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Foreword

Going concern is a fundamental principle in the preparation of the financial statements. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded in a manner that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. As per the International Standard on Auditing (ISA) 570 (Revised), *Going Concern*, auditors are required to obtain sufficient appropriate audit evidence regarding, and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements. Based on this audit evidence, the auditors are required to conclude whether a material uncertainty exists about an entity's ability to continue as a going concern. Considering the recent corporate failures across the globe the International Auditing and Assurance Standards Board (IAASB) issued an exposure draft of ISA 570 (Revised 202X) (ED-570) which proposes greater transparency with regard to going concern. The ED-570 augments the risk assessment procedures, draws on a wider range of information (including external or third-party information) to obtain sufficient and appropriate audit evidence, enhances the use of professional skepticism and requires more transparency and communication. In this edition of Accounting and Auditing Update (AAU), we will provide an overview of the proposed revisions to the auditing standard on going concern (ISA 570).

Sustainable finance has become a prominent initiative and is gaining traction as the world faces challenges relating to climate change, biodiversity, health, financial inclusion, livelihood, women empowerment and food security. It is the term used to describe financing and investment decisions that consider Environmental, Social, and Governance (ESG) issues. Considering that investors and asset managers are key pillars in the sustainable finance structure, the Securities and Exchange Board of India (SEBI) has issued regulatory guidelines which administer and give an impetus to ESG investing. It would enable consistent, comparable and decision useful scheme disclosures which would empower investors to make informed investment decision and prevent greenwashing. 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[1]. 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 for mutual funds, implementing some key measures to facilitate green financing with a thrust on enhanced disclosures and mitigation of green washing risk (circular on ESG investing). Our second article provides an overview of the recent developments relating to ESG investing.

As is the case each month, we have also included a regular round-up of some recent regulatory updates in India and internationally.

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

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1. SEBI Consultation paper on ESG Disclosures, Ratings and Investing issued in February 2023

CHAPTER 1

Enhanced requirements proposed for going concern assessment

CHAPTER 2

ESG investing by mutual funds

CHAPTER 3

Regulatory updates

CHAPTER 1

Enhanced requirements proposed for going concern assessment

This article aims to:

- Provide an overview of the proposed revisions to the auditing standard on going concern (ISA 570).

Introduction

Going concern is a fundamental principle in the preparation of financial statements. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded in a manner that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

In assessing whether the going concern assumption is appropriate, management assesses all available information about the future for at least, but not limited to, 12 months from the reporting date. The International Accounting Standard (IAS) 1, *Presentation of Financial Statements* also prescribes certain disclosures related to going concern[1].

Additionally, as per the International Standard on Auditing (ISA) 570 (Revised)[2], *Going Concern*, auditors are required to obtain sufficient appropriate audit evidence regarding, and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements. Based on this audit evidence, the auditors are required to conclude whether a material uncertainty exists about an entity's ability to continue as a going concern.

New development

Corporate failures across the globe and economic uncertainties have emphasised the need for a more robust standard and enhanced transparency about the auditor's responsibilities and work related to going concern. Accordingly, in April 2023, the International Auditing and Assurance Standards Board (IAASB) issued an exposure draft of ISA 570 (Revised 202X) (ED-570) which proposes greater transparency with regard to going concern. The ED-570[3] augments the risk assessment procedures, draws on a wider range of information (including external or third-party information) to obtain sufficient and appropriate audit evidence, enhances the use of professional skepticism and requires more transparency and communication.

In this article, we will provide an abstract of the key revisions proposed in ED-570.

1. These disclosures mainly pertain to cases where events or conditions have been identified which may cast a significant doubt on an entity's ability to continue as a going concern. In such a case, the management may conclude that (a) there are no material uncertainties on an entity's ability to continue as a going concern (close call) or (b) there are material uncertainties on an entity's ability to continue as a going concern (material uncertainty).
2. ISA 570 was last revised in January 2015.
3. The comment period for ED-570 ended on 24 August 2023.

Key revisions proposed in ISA 570

The key revisions to ISA 570 are given below:

Risk identification and assessment

The ED-570 prescribes a vigorous approach for performing risk assessment procedures that go beyond inquiry and discussion. These procedures would build on the foundational requirements in ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment,* and enable auditors to perform risk assessment from a going concern lens. This includes understanding the entity and its environment, the applicable financial reporting framework and the entity's system of internal control. Where fraud risks have been identified, ED-570 requires the auditors to consider and address these in accordance with ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.*

Such risk assessment procedures would facilitate timely identification of events or conditions that may cast a significant doubt on an entity's ability to continue as a going concern (events or conditions).

Management's going concern assessment

Timeline over which management's going concern assessment is being made

One of the significant changes proposed in ISA 570 is a change in the commencement date of the period of managements' going concern assessment. Management is now required to perform a going concern assessment for a minimum period of 12 months from the ***date of approval of the financial statements.*** The current ISA 570 requires the management to perform a going concern assessment for a minimum period of 12 months from the date of financial statements.

Some jurisdictions globally[4] have already adopted such a commencement date, accordingly, this change would aid to align the global practice and thus abet comparability and consistency among jurisdictions. It would also benefit users of financial statements, as management's going concern assessment would be based on more current information, and from a date when management and Those Charged With Governance (TCWG) have taken responsibility for the financial statements.

4. These include the United Kingdom, Australia and New Zealand

Extension of management assessment and consequences of management unwillingness

Where management's going concern assessment is for a period which is lesser than 12 months, the auditor would need to request the management to extend such assessment to at least 12 months. In case the management is unwilling to extend its assessment, ED-570 has stipulated certain revised procedures. It has been proposed that the auditor would need to discuss with management or TCWG (when appropriate) regarding the rationale for such unwillingness.

Where management or TCWG are able to provide additional information to support the appropriateness of their use of the going concern basis of accounting[5], the auditor should document the significant judgements related to the appropriateness of the period used by management in its going concern assessment.

However, where the auditor is unable to obtain sufficient appropriate audit evidence that supports the management's use of the going concern basis of accounting due to management's limited going concern assessment, the auditor would need to assess the impact on the audit. This impact could be a change in the risk assessment and planned audit procedures and/or could have implications on the audit report- in terms of a qualification or a disclaimer of opinion.

Evaluating management's assessment of going concern

The ED-570 has augmented the requirement for a robust evaluation of management's going concern assessment, including reviewing and appropriately challenging the method, assumptions and data used by the management to make its going concern assessment[6]. The ED-570 also prescribes additional procedures to be undertaken on management's revised assessment when necessary, if events or conditions exist that the management has not previously identified or disclosed.

In verifying the management's going concern assessment, the auditor should assess the management's plan for future actions[7]. It should be evaluated if the management's plan for future action includes financial support from third parties, related parties or from the entity's owner-manager. In such a case, the **intent and ability** of these parties to maintain and provide the necessary financial support should be evaluated. The auditor may also consider obtaining a **written confirmation** from such parties to obtain sufficient audit evidence.

Where the finance providers refuse to provide such a confirmation, and alternative strategies and sources of finance are not available, then it should be evaluated whether a material uncertainty exists.

Transparency about going concern in the auditor's report

Stakeholders demanded greater transparency of the auditors' work with regard to going concern assessment of an entity[8]. The ED-570 has now addressed this, thereby proposing another significant amendment to ISA 570.

The ED-570 now requires the auditors' report of **all entities** to include an explicit statement (or a section) on going concern. This section would include more information about the nature and extent of the auditor's work as well as the results and any significant findings of the auditor. The heading of this section would be 'Going Concern' where no material uncertainty exists or 'Material Uncertainty related to Going Concern' where material uncertainty exists. Further requirements pertaining to this section, when the auditor's report is not modified in relation to going concern is given in Table 1 on the next page.

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5. For example, management's assessment does not cover a period of at least 12 months from the date of approval of the financial statements, however, the entity has profitable operations and no liquidity concerns, and management or TCWG have not identified any events or conditions that may cast significant doubt on the entity's ability to continue as going concern beyond the period of assessment they have chosen.

6. In making such assessment, ISA 540, *Auditing Accounting Estimates and Related Disclosures* should be referred to.

7. When events or conditions are identified, the auditor's conclusion as to whether a material uncertainty exists is dependent on the auditor's evaluation of management's plans for future actions.

8. Additionally, stakeholders had commented that there was lack of clarity with respect to the use of Key Audit Matters (KAM), material uncertainty and emphasis of matter paragraph in the auditor's report.

Table 1: Explicit statement on going concern in the auditor's report when the auditor's report is not modified in relation to going concern

Particulars	Disclosure requirement in audit reports of	
	Listed entity	Unlisted entity
Going concern section		
Explicit statement on going concern State that the auditor: • Concluded that the going concern basis of accounting is appropriate • Based on the audit evidence obtained, has not identified a material uncertainty	Disclosures required	Disclosures required
Events or conditions identified but no material uncertainty exists (including close call) If events and conditions have been identified but no material uncertainty exists, auditor to make: • A reference to the related disclosures in the financial statements, if any • A description of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern	Disclosures required	Not required (Disclosures may be made on a voluntary basis)
Material uncertainty related to going concern section		
Material uncertainty exists but going concern basis of accounting is appropriate Auditor to state that: • A material uncertainty exists, but going concern basis of accounting is appropriate • Auditor's opinion is not modified • Include a reference to the related disclosures in the financial statements	Disclosures required	Disclosures required
Additional disclosures on material uncertainty A description of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern	Disclosures required	Not required (Disclosures may be made on a voluntary basis)

(Source: KPMG in India's analysis, 2023 read with Proposed International Standard on Auditing 570 (Revised 202X), *Going Concern* and Proposed Conforming and Consequential Amendments to Other ISAs issued by the IAASB in April 2023)

Where there are inadequate disclosures about a material uncertainty, the auditor is required to express a qualified or adverse opinion (in accordance with ISA 701, *Modifications to the Independent Auditor's Report*). In such a case, the material uncertainty section of the audit report would give reference to the qualification.

Further, in case of a disclaimer of opinion, the going concern or the material uncertainty section would not be required to be inserted in the audit report (which is consistent with the current practice).

Enhanced communication

The ED-570 requires better communication between the auditor and TCWG and with third parties. This is further explained below:

Communication with TCWG: The ED-570 has emphasised on the need for an effective and timely two-way communication between the auditor and TCWG throughout the audit. As a new requirement, the auditors would need to obtain an understanding of how TCWG exercise oversight over management's assessment of going concern. Additionally, they would need to understand from TCWG on what they consider to be identified events and conditions. The auditor would also need to communicate to TCWG when they come across events and conditions and on other matters, such as:

- Adequacy of the disclosures that describe significant judgments made by management and the mitigating factors in management's plans,
- The basis for the auditor's conclusions and an overview of the audit procedures performed, and
- When applicable, management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern.

Communication with external parties: The ED-570 has inserted a new requirement to communicate with appropriate external parties when law, regulation or relevant ethical requirements require or establish responsibilities permitting the auditor to report to an appropriate authority outside the entity.

Other amendments

Other amendments to ISA 570 include:

- **Clarifying terminology:** The ED-570 has defined certain terms, such as ‘Material Uncertainty (Related to Going Concern)’, thus minimising the likelihood of varying interpretations and has also clarified the concept of the term ‘may cast significant doubt’.
- **Professional skepticism:** The ED-570 has emphasised the need to exercise professional skepticism when performing procedures related to going concern to prevent possible management and auditor bias.
- **Technology:** The ED-570 through its examples of automated tools and techniques reflects the auditor’s use of technology to perform the auditor’s work related to going concern.

Next steps

The proposed changes to ISA 570 would help to provide greater clarity, as well as enhance the overall approach to auditing the going concern assessment by more closely aligning it with foundational standards. Some of the key considerations for management and members of the audit committee include:

- The amendments have been proposed to ISA 570, however, considering that the Standards on Auditing (SA) issued in India are closely aligned with ISAs, we expect similar amendments to be issued in the SA.
- ED-570 requires management to perform a going concern assessment for a minimum period of 12 months from the date of approval of the financial statements, this would require management to prepare comprehensive business and financial plans for an extended period. The absence of such evaluation and plans or alternative strategies could impact the planned audit procedures, including the auditor’s report. ED-570 also clarifies that the auditor would base their assessment based on the evaluation conducted by the management.
- The audit committee would need to be vigilant while they assess the management’s going concern assessment, and have a robust oversight over this process. They would also need to actively engage with the auditors to discuss their concerns and expectations of the audit at the beginning of the audit and understand the auditor’s observations and issues on a timely basis throughout the course of the audit.
- There is increased stakeholder focus on the risks of climate change, environmental damage and societal issues, which have a close relationship with longer term aspects of ‘going concern’ considerations. As a result, there would be greater demand for reporting by companies that address their impacts and initiatives in relation to these overarching global concerns as a core feature impacting their market value.

CHAPTER 2

ESG investing by mutual funds

This article aims to:

- Provide an overview of the recent developments in the area of ESG investing.

Introduction

Sustainable finance has become a prominent initiative and is gaining traction as the world faces challenges relating to climate change, biodiversity, health, financial inclusion, livelihood, women empowerment and food security. As a result, organisations, investors, financial intermediaries and other stakeholders are taking into account Environmental, Social and Governance (ESG) assessments in their investment decisions.

Considering that investors and asset managers are key pillars in the sustainable finance structure, the Securities and Exchange Board of India (SEBI) has issued regulatory guidelines which administer and give an impetus to ESG investing. It would enable consistent, comparable and decision useful scheme disclosures which would empower investors to make informed investment decision and prevent greenwashing.

Circular on ESG investing

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[1]. 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.

Accordingly, on 20 July 2023, SEBI issued a circular for mutual funds, implementing some key measures to facilitate green financing with a thrust on enhanced disclosures and mitigation of green washing risk (circular on ESG investing).

1. SEBI Consultation paper on ESG Disclosures, Ratings and Investing issued in February 2023.

The diagram below illustrates the requirements prescribed in the circular on ESG investing:

Multiple strategies under ESG schemes

A separate sub-category for ESG investments introduced under 'equity schemes'.

Effective immediately

Investment criteria

At least 65 per cent of the Assets Under Management (AUM) to be invested in companies reporting on comprehensive BRSR and providing assurance on BRSR Core disclosures.

Effective from 1 October 2024*

Disclosure requirements

- Scheme strategy
- ESG scores of securities
- Voting disclosures
- Annual fund manager commentary.

Effective date:

- *Strategy and ESG scores:* Immediately
- *Voting disclosures:* FY 2024-25
- *Annual fund manager commentary:* FY 2023-24 (certain disclosures are required w.e.f. FY24-25 and FY25-26)

Assurance

- Independent reasonable assurance
- Certification by the board of Asset Management Company (AMC).

Effective date:

- ***Independent assurance:*** FY22-23- on a comply or explain basis by 31 December 23. Mandatory thereafter.
- ***Certificate by board:*** Mandatory w.e.f. FY22-23. FY22-23 reporting by 31 December 23.

* In case of non-compliance with the investment criteria by 1 October 2024, an extension period till 30 September 2025 has been prescribed (subject to certain conditions) to ensure compliance.

(Source: KPMG in India's analysis, 2023, read with circular on ESG investing)

I. Multiple strategies under the ESG scheme

Prior to the issuance of the circular on ESG investing, mutual funds could launch only one ESG scheme under the thematic category of equity schemes.

SEBI has now introduced a separate sub-category for ESG investments under the thematic category of equity schemes, by including six new strategies that the mutual funds can adopt to align their investments with ESG considerations. The strategies include:

- **Exclusion:** This strategy involves excluding securities based on certain ESG-related activities, business practices, or business segments. The exclusions can be based on factors such as adverse impact, controversy, faith, etc.
- **Integration:** Funds adopting this theme will consider ESG-related factors that are material to the risk and return of the investment, alongside traditional financial factors while making investment decisions.
- **Best-in-class and positive screening:** This strategy aims to invest in companies and issuers that outperform their peers on one or more ESG performance metrics.
- **Impact investing:** The fund based on this strategy should seek a non-financial (real world) impact and evaluate if that impact is being measured and monitored. Fund managers should provide a methodology for assessing the impact of investments and have processes in place to identify and manage any adverse effect.
- **Sustainable objectives:** Funds based on this strategy aim to invest in sectors, industries, or companies that are expected to benefit from long-term macro or structural ESG-related trends.
- **Transition or transition related investments:** Funds under this category aim to invest in companies and issuers that support/facilitate environmental transition.

AUM requirement: In accordance with the Master Circular[2], at least **80 per cent** of the total Assets Under Management (AUM) of ESG schemes should be invested in equity and 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, etc.

Effective date: The requirements related to the new category for ESG schemes are applicable with immediate effect.

Key considerations

A separate category for ESG investments under the equity schemes will enable AMCs to launch multiple ESG schemes with diversified strategies. This is likely to help investors direct their funds on ESG themes they resonate the most with, while boosting growth in select companies.

2. As per the Master Circular, a mutual fund with a thematic category under the equity scheme should have a minimum investment of 80 per cent of total Assets Under Management (AUM) in equity and equity related instruments of that theme.

14

II. Investment criteria

Currently, ESG schemes of mutual funds are mandated to invest only in such companies which have comprehensive Business Responsibility and Sustainability Reporting (BRSR) disclosures.

SEBI vide the circular on ESG investing has 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 (investment criteria).

Effective date: This requirement will be applicable with effect from 1 October 2024.

Extension period for compliance: In case ESG schemes are unable to comply with the investment criteria by 1 October 2024, an extension period of one year (till 30 September 2025) has been prescribed to ensure compliance. However, during this extended period of one year, ESG schemes cannot undertake any fresh investments in companies that do not have assurance on BRSR Core.

65 per cent AUM

Companies disclosing

Comprehensive BRSR + Assurance on BRSR Core

35 per cent AUM

Companies disclosing

Comprehensive BRSR

(Source: KPMG in India's analysis, 2023 read with circular on ESG investing)

Key considerations

Investment opportunities for fund managers: Currently, the top 1,000 listed entities are required to report on comprehensive BRSR as part of their annual report. SEBI, vide a circular dated 12 July 2023[3] has also prescribed a regulatory framework for reporting and assurance of BRSR Core[4]. As per this framework, the top 1,000 listed entities (by market capitalisation) are required to provide the BRSR Core disclosures as part of the annual report from FY2023-24. Additionally, a glide path has been provided for listed entities to obtain a mandatory reasonable assurance on the BRSR Core disclosures by an independent assurance provider (glide path). The glide path is given in the table below:

Financial Year	Applicability of mandatory assurance on BRSR Core
2023-24	Top 150 listed entities*
2024-25	Top 250 listed entities*
2025-26	Top 500 listed entities*
2026-27	Top 1,000 listed entities*

* by market capitalisation

Mutual funds with ESG schemes are required to comply with the investment criteria of investing 65 per cent of the AUM in companies reporting comprehensive BRSR and obtaining assurance on BRSR Core by 1 October 2024. As per the glide path, only the top 150 companies (by market capitalisation) would have compulsorily obtained an assurance on their BRSR core disclosures. This will reduce the investment universe size, in the initial year and could restrict fund managers in terms of the investment flexibility of the mutual funds.

However, given that BRSR Core has a limited set of KPIs for assurance, companies desirous of attracting investments from mutual funds could voluntarily obtain an assurance on BRSR Core disclosures voluntarily from FY2023-24 onwards.

Assets Under Management: While making investment decisions and managing AUM, fund managers would need to consider the following regulations:

- As per the Master Circular, sectoral/thematic funds under the equity schemes should at the minimum invest 80 per cent of their AUM in equity and equity related instruments of a particular sector/theme. The remaining portion of the investment should not contradict the strategy of the scheme.
- As per the circular on ESG investing, ESG funds should *inter alia* comply with a specific investment criterion- i.e. 65 per cent of the AUM should be invested in companies reporting comprehensive BRSR and obtaining assurance on BRSR Core. Balance 35 per cent of the AUM could be invested in companies reporting BRSR.

Fund managers would need to ensure compliance of both these regulations when they make investment decisions.

3. SEBI circular no. SEBI/HO/CFD/CFD-SEC-2/P/CIR/2023/122 dated 12 July 2023.
4. The BRSR Core is a sub-set of the BRSR, comprising of a set of Key Performance Indicators (KPIs) under nine ESG attributes.

III. Disclosure requirements

The circular on ESG investing has prescribed the following disclosure requirements:

Scheme strategy

The name of the ESG fund/scheme should clearly disclose the ESG strategy it is based on. For example, ABC ESG Best-in-class Strategy Fund[5].

ESG scores of securities

New disclosure requirements

The monthly portfolio statements of ESG schemes should include the following information:

- Security wise **BRSR Core scores** along with BRSR scores
- Name of the ESG Rating Providers (ERPs) providing ESG scores, along with the ESG scores. In case there is a change in the ERP, the reason for such change should also be disclosed in the next monthly portfolio statements of ESG schemes

Effective date: These requirements are applicable with immediate effect.

Voting disclosures

The Master Circular requires mutual funds to compulsorily vote on all resolutions of their investee companies. Additionally, it requires mutual funds to disclose certain matters, which *inter alia* include:

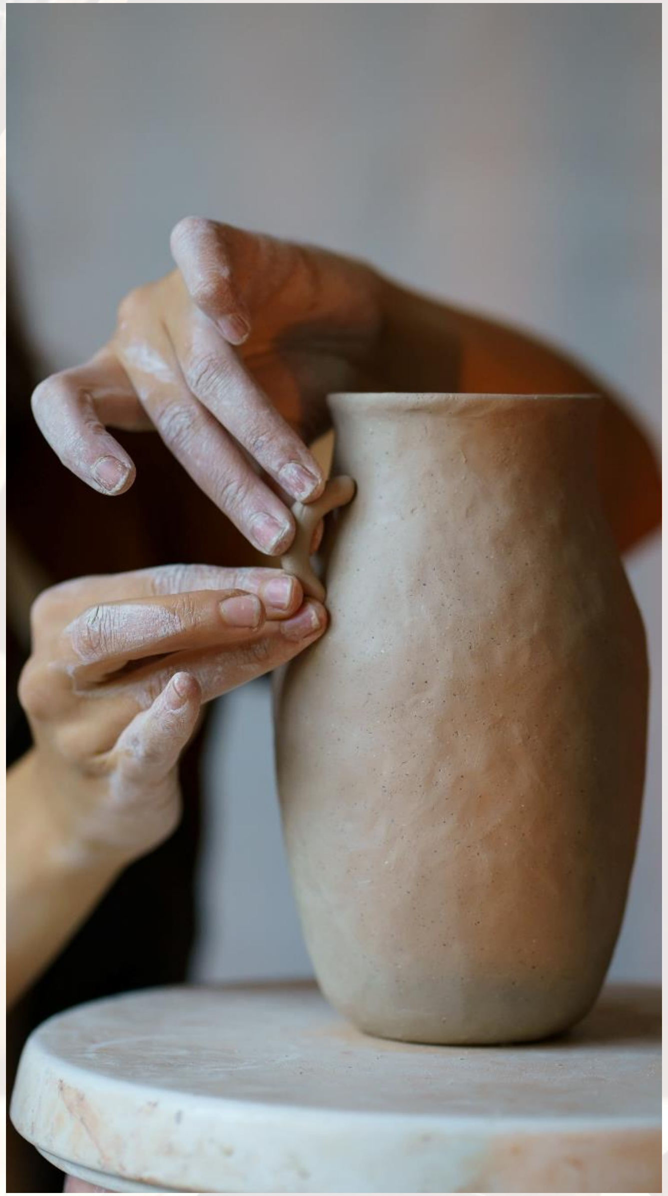
- Votes cast by mutual funds in respect of resolutions passed in general meetings of the investee companies
- Specific rationale supporting their voting decisions (for, against or abstain) with respect to each vote proposal.

New requirements for ESG funds

In order to enhance transparency on votes cast by ESG funds, the following additional disclosure requirements have been prescribed:

- While disclosing the rationale for voting decisions (whether in favor or against), AMCs should categorically disclose whether the resolution has or has not been supported due to any environmental, social or governance reasons
- Mutual funds may have holdings in the same investee company(ies) under both, the ESG and non-ESG schemes. Where voting approach for both ESG and non-ESG schemes is the same, disclosure of the voting rationale may be made at the mutual fund level. However, where the voting approach for ESG and non-ESG schemes of any mutual fund is not the same, the details and rationale for votes cast on behalf of ESG schemes and non-ESG schemes should be disclosed separately.

Effective date: These enhanced voting disclosures are applicable from FY 2024-25 i.e. for Annual General Meetings held from 1 April 2024 onwards.



5. This requirement is in line with SEBI's earlier communication to AMFI on disclosure norms for ESG mutual fund schemes dated 8 February 2022. As per SEBI's earlier communication, the name of the scheme should accurately reflect the nature and extent of the scheme's ESG focus taking into account investment objective and type of strategy followed.

Annual fund manager commentary and case studies

SEBI, vide its letter dated 8 February 2022 had prescribed that mutual funds should provide disclosures about their stewardship and shareholder engagements. SEBI, vide its letter dated 8 February 2022 had prescribed that mutual funds should provide disclosures about their stewardship[6] and shareholder engagements.

New requirements for ESG funds

In addition to disclosures of the engagements undertaken by mutual funds for ESG schemes, ESG funds are required to provide a 'fund manager commentary', which would be included in the annual report of the ESG schemes.

The annual fund manager commentary should include the following:

A. ESG strategy

- Examples on how ESG strategy was applied on the fund
- How engagements were carried out
- Any escalation strategy that the fund manager may have applied on the portfolio companies
- Annual tracking of ESG rating movements in the investee companies etc.

B. Case studies

Case studies where fund managers have engaged with portfolio companies with a clear objective of engagement and engagements carried out for exercise of votes.

C. Engagements

- Details on number of engagements carried out in a year
- The modes of communication employed
- Outcomes achieved by ESG schemes based on objectives of the scheme
- Additional areas to be covered in case studies and
- Minimum disclosures should be specified by AMFI in consultation with SEBI.

D. ESG rating/score

Annual tracking of ESG rating/score movements in the investee companies.

E. AUM

Percentage of AUM invested in such companies where there are no BRSR disclosures (investments prior to 1 October 2022) and its impact, if any, on the fund score.

F. Change in ERP

Where there is a change in the ERP, reason for such a change.

Effective date: The requirement of the annual fund manager commentary should be applicable from FY 2023-24. The disclosure of case studies mentioned in point (B) and (C) above would be applicable from FY 2024-25 and the engagement details should be disclosed from FY 2025-26 onwards.

6. Stewardship responsibilities include monitoring and actively engaging with investee companies on various matters including performance (operational, financial, etc.), strategy, corporate governance (including board structure, remuneration, etc.), material environmental, social, and governance (ESG) opportunities or risks, capital structure, etc. Such engagement may be through, detailed discussions with management, interaction with investee company boards, voting in board or shareholders meetings, etc.

IV. Assurance

A. Independent assurance

New requirements for ESG funds

- AMCs should obtain an independent and reasonable assurance on an annual basis regarding their ESG scheme's portfolio being in compliance with the strategy and objective of the scheme stated in the Scheme Information Documents (SIDs).
- 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[7] with the assurance provider appointed.

Effective date: Such assurance is applicable as below:

- On a 'comply or explain basis' for all ESG schemes for FY 2022-23 by 31 December 2023.
- On a mandatory basis for FY 2023-24 and onwards. Disclosure of such assurance should be made in the scheme's annual report.

Key considerations

The circular on ESG investing requires the assurance provider to have necessary expertise for undertaking reasonable assurance that the ESG scheme's portfolio is in compliance with the strategy and objective of the scheme. The AMCs should ensure that there is no conflict of interest with the assurance provider appointed. 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 AMC or its group entities. There is a need for AMCs and their audit committees to assess the relationships of the potential assurance providers with the AMCs or its group entities in determining any potential conflicts of interest before appointing the service providers.

The SEBI, vide the Frequently Asked Questions (FAQs) dated 8 August 2023 has provided clarifications on certain matters pertaining to assurance providers of BRSR Core (the FAQs)[8]. Both, the BRSR Core Framework and the ESG investing framework have similar qualification requirements for assurance providers. Both the frameworks require the assurance provider to:

- Have the necessary expertise for undertaking reasonable assurance
- Not have any conflict of interest with the company- i.e. the assurance provider or any of its associates should not sell its products or provide any non-audit/non-assurance related service including consulting services, to the AMC or its group entities.

In the absence of similar clarifications for assurance providers of ESG schemes, reference may be made to the FAQs while appointing assurance providers for the scheme.

B. Certification by the board of directors of AMCs

New requirements for ESG funds

Basis a comprehensive internal ESG audit[9], the board of directors of AMCs are required to certify compliance of ESG schemes with the regulatory requirements, including disclosures, in the annual report of the scheme.

Effective date: 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.

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7. The circular on ESG investing has stated that to ensure there is no conflict of interest, the assurance provider or any of its associates do not sell its products or provide any non-audit or non-assurance related service to the AMC or its group companies.
8. The FAQs have clarified the following matters:
    - The qualification of assurance providers, and who can be appointed as an assurance provider
    - What activities can be undertaken by the assurance provider, and which activities would lead to a conflict of interest
    - What is the meaning of 'group' of an entity and who would be considered as an 'associate' of an assurance provider
    - Which assurance standard should be followed by an assurance provider for the BRSR Core.
9. Internal ESG audit would inter-alia include verifying the Scheme Information Documents, Stewardship Reporting and Responsible Investment Policy of the ESG Funds and any other relevant document, to ensure that the statements made in these documents are factual.

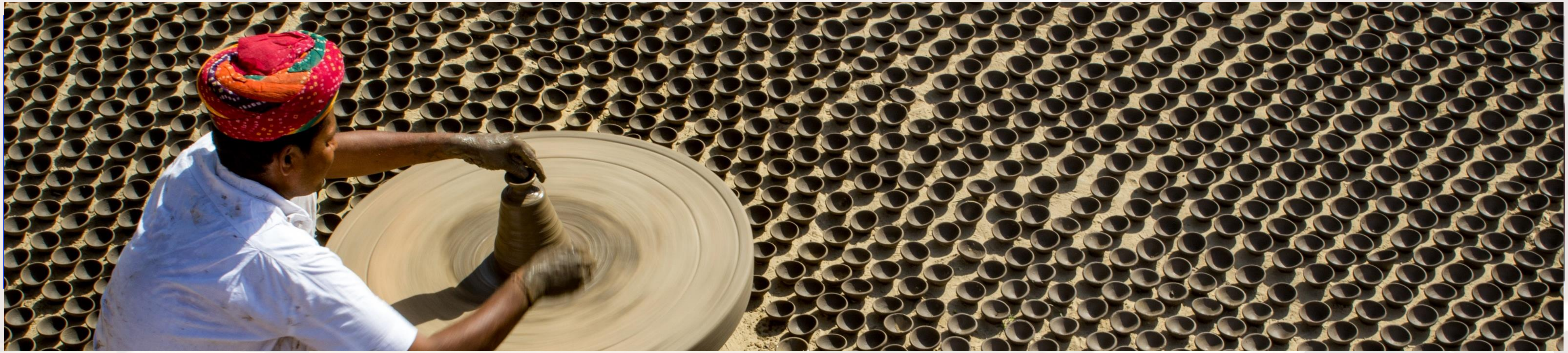
Bottom line and next steps

The circular on ESG investing prescribes a balanced regulatory framework for ESG investing, to mitigate greenwashing and mis-selling risks, while facilitating easier compliances. Given here are some of the key considerations:

Strong internal processes: Reasonable assurance is now applicable to AMCs on a comply or explain basis with effect from FY 2022-23 and on a mandatory basis for FY 2023-24 and onwards. Additionally, there has been an increased focus on internal ESG audit. AMCs will need to ensure that strong risk management processes and robust internal processes are in place so that AMCs meet all compliances and disclosures on a timely basis.

Business opportunities: The adoption of sustainable investing will help companies attract capital from investors based on good governance, environmental and social practice adopted by them (non-financial criteria) and thus could help them enhance their businesses.

Investor education: SEBI should, through webinars and other mechanisms, educate the investors regarding the ESG funds and the manner of interpreting the data surrounding it, such as the investment criteria, disclosure requirements and assurance.



CHAPTER 3

Regulatory updates

SEBI updates

Framework for voluntary delisting

On 23 August 2023, the Securities and Exchange Board of India (SEBI) introduced a framework for voluntary delisting of non-convertible debt securities and non-convertible redeemable preference shares by inserting Chapter VIA in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations). This framework is not applicable to the certain listed entities that have issued listed non-convertible debt securities or non-convertible redeemable preference shares. The listed entities to whom framework is not applicable are:

i. If the above-mentioned securities or sharers are outstanding and are issued through a public issue or

ii. In case there are more than 200 securities holders excluding qualified institutional buyers in any International Securities Identification Number (ISIN) relating to such securities or shares

iii. If the above-mentioned securities or shares have been delisted by the stock exchanges due to any penalty or action initiated against the listed entity or on any other grounds specified under Rule 21 of the Securities Contracts (Regulation) Rules, 1957

iv. If the above-mentioned securities or shares have been delisted by the stock exchanges due to redemption of such securities or shares

v. If the above-mentioned securities or shares have been delisted due to a resolution plan as per Section 31 of the Insolvency Code.

The framework also lays down the provisions with respect to:

- In-principle approval of the stock exchanges and approval from the holders and no-objection letter from the Debenture Trustee (DT)
- Obligations of the listed entity
- Procedure for sending a notice for delisting
- Final application to the stock exchange and circumstances for failure of delisting proposal.

The provisions of this framework are applicable from 23 August 2023.

(Source: SEBI notification no. No. SEBI/LAD-NRO/GN/2023/149 dated 23 August 2023)

New format of abridged prospectus

SEBI through its circular dated 4 September 2023, revised the format of abridged prospectus for public issues of non-convertible debt securities and/or non-convertible redeemable preference shares. This has been done with an aim to provide clarity and consistency amongst the disclosures of various documents and to provide additional but critical information, The revised format of the abridged prospectus has been provided in Annexure I of the circular.

The circular requires that a copy of the abridged prospectus should be made available on the website of issuer, merchant bankers, registrar to an issuer. Further, a link for downloading the same should be provided in the advertisement for the public issue. Additionally, the issuer/merchant bankers shall insert a Quick Response (QR) code on the last page of the abridged prospectus which would lead to the prospectus. The QR code should also be placed on the front page of documents such as front outside cover page, advertisement, etc.

The circular further provides that an issuer or merchant bankers should ensure that the disclosures provided in the abridged prospectus are adequate, accurate and does not contain any misleading information or any misstatement. Further, the qualitative statements provided in the abridged prospectus should be substantiated with the quantitative factors and qualitative statement should not be made which cannot be substantiated with quantitative factors.

The provisions of the circular are applicable to all public issues opening on or after 1 October 2023.

(Source: SEBI circular no. SEBI/HO/DDHS/PoD1/CIR/P/2023/150 dated 4 September 2023)

Clarification on computation of asset allocation limits of mutual funds

In July 2023, SEBI issued a circular on investment by Mutual Fund (MF) schemes and Asset Management Companies (AMCs) in units of Corporate Debt Market Development Fund (CDMF). In this respect, on 6 September 2023, SEBI issued a clarification on the calculation of asset allocation limits of MF schemes.

Accordingly, SEBI has clarified that, for calculation of asset allocation limits of MF schemes, the investment in units of CDMDF should be excluded from base of net assets.

This is effective from 6 September 2023.

(Source: SEBI circular no. SEBI/HO/IMD/PoD2/P/CIR/2023/152 dated 6 September 2023)

Consultation paper regrading registration of NPOs with SSE

SEBI issued a regulatory framework for Social Stock Exchange (SSE) in 2022 and corresponding amendments were made in the respective SEBI Regulations. As per the framework, a Not for Profit Organisation (NPO) is required to be registered with an SSE to raise funds. However, NPOs encountered certain challenges. Thus, the following recommendations have been proposed:

- **Minimum issue size for NPOs issuing Zero Coupon Zero Principal Instruments (ZCZP):** The minimum issue size is INR1 crore as per the existing provisions of SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 (ICDR Regulations). It is proposed to reduce the limit to INR50 lakh on account of the difficulty faced by NPOs to raise funds from a limited set of investors.
- **Minimum application size for NPOs issuing ZCZP:** The current framework states that the minimum application size should be INR2 lakh. It has been proposed to reduce the same to INR10,000.
- **Expansion of scope:** As per the existing regulatory provisions, entities that are registered under Section 12A/12AA/12AB under the Income-tax Act, 1961 (IT Act) and which have valid 80G registration are eligible for registration as an NPO with an SSE. It has been proposed to also permit NPOs having registration certificate under Section 10(23C) (i.e. education institutes) and Section 10(46) of the IT Act (i.e. body/authority/board/trust/commission established or constituted by or under a Central/State/Provincial Act or constituted by the Central/State Government with the object of regulating or administrating any activity for the benefit of general public). However, the requirement for valid 80G certificate for such NPOs to register with SSE may not be mandated.

- **Relaxation - pending notice or ongoing scrutiny by income tax:** As per the existing provisions, an NPO having pending notice or ongoing scrutiny by income tax is ineligible for registration with an SSE. It has been proposed that, NPOs having notice or ongoing scrutiny by IT would be permitted on an SSE subject to certain conditions as stipulated in the consultation paper.
- **Social Impact Assessor:** It has been proposed to substitute the term 'Social Auditor' with 'Social Impact Assessor' as it was observed that the term 'audit' gives a negative connotation. Thus, it is proposed to change the nomenclature but the scope of work would remain the same.
- **Disclosure of past social impact:** The existing regulation requires disclosure of past social impacts as per the format specified by SEBI in the fund raising document. As many NPOs would have already carried out social impact assessment in the past and it would not be in the format prescribed by SEBI, it has been proposed that the format of the past social impact could be provided based on past practice of the NPO.

The comment period on the above proposal ended on 19 September 2023

(Source: SEBI reports for public consultation on 'Flexibility in the framework on Social Stock Exchange (SSE)' dated 29 August 2023)

Board nomination rights for unitholders of Infrastructure InvITs and REITs

As per the SEBI (Infrastructure Investment Trusts) Regulations, 2014 (InvIT Regulations) and SEBI (Real Estate Investment Trusts) Regulations, 2014 (REIT Regulations), eligible unitholder(s) i.e. unitholders holding not less than 10 percent of the total outstanding units of the InvIT/REIT, either individually or collectively, are entitled to nominate one director on the board of directors of the investment manager/manager.

In order to specify the framework to exercise board nomination rights by such eligible unitholders, SEBI issued a circular on 11 September 2023. The circular stipulates conditions for nomination of a unitholder nominee director. It also stipulates the procedure for first time nomination after the issuance of this circular and subsequent nomination by unitholders on an annual basis. Further, within 10 days from the end of each calendar month, the investment manager/manager should review whether the eligible unitholder(s) who have exercised the board nomination right, continue to have/hold the required number of units of InvIT/REIT and should make a report of the same. This report should be submitted to the Trustee of the InvIT/REIT. The circular also prescribes the manner for change in unitholder nominee director or withdrawal of nomination and procedure for vacating of office of a unitholder nominee director.

The provisions of this circular are applicable from 11 September 2023.

(Source: SEBI circular no. SEBI/HO/DDHS-PoD-2/P/CIR/2023/154 and SEBI/HO/DDHS-PoD-2/P/CIR/2023/153 dated 11 September 2023)

RBI updates

Revised regulatory framework for investment portfolio

The existing regulatory framework on classification and valuation of investment portfolio for commercial banks is based on a framework introduced in October 2000. However, considering the significant development in global financial reporting standards, the linkages with the capital adequacy framework as well as progress in the domestic financial markets, the Reserve Bank of India (RBI) issued a discussion paper in 2021 to revise the regulatory framework for the investment portfolio.

Subsequently on 12 September 2021, RBI issued the Classification, Valuation and Operation of Investment Portfolio of Commercial Banks, Directions, 2023. The revised regulatory framework is applicable from 1 April 2024 to all commercial banks excluding regional rural banks. These revised norms majorly consist of the following:

- It updates the regulatory guidelines with global standards and best practices while introducing a symmetric treatment of fair value gains and losses
- Requirement for a clearly identifiable trading book under Held for Trading (HFT)
- Removes the 90-day ceiling on holding period under HFT
- Removal of ceilings on Held to Maturity (HTM)
- Detailed disclosures on the investment portfolio
- Illustrative guidance on the revised framework for delisting

(Source: RBI notification no. RBI/DOR/2023-24/104 DOR.MRG.36/21.04.141/2023-24 dated 12 September 2023)

NBFCs in the upper layer under Scale Based Regulation

In October 2021, RBI had issued the Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs (the framework). The framework categorises Non-Banking Financial Companies (NBFCs) in Base Layer (NBFC-BL), Middle Layer (NBFC-ML), Upper Layer (NBFC-UL) and Top Layer (NBFC-TL) and gives the methodology to identify the NBFCs in the upper layer as per their asset size and scoring methodology. In this regard, on 14 September 2023, RBI issued the list of NBFC-UL under SBR for the year 2023-24 on its website.

It is important to note that, as per the framework, once an NBFC is classified as NBFC-UL, it would be subject to enhanced regulatory requirement, for at least five years from its classification, even if it does not meet the parametric criteria in the subsequent years.

(Source: RBI press release no. 2023-2024/923 dated 14 September 2023)

Other updates

Amendments to Re-insurance Regulations

With an aim to promote a favorable business environment and attracting more reinsurers to establish operations in India, the Insurance Regulatory and Development Authority of India (IRDAI) issued amendments to the IRDAI (Re-insurance) Regulations, 2018 (Re-insurance Regulations). These amendments simplify the existing regulations, enhance the competitiveness and align with global financial services trends.

The amendments aim to increase the overall capacity of the reinsurance sector, which could accommodate growing demand and manage larger risks. There is also a reduction of the compliance burden on various entities operating in this sector thereby allowing them to navigate the regulatory landscape more efficiently. The amendment has reduced the minimum capital requirement for Foreign Reinsurance Branches (FRBs) from INR100 crore to INR50 crore with the provision to repatriate any excess assigned capital. Also, the format for reinsurance programs has been simplified, and regulatory reporting requirements have been rationalised for increased clarity and effectiveness.

The amendments are effective from 23 August 2023.

(Source: IRDAI notification no. F. No. IRDAI/Reg/5/193/2023 dated 23 August 2023)

Clarification on the documents issued by ICAI

Over the years the Institute of Chartered Accountants of India (ICAI) has issued various documents like Guidance Note (GN), Standards on Auditing (SA) etc. The members of ICAI raised concerns regarding the level of authority attached to the various documents issued by the ICAI and the degree of compliance with respect to the same. In this regard, on 19 August 2023, ICAI issued a clarification on this matter.

As per the clarification, a professional accountant who does not consider and apply the guidance stipulated in a relevant GN, should take reasonable and adequate care in performing the alternate procedures to deal with the objectives and basic principles stipulated in the GN and should also document the rationale in performing such alternate procedures. Similarly, while discharging an attest function, the recommendations in a GN relating to an accounting matter should be followed. If the same have not been followed, the member should consider providing a disclosure in the report in accordance with engagement standards. The clarification further states that Accounting Standard (AS) and Standards on Auditing (SAs) issued by the Accounting Standards Board (ASB) and the Auditing and Assurance Standards Board (AASB) become mandatory on the dates specified in the respective document or as per the notification issued by the Council of ICAI.

(Source: ICAI announcement dated 19 August 2023)

Guidance Note on tax audit issued by ICAI

Section 44AB of the IT Act requires an assessee to get the accounts of his business/profession audited if the total sales, turnover or gross receipts exceed the prescribed limits. The Direct Taxes Committee (DTC) of ICAI has prepared a Guidance Note (GN) on tax audit which explains the scope the requirements.

On 4 September 2023, ICAI revised the GN on tax audit. The revised publication includes amendments made upto the Finance Act, 2023. The publication aims to address situations faced by Chartered Accountants (CAs) while conducting an audit as it provides explanations that will help in streamlining the tax audit process. Further, it emphasises on the importance of maintaining accurate records and the significance of a proactive approach in meeting statutory obligations.

(Source: ICAI announcement dated 4 September 2023)

Technical guide on audit of NBFCs issued by ICAI

NBFCs play an important role in the Indian financial sector. They are complementary to the banking sector as they cater to the funding requirements of organised as well as unorganised sector like small scale industries, small entrepreneurs, people in self-employment, etc.

On 6 September 2023, ICAI issued the revised edition of the technical guide on audit of NBFCs. This technical guide deals with various aspects of audit of NBFCs such as introduction of NBFCs, financial reporting framework, auditing framework, areas of audit concern, operations of NBFCs, governance, etc. Additionally, it also contains illustrative templates of audit report/certificate, illustrative audit checklist, illustrative list of master directions, circulars, RBI notifications, illustrative disclosure norms for NBFCs, illustrative list of returns to be submitted by NBFCs, etc.

(Source: ICAI announcement dated 6 September 2023)

FASB issued ASU on accounting for Joint Venture (JV) formations

The erstwhile provisions of US Generally Accepted Accounting Principles (US GAAP) did not provide any guidance as to how a JV, on formation, should recognise and initially measure assets contributed and liabilities assumed. In fact, JV formation transactions were explicitly scoped out of Accounting Standards Codification (ASC) 805, *Business Combinations* − even when two existing business were combined − and ASC 845, *Nonmonetary Transactions*. This lack of guidance led to diversity in practice, with some JVs initially measuring their net assets at carryover basis and others at fair value.

To address this diversity in practice, on 23 August 2023, the Financial Accounting Standards Board (FASB) issued an Accounting Standard Update (ASU) by specifying how net assets contributed to a joint venture are accounted for on the joint venture's formation. This ASU is applicable to all entities involved in newly formed and existing joint ventures. The ASU requires joint ventures to:

- Recognise a new basis of accounting for contributed net assets as of the formation date.
- Measure the contributed identifiable net assets at fair value on the formation date using the business combination guidance in ASC 805-20 (with certain exceptions) regardless of whether an investor contributes a business.
- Measure the net assets' fair value based on 100 per cent of the JV's equity immediately following formation.
- Record goodwill (or an equity adjustment, if negative) for the difference between the fair value of the JV's equity and its net assets.
- Provide disclosures about the nature and financial effect of the formation transaction.

The above amendments are effective prospectively for all joint ventures with a formation date on or after 1 January 2025, and early adoption is permitted. Additionally, a joint venture that was formed before the effective date of the ASU could elect to apply the amendments retrospectively if it has sufficient information. The early adoption is permitted in any interim or annual periods for which financial statements have not yet been issued (or made available for issuance).

(Source: FASB media advisory dated 23 August 2023 read with KPMG LLP's article 'ASU 2023-05 requires a joint venture formation transaction to be measured at fair value' dated 24 August 2023)

FASB issues conceptual framework on recognition and derecognition

The Conceptual Framework or Concept Statements is a body of interrelated objectives and fundamentals that enables FASB to develop standards of financial accounting and reporting. It is non-authoritative and does not establish or change the GAAP.

On 30 August 2023, FASB issued a concept statement on recognition and derecognition of an item in financial statements. It stipulates the recognition and derecognition criteria to guide when an item should be incorporated into and removed from the financial statements.

As per the concept paper, an item should be recognised in the financial statements if the following criteria are met:

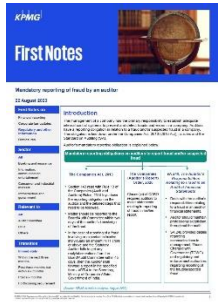
- **Definitions:** An item should meet the definition of an element as described in Chapter 4, *Elements of Financial Statements* of the Concepts Statement to be recognised in financial statements. If it does not meet the definition, it would be inconsistent with the fundamental qualitative characteristic of faithful representation by misrepresenting a reporting entity's:
  i. Resources
  ii. Claims to those resources or
  iii. Changes in those resources and claims during the period.
- **Measurability:** An item must be measurable with a relevant measurement attribute to be recognised in the financial statements. Relevance should be evaluated in the context of the objective of the general purpose financial reporting i.e. useful information for decision making should be provided to existing and potential investors, lenders, and other resource providers. The decision usefulness of financial information could also be affected by measurement uncertainty.
- **Faithful representation:** In order to achieve the objective of general purpose financial reporting, an item recognised in financial statements should be depicted and measured with faithful representation.

  Faithful representation is a fundamental qualitative characteristic. Financial information that is faithfully represented must be complete, neutral, and free from error.

The concept paper also lays down the derecognition criteria. Derecognition is the process of removing an item from financial statements of a reporting entity as an asset, liability, or equity. As per the concept paper, derecognition should occur when an item no longer meets any one of the above recognition criteria.

(Source: FASB media advisory dated 30 August 2023)

First Notes



Mandatory reporting of fraud by an auditor

The management of a company has the primary responsibility to establish adequate internal control systems to prevent and detect frauds and errors in a company. Auditors have a reporting obligation in relation to a fraud and/or suspected fraud in a company.

On 26 June 2023, the National Financial Reporting Authority (NFRA) issued a circular (the Circular) to clarify the responsibility of statutory auditors in relation to reporting of fraud in a company. Some important clarifications from the circular are as follows:

- Mandatory obligation to report fraud by an auditor
- Procedure to report fraud by an auditor
- Auditor not being the first person to identify the fraud
- Resignation by an auditor
- Professional skepticism.

This issue of First Notes provides an overview of the above-mentioned clarifications provided by NFRA.

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

Voices on Reporting

KPMG in India has scheduled a webinar on Friday, 6 October 2023 from 4 p.m. to 5 p.m. to discuss the key financial reporting and regulatory matters which are expected to be relevant for the stakeholders for the quarter ended 30 September 2023.

In this session of Voices on Reporting webinar, some of the key updates that will be discussed are as follows:

- Key financial reporting issues: Key considerations with respect to the accounting and financial reporting issues highlighted by the reviews of the regulatory authorities through orders, press releases etc.
- Other relevant regulatory updates.

For registration details, please **click here.**

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