Introduction of a temporary and mandatory exception from accounting for deferred tax that arise from a legislation implementing the global anti-base erosion model rules. Companies would effectively be exempt from providing for deferred tax related to top-up tax. However, the company would be required to disclose that it has applied the exception.
- New disclosures requirements have been provided for annual financial statements for periods beginning on 1 January 2023.

The comments on the above ED can be provided till 10 March 2023.

Further, ASB of ICAI has also requested to the various stakeholders in India to provide their comments on the ED.

(Source: IASB news dated 9 January 2023, KPMG IFRG article on 'Global minimum top-up tax – potential exception to deferred tax accounting' dated 9 January 2023 and ICAI announcement dated 16 January 2023)

IASB issued project report and feedback statement on the post implementation review on IFRS 9

During 2020 and 2022, the IASB undertook a Post-implementation Review (PIR) on the classification and measurement requirements of IFRS 9, Financial Instruments. On analysing the evidence gathered in the PIR, the IASB noted that the classification and measurement requirements are working as intended.

Further, the IASB has also identified areas for further research and standard-setting to enhance the information provided to users of financial statements as follows:

- In June 2022, IASB had initiated a standard-setting project focusing on a company's assessment of the contractual cash flow characteristics of financial assets with ESG-linked features and on electronic cash transfers as settlement of a financial asset or liability. The exposure draft with respect to the same will be published in first quarter of 2023.
- A research project has been added to explore whether IASB can clarify the requirements for applying the effective interest method to financial instruments measured at amortised cost and requirements for modifications of financial instruments.

(Source: IASB news dated 21 December 2022)

FASB defers sunset date of reference rate reform guidance

In 2020, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting, providing optional guidance to ease the potential burden in accounting for (or recognising the effects of) reference rate reform on financial reporting. The objective of the guidance in Topic 848 is to provide relief during the temporary transition period. Therefore, FASB provided a sunset provision based on the expectations of when the London Interbank Offered Rate (LIBOR) would cease being published. The sunset provision was initially set for 31 December 2022.

In 2021, the UK Financial Conduct Authority (FCA) delayed the intended cessation date of certain tenors of USD LIBOR to 30 June 2023. Accordingly, on 21 December 2022, FASB issued an ASU that extends the period of time the preparers can utilise the reference rate reform relief guidance. FASB has deferred the sunset date of Topic 848 to 31 December 2024, after which entities will no longer be permitted to apply the relief in Topic 848. This amendment is applicable to all entities, subject to meeting certain criteria, that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform. The amendment is effective from 21 December 2022.

(Source: FASB media advisory dated 21 December 2022)

IAASB issued fact sheet to help auditors navigate quality management for group audits

ISA 220 (Revised), *Quality Management for An Audit of Financial Statements* and International Standard on Quality Management (ISQM) 1, *Quality Management for Firms That Perform Audits or Reviews of Financial Statements*, or Other Assurance *or Related Services Engagements* are also applicable for group audits under ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

In April 2022, IAASB issued ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* which is effective for group audits beginning on or after 15 December 2023. In this regard, IAASB issued a fact sheet on 15 December 2022 to explain the interactions between ISA 220 (Revised) and extant standard ISA 600 on group audits until ISA 600 (Revised) becomes effective for audits of financial statements. It also highlights certain provisions from ISQM 1 that are relevant to the application of ISA 220 (Revised) to group audits.

The key considerations explained in the fact sheet are:

- **Definition of an engagement team:** The revised definition of an engagement team under ISA 220 (Revised) recognises the fact that in a group audit, engagement team includes component auditors that perform audit work. Such component auditors can be from a firm, a network firm, or a firm that is not a network firm. Accordingly, the following requirements of ISA 220 (Revised) are also applicable to a group audit engagement:

  i. Leadership responsibilities for managing and achieving quality on audits

  ii. Relevant ethical requirements

  iii. Engagement resources, and

  iv. Engagement performance.

  Similarly, the relevant provisions of ISQM 1 related to the above would also apply for group audits.

- **Leadership and direction, supervision, and review responsibilities:** ISA 220 (Revised) includes enhanced requirements relating to the leadership responsibilities of an engagement partner and the direction, supervision and review of an engagement team. Accordingly, in a group audit, a group auditor should obtain an understanding of whether a component auditor is subject to any restrictions that limit communication with the group auditor, including with regard to sharing audit documentation with the group auditor.

Further, the group engagement partner may assign direction, supervision and review responsibilities to other members of the engagement team. However, ISA 220 (Revised) requires an engagement partner to continue to take overall responsibility for managing and achieving quality on the audit engagement through direction those procedures are assigned. Similarly, ISQM 1 requires a firm to establish quality objectives that address the performance of quality engagements.

(Source: IAASB announcement dated 15 December 2022)

First Notes

Social Stock Exchange - A detailed framework issued by SEBI

In 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).

Further in 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 NPO

b. Disclosure to be provided by NPOs for raising funds through the issuance of Zero Coupon Zero Principal (ZCZP) Instruments

c. Annual disclosures and disclosures forming part of the Annual Impact Report (AIR)

d. The circular also prescribes the time limit for submission of statement of utilisation of funds by an NPO.

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

To access the First Note, please click here

On 18 January 2023, KPMG in India released its VOR – Quarterly updates publication. The publication provides a summary of key updates from Securities and Exchange Board of India (SEBI), Reserve Bank of India (RBI), National Financial Reporting Authority (NFRA), Department of Economic Affairs, Ministry of Finance and the Institute of Chartered Accountants of India (ICAI) for the quarter ended 31 December 2022.

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