Accounting and Auditing Update

Issue no. 82/2023

May 2023

kpmg.com/in

Foreword

To prepare consolidated financial statements, it is imperative to first understand whether an investment in a company falls in the category of a subsidiary or an associate, as the accounting treatment and presentation requirements are different for a subsidiary and an associate. Therefore, while assessing whether an entity is a subsidiary or an associate, entities must determine the level of influence to decide if there is an existence of control or significant influence. The determination of existence of control or significant influence is an important area of evaluation which may require judgement depending on the facts and circumstances of each case. This edition of Accounting and Auditing Update (AAU) contains an article on this topic which discusses the key regulatory requirements relating to assessment of control and significant influence and provides a brief overview of classification of an investment as a subsidiary or an associate with the help of an illustration.

Factoring is a means of working capital financing used by companies to improve its cashflows. The factoring arrangement typically allows the entity that is supplier of goods or services to obtain cash from a bank or financial institution (i.e. the factor) against receivables due from the entity's customers. The terms of factoring arrangements vary depending on the agreement between the entity, its debtor and the financial institution. Therefore, when a company sells its receivables to a factor, from its financial reporting perspective it would need to analyse whether such account receivables can be derecognised from its balance sheet. In this regard, a detailed evaluation of the term factoring arrangements is required to determine its accounting. An entity would need to follow the principles under Ind AS 109, *Financial Instruments,* to evaluate if such financial assets can be derecognised. Our article on this topic demonstrates the accounting consideration under Ind AS 109 for derecognition of such assets with the help of illustrative example.

There have been various regulatory developments in India and internationally during the month. Recently on 12 May 2023, RBI issued an advisory to state that publication of the remaining LIBOR[1] settings will cease permanently post 30 June 2023. Further, SEBI proposed to review the definition of Unpublished Price Sensitive Information (UPSI) under SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations). The new definition would require the disclosures under Regulation 30 of LODR should be considered and disclosed as UPSI under the PIT Regulations. Additionally, MCA issued certain amendments to Rules to the Companies, Act 2013 such as Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 which deals with the approval procedure of merger and amalgamation and Companies (Removal of Names of Companies from the Registrar of Companies) Rules, 2016. Our regulatory updates articles cover these and other important regulatory developments.

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

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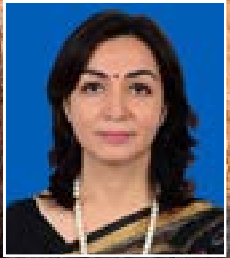

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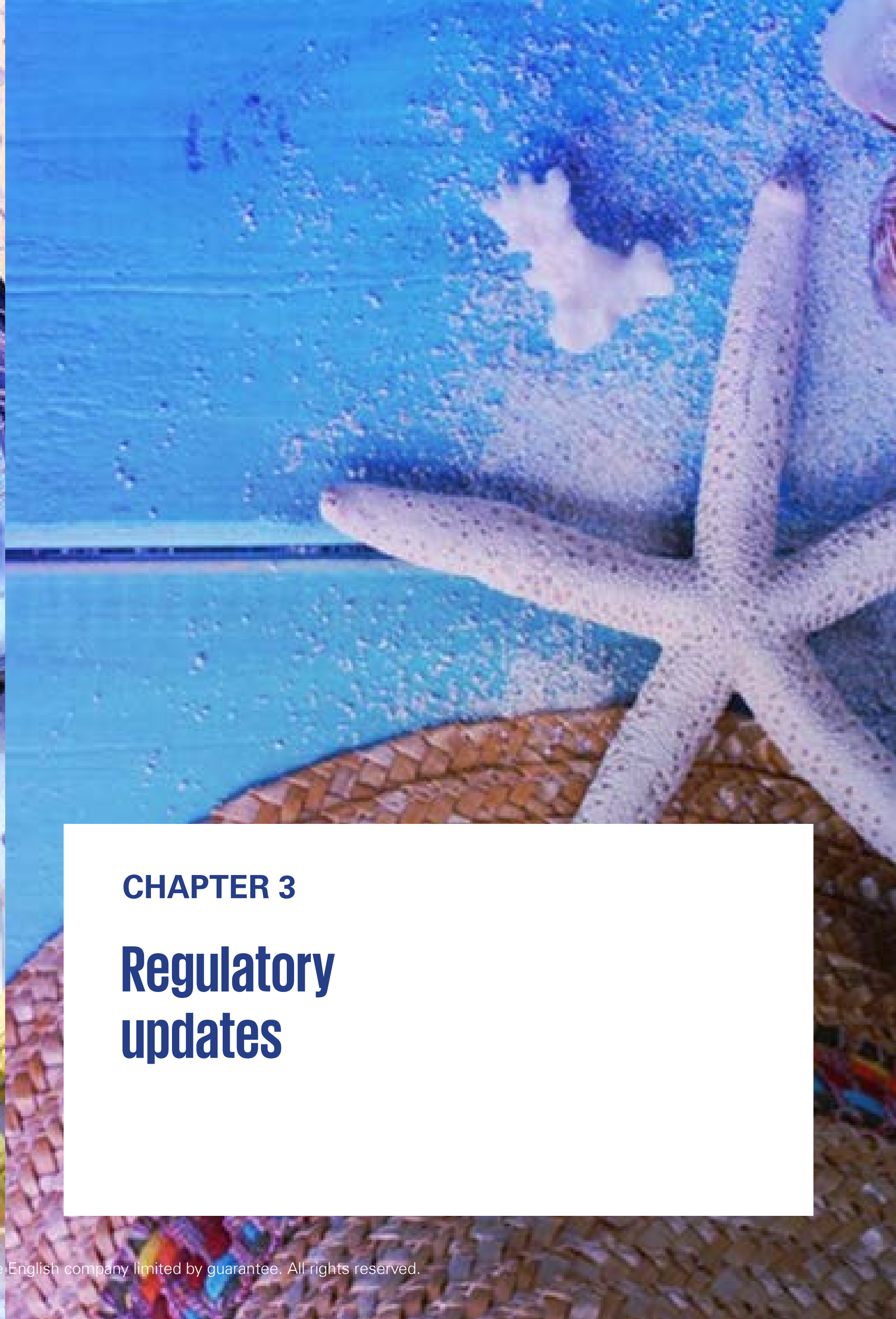
1. In 2017, the Financial Conduct Authority (FCA) had announced that post 2021, corporates and banking institutions should adopt Alternative Reference Rates (ARRs) in place of LIBOR. LIBOR linked with most of the currencies have ceased permanently by 31 December 2021 with certain select like USD LIBOR, which would finally phase out by 30 June 2023.

CHAPTER 1

Assessment of control and significant influence for consolidated financial statements

CHAPTER 2

Application of derecognition requirements to a factoring arrangement



CHAPTER 3

Regulatory updates

CHAPTER 1

Assessment of control and significant influence for consolidated financial statements

This article aims to:

- Highlight the requirements relating to assessment of control and significant influence and
- Provide a brief overview for classification of an investment as a subsidiary or an associate.

The business environment in which entities operate is dynamic as one company can have business interests and investments in other entities in the form of joint ventures, associates, or subsidiaries. The stakeholders such as investors, promoters, lenders, government authorities, etc. are interested in knowing the complete overview of the operations and profitability of the group as a whole. Although separate financial statements of each entity would provide the financial position of an individual entity, but the consolidated financial statements would present the financial position of the entire group. Therefore, it is of utmost importance that the investments in other entities are accounted and disclosed appropriately by the parent entity in accordance with the applicable accounting standard framework.

Over a period of time, the business structures have become more complex. There have been instances wherein such complex business structures are misused to represent and misstate the financial statements to achieve certain outcome. As a result, the regulators time to time amend the regulatory provisions to ensure that the classification of investments as a subsidiary or an associate is based on the substance of the transaction and not merely its form. Over the past few years, regulators are closely monitoring the basis as per which an investor company is accounting its investment as a subsidiary or as an associate.

Following section provides an overview of regulatory requirements relating to preparation of consolidated financial statements.

Regulatory framework

As per Section 129 of the Companies Act 2013 (2013 Act), if a company has one or more subsidiaries or associate companies, then such a company is required to prepare consolidated financial statements. In addition to this, as per Regulation 33[1] and Regulation 52[2] of the Securities Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations), a listed entity having subsidiaries is required to submit consolidated financial results and statements in addition to standalone financial results and statements to the stock exchange.

To prepare consolidated financial statements, it is imperative to first understand whether the investment in a company falls in the category of a subsidiary or an associate, as the accounting treatment and presentation requirements is different for a subsidiary and an associate.

The following table prescribes the regulatory conditions for distinguishing between a subsidiary and an associate:

Subsidiary	Associate
As per the Section 2(87) of the 2013 Act, a subsidiary company is a company in which the holding company: **i. Controls** the composition of the Board of Directors; or ii. Exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies: It is further clarified that: a. A company shall be deemed to be a subsidiary company of the holding company even if the control referred in clause (i) or (ii) above, is of another subsidiary company of the holding company b. The composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors.	As per Section 2(6) of the 2013 Act, an associate company means a company in which the other company has a **significant influence**, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

(Source: KPMG in India's analysis, 2023)

Thus, as demonstrated in the above table, to distinguish between subsidiary and an associate its important to determine the level of of influence i.e. to decide if there is an existence of control or significant influence. The determination of level of influence i.e. control or significant influence

1. SEBI provisions applicable to a listed entity which has listed specified securities Regulation 33(3)(b) clarifies that that a listed entity having subsidiaries is required to submit quarterly/year-to-date consolidated financial results.
2. SEBI provisions applicable to a listed entity which has listed its non-convertible securities on a recognised stock exchange

is an important area of evaluation which may require judgement depending on the facts and circumstances of each case. The table below provides an overview of the distinction between the two elements as per the provisions of the 2013 Act and Ind AS:

Control	Significant influence
Provisions of the 2013 Act	
As per Section 2(27) of the 2013 Act control includes: a. The right to appoint majority of the directors or b. To control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders' agreements or voting agreements or in any other manner;".	As per the explanation to Section 2(6) of the 2013 Act, significant influence means control of at least 20 per cent. of total voting power, or control of or participation in business decisions under an agreement.
Principles of the applicable Ind AS	
AS 110, *Consolidated Financial Statements*, further states that, an investor controls an investee if the investor satisfies all the following conditions: a. Power over the investee and current ability to direct the relevant activities b. Exposure, or rights, to variable returns from its involvement with the investee; and The ability to use its power over the investee to affect the amount of the investor's returns	Ind AS 28, *Investments in Associates and Joint Ventures states* that significant influence refers to the power to participate in the financial and operating policy decisions of the investee but is not a control or a joint control. It is further stated that, the existence of significant influence by an entity is usually evidenced in one or more of the following ways: a. Representation on the board of directors or equivalent governing body of the investee b. Participation in policy-making processes, including participation in decisions about dividends or other distributions c. Material transactions between the entity and its investee d. Interchange of managerial personnel; or e. Provision of essential technical information.

(Source: KPMG in India's analysis, 2023)

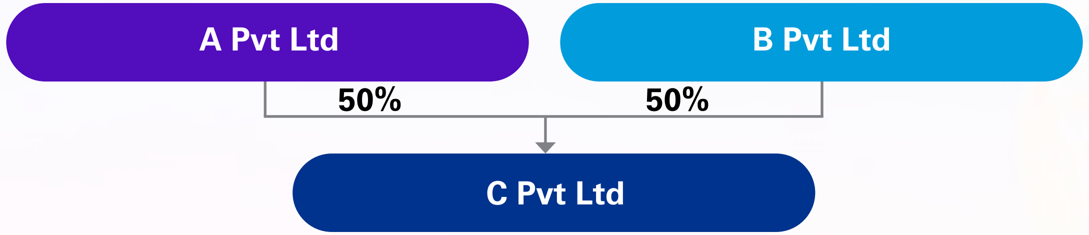
Therefore, while assessing whether an entity is a subsidiary or an associate, the threshold for shareholding is an important factor for identification but a deeper analysis and an enhanced understanding of the facts of the case is required to assess whether an entity is to be considered as a subsidiary or an associate.

Accordingly, basis the above evaluations, if the investee company is considered as a subsidiary then the procedure for consolidation as stipulated in Ind AS 110 is required to be followed by the parent entity. In such a scenario, the parent entity, *inter alia*, is required to consider the requirements for elimination of inter-company transactions, accounting of non-controlling interest and accounting for loss of control of subsidiaries, if any. In case the investee company is determined to be an associate, then the principles of application of equity method of accounting, as stipulated in Ind AS 28, is required to be followed by the investor company.

Further, the regulators in the recent past have also made certain observations relating to non-compliance with the regulatory requirements relating to determination of control, correct classification of an entity as subsidiary or an associate. We have discussed the key criteria relating to determination of relation between subsidiary and parent through an illustration below which has also been highlighted by the regulators:

Illustration

A Pvt Ltd and B Pvt Ltd entered into a Memorandum of Understanding (MOU) to jointly operate the business of C Pvt Ltd. As a result, A Pvt Ltd and B Pvt Ltd, each held 50 per cent of the total shareholding of C Pvt Ltd.



Key facts from the MOU are as follows:

- *Board of directors:* The board of directors of C Pvt Ltd would consist of five directors out of which
  - Three directors would be nominated by A Pvt Ltd and
  - Two directors by B Pvt Ltd.
- Additionally, two independent directors are to be appointed, out of which
  - One director would be appointed by A Pvt Ltd and
  - One by B Pvt Ltd.
- *Chairman and managing director:* From the board of directors of C Pvt Ltd, A Pvt Ltd will appoint a chairman. The managing director is to be appointed by B Pvt Ltd.
- *Control:* The control relating to operations, management, supervising, service & directions, etc. of the business of C Pvt Ltd lies with A Ltd. Further, A Pvt Ltd also has the capacity of taking major decisions with respect to the business projects of C Pvt Ltd.
- *Working capital:* B Pvt Ltd will provide certain initial working capital to C Pvt Ltd.
- *Auditor appointment:* The statutory auditor of C Pvt Ltd is to be appointed by A Pvt Ltd whereas the internal auditor is to be appointed by B Pvt Ltd.
- *Expenses:* A Pvt Ltd has rights/exposure to get management fee of 2 per cent of the turnover and further earning of 6 per cent of the gross profit. Further, A Pvt Ltd is also required to bear the repair and maintenance expenses.
- *Treatment of surplus:* The surplus remaining after deducting the management fee and after reducing a reasonable allowance of working capital is to be transferred to B Pvt Ltd.

Relevant facts from Articles of Association (AoA) of C Pvt Ltd are as follows:

- In case of an equality of votes, the chairman shall be entitled to a second or casting vote.
- C Pvt Ltd may increase or reduce the number of directors from time to time by passing an ordinary resolution
- C Pvt Ltd has empowered A Pvt Ltd to appoint majority of the directors

Other key points to consider:

- C Pvt Ltd appointed two independent directors
- The key personnel who head the operations of C Pvt Ltd and are also the employees of A Pvt Ltd

In order to determine if A Pvt Ltd should recognise C Pvt Ltd as a subsidiary or an associate, a deeper analysis is required.

On the face of this illustration, it appears that both, A Pvt Ltd and B Pvt Ltd hold 50 per cent equity in C Pvt Ltd and have equal rights in C Pvt Ltd - however, there is a need to look into the substance of the transaction considering the key clauses in the MOU and AOA, and a detailed evaluation of the regulations to understand the relationship between A Pvt Ltd and C Pvt Ltd.

The following factors should be considered for this assessment:

a. A Pvt Ltd's control/power over the composition of the Board of Directors of C Pvt Ltd:

- **Voting rights:** In addition to 50 per cent voting rights of C Pvt Ltd, it is important to note that A Pvt Ltd appointed the chairman of C Pvt Ltd. The chairman has a casting vote in case of equality of voting shares indicating that A Pvt Ltd also has control over casting vote through the Chairman.
- **Right to appoint majority of directors:** The AOA empowers A Pvt Ltd to appoint majority of the directors.
- **Right to removal of directors:** As A Pvt Ltd has a second or casting vote, through the Chairman of C Pvt Ltd, by exercising such a casting vote, A Pvt Ltd holds a decisive voting right and therefore has the power to pass an ordinary resolution to remove a director from C Pvt Ltd's board at its discretion.

  Further, Section 169[3] of the 2013 Act, *inter alia*, states that in case an independent director is re-appointed for a second term as per Section 149[4] of the 2013 Act, then such an independent director shall be removed by the company only by passing a special resolution. In the given case, the independent directors of C Pvt Ltd. have been appointed through ordinary resolution. Therefore, unless they are re-appointed for a second term as per Section 149 of the 2013 Act, they can be removed through ordinary resolution, which is within the rights and control of A Pvt Ltd.

Thus, above point implies that majority representation on the Board of Directors of C Pvt Ltd is of A Ltd. so it is able to control various decisions.

b. A Pvt Ltd's current ability to direct the relevant activities of C Pvt Ltd: As per the MOU between A Pvt Ltd and B Pvt Ltd, A Pvt Ltd had the capacity of taking major decisions with respect to the business projects of C Pvt Ltd and also control the operations, management, supervising, service & directions, etc. of the business of C Pvt Ltd. Therefore, since the critical and significant decisions of C Pvt Ltd's operations lie with A Pvt Ltd, it can be construed that A Pvt Ltd is able to direct the relevant activities of C Pvt Ltd.

c. A Pvt Ltd's exposure/rights to variable returns from involvement with C Pvt Ltd: As stated in MOU, A Pvt Ltd not only has rights with respect to the operations and management of the business of C Pvt Ltd but also entitled to two per cent of turnover as management fee and six per cent of the gross profit as further earning and A Pvt Ltd is also required to bear the expenses relating to repair and maintenance. Therefore, A Pvt Ltd is exposed or has rights, to variable returns from its involvement with C Pvt Ltd.

d. A Pvt Ltd's ability to use its powers to affect returns: Considering the list of rights vested with A Pvt Ltd, as stated above, and the number of its employees working in senior positions of C Pvt Ltd, it is evident that A Pvt Ltd has rights/powers to affect the returns.

Based on the above analysis, A Pvt Ltd controls C Pvt Ltd and would need to consolidate it in financial statements.

3. Section 169 of the 2013 Act stipulates the provisions with respect to removal of directors
4. Section 149 of the 2013 Act lays down the provisions with respect to Board of Directors of a company

Bottom line

As companies are growing and expanding their operations, the corporate structures are also becoming more complex and complicated. Therefore, it is important for management to consider existence of control or significant influence in addition to the percentage of shareholding for the purpose of ensuring correct classification of an investment into a subsidiary or an associate. The regulators are also highlighting lapses in the classification and identification of an investment into a subsidiary or an associate. Therefore, this is an important area of evaluation and continuous assessment.

CHAPTER 2

Application of derecognition requirements to a factoring arrangement

This article aims to:

- Provide key considerations to determine whether a factoring arrangement results in derecognition of financial assets

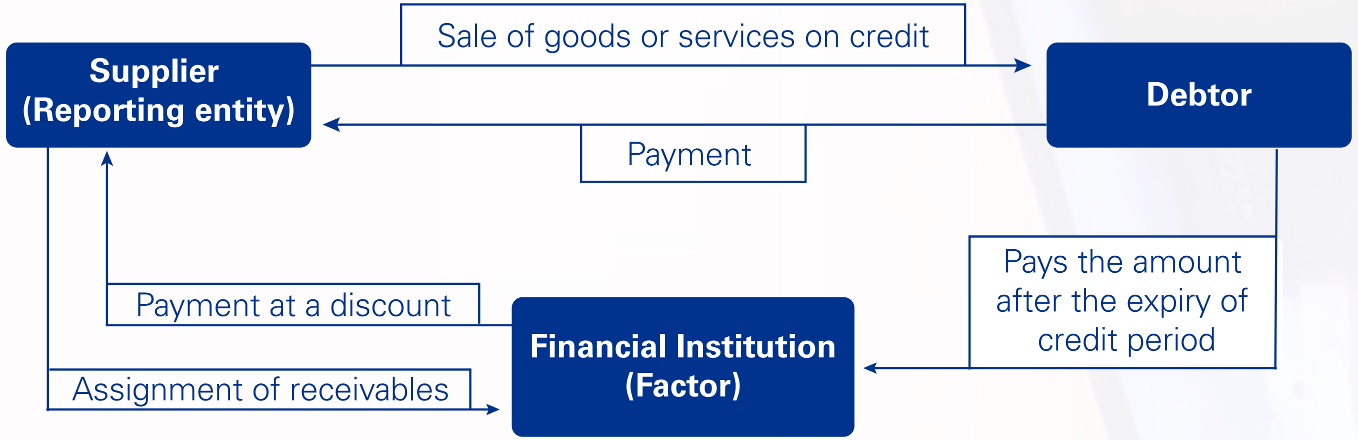
Introduction

Factoring helps the company to improve its cashflows. It is a means of working capital financing which is frequently used by companies across industries. It involves three parties: an entity that sells the receivables (supplier), a debtor who has a financial liability to make a payment to the supplier and a financing institution (a factor) that purchases accounts receivable from supplier at a discounted price.

The factoring arrangement typically allows the entity that is a supplier of goods or services to obtain cash from a bank or a financial institution (i.e. the factor) against receivables due from the entity's customers.

The factoring arrangement might take different legal forms e.g. the receivables might be sold to the factor or pledged as security for a loan from the factor and the factor may or may not have recourse to the entity in the event that the customer does not settle. A traditional factoring arrangement is initiated by the entity and the factor, rather than the customer. In many cases, the customer might be unaware of the arrangement.

The factor may also provide different types of services related to collection of suppliers account receivables from the debtor, credit control and protection, etc., which helps to save time and the cost of collecting customers receivables.



(Source: KPMG IFRG Limited's Insights into IFRS, 19th Edition 2022/23)

The terms of factoring arrangements vary depending on the agreement between the entity, its debtor and the financial institution. Therefore, when a company sells its receivables to a factor, from its financial reporting perspective it would need to analyse whether such account receivables can be derecognised from its balance sheet.

In this regard, a detailed evaluation of the term factoring arrangements is required. As accounts receivable fall within the scope of Ind AS 109, *Financial Instruments*, a company would need to follow its guidance to evaluate if such assets can be derecognised.

Illustrative example

Generally, a company enters into an agreement with a bank to 'sell and assign' its accounts receivables to the bank. The terms of the sale/ assignment could include following terms:

- The benefit of all guarantees, indemnities and securities in respect of the account receivables shall be assigned to the bank with full title guarantee upon purchase of accounts receivables by the bank and upon payment of purchase price.
- Upon purchase of accounts receivable, the bank would pay to the company 100 per cent of value of the aggregate accounts receivables net of appropriate discount/interest charged till maturity date.
- The bank may appoint the company as its agent (without any consideration) to collect all amounts due in respect of each account receivable. The bank may, at any time and in its sole discretion replace the company as its agent.
- In case the receivables are not collected, the recourse to the company is as below:
  - If failure to pay is due to certain 'excluded risk events', the face value of such receivables would be paid by the company to the bank and the receivables would be re-assigned to the company
  - If failure to pay is due to 'insolvency events', then the company would bear first loss which shall not exceed 5 per cent of the maximum facility amount during any calendar year.

In order to analyse whether in this fact pattern the company can derecognise its accounts receivables, following principles would be important to consider:

- Whether derecognition principles are applied to a part of all of an asset?
- Have the rights to the cash flows from the asset expired?
- Has the company transferred its rights to receive the cash flows from the asset?

Determining the financial asset subject to derecognition

In applying the derecognition principles under Ind AS 109, the first step is to determine the financial assets that are subject to possible derecognition. This could be specifically identified, fully proportionate share of the cash flows of the financial assets or fully proportionate share of specifically identified cash flows from a financial asset or a group of similar financial assets.

Ind AS 109 indicates that the derecognition assessment may be applied either to an individual financial asset or to a portfolio of similar financial assets. However, Ind AS 109 does not specify the circumstances in which a portfolio assessment is appropriate. This assessment would depend on the contractual terms for transfer of financial assets.

In this case, the company has provided a first loss recourse up to a maximum of 5 per cent of the facility amount during the calendar year. Hence, the assessment should be done at the portfolio level of accounts receivables sold/assigned.

Transfer of rights to receive cash flows

A financial asset qualifies for derecognition under Ind AS 109 either if the contractual rights to the cash flows from that financial asset expire or if an entity transfers a financial asset in a transfer that meets the criteria for derecognition specified in Ind AS 109.

An entity is considered to have transferred a financial asset only if it transfers the contractual rights to receive the cash flows of the financial asset or it enters into a qualifying pass-through arrangement.

Generally, transfer of legal title would result in a transfer of all existing rights associated with the financial asset, however, a transaction involving sale of beneficial interest in an asset without an actual transfer of legal title should be assessed for ‘transfer of rights to receive cash flows’ considering the facts of the case. In either case, for a transfer of contractual rights to take place, the transferee should have an unconditional right to demand payment from the original debtor in the case of default by the original debtor.

A right to demand payment or to obtain legal title that is conditional on the transferor defaulting under a servicing agreement does not constitute a transfer of contractual rights.

A transferor may continue to administer or provide servicing for assets that it has previously transferred to another entity. For example, a transferor may transfer all rights to receivables but then continue to collect the cash flows of those receivables as a servicer in the capacity of an agent of the transferee. The IFRS Interpretations Committee discussed a related issue and noted that the determination of whether the contractual rights to cash flows have been transferred is not affected by the transferor retaining the role of agent to collect the cash flows of the receivables in this case. Therefore, retention of the servicing rights by the entity transferring the financial asset does not in itself cause the transfer to fail the derecognition principles.

In this case, the company has transferred its contractual rights to receive its receivables to the bank and it is merely continuing to act as a service/ administrator to collect the outstanding dues on behalf of the bank.

Transfer of substantial risks and rewards

An entity needs to evaluate whether:

- The company has transferred substantially all the risks and rewards, or
- The company has retained substantially all the risks and rewards or
- The company has neither transferred nor retained substantially all the risks and rewards.

The risks and rewards analysis is performed by comparing the entity's exposure, before and after the transfer, to the variability in in the amounts and timing of the net cash flows (present value of the future net cash flows) from the financial asset.

There is no specific guidance provided in Ind AS 109 on what constitutes 'substantially' all of the risks and rewards of a financial asset. Assessing whether and to what extent exposure to variability in the present value of cash flows has been retained requires consideration of all relevant facts and circumstances. This analysis should be based on the terms of the contract and other facts and circumstances, considering all of the risks inherent in a financial asset (excluding dispute risk and other legal risks) associated with the financial asset on a probability-weighted basis. Generally, dispute risk and other legal risks is not considered for the risks and rewards analysis, because it relates to the existence of a financial asset rather than to the risks and rewards inherent in a financial asset.

In this case, there is a clause with regard to excluded risk events i.e. If the failure to pay is due to 'excluded risk events', the face value of such receivables would be paid by the company to the bank and the receivables would be re-assigned to the company. Excluded risk events generally include aspects like – dispute, fraud or breach of agreement by the company, i.e. cover dispute or legal risks.

Thus, on the basis of guidance from Ind AS 109, excluded risk events would be ignored for the purpose of assessing whether substantial risk and rewards have been transferred to the bank.

In case of financial assets with short maturities such as most accounts receivables, the only substantial risk is generally credit risk. Thus, the evaluation of risks and rewards shall depend on which party has assumed the risk of possible credit losses.

In this case, if failure to pay is due to 'insolvency events' then the company would bear first loss which shall not exceed 5 per cent of the maximum facility amount during any calendar year.

The company is transferring receivables with relatively short maturities for which the only substantial risks in credit risk (i.e. risk of default). The interest risk is transferred to the bank but the same is not expected to be significant given the short maturities.

Hence, the risk borne by the company to be considered for derecognition assessment is the first loss upto 5 per cent of the maximum facility amount during any calendar year.

Thus, basis above, **the company should perform an appropriate risk and reward analysis** to determine if the accounts receivables should be derecognised i.e. if the likely Expected Credit Loss (ECL) range of the portfolio of receivables is 0 to 5 per cent then it should be concluded that by way of first loss recourse of upto 5 per cent, the company has retained significant risks and rewards and hence, accounts trade receivables are not derecognised. The company should not only consider the historical experience but also consider the aspects like – credit rating of the customer, etc. in determining the likely ECL range of the portfolio transferred to the bank.

For other situations, it may require appropriate statistical analysis to determine if significant risk and rewards are transferred or retained or neither transferred nor retained.

Key considerations for determining financial asset subject to derecognition

Ind AS 109 advocates detailed guidelines on the principles to be applied while derecognising financial assets. These are assessed in Figure 1 below:

Ind AS 109 guidance

1. Whether derecognition principles are applied to a part or all of an asset?
2. Have the rights to the cash flows from the asset expired?
   - Yes → Derecognise the asset
   - No → 3
3. Has the entity transferred its rights to receive the cash flows from the asset?
   - Yes → 5
   - No → 4
4. Has the entity assumed an obligation to pay the cash flows from the asset that meet conditions in para 3.2.5 of Ind AS 109?
   - No → Continue to recognise the asset
   - Yes → 5
5. Has the entity transferred substantially all risks and rewards?
   - Yes → Derecognise the asset
   - No → 6
6. Has the entity retained substantially all risks and rewards?
   - Yes → Continue to recognise the asset
   - No → 7
7. Has the entity retained control of the asset?
   - No → Derecognise the asset
   - Yes → Continue to recognise the asset to the extent of the entity's continuing involvement

Source: KPMG IFRG Limited's Insights into IFRS, 19th Edition 2022/23

Key points for consideration

Each factoring arrangement must be assessed separately, taking into account the contractual terms and conditions.

Entities should also carefully consider the disclosures that will be necessary to explain the nature of the factoring arrangement, impact of the arrangement and the judgements made by the entity.

Source: KPMG IFRG Limited's Insights into IFRS, 19th Edition 2022/23

CHAPTER 3

Regulatory updates

The final leg to LIBOR transition

Prior to 2021, the London Inter-Bank Offered Rate (LIBOR) was one of the most critical numbers as it was used as an interest rate benchmark across various contracts in multiple currencies. However, with questions being raised on the integrity and reliability of LIBOR, in 2017, the Financial Conduct Authority (FCA) had announced that post 2021, corporates and banking institutions should adopt Alternative Reference Rates (ARRs) in place of LIBOR.

IBOR linked with most of the currencies have ceased permanently by 31 December 2021 with certain select like USD LIBOR, which would finally phase out by 30 June 2023.

While transition to IBOR has various consequences, some of the critical ones are on business and on accounting:

Business impact

- Insertion of fallback clauses
- Transition to ARRs
- Development of systems and processes to manage transition away from LIBOR.

Accounting impact

- The International Accounting Standards Board (IASB) has issued amendments to IFRS- similar amendments have been issued to Ind AS
- Phase II amendments provide various exemptions, relaxations and practical expedients on transition to ARR.

(Source: KPMG in India's analysis, 2023)

Globally, most banks and financial institutions have processed all business-related changes and have also adopted the accounting amendments (phase 2 amendments were applicable from 1 January 2021 internationally, and for annual reporting periods beginning on or after 1 April 2021 in India).

With 30 June 2023 nearing, regulators are issuing constant reminders to banks/financial institutions and other businesses to complete the transition.

Position in India

India too had trillions of dollar worth contracts that were linked to LIBOR. Post the announcements made by FCA and RBI (in July 2021), India has achieved a smooth transition with respect to LIBOR settings that have ceased to be published/become non-representative after 31 December 2021. New transactions are now predominantly undertaken using ARRs, such as Secured Overnight Financing Rate (SOFR) and Modified MIFOR (Mumbai Interbank Offered Rate).

However, there are still certain contracts that have not transitioned from LIBOR to ARRs.

With effect from 30 June 2023, the publication of remaining five USD LIBOR settings would cease permanently, and accordingly, the MIFOR would also cease to be published[1]. RBI vide its circular dated 12 May 2023 has stated the following:

- Banks/financial institutions/their customers should not enter into any new transaction that relies on or is priced using the USD LIBOR or the MIFOR
- Banks/financial institutions should take all necessary steps to ensure insertion of fallback clauses in all remaining legacy financial contracts that reference USD LIBOR or MIFOR
- While certain synthetic LIBOR settings would continue to be published post 30 June 2023, these settings are not meant to be used in new financial contracts.
- Banks/financial institutions should develop systems and processes to manage the complete transition away from LIBOR from 1 July 2023.

1. MIFOR is a domestic interest rate benchmark that is reliant on USD LIBOR- it is published by the Financial Benchmarks India Private Limited (FBIL)

(Source: RBI notification no RBI/2023-24/30 dated 12 May 2023)

Amendments to the approval process of merger and amalgamation of companies

Rule 25 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 deals with the approval procedure of merger and amalgamation of certain companies. The Ministry of Corporate Affairs (MCA), on 15 May 2023, notified the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2023 in order to amend the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

The amendment has modified the below mentioned sub-rules to Rule 25 (Directions at hearing of the application) to streamline the approval process for mergers and bring clarity with respect to deemed approvals in the following cases:

No objection received (Rule 25(5)):

The amended rule provides that if no objection/ suggestion is received within a period of 30 days from the Registrar of Companies (RoC)/official liquidator by the Central Government (CG), and if the CG is of the opinion that the scheme is in the public interest or in the interest of creditors, then CG can issue a confirmation order of such scheme of merger or amalgamation in Form No. CAA.12 within a period of 15 days after the expiry of the said 30 days. However, if the CG does not issue a confirmation order within 60 days, it will be deemed that there is no objection, and a confirmation order will be issued by the CG.

Objections received from RoC (Rule 25(6)):

The amended rule provides that if objections or suggestions are received within the 30 days window from the RoC or official liquidator, then the CG should undertake the following action:

- Issue a confirmation order within 30 days, if the CG is of the opinion that the objections/ suggestions are unsustainable, and the scheme is in the public interest or the interest of creditors.
- If CG is of the opinion that the scheme is not in the public interest or the interest of creditors, CG can file an application before the Tribunal within 60 days, stating the objections/opinion and requesting the Tribunal to consider the scheme under Section 232 of 2013 Act.

Further, if the CG does not issue a confirmation order or file an application within a period of 60 days of the receipt of the scheme under Section 233 of the 2013 Act, it would be deemed that it has no objection to the scheme and a confirmation order should be issued accordingly.

(Source: MCA notification no G.S.R. 367(E) dated 15 May 2023)

Amendments to the Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016

Rule 4 of the Companies (Removal of Names of Companies from the Registrar of Companies) Rules, 2016 specifies the procedure to be followed by companies for making an application for removal of its name from RoC.

On 17 April 2023, MCA issued amendments to the Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016 relating to application process for removing of a company's name from the RoC (MCA). The amendment revised Rule 4(1) and inserted a new Rule 4 (3A) to include provisions relating to establishment of Centre for Processing Accelerated Corporate Exit (C-PACE) and application made to C-PACE for removal of name of a company under Section 248(2) of the 2013 Act. The C-PACE has been set up to centralise the process of striking off companies and to promote ease of doing business and the ease of exit for companies.

Additionally, the eForms related to striking up off companies such as eForm STK-2, eForm STK-6 and eForm STK-7 have also been revised.

Subsequently, on 10 May 2023, the MCA issued further amendments to Rule 4(1) to include following requirements for companies while filing an application for removal of a company's name from RoC:

- The company should not file an application unless the company has filed overdue financial statements under Section 137 and overdue annual returns under Section 92 of the 2013 Act up to the end of the financial year in which the company ceased to carry out its business operations
- In case the company intends to file an application after the RoC initiated steps to remove the name of the company, it can only file the application after filing all pending financial statements under Section 137 and all pending annual returns under Section 92 of the 2013 Act
- Once RoC has issued a notice for publication pursuant to action initiated under Section 248(1), then the company will not be allowed to file the application under this sub-rule.

(Source: MCA notification dated 17 April 2023 and 10 May 2023)

SEBI introduces Legal Entity Identifier (LEI) for issuers

On 3 May 2023, the Securities and Exchange Board of India (SEBI) introduced the Legal Entity Identifier (LEI) system for issuers that have listed or are planning to list non-convertible securities, securitised debt instruments and security receipts. This unique global identifier for legal entities participating in financial transactions aims to create a global reference data system that uniquely identifies every legal entity, in any jurisdiction, that is a party to a financial transaction basis a unique 20-character code.

Presently, the RBI's directions require non-individual borrowers having aggregate exposure of above INR25 crore, to obtain an LEI code.

Further, SEBI has specified a deadline to obtain and report the LEI code by issuers, as tabulated below:

Category of security	Relevant regulation	Applicability	Timeline
Non-convertible Securities	SEBI (Issue and listing of Non-convertible Securities) Regulations, 2021	Issuer proposing to issue and list non-convertible security	On or after 1 September
		Issuer having outstanding listed non-convertible security as on 31 August 2023	On or before 1 September
Securitised debt instruments and security receipts	SEBI (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008	Issuer proposing to issue and list Securitised Debt Instruments or Security Receipts	On or after 1 September
		Issuer having outstanding listed Securitised Debt Instruments and Security Receipts as on 31 August 2023	On or before 1 September

SEBI would additionally specify the requirement of LEI for issuers proposing to list or that have outstanding municipal debt securities in future.

(Source: SEBI circular no. SEBI/HO/DDHS/DDHS_Div1/P/CIR/2023/64 dated 3 May 2023)

Additional requirements for issuers of transition bonds

In February 2023, SEBI issued amendments to certain provisions of the NCS Regulations, *inter alia* expansion of the definition of green debt security that included transition bonds as one of the sub-categories of green debt security. Further, as per the SEBI (Issue and Listing of Non-Convertible Securities), 2021, transition bonds comprise 'funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions.'

Additionally, on 6 February 2023, SEBI issued revised disclosure requirements for such issuances.

New development

With the aim to facilitate transparency and informed decision-making among the investors and to ensure that the funds raised through transition bonds are not being misallocated, on 4 May 2023, SEBI prescribed certain additional disclosure requirements for issuance and listing of transition bonds. The additional requirements are as follows:

- For differentiating transition bonds from other categories of green debt security, an issuer should disclose the denotation GB-T in the offer documents on the cover page and in type of instrument field in the term sheet. It should also disclose it in the centralised database for corporate bonds/debentures.
- Details of transition plans such as interim targets, project implementation strategy, usage of technology and overseeing mechanism should be disclosed in the offer document.
- Revised transition plan accompanied by an explanation for each revision should be disclosed to the stock exchanges.
- Details of transition plans along with a brief on the progress of its implementation should be disclosed in the annual report.

(Source: SEBI circular no. SEBI/HO/DDHS/DDHS_Div1/P/CIR/2023/66 dated 4 May 2023)

Consultation paper on review of the definition of UPSI

Background

The Unpublished Price Sensitive Information (UPSI) defined under SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations) means 'any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:

- Financial results
- Dividends
- Change in capital structure
- Mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions
- Changes in key managerial personnel.'

Further, Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations) requires listed entities to disclose material events or information to the stock exchanges. The events specified in Para A of Part A of Schedule III of LODR are deemed to be material events which listed entities are mandatorily required to disclose.

Further, events under Para B of Part A of Schedule III of LODR are required to be disclosed based on application of the guidelines for materiality, which the listed entities are required to frame (materiality policy) based on the criteria specified in Regulation 30.

Additionally, SEBI in its board meeting dated 29 March 2023 approved the proposal for review and rationalisation of the disclosure of material events or information by the listed entities.

In this regard, SEBI observed that certain information/event which are disclosed as material events in accordance with the LODR Regulations and should have been categorised as UPSI was not done so by the listed entity, highlighting that companies were not exercising due care in this regard.

Proposal

Considering the above-mentioned background as base, SEBI, has issued a consultation paper on 18 May 2023, proposing that the current definition of UPSI be amended and the disclosures as required under Regulation 30 of LODR should be considered and disclosed as UPSI under the PIT Regulations.

The comments on the consultation paper can be provided upto 2 June 2023.

(Source: SEBI consultation paper on proposed review of the definition of Unpublished Price Sensitive Information (UPSI) under SEBI (Prohibition of Insider Trading) Regulations, 2015 issued on 18 May 2023)

Draft guidelines on remuneration of non-executive directors and key managerial persons of private sector insurers

In 2016, the Insurance Regulatory and Development Authority of India (IRDAI) had issued the framework of remuneration of non-executive directors/chief executive officer/whole time director/managing director of private sector insurers.

On 2 May 2023, IRDAI has issued an exposure draft proposing to replace the extant guidelines of the remuneration framework. The key revisions proposed in the exposure draft aim to:

Bring the remuneration of other Key Managerial Persons (KMPs) also within the ambit of the guidelines

Provide more clarity to the extent of variable pay with respect to the total remuneration of directors and KMPs, variable pay deferral, malus and clawback provisions, accounting, disclosures, etc.

The revised guidelines have been proposed to be made applicable for remuneration payable to KMPs of private sector insurers from F.Y. 2023-24.

The period to provide comments ended on 15 May 2023.

(Source: IRDAI issued exposure draft dated 2 May 2023)

Proposed ASU to determine accounting of profit interest awards

On 11 May 2023, FASB issued a proposed Accounting Standard Update (ASU) to demonstrate how an entity should account for profit interest awards.

As profit interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the partnership, stakeholders have indicated that it can be complex to determine whether a profits interest award should be accounted for as a share-based payment arrangement (Topic 718 - Stock Compensation) or similar to a cash bonus or profit-sharing arrangement (Topic 710 – General Compensation).

The amendments in this proposed update would improve Generally Accepted Accounting Principles (GAAP) by adding an illustrative example that includes four fact patterns to demonstrate how an entity should apply the scope guidance to determine whether a profits interest award should be accounted for in accordance with Topic 718.

(Source: FASB news and media advisory issued on 11 May 2023)

Public consultation for proposed revisions ISA 570

Recently, on 26 April 2023, the International Auditing and Assurance Standards Board (IAASB) proposed revisions to International Standard on Auditing (ISA) 570 (Revised), *Going Concern*. The exposure draft issued aims to:

- Promote consistent practice and behaviour and facilitate effective responses to identified risks of material misstatement related to going concern
- Strengthen the auditor's evaluation of management's assessment of going concern, including reinforcing the importance, throughout the audit, of the appropriate exercise of professional skepticism; and
- Enhance transparency with respect to the auditor's responsibilities and work related to going concern where appropriate, including strengthening communications and reporting requirements.

Some of the key changes proposed in the exposure draft are as follows:

- Enhanced requirements and application materials under:
  - Risk identification and assessment
  - Information from sources external to the entity
  - Management's assessment of going concern
  - Professional Skepticism
  - Communication with Those Charged With Governance (TCWG) and external parties.
- Insertion of a newly defined term "material uncertainty related to going concern" and its enhanced application material to clarify key concepts such as 'significant doubt' along with other related terminology.

The period to provide comments on exposure draft is upto 24 August 2023.

(Source: IRDAI issued exposure draft dated 2 May 2023)

ISSB issued a consultation regarding SASB standards

The International Sustainability Standards Board (ISSB) has issued an exposure draft to gather feedback on its proposed methodology for enhancing the international applicability of the Sustainability Accounting Standards Board's (SASB) standards as it is an important source of guidance for companies applying IFRS S-1, *General Requirements for Disclosure of Sustainability-related Financial Information.*

The proposed methodology aims to remove jurisdiction-specific references from SASB standards and directing users to equivalent requirements that are more relevant to a global audience. The enhancements are designed to ensure that entities can apply the SASB Standards regardless of the jurisdiction in which they operate or the type of GAAP an entity applies.

Thus, the ISSB aims to incorporate the feedback received from stakeholders and revise the metrics before the implementation of IFRS S1 in January 2024.

The period to respond to this consultation ends on 9 August 2023.

(Source: ISSB consultation to enhance the international applicability of the SASB standards issued on 11 May 2023)

First Notes

Framework on green deposits and its use for green activities

In India, in recent times, there has been an increase in focus of the financial system to move towards green financing. Green finance means lending to and/or investing in the activities/projects that contribute to climate risk mitigation, climate adaptation and resilience, and other climate-related or environmental objectives - including biodiversity management and nature-based solutions. As stated by the Reserve Bank of India (RBI), the financial sector can play a pivotal role in mobilising resources and their allocation thereof in green activities/projects.

A key mode of green finance that has progressively gained traction is ‘green deposit’. Green deposit refers to an interest-bearing deposit, received by a Regulated Entity (RE) for a fixed period and the proceeds of which are earmarked for being allocated towards green finance.

Consequently, on 11 April 2023, RBI issued a Framework for Acceptance of Green Deposits (the framework). The framework is effective from 1 June 2023. The framework aims to direct the flow of funds to sustainable projects and initiatives, protect the interest of the depositors and address greenwashing concerns.

To access the First Note, please **click here.**

Voices on Reporting

On 2 May 2023, KPMG in India released its VOR-Annual updates publication which provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Reserve Bank of India (RBI), the National Financial Reporting Authority (NFRA), the Ministry of Finance, the Institute of Chartered Accountants of India (ICAI) and the Insurance Regulatory and Development Authority of India (IRDAI) for the year ended 31 March 2023.

To access the publication, please **click here.**

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