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Foreword

All companies are facing climate-related risks and opportunities. Some are affected more than others. As the impact of climate change intensifies, investors, and regulators are increasingly seeking greater transparency of climate-related information in the financial statements. How a company presents the impact of climate-related matters in the financial statements will depend on specific facts and circumstances, including the nature and extent of those impacts on the company. Therefore, companies should consider materiality carefully in deciding what information to provide about these matters. IFRS Standards (or Ind AS) do not refer explicitly to climate-related risks or climate-related matters, but they implicitly require relevant disclosures in the financial statements when climate-related matters considered in preparing the financial statements are material. Therefore, to provide climate-related disclosures companies are required to overarching requirements in IAS 1, *Presentation of Financial Statements* and requirements in individual standards as well. Recently, the IFRS Foundation republished its educational material on climate-related disclosures to reiterate requirements in IFRS Accounting Standards to report on the effects of climate-related matters in the financial statements when those effects are material. This edition of Accounting and Auditing Update (AAU) carries an article on this topic which highlights the requirements in accounting framework to report on the effects of climate-related matters on the financial statements.

Sustainable finance refers to the process of taking Environmental, Social and Governance (ESG) considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects. The increasing awareness of ESG has transformed the landscape of the financial sector. The focus on stability and ethical practice is gaining importance over attractive quantitative returns on investment. Recently more advanced ESG-related products (e.g., green bonds and sustainability-linked loans) have been issued in the market, in response to rising investor demand for such products. All nations are introducing regulations to boost sustainable finance including India. Our second article aims to explain the developments in the area of sustainable finance, highlights Organisation for Economic Co-operation and Development's (OECD) publication on 'ESG Investing: Practices, Progress and Challenges' and actions taken in India.

There have been various regulatory developments in India during the month. Recently, the Securities Exchange Board of India (SEBI) issued various notifications and circulars to prescribe frameworks relating to sustainability and ESG. Some of these include framework for Business Responsibility and Sustainability Reporting (BRSR) Core, BRSR Core for a company's value chain and assurance requirements for the same. Additionally, SEBI issued regulatory framework for ESG Rating Providers (ERPs) and specified norms for ESG investing. Further, the National Financial Reporting Authority (NFRA) issued a circular with respect to the statutory auditors' responsibilities in relation to fraud in a company. Our regulatory updates article cover these and other important regulatory developments.

We would be delighted to receive feedback/suggestions from you on the forthcoming editions of AAU.

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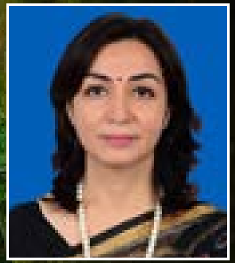

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CHAPTER 1

Effects of climate-related matters on financial statements

This article aims to:

- Highlight requirements in accounting frameworks (Ind AS/IFRS) to report on the effects of climate-related matters on the financial statements.

Introduction

Climate-related risks and opportunities are faced by all companies. Some are affected more than others. As the impact of climate change increases investors and regulators are increasingly looking for greater transparency in relation to climate change and detailed information in the financial statements. Considering the growing implications of climate risk for the preparation of financial statements and lack of sufficient disclosure of climate-related information in financial statements, regulators and standard setting bodies around the globe are working on developing the climate-related disclosure requirements.

However, IFRS Accounting Standards or Ind AS do not refer explicitly to sustainability or climate-related matters. In this regard, in June 2023 the International Sustainability Standards Board (ISSB) issued the final version of the first two IFRS Sustainability Disclosure Standards:

- IFRS S1, *General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1)
- IFRS S2, *Climate-related Disclosures* (IFRS S2).

The standards aim to put sustainability reporting on an equal footing with financial reporting and facilitate the much needed connectivity between sustainability-related financial information and the financial statements. The IFRS S2, the standard on climate-related disclosures specifically requires an entity to disclose information about its climate-related risks and opportunities that is useful to primary users of general purpose financial reports in making decisions relating to providing resources to the entity.

Considering the recent sustainbility framework related developments, the IFRS Foundation republished its educational material on climate-related disclosures to reiterate requirements in IFRS Accounting Standards to report on the effects of climate-related matters in the financial statements when those effects are material.

The education material also highlights that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that primary users of financial statements (hereafter, investors) make on the basis of those financial statements, which provide financial information about a specific company. For example, information about how management has considered climate-related matters in preparing a company's financial statements may be material with respect to the most significant judgements and estimates that management has made.

Overview of the disclosure requirements

IAS 1, *Presentation of Financial Statements* deals with the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. While preparing financial statements, companies should consider overarching requirements under IAS 1 that could be relevant when considering climate-related matters. As per IAS 1 companies are also expected to provide additional disclosures when compliance with the specific requirements in IFRS Accounting Standards is insufficient to enable investors to understand the impact of climate-related matters on the company's financial position and financial performance.These overarching requirements in IAS 1 may be especially relevant for companies whose financial position or financial performance is particularly affected by climate-related matters.

The following section contains relevant disclosure considerations for certain key areas under IFRS Accounting Standards related to effects of climate-related matters that companies should consider in applying the principles of IFRS Standards.

IAS 1, *Presentation of Financial Statements*

Significant judgements and estimation uncertainty

IAS 1 requires specific disclosures on key judgements and estimates made by the management in preparing the financial statements. This includes the disclosure of:

- Judgements that management has made in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements; and
- Information about the assumptions that management has made about the future, and other major sources of estimation uncertainty as at the reporting date, that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year.

Therefore, disclosure of such judgements and assumptions about climate-related matters would be required to be made.

Going concern

The provisions of IAS 1 requires management to assess a company's ability to continue as a going concern when preparing financial statements. In assessing whether the going concern basis of preparation is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period.

It is important to note that climate-related risks may result in:

- Material uncertainties affecting a company's ability to continue as a going concern or
- May involve significant judgements in concluding that there is no material uncertainty (commonly referred as a 'close call' scenario).

IAS 1 requires disclosure of those uncertainties and significant judgements involved.

• IAS 16, *Property, Plant and Equipment*
• IAS 38, *Intangible Assets*

On an annual basis, companies should review the estimated residual values and expected useful lives of Plant, Property and Equipment (PPE) and intangible assets as per IAS 16 and IAS 38. Further, companies should also reflect changes in the amount of depreciation or amortisation recognised in the current and subsequent periods.

Climate-related matters may significantly affect the useful lives and the residual values of PPE and intangible assets. If management re-estimates an asset's useful life and/or residual value, then it discloses the nature and amount of the change in that estimate.

IAS 12, *Income Taxes*

IAS 12 requires companies to recognise deferred tax assets for deductible temporary differences and unused tax losses and credits, to the extent it is probable that future taxable profit will be available against which those amounts can be utilised.

Climate related factors could increase the level of uncertainty with respect to the future tax profits. As a result, a company would not be able to recognise deferred tax assets or would be required to derecognise deferred tax assets previously recognised.

IAS 2, *Inventories*

As per IAS 2, inventory is measured at the lower of cost and Net Realisable Value (NRV). Further, if the cost of inventories is not recoverable then the company should write down those inventories to their NRV. The NRV estimates are based on the most reliable evidence available, at the time that estimates are made, of the amount the inventories are expected to realise.

Climate-related matters could impact both the selling price and the cost of an inventory item, such as climate-related matters could cause a company's inventories to become obsolete, their selling prices to decline or their costs of completion to increase. Therefore, management needs to consider these carefully when determining the NRV of its inventories.

IAS 36, *Impairment of Assets*

Under IAS 36, companies are required to assess at each reporting date whether there is an indication that an asset or Cash-Generating Unit (CGU) may be impaired. One such impairment indicator could be external information such as significant changes in the environment (including for example changes in regulation) in which a company operates having an adverse effect on the company.

Climate-related matters may give rise to indications that an asset (or a group of assets) is impaired. For example, a decline in demand for products that emit greenhouse gases could indicate that a manufacturing plant may be impaired, requiring the asset to be tested for impairment.

The Discounted Cash Flow (DCF) technique is used to calculate the recoverable amounts of assets or CGUs for the purpose of testing impairment. While estimating the recoverable amount using the value in use, the calculation should reflect an estimate of the future cash flows it expects to derive from an asset and expectations about possible variations in the amount or timing of those future cash flows. For this purpose, the cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the range of future economic conditions. This requires companies to consider whether climate-related matters affect those reasonable and supportable assumptions.

IAS 36 requires disclosure of the events and circumstances that led to the recognition of the impairment loss. Disclosure of key assumptions used to estimate the asset's recoverable amount, as well as information related to reasonably possible changes in those assumptions, is also required in specified circumstances.

• IAS 37, Provisions, *Contingent Liabilities and Contingent Assets*
• IFRIC 21, *Levies*

IAS 37 ensures that a company applies appropriate recognition criteria and measurement bases to provisions, contingent liabilities and contingent assets. IAS 37 requires a company to disclose the nature of a provision or contingent liability and an indication of the uncertainties about the amount or timing of any related outflows of economic benefits.

Climate-related matters could affect the recognition, measurement and disclosure of liabilities in the financial statements. For instance levies imposed by governments for failure to meet climate-related targets or to discourage or encourage specified activities could impact the determination of provisions and contingent liabilities and appropriate disclosures should be made as per the provisions of IAS 37.

IFRS 7, *Financial Instruments: Disclosures*

As per IFRS 7, companies are required to disclose information about its financial instruments, including information about the nature and extent of risks arising from financial instruments and how the company manages those risks.

Climate-related matters may expose a company to risks in relation to financial instruments, and disclosure of such risk should be provided.

For instance,

- For lenders: Information about the effect of climate-related matters on the measurement of expected credit losses or on concentrations of credit risk should be provided.
- For holders of equity investments: Information about investments by industry or sector, identifying sectors exposed to climate-related risks, when disclosing concentrations of market risk, should be provided.

IFRS 9, *Financial Instruments*

The objective of IFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities. Climate-related matters could impact the accounting for financial instruments. For instance, borrower's ability to meet its debt obligations could be negatively impacted due to wildfires, floods, or policy and regulatory changes which would have a consequential impact on the expected cash flows to be received from such a loan and the lender's exposure to credit losses.

Thus, climate-related matters could affect the range of potential future economic scenarios, the lender's assessment of significant increases in credit risk, whether a financial asset is credit impaired and/or the measurement of expected credit losses.

IFRS 13, *Fair Value Measurement*

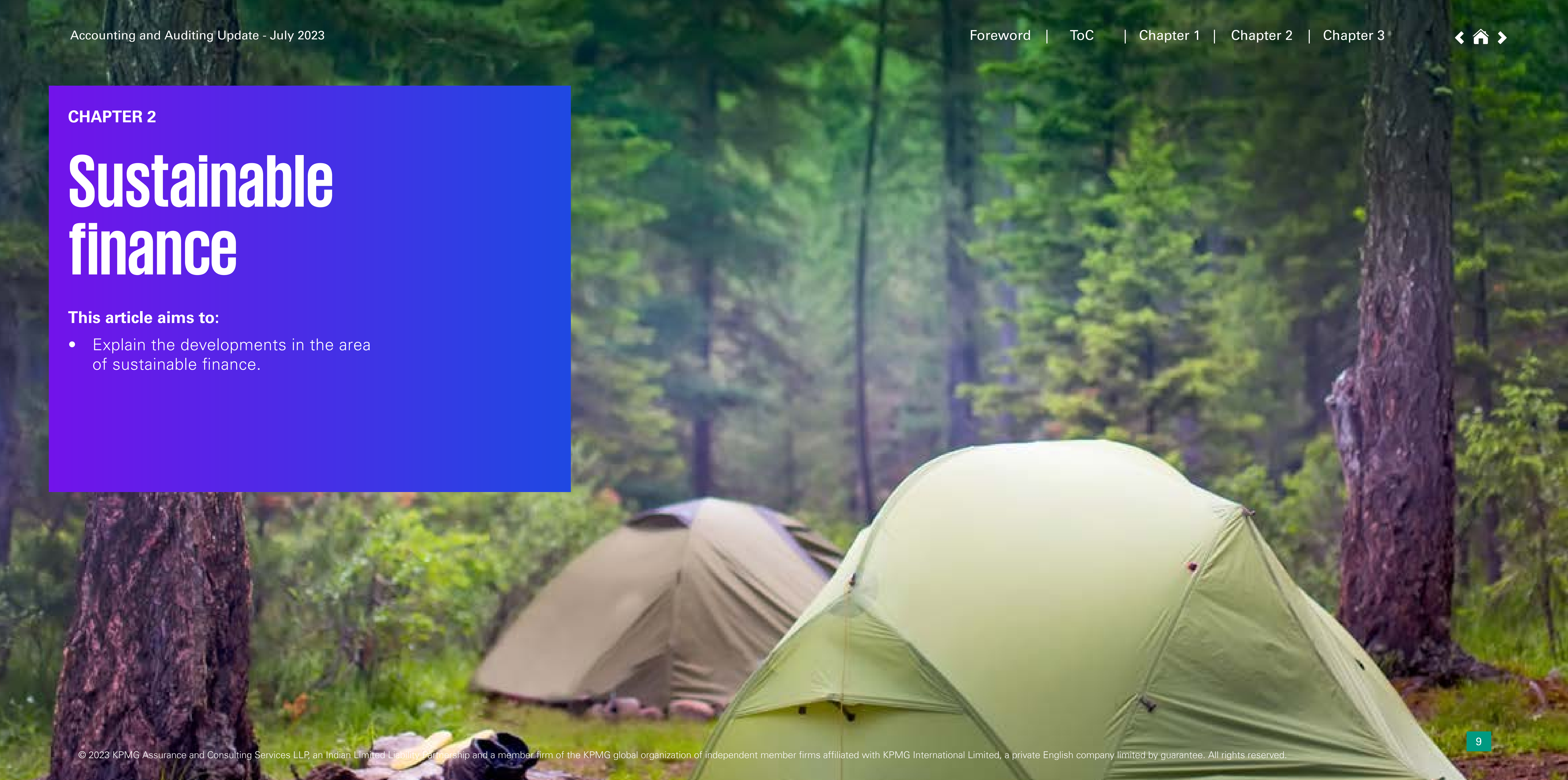
IFRS 13 provides guidance for measurement of fair value. Climate-related matters could affect the fair value measurement of assets and liabilities in the financial statements e.g. the market participants' views of potential climate-related legislation could affect the fair value of an asset or liability.

Climate-related matters could also impact the disclosures about fair value measurement. More specifically, for fair value measurements categorised within Level 3, IFRS 13 requires that unobservable inputs should reflect the assumptions that market participants would use when pricing, including assumptions about risk which may include climate-related risk. Further, a comprehensive disclosure should be provided as per the requirements of IFRS.

Conclusion

Climate-related information is a key area of focus for many regulators and users of the financial staements. Therefore, companies are expected to improve the clarity and transparency of climate-related disclosures. To meet these expectations, companies need to consider the specific disclosure requirements in individual standards as well as the overarching requirements of IAS 1 when providng climate-related disclosures.

Source: IFRS Foundation, Educational material - Effects of climate-related matters on financial statements, published July 2023



CHAPTER 2

Sustainable finance

This article aims to:

- Explain the developments in the area of sustainable finance.

Sustainable finance supports sustainable economic, social, and environmental development. It is the term used to describe financing and investment decisions that consider Environmental, Social and Governance (ESG) issues. Sustainable finance can be considered an umbrella concept, while ESG is more specific, and focused on environmental, social, and governance. Sustainable financing has become a prominent initiative to address some of the most challenging issues that the world faces today, ranging across climate change, biodiversity, health, financial inclusion, livelihood, women empowerment, and food security. One of the most relevant instruments in sustainable finance is - green bonds.

Background on sustainable finance

Sustainable finance is not a new form of investment. There were socially responsible investors in the mutual fund industry in the US in the 1960s, but they were a minuscule component of the investment community – and in Asia hardly existed. In 1971 Pax World launched the first sustainable mutual fund in the US. The first United Nations Scientific Conference - also known as the First Earth Summit- was held in Stockholm (Sweden) in 1972. The objective of the creation of the framework of the International Finance Corporation of the World Bank (IFC principles) was to reduce the detrimental environmental impacts and risks of business activities.

Sustainable finance has gained momentum after Paris Agreement (2015) and a non-financial crisis like Covid-19. This got further momentum in the recently concluded COP 27.

The financial and non-financial (Covid-19) crisis has restructured the economic and political milieu. Most importantly, awareness of ESG has transformed the landscape of the financial sector. The focus on stability and ethical practice is gaining importance over attractive quantitative returns on investment. Recently more advanced ESG-related products (e.g., green bonds and sustainability-linked loans) have been issued in the market, in response to rising investor demand for such products. Common forms of sustainable finance include green bonds, renewable and sustainable equities, green (ESG) mutual funds, solar bonds, green mortgages, green credit cards, and renewable energy credits.

In 2021-2022, a number of new or revised policy initiatives were established globally having a focus on sustainability. Globally, Europe is the leader in terms of developing a framework for sustainable finance, and ESG integration into different asset classes. The EU Taxonomy for sustainable activities is the first comprehensive science-based classification system designed to help understand whether an economic activity is sustainable. The Sustainable Finance Disclosure Regulation (SFDR) was introduced by the European Commission alongside the Taxonomy Regulation and the Low Carbon Benchmarks Regulation as part of a package of legislative measures arising from the European Commission's Action Plan.

All nations have started following the[1] footprints of Europe and introducing regulations to boost sustainable finance.

Overview of the sustainable finance structure

As mentioned above, the importance of sustainable finance has increased significantly, as a result, organisations, investors, financial intermediaries and other stakeholders are taking into account ESG assessments in their investment decisions.

In this regard, it is important to understand the structure of sustainable finance.

This can be explained through a diagrammatic representation.

Issuers
Entity issuing sustainability labelled instruments

Rating providers and indices

Asset managers

Institutional investors

End investors
Subscribers to the instrument who bear the risk and rewards

Statutory regulations
Includes regulatory bodies, stock exchanges, government authorities, etc.

Standard setter
Includes international bodies providing guidelines on responsible conduct of social value guidance on disclosure requirements, materiality, etc.

(Source: :Organisation for Economic Co-operation and Development (OECD) publication on 'ESG Investing: Practices, Progress and Challenges' and KPMG in India's analysis)

The above diagram depicts:

- Issuers are entities issuing instruments in the financial market, either through public or private channels, with an aim to raise funds towards sustainable development[1].
- ESG ratings are the rating products that are marketed as opinions about an issuer or a security, regarding its ESG profile or characteristics or exposure to the ESG risk, governance risk, social risk, climatic or environmental risks, or impact on society, climate and the environment, that are issued using a defined ranking system of rating categories. Such ratings are provided by ESG Rating Providers (ERPs).[2]
- Index providers convert ratings into market indices by reweighting market portfolios[1].
- Asset managers develop investment products with the help of ESG ratings. This is done to either take portfolio composition decisions or to contribute to the portfolio managers' own ESG ratings[1]. Institutional investors incorporate ESG ratings for portfolio management.[1]
- End users are the subscribers to the instruments.
- Statutory authorities are the regulatory and oversight bodies, market regulators etc. who develop a regulatory framework to ensure issuers are held accountable for their ESG impact and ensure investors have access to the information they need to make informed investment decisions.
- Standard setters lay down the disclosure and measurement requirements for sustainable investing[1].

1. OECD publication on 'ESG Investing: Practices, Progress and Challenges'
2. As per the master circular issued by the Securities Exchange Board of India (SEBI) on ERPs. Circular No. SEBI/HO/DDHS/POD2/P/CIR/2023/ 121 dated 12 July 2023

Challenges in ESG ratings and methodologies

ESG ratings are based on the relevant criteria for each factor of E, S, and G. Rating providers use metrics and sub-metrics to determine the overall ESG score. According to OECD's publication on 'ESG Investing: Practices, Progress and Challenges'[1], investors are facing challenges due to the lack in consistent and comparable information amongst ESG investing products. This is because different ERPs use different methodologies resulting in ESG rating variance. Further, different ERPs rank different aspects of the sustainability of the companies they assess. Also, as per SEBI's consultation paper on 'ESG Disclosure, Ratings and Investment', issued on 20 February 2023, it was observed that emerging markets have different set of environmental and social challenges. Therefore, it becomes critical for ERPs to consider these factors while assessing a company's ESG risks/ opportunities and impact.

Thus, there is a need for a consistent set of metrics for assigning ESG ratings. For this purpose, regulatory bodies should establish a set of metrics for the purpose of assigning ratings to ensure consistency.

India landscape

Developments for sustainable finance is taking shape globally and in India also there is continued government focus and policy initiatives on sustainability. The Sustainable Finance Group (SFG) in the Department of Regulation (DoR), Reserve Bank of India (RBI), carried out a survey in January 2022 to assess the status of climate risk and sustainable finance in leading scheduled commercial banks. The responses indicate that although banks have begun taking steps in the area of climate risk and sustainable finance, there remains need for concerted effort and further action in this regard. On the basis of the survey, RBI issued a Discussion Paper on Climate Risk and Sustainable Finance (discussion paper). The discussion paper discusses a need to prepare a strategy based on global best practices on mitigating the adverse impacts of climate change, learnings from participation in standard-setting bodies and other international fora.

Based on the feedback received from various stakeholders, RBI issued a press release dated 8 February 2023 on the 'Statement on Developmental and Regulatory Policies'. One of the guidelines proposed in the press release was on developing an overall green finance ecosystem including a broad framework for acceptance of green deposits.

Consequently, on 11 April 2023, RBI issued a Framework for Acceptance of Green Deposits (the framework). The framework is effective from 1 June 2023.

Recently, a number of ESG funds have been launched in India. As ESG investing becomes mainstream, there is a need to provide adequate regulatory support, and consistent, comparable and decision useful scheme disclosures to make informed investment decision and to prevent greenwashing.

In this area, the Securities and Exchange Board of India (SEBI) had prescribed disclosure norms for ESG schemes of mutual funds to the Association of Mutual Funds in India (AMFI) as stated in the Master Circular on Mutual Funds[3] (the Master Circular). In May 2022, SEBI constituted an ESG Advisory Committee (EAC) which, *inter alia*, provided recommendations for expanding the disclosure norms for ESG funds through public consultations. Subsequently, the SEBI (Mutual Funds) Regulations, 1996 (MF Regulations) were amended on 27 June 2023 to *inter-alia* specify that the funds under ESG schemes should be invested in the manner as specified by SEBI periodically.

Accordingly, on 20 July 2023, SEBI issued a circular to implement measures to facilitate green financing with a thrust on enhanced disclosures and mitigation of green washing risk.

Through the circular, SEBI has introduced a separate sub-category for ESG investments under the thematic category of equity schemes.

Next steps

The market is still at a nascent stage, and commercial banks and investors both institutional and retail will have to play a vital role in the accomplishment of sustainable finance products in India, as the Indian economy grapples with achieving the long-term net-zero objectives.

Pre-requisites for strengthen the progress made so far on sustainable finance policy setting process are as follows:

1. Strong comparability of ESG ratings and investing approaches
2. Good quality data to be used for investment decisions
3. Improvement in ESG disclosures by companies with use of science-based targets and disclosures of annual progress in quantitative and comparable format
4. Greater international cooperation to ensure ESG and climate transition related practices strengthen investor confidence and market integrity.

3. As available under the 'Policy related letters/Emails issued by SEBI' in the Master Circular on Mutual Funds No. SEBI/HO/IMD/IMD-PoD-1/P/CIR/2023/74 dated May 19, 2023. The letters sent to AMFI were dated 8 February 2022 and 21 June 2022

CHAPTER 3

Regulatory updates

SEBI updates

Framework on BRSR Core and disclosures for value chain

As per the existing provisions of the Securities Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations), top 1,000 listed entities[1] are mandatorily required to file Business Responsibility and Sustainability Reporting (BRSR) as part of their Annual Report with SEBI from Financial Year (FY) 2022-23 onwards.

On 14 June 2023, SEBI through a notification amended the Listing Regulations to introduce the BRSR Core and BRSR Core for a company's value chain. Subsequently, on 12 July 2023, SEBI issued a circular prescribing the disclosure requirements for BRSR Core, disclosures for value chain and assurance requirements.

The key takeaways are as follows:

- **BRSR Core and updated BRSR:** BRSR Core is a sub-set of BRSR, consisting of a set of Key Performance Indicators (KPIs)/metrics under nine ESG attributes. The BRSR Core specifies the data and approach for reporting and assurance. It has been further clarified that the approach specified is only a base methodology. Any changes or industry specific adjustments/estimations should be disclosed.

  Certain key considerations are as follows:

  a. BRSR core:

  - **KPIs of BRSR Core:** The KPIs of BRSR Core are as follows:

Sr. No.	KPI Name
1.	Green-house gas (GHG) footprint
2.	Water footprint
3.	Energy footprint
4.	Embracing circularity - details related to waste management by the entity
5.	Enhancing employee wellbeing and safety
6.	Enabling gender diversity in business
7.	Enabling inclusive development
8.	Fairness in engaging with customers and suppliers
9.	Open-ness of business

  - **Applicability:** Top 1,000 listed entities (by market capitalisation) should make disclosures as per the updated BRSR format from FY 2023 – 2024.
  - **Reasonable assurance:** Mandatory reasonable assurance of the BRSR Core should be obtained by the listed entities. The format of BRSR Core for reasonable assurance has been provided in Annexure I to the circular. The glide path for applicability of mandatory reasonable assurance is as follows:

Financial Year	Applicability of BRSR Core to top listed entities
2023 – 24	Top 150 listed entities
2024 – 25	Top 250 listed entities
2025 – 26	Top 500 listed entities
2026 – 27	Top 1000 listed entities

  b. Revised format of BRSR: The existing format of BRSR has been updated to incorporate the KPIs of BRSR. Annexure II to the circular provides the revised format of BRSR.

- **BRSR Core for value chain:** As per the BRSR format, the value chain metrics form part of the leadership indicators which are to be reported on a voluntary basis. The circular now requires certain listed entities to provide disclosures of value chain as per BRSR Core.

  Certain key considerations are as follows:

  a. **Determination of value chain:** The value chain should encompass the top upstream and downstream partners of a listed entity, cumulatively comprising 75 per cent its purchases/sales (by value) respectively. Such reporting may be segregated for upstream and downstream partners or can be reported on an aggregate basis. Further, the scope of reporting and any assumptions or estimates, if any, shall be clearly disclosed.

  b. **Reporting format:** Disclosures for value chain should be made by the listed entity as per BRSR Core, as part of its Annual Report

  c. **Applicability:** The BRSR Core disclosures for the value chain is applicable to the top 250 listed entities (by market capitalisation), on a comply-or-explain basis from FY 2024-25.

  d. **Limited assurance:** The above-mentioned companies should obtain limited assurance on a comply or-explain basis from FY 2025 – 26.

1. As per market capitalisation as on 31 March of previous year.

- **Assurance provider:** Following requirements to be evaluated by a listed entity while appointing an assurance provider:
  a. **Expertise:** The Board of the listed entity should ensure that the assurance provider of the BRSR Core has the necessary expertise, for undertaking reasonable assurance.
  b. **Independence:** The listed entity should ensure that there is no conflict of interest with the assurance provider appointed for assuring the BRSR Core disclosures. For instance, it should be ensured that the assurance provider or any of its associates do not sell its products or provide any non-audit/non-assurance related service including consulting services, to the listed entity or its group entities.

Also refer to KPMG in India's First Notes on SEBI framework on 'BRSR Core and value chain – disclosures and assurance by listed entities' dated 15 July 2023 that provides an overview of recent SEBI circular.

(Source: SEBI circular no. SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122 dated 12 July 2023)

Regulatory framework for ESG Rating Providers (ERPs)

On 3 July 2023, SEBI issued amendment to the SEBI (Credit Rating Agencies) Regulations, 1999 (CRA Regulations), thereby introducing Chapter VIA on ERPs. These regulations would be applicable to an ESG Rating provider i.e. a person engaged in, or proposes to engage in, the business of issuing ESG ratings.

These regulations, *inter-alia,* prescribe guidelines for registration of ERPs, general obligations of ERPs, manner of inspection and code of conduct applicable to ERPs. These regulations are effective from 3 July 2023.

Subsequently on 12 July 2023, SEBI issued a mater circular which lays down the procedural/disclosure requirements and obligations for ERPs. ERPs are required to comply with the conditions laid down in this master circular. The master circular consists of guidance on the following sections:

- **Registration, approval and surrender requirements:** The master circular provides guidance with respect to registration mechanism for ERPs, approvals for change in control of ERPs, guidelines on suspension, cancellation or surrender of certificate of registration.
- **Rating operations:** This section provides insights with respect to the types of ESG ratings/ scores, business model for ERPs, rating process, guidance on monitoring and review of ratings, etc.
- **Reporting and disclosures:** The master circular provides guidance with respect to periodic and continuous disclosures. It also includes the guidelines for disclosures by ERPs on its website.
- **Other requirements:** The master circular also provides guidance with respect to the internal audit and other miscellaneous requirements applicable to ERPs.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2023/136 dated 3 July 2023 and circular no. SEBI/HO/DDHS/POD2/P/CIR/2023/ 121 dated 12 July 2023)

Disclosure of information on Issuers Not Cooperating (INC) with Credit Rating Agencies (CRAs)

As per the provisions of SEBI CRA Regulations, every CRA is required to carry out periodic reviews of all published ratings during the lifetime of the securities, unless the rating is withdrawn. However, in case a client does not cooperate then the CRA is required to carry out the review on the basis of best available information or in the manner specified by SEBI.

SEBI observed that the number INCs have increased over a period of time. Therefore, to provide enhanced transparency and information regarding non-cooperative issuers to various stakeholders, market participants and investors, SEBI issued a circular on 27 June 2023, prescribing the disclosure requirements for CRA with respect to INCs.

The circular requires the CRA to separately disclose the following lists of INCs in the format as prescribed in the circular:

i. Securities that are listed, or proposed to be listed, on a recognised stock exchange, and

i. Other ratings

Further, these disclosures should be updated on a daily basis.

This circular is applicable with effect from 15 July 2023, and CRAs shall report on their compliance with this circular (as ratified by their respective board of directors) to SEBI within one quarter from the date of applicability of this circular. Further, such compliances should be monitored by half-yearly internal audits for CRAs.

(Source: SEBI circular no. SEBI/HO/DDHS/DDHS-POD2/P/CIR/2023/105 dated 27 June 2023)

Circular on disclosure of material events and information by listed entities

As per the provisions of Regulation 30 of the Listing Regulations, a listed entity that has listed specified securities[2], is required to disclose material events or information to the stock exchange in accordance with Part A of Schedule III of the Listing Regulations.

On 14 June 2023, SEBI issued amendments[3] to the Listing Regulations with respect to disclosure of material events or information. These amendments are with respect to:

- Determination of materiality threshold and policy (Regulation 30(4)(i) and (ii))
- Revised timelines for disclosure of material events (Regulation 30(6))
- Verification of market rumors (Regulation 30(11))
- Disclosure requirements for certain types of agreements binding listed entities (Regulation 30A)
- Additions and modifications of disclosure of events specified under Para A and Para B of of Part A of Schedule III

Subsequently, on 13 July 2023, SEBI issued a circular which specifies the details required to be disclosed for the events specified under Part A of Schedule III and the timeline for disclosure of such events. It also provides guidance on when an event information can be said to have occurred and on determination of materiality. The provisions of this circular are applicable from 15 July 2023.

(Source: SEBI circular no. SEBI/HO/CFD/CFD-PoD-1/P/CIR/2023/123 dated 13 July 2023)

Appointment of director nominated by debenture trustee

Regulation 23 of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations) stipulates the obligations of an issuer. The provisions of Regulation 23(6) of the NCS Regulations, obligates an issuer which is a company under the Companies Act, 2013 (2013 Act) to ensure that its Articles of Association (AoA) require its Board of Directors to appoint a director which is nominated by the debenture trustee(s) in accordance with Regulation 15(1)(e)[4] of the SEBI (Debenture Trustees) Regulations, 19931 (DT Regulations).

However, such obligations did not exist for an issuer which is not a company. In this regard, on 4 July 2023, SEBI issued a circular for issuers that are not companies. As per the circular, such issuers are required to submit an undertaking to their debenture trustees stating that a non-executive/ independent director/trustee/ member of its governing body should be designated as a nominee director in consultation with the debenture trustees in case of events mentioned in Regulation 15(1)(e) of DT Regulations.

The provisions of this circular are applicable from 4 July 2023.

(Source: SEBI circular no. SEBI/HO/DDHS/POD1/P/CIR/2023/112 dated 4 July 2023)

Amendments to mutual fund regulations

The SEBI (Mutual Funds) Regulations, 1996 (MF Regulations) lay down the regulatory framework for operations and functioning of mutual funds. On 27 June 2023, SEBI issued amendments to the MF Regulations.

The key takeaways from the amendments are as follows:

- **Eligibility criteria for sponsor:** As per the existing provisions of the MF Regulations, the sponsor should have a sound track record and a general reputation of fairness and integrity in all business transactions. The amendment has revised the definition of the term 'sound track record' and also stipulates the requirements to be fulfilled in case the sponsor is not carrying on business in financial services for a minimum period of five years.
- **Disassociation by sponsor:** The amendment now allows the sponsor to disassociate itself from the Asset Management Company (AMC) and the mutual fund subject to certain conditions specified by SEBI. In case of disassociation, the shareholding for any shareholder in the AMC should be below 10 per cent and the board of directors of such AMC should have at least two third independent directors.
- **Trustee of a mutual fund:** In case a company is appointed as a trustee of a mutual fund, the amendment requires the chairperson of the board of directors of the trustee company to be an independent director.
- **Rights and obligations of trustees:** The amendment has modified certain requirements with respect to the rights and obligations of trustees as follows:
  a. The trustees should approve the policy for empanelment of brokers by the AMC.
  b. The trustees should also ensure that the income calculated by the AMC is in accordance with the provisions of Regulation 25(5) of the MF Regulations

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2. Regulation (2)(1)(zl) of Listing Regulations defines specified securities as equity shares and convertible securities as defined under Regulation 2(1)(eee) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.
3. SEBI Listing Regulations (Second Amendment) Regulations, 2023
4. Regulation 15(1)(e) of DT Regulations requires the debenture trustees to appoint a nominee director on the Board of the company in the event of:
i. two consecutive defaults in payment of interest to the debenture holders; or
ii. default in creation of security for debentures; or
iii. default in redemption of debentures

c. In case of change in fundamental attributes of any scheme, the fees and expenses payable or any other change affecting the interest of the unit holders then such a change should be in accordance Regulation 25(26) of the MFR Regulations

d. Periodical review to be conducted with respect to the service contracts relating to custody arrangements and trustees should satisfy themselves that such contracts are executed in the interest of the unit holders

e. Exercise due diligence on matters to be specified by the SEBI from time to time.

- **Obligations for an AMC:** The amendment requires the board of directors of the AMC to ensure that the activities of the AMC are in accordance with the MF Regulations. The amendment also stipulated the steps for conducting due diligence by the board of directors of the AMC.
- **Other amendments:** The amendment has also prescribed the requirements with respect to:

  a. Meeting of the board of directors of the trustee company and the board of directors of the AMC

  b. In-principle approval from recognised stock exchange

  c. Allocation of money under Environmental, Social and Governance (ESG) schemes

  d. Investment in corporate debt market development fund

  e. Valuation of investments.

(Source: SEBI notification no. SEBI/LAD-NRO/GN/2023/134 dated 27 June 2023)

SEBI issued norms for ESG Investing

Considering the amendments issued to MF Regulations relating to ESG investing, on 20 July 2023, SEBI issued a circular implementing some key measures to facilitate green financing with thrust on enhanced disclosures and mitigation of green washing risk. Following are the broad categories discussed in the circular related to ESG schemes:

I. Thematic schemes on ESG strategies

SEBI has introduced a separate sub-category for ESG investments under the thematic category of equity schemes, by including various strategies that the mutual funds can adopt to align their investments with ESG considerations. Additionally, SEBI has mandated that at least **80 per cent** of the total Assets Under Management (AUM) of ESG schemes should be invested in equity & equity related instruments of the chosen strategy. The remaining portion of the investment should not contradict the strategy of the scheme. There should be a clear distinction in terms of asset allocation, investment strategy of the mutual fund schemes launched.

II. Investment criteria

SEBI through its circular mandated ESG schemes to invest at least **65 per cent** of its AUM in companies which are reporting on comprehensive BRSR **and** are also providing assurance on BRSR Core disclosures. The balance AUM of the scheme can be invested in companies having BRSR disclosures. This requirement will be applicable with effect from 1 October 2024.

In case of non-compliance by ESG schemes with the aforementioned investment criteria by 1 October 2024, an extension period to ensure compliance has been prescribed till 30 September 2025. However, ESG schemes cannot undertake any fresh investments in companies without assurance on BRSR Core during the extended period of one year.

III. Disclosure requirements

SEBI circular prescribed following disclosure requirements

- *Scheme strategy* – The name of the ESG fund/scheme should clearly disclose the ESG strategy it is based on.
- *ESG scores of securities:* Disclosure of BRSR and BRSR Core scores provided by ESG Rating Providers (ERPs), along with name of EPRs, applicable with immediate effect.
- *Voting disclosures:* While disclosing votes cast by AMCs on resolutions of their investee companies, mutual fund should disclose whether vote has been cast in favour or against the proposal on account of any ESG reasons. *(Applicable for annual general meetings held from 1 April 2024 onwards)*
- *Annual fund manager commentary and disclosure of case studies:* The requirement of Annual Fund Manager commentary should be applicable from FY 2023-24. The disclosure of case studies mentioned in point (b) and (c) above should be applicable from FY 2024-25 and the engagement details should be disclosed from FY 2025-26 onwards.

IV. Assurance

A. Independent assurance

- SEBI has mandated an independent reasonable assurance on an annual basis for AMCs regarding their ESG scheme's portfolio being in compliance with the strategy and objective of the scheme stated in Scheme Information Documents (SIDs). Such assurance is applicable on a "comply or explain basis" for all ESG schemes for FY 2022-23 by 31 December 2023. Thereafter, disclosure of assurance should mandatorily be made in the scheme's annual report.
- The AMCs should ensure that the assurance provider for an ESG scheme has the necessary expertise for undertaking reasonable assurance and there is no conflict of interest with the assurance provider appointed.

B. Certification by the board of AMCs

- Basis a comprehensive internal ESG audit, the Board of Directors of AMCs are required to certify compliance of ESG schemes with the regulatory requirements as a part of the annual report of the scheme.
- The board of directors of AMCs should provide the certificate for FY 2022-23 by 31 December 2023. Thereafter, the certification should be disclosed in the annual reports of the schemes.

(Source: SEBI circular SEBI/HO/IMD/IMD-I –PoD1/P/CIR/2023/125 dated 20 July 2023)

SEBI prescribed roles and responsibilities of trustees and board of directors of AMCs of mutual funds

As per the SEBI MF Regulations, the trustees hold the property of the mutual fund in trust for the benefit of the unit holders and their primary role is to ensure that AMCs appointed by them act in the best interests of the unitholders. Further, an AMC is responsible for managing the funds of the schemes and to ensure that the interests of the unitholders are protected.

With an aim to streamline the responsibilities of the trustees and AMCs, SEBI has issued a circular on 7 July 2023 prescribing the roles and responsibilities for the trustees and AMCs.

The key takeaways are as follows:

- **Core roles and responsibilities:** The circular prescribes the core responsibilities for trustees which, inter alia, include:
  a. The trustees should ensure fairness of the fees and expenses charged by the AMCs and should review their performance in its schemes vis-a-vis performance of peers or the appropriate benchmark.
  b. The trustees should ensure that AMCs have system level checks in place to prevent fraudulent transactions including front running by employees, form splitting/mis-selling by distributors etc.
  c. The operations of AMCs should not be unduly influenced by the AMCs Sponsor, its associates and other stakeholders of AMCs and that undue or unfair advantage is not given by AMCs to any of their associates/ group entities.
  d. AMCs should have suitable mechanisms/ systems to generate system based information/data/reports for evaluation and effective due diligence by trustees. Trustees should perform such reviews on a periodic basis.
  e. AMCs should submit exception reports/ analytical information to the trustees, that add value to the process of exercising their oversight role. The trustees shall evaluate the nature and adequacy of the alerts and the manner of dealing with such alerts by AMCs.
- **Third-party assurance:** The trustees may rely on professional firms such as audit firms, legal firms, merchant bankers, etc. for carrying out due diligence on their behalf.
- **Appointment of a trustee company and meeting between trustee company and AMCs:** As per the provisions of MF Regulations, if the trustee is a company, the chairperson of the board of directors of such a trustee company should be an independent director. The circular states that in case a trustee company has not complied with these regulations, then a time period of six months from 1 January 2024 is provided to such trustee companies to appoint an independent director as chairperson of the board of directors.

  Further, the board of directors of the AMCs and the board of directors of the trustee company should meet at least once a year to discuss the issues concerning the mutual fund, if any, and future course of action, wherever required.
- **Unit Holder Protection Committee (UHPC):** As per the provisions of MF Regulations, the AMC is required to constitute a UHPC. The circular prescribes the roles and responsibilities of UHPC which, *inter alia*, include review of the various compliance issues relating to protection of the interests of the unit holders and keeping the unit holders well informed of and educated about mutual fund products, investor charter and compliant handling procedures. Annexure-1 to the circular provides the detailed guidelines for UHPC.

The provisions of this circular are effective from 1 January 2024.

(Source: SEBI circular no. SEBI/HO/IMD/IMD-PoD-1/P/CIR/2023/117 dated 7 July 2023)

Regulatory framework for sponsors of a mutual fund

SEBI has issued a circular prescribing the regulatory framework (the framework) for sponsors of a mutual fund with an aim to enhance the penetration of the mutual fund industry and to facilitate new types of players to act as sponsors of mutual funds.

Certain key points to consider from the framework are as follows:

i. The framework stipulates the asset classes for deployment of minimum net worth requirements by AMCs.

ii. The framework lays down the requirements for acquisition of an AMC by a sponsor

iii. The framework prescribes the conditions for permitting a private equity fund or a pooled investment vehicle or a pooled investment fund to sponsor mutual funds

iv. The requirements and conditions with respect to reduction of stake, disassociation of sponsor and re-association of sponsor are also prescribed in the framework.

The provisions of point (i) are appliable from 1 January 2024 whereas the provisions stipulated in point (ii) to (iv) are effective from 1 August 2023.

(Source: SEBI circular dated 7 July 2023)

Standardised approach to valuation of investment portfolio of Alternative Investment Funds (AIFs)

Regulation 23 of the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations), requires an AIF to carry out valuation of their investments. In this regard, on 21 June 2023, SEBI issued circular prescribing a standard approach to valuation of investment portfolio of AIFs. The provisions of the Circular are effective from 1 November 2023.

The key takeaways from the circular are as follows:

- **Manner of valuation of AIF's investments**

  a. With respect to the securities for which valuation norms have already been prescribed under MF Regulations the valuation for such securities should be carried out as per the norms prescribed under MF Regulations.

  b. Valuation of securities which are not covered above, should be as per the valuation guidelines endorsed by any AIF industry association, which in terms of membership represents at least 33 per cent of the number of SEBI registered AIFs.

  c. The details of the valuation methodology and approach adopted under the stipulated guidelines for each asset class of the scheme of the AIF should also be disclosed by the manager in the Private Placement Memorandum (PPM)

- **Responsibility of manager of AIF**

  a. It should be ensured that the independent valuer computes and carries out valuation of the investments of the scheme of the AIF in the specified manner.

  b. The manager would be responsible for true and fair valuation of the investments of the scheme of the AIF.

  c. The circular also prescribes the disclosure requirements for deviations and changes. As per the circular, at each asset level, in case there is a deviation of more than 20 per cent between two consecutive valuations or a deviation of more than 33 per cent in a financial year, the same should be intimated to the investors along with the reasons/factors for the same, both generic and specific.

  d. Further, details regarding changes in accounting practices/policies, valuation methodology and approach, and impact of such changes should be disclosed in the PPM to be submitted on an annual basis to the SEBI and investors.

- **Reporting of valuation of investments of AIF to performance benchmarking agencies**

  a. AIFs should report the valuation of investments on the basis of the audited data of investee companies as on 31 March to performance benchmarking agencies within the specified timeline of six months

  b. For this purpose, the manager of AIF should ensure that a specific timeframe for providing audited accounts by the investee company to the AIF is included as one of the terms in subscription agreement/investment agreement with the investee company.

- **Eligibility criteria for independent valuer**

  The circular also prescribes the eligibility criteria for appointment for independent valuer for valuing investment portfolio of AIFs.

(Source: SEBI circular no. SEBI/HO/AFD/PoD/CIR/2023/97 dated 21 June 2023)

Other updates

NFRA's circular on statutory auditor's responsibility in relation to a fraud in a company

On 26 June 2023, the National Financial Reporting Authority (NFRA) issued a circular with respect to the statutory auditors' responsibilities in relation to fraud in a company.

The key takeaways are as follows:

a. Statutory auditors are under a mandatory obligation to report fraud or suspected fraud if they observe suspicious activities, transactions or operating circumstances in a company that indicate reasons to believe that an offence of fraud is being or has been committed against the company by its officers or employees.

b. In case an event of fraud, the statutory auditor should initiate the steps prescribed under Rule 13 of Companies (Audit and Auditors) Rules, 2014 which begins with reporting the matter to the board/audit committee within two days of his/her knowledge of the fraud.

c. In the case of reporting of a fraud involving or expected to involve individually an amount of INR1 crore or above, the statutory auditor fails to get any reply/observations from the Board/Audit Committee within 45 days, the auditor should forward a report in the specified form viz., ADT-4 to Secretary, Ministry of Corporate Affairs, Government of India

d. The statutory auditor is duty bound to submit Form ADT-4 to the Central Government as per Section 143(12) of the 2013 Act even in cases where the statutory auditor is not the first person to identify the fraud/suspected fraud.

e. Resignation does not absolve the auditor of his responsibility to report suspected fraud or fraud as mandated by the law.

f. The statutory auditor should exercise his/her own professional skepticism while evaluating fraud, and need not be influenced by legal opinion provided by the company or its management.

(Source: NFRA circular no. NF-25013/2/2023 dated 26 June 2023)

Checklist on standards on auditing

Standards on Auditing (SA) prescribe a detailed auditing framework for conducting audits of financial statements of various entities. These Standards contain various audit requirements and related application guidance to explain these requirements.

On 22 June 2023, the Auditing and Assurance Standards Board (AASB) of the Institute of Chartered Accountants of India (ICAI) issued the ‘Checklist on Standards on Auditing’ (the Checklist). This publication covers checklist on all the 38 SAs issued till date. It also contains detailed checklist on various audit requirements and relevant guidance.

(Source: ICAI announcements dated 22 June 2023)

Audit working paper templates issued by ICAI

Audit documentation i.e. audit working papers are considered to be the backbone of an audit. SA 230, *Audit Documentation* stipulates the principles that auditors should follow when preparing audit documentation. On 3 July 2023, the AASB of ICAI issued a publication on audit working paper templates with an aim to help the auditors in preparing their audit working papers in consistent and effective manner.

The publication consists of templates of various audit working papers which are required to be prepared by auditors during the course of their audit assignment i.e. during the planning, execution and completion stage of the audit. These templates are prepared in accordance with the requirements of SAs, Schedule III of the Companies Act 2013 checklist, CARO 2020 checklist etc.

(Source: ICAI announcement dated 3 July 2023)

IRDAI issues guidelines on remuneration of directors and Key Managerial Personnel (KMP) of insurers

On 30 June 2023, the Insurance Regulatory and Development Authority of India (IRDAI) issued remuneration guidelines for non-executive directors and KMP of insurers. These guidelines replace and supersede the guidelines issued in 2016[5].

The guidelines are applicable to directors and KMPs of private insurers from Financial Year 2023-24. The guidelines require the insurer to complete the process of framing/ reviewing the remuneration policy within 3 months of the issuance of these guidelines. The guidelines also prescribe the disclosure requirements for insurers in their notes to accounts forming part of the annual financial statements.

The key takeaways are as follows:

- **Directors:** The Board of Directors in consultation with the nomination remuneration committee should formulate and adopt a comprehensive remuneration policy and the same should be in compliance with the provisions of the Companies Act 2013 (2013 Act). The total for each non-executive director should not exceed INR20 lakh per annum. It is further stated that the non-executive directors would not be eligible for any equity-linked benefits. The guidelines also permit payment of sitting fees and reimbursement of expenses, subject to the compliance with the provisions of the 2013 Act. The guidelines also prescribe the age limit and tenure of non-executive directors.
- **KMPs:** The remuneration policy should be approved by the board and should cover all the KMP. Further, the policy should not encourage KMPs to take inappropriate or excessive risks for their performance based variable remuneration. The policy should cover all aspects of remuneration structure including fixed pay, allowances, perquisites, retirement benefits, variable pay including incentives, bonus, share linked instruments, joining/sign on bonus, etc. Accordingly, the guidelines provide clarity with respect to these elements of the remuneration structure, malus and clawback provisions, accounting and disclosures requirements.

(Source: IRDAI circular reference no. IRDAI/F&A/GDL/MISC/141/6/2023 dated 30 June 2023)

5. IRDAI Circular no. IRDA/F&A/GDL/LSTD/155/08/2016 prescribed remuneration guidelines for non-executive directors and managing directors/ chief executive officer/whole-time director.

First Notes

SEBI framework on BRSR Core and value chain – disclosures and assurance by listed entities

In May 2021, the Securities Exchange Board of India (SEBI) introduced Business Responsibility and Sustainability Reporting (BRSR) which requires top 1,000 listed entities (by market capitalisation) to file BRSR as part of the Annual Report with SEBI from FY 2022-23 onwards.

Given the growing importance of ESG disclosures for investors and other stakeholders, there was a need for entities to obtain assurance on the ESG disclosures. In February 2023, SEBI issued a consultation paper proposing a regulatory framework for enhancing the ESG disclosures which consisted of applicability of BRSR Core, disclosures for value chain and specifications on assurance, including a glide path.

Subsequently, on 29 March 2023, SEBI approved these proposals with respect to BRSR Core, value chain disclosures, and assurance thereof in a phased manner. Based on recommendations of the ESG Advisory Committee and the consultation paper, SEBI through a notification dated 14 June 2023 amended the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) to introduce the BRSR Core and BRSR Core for company's value chain. Subsequently, on 12 July 2023, SEBI issued a framework (the framework) prescribing the disclosure and assurance requirements for BRSR core, ESG disclosures for value chain and assurance requirements.

The key aspects in the framework are with respect to:

- BRSR Core
- Revised format for BRSR
- Assurance requirements for BRSR Core and value chain

In this issue of the First Notes, we aim to provide an overview of the framework.

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

Voices on Reporting - Quarterly updates publication

On 28 July 2023, KPMG in India released its VOR – Quarterly updates publication which provides a summary of the 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 Institute of Chartered Accountants of India (ICAI) and the Insurance Regulatory and Development Authority of India (IRDAI).

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

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