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Editorial

To keep global warming to no more than 1.5°C – as called for in the Paris Agreement – emissions need to be reduced by 45 per cent by 2030 and reach net zero by 2050. Transitioning to a net-zero world is one of the greatest challenges humankind has faced. Governments around the globe have made commitments to limit global warming and have also announced net zero carbon emissions targets under the Paris Agreement. In this regard, carbon markets have a significant role to play in helping to achieve these commitments by enabling governments and organisations to manage emissions and achieve emission reduction targets effectively. Carbon markets generally provide incentive for taking actions to address climate change. Carbon credits generated by the reduction or removal of Greenhouse Gas (GHG) emissions from the atmosphere are usually traded by entities. These carbon credits are transferable or tradeable instruments. By purchasing carbon credits, a company can compensate the emissions from its direct and indirect activities to achieve net emissions targets or meet regulatory requirements. As more companies announce their commitments to reduce their carbon emissions or invest in renewable energy, there is a need to deliberate on the manner of accounting for carbon offsets and credits. This edition of Accounting and Auditing Update (AAU) aims to provide an overview of regulatory requirement and accounting consideration relating to carbon credit.

Financial reporting enables companies to recount the transactions and events that have taken place in a company during a reporting period. It provides insight and transparency regarding the operations of the company, and thus facilitates users to make financial decisions, such as investing, lending, etc. High-quality financial reporting, which complies with relevant accounting and reporting standards, has been at the forefront of regulators' priorities. Accordingly, regulators are globally undertaking reviews of financial statements of companies and highlighting non-compliances or improvement points. This edition of our publication carries an article on the topic 'Key accounting and financial reporting issues- Fair valuation and financial instruments'. The article aims to highlight key areas that regulators have highlighted and provided improvement points in the area of fair value measurement and financial instruments, and also provides illustrations of disclosures from thematic reviews performed by the Financial Reporting Council (FRC) and illustrative disclosures issued by KPMG IFRG Limited in 2023.

There have been various regulatory developments in India and internationally during the month. Recently, the Securities and Exchange Board of India (SEBI) extended the applicability of Regulation 30(11) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) which requires certain listed companies, to confirm, deny or clarify market rumours. Additionally, SEBI issued a circular on 19 October 2023 to revise the framework for Large Corporates (LCs) with respect to raising funds by issuance of debt securities. Further, the Ministry of Corporate Affairs (MCA) and SEBI provided relaxation to companies to hold their Annual General Meeting (AGM) which are due in years 2023 and 2024, and EGM through Video Conference (VC) or Other Audio Visual Means (OVAM) till 30 September 2024. Our regulatory updates articles cover these and other important regulatory developments.

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

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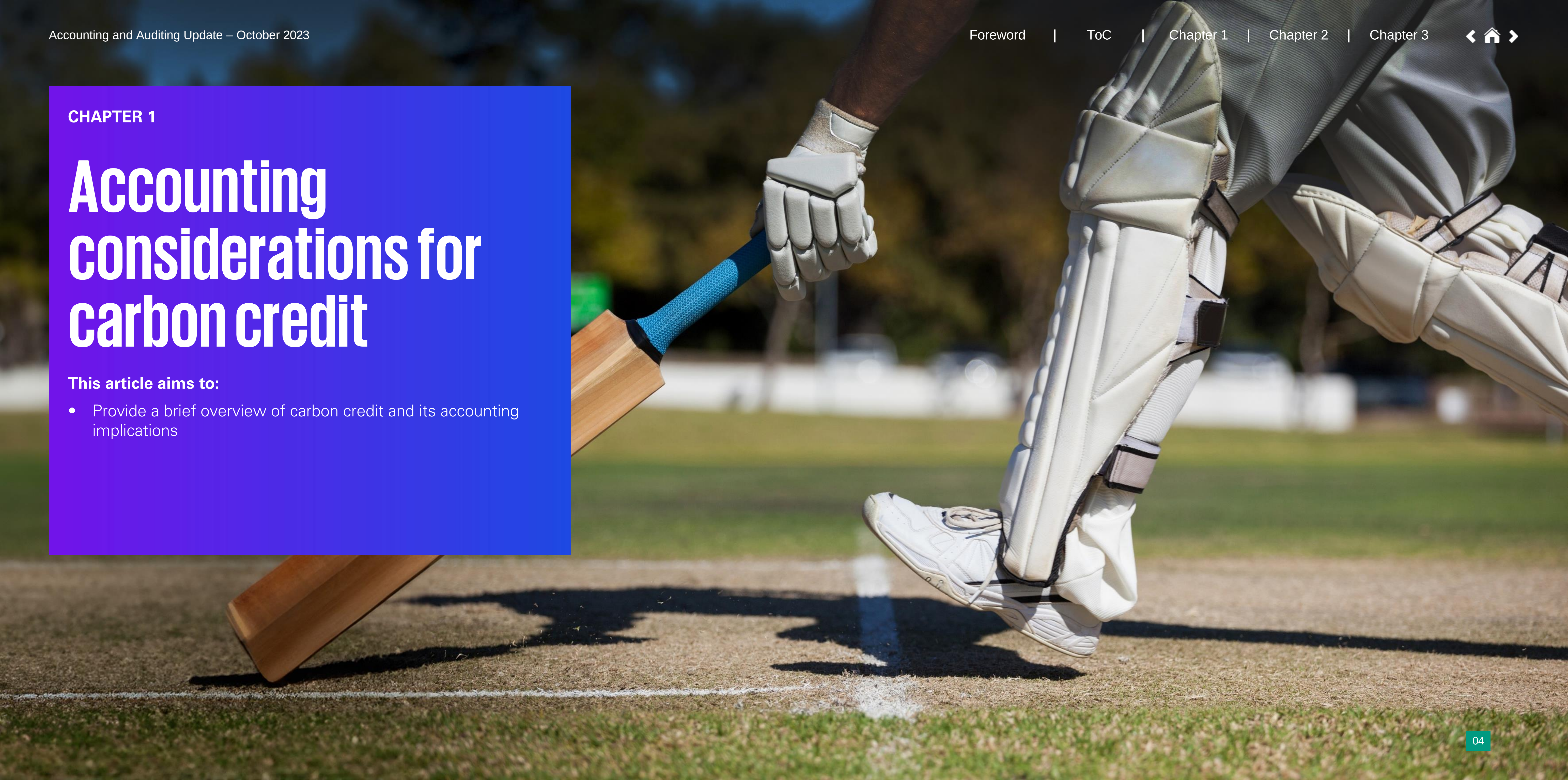


CHAPTER 1

Accounting considerations for carbon credit

This article aims to:

- Provide a brief overview of carbon credit and its accounting implications

Everything we do leaves a carbon footprint such as - from the cars we drive, the food we consume, or the clothes we wear. To achieve a greener economy, governments and corporations around the globe have made commitments to limit global warming and have announced net-zero targets. Net-zero refers to reduction of Greenhouse Gas (GHG) emissions to as close to zero, as much as possible, and offsetting the remaining emissions. In this context, offset means verified removals of carbon (e.g. through growing new forests). Net-zero commitments typically include all value chain emissions as defined in the GHG Protocol. Carbon markets play a significant role to achieve such net-zero commitments.

Carbon markets

Carbon markets generally provide incentive for taking actions to address climate change. Carbon credits generated by the reduction or removal of GHGs from the atmosphere are usually traded by entities. These carbon credits are transferable or tradeable instruments. By purchasing carbon credits, a company can compensate the emissions from its direct and indirect activities to achieve net emissions targets or meet regulatory requirements.

Regulatory framework relating to carbon credits in India

The Energy Conservation Act, 2001 (EC Act) lays down the regulatory framework with respect to efficient use of energy and its conservation. The Act was amended in 2022 to insert new provisions relating to carbon credit. The following diagram depicts the various developments that happened in recent years relating to evolution of carbon market in India.

December 2022

The EC Act was amended to empower Central Government to specify a carbon credit trading scheme.

27 March 2023

The Ministry of Power issued the Draft Carbon Credit Trading Scheme

26 June 2023

The Ministry of Environment, Forest and Climate Change issued the Draft Green Credit Programme Implementation Rules, 2023

28 June 2023

Carbon Credit Trading Scheme, 2023 notified

Following to be notified to operationalise the scheme:

- Formation of the National Steering Committee
- Framework for monitoring, reporting and verification of GHG emissions, and the criteria for issuance of carbon credit certificates including, validity, floor and forbearance price, etc.

12 October 2023

Green Credit Rules, 2023 notified

Following to be notified to operationalise the rules:

- Formation of the Steering Committee
- Methodology and procedure for calculation of generating green credit for each of the environment activities.

(Source: KPMG in India's analysis read with Notification no. 26 issued on 20 December 2022 issued by Ministry of Law and Justice, notification no. S.O. 2825 issued by Ministry of Power on 28 June 2023 and notification no. S.O. 4458 (E). dated 12 October 2023 issued by the Ministry of Environment, Forest and Climate Change)

Amendment to EC Act

The amendment Act introduced changes to Section 14 of the EC Act, which requires Central Government to specify a Carbon Credit Trading Scheme for reduction of carbon emissions. Further, Section 14AA has been added, through this section, the Central Government or any agency authorised by it can issue carbon credit certificate to a registered entity which complies with the requirements of the carbon credit trading scheme. The registered entity would be entitled to purchase or sell the carbon credit certificate in accordance with the Carbon Credit Trading Scheme.

Carbon Credit Trading Scheme 2023

Consequent to notification of carbon market through EC Act and requirement of Carbon Credit Trading Scheme, the central government notified the Carbon Credit Trading Scheme, 2023 (the scheme) on 28 June 2023. As per the Scheme, a carbon credit means a value assigned to a reduction or removal or avoidance of GHG emissions achieved and is equivalent to one ton of carbon dioxide equivalent (tCO2e). The Scheme requires obligated entities[1] to comply with the GHG emission norms as notified by the Central Government.

Process of issue of certificates: The Scheme requires, obligated entities to achieve GHG emission intensity in accordance with the targets notified by the Ministry of Environment, Forest and Climate Change. The entities should also meet any other targets such as use of non-fossil energy consumption or specific energy consumption notified by the Ministry of Power. For this purpose, carbon credit certificates would be issued to obligated entities for their achievement in reducing the GHG emission intensity exceeding the set target. Whereas those obligated entities who did not achieve their targeted reduction in GHG emission intensity, should meet their shortfall by purchasing carbon credits certificates from Indian carbon market.

To be notified

It is important to note that, the Central Government would constitute a National Steering Committee for Indian carbon market which would govern and directly oversee the functioning of the Indian carbon market.

Further, for operationalising the Indian carbon market, the National Steering Committee and other authorities would frame the detailed procedure with respect to:

- Criteria for issuance of carbon credit certificates,
- Validity of carbon credit certificates,
- Floor and forbearance price of carbon credit certificates,
- Requirement, format and timeline for submissions,
- Monitoring, reporting and verification and
- Any other related and incidental matters.

1. The Scheme defines obligated entities as 'registered entities' that are notified under the compliance mechanism of the Scheme and non-obligated entities as 'registered entities' that can purchase the carbon credit certificates on voluntary basis. As per EC Act, a registered entity means any entity, including designated consumers, registered for carbon credit trading scheme.

Green Credit Rules, 2023

On 12 October 2023, the Ministry of Environment, Forest and Climate Change issued the Green Credit Rules, 2023. The main objective of this programme is to incentivise environmental positive actions through market-based mechanism and generate green credit, which would be tradable and made available for trading on a domestic market platform. The green credit would arise by undertaking any of the following environment activities:

i. Tree plantation: to promote activities for increasing the green cover across the country

ii. Water management: To promote water conservation, water harvesting and water use efficiency or water savings, including treatment and reuse of wastewater

iii. Sustainable agriculture: To promote natural and regenerative agricultural practices and land restoration to improve productivity, soil health and nutritional value of food produced

iv. Waste management: To promote circularity, sustainable and improved practices for waste management, including collection, segregation, and environmentally sound management

v. Air pollution reduction: To promote measures for reducing air pollution and other pollution abatement activities

vi. Mangrove conservation and restoration: to promote measures for conservation and restoration of mangroves

vii. Ecomark label development: To encourage manufacturers to obtain ecomark label for their goods and services

viii. Sustainable building and infrastructure: To encourage the construction of sustainable buildings and other infrastructure using environment friendly technologies and materials.

It is important to note that, the green credit programme is an environmental activity resulting in generation of green credit which could have climate co-benefits, such as reduction or removal of carbon emissions. However, it is independent of the carbon credit under the Carbon Credit Trading Scheme, 2023.

To be notified

The Central Government would constitute a Steering Committee for monitoring the implementation of the Green Credit programme.

Further the Central Government would also set up a technical committee for each activity to assist in the implementation of the Green Credit programme.

The methodology and procedure for calculation of generating green credit for each of the abovementioned environment activities and the trading platform are yet to be developed. In this regard, on 23 October 2023, the Ministry of Environment, Forest and Climate Change notified the draft methodology for water harvesting.

Accounting and recognition considerations

The accounting for carbon credits and its offsets[2] is an emerging issue. Currently, there is no specific guidance under Ind AS or IFRS Accounting Standards on accounting for such carbon credits. Internationally companies are using certain accounting principles under IFRS for accounting of carbon credits.

The following section provides an overview of the accounting framework companies are adopting internationally under IFRS. However, in the absence of the specific guidance, companies are expected to consider the specific facts and circumstances, nature of the arrangement and the business purpose for purchasing the credits to select the appropriate accounting treatment as per the IFRS.

Further, the principles for accounting and recognition of carbon credit are different for an acquirer of carbon credits i.e. company that purchases carbon credits and a vendor of carbon credits (where a company incorporates carbon credits into revenue arrangements). The below discussed accounting framework is bifurcated between the acquirer's perspective and vendor perspective for accounting and recognition of carbon credit.

Acquirer's perspective: company purchases carbon credits

A company aiming to reduce its carbon emissions may opt for mandatory 'cap and trade' scheme introduced by a government - or may reduce the impact of its carbon emissions voluntarily - e.g. by purchasing carbon credits or offsetting services. The distinction between the two is as follows:

a. **Mandatory/compliance schemes (i.e Cap and trade schemes):** The mandatory schemes are driven by regulatory bodies and the participants are identified by governments based on carbon intensity, sector or size. Under such scheme, an entity would be subject to specific requirements to reduce its carbon emissions.

   When a company reduces its emissions, the government would grant certain number of emissions certificates to an entity which it could use during its compliance period. The entity can then trade certificates with other parties to ensure that it has sufficient certificates to match its emissions.

Accounting consideration

In such schemes, the emission allowance could be recognised as a government grants as per the principles of IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance.* IAS 20 provides that such non-monetary government grant at initial recognition would be recognised either at fair value or at a nominal amount. Recognition of a non-monetary government grant at the amount paid (often zero) would result in no liability being recognised if the liability is measured at the carrying amount (zero) of the related assets. As per IAS 20, fair value is the usual approach for non-monetary grants.

2. Offset means verified removals of carbon (e.g. through growing new forests).

For subsequent measurement, depending upon the classification of emission certificates a participant should choose an accounting policy, to be applied consistently, based on one of the following approaches:

- To be classified as intangible assets as per IAS 38, *Intangible Asset:* Under this approach, emissions certificates are identifiable non-monetary assets that do not have physical substance and thus they meet the definition of an intangible asset.
- To be classified as inventories as per IAS 2, *Inventories:* Under this approach, emissions certificates are effectively an input to be consumed in the production process, similar to inventories.

b. **Voluntary schemes:** An entity may voluntarily purchase carbon credits representing a reduction or removal of emissions e.g. a certified offsetting project such as planting of trees. Under this scheme, credits are often registered with a registry authority and an entity could trade or sell them to a third party.

As the arrangements could vary, the specific facts and circumstances applicable to the entity should be considered to determine the appropriate accounting treatment.

An entity may consider following factors for evaluation:

- **Credit purchased together with other goods or services:** In such a scenario, management should determine if the credit is part of the cost of another good or service or if it is a separate unit of account. If it is part of the cost of another good or service, then it is not accounted for separately.
- **Credit is purchased for advertising or promotional activities:** A company recognises expenditure for advertising and promotional activities when the benefit of those goods or services is available to it. However, it has been observed that credits are typically not acquired with the sole purpose of undertaking advertising or promotional activities.
- **Credit purchased for selling or to fulfil contracts with customers:** If the credit is purchased with the intention of selling it in the ordinary course of business or the credit is purchased to fulfil contracts with customers, then the credit is accounted as inventory under IAS 2. In other words, carbon credits would meet the definition of inventories if they are held for sale in the ordinary course of business or consumed in the production process. Additionally, the disclosure requirements of IAS 2 should also be considered.

- **Credit held for use:** The company's ability to use the carbon credit to offset its own emissions generally represents economic benefits flowing to the company from the credit. If economic benefits arise from the ability to offset, then the company may have an intangible asset as per IAS 38. This is because it has the power to obtain the future economic benefits and restrict others' access to those benefits.

  The management of the company would be required to exercise judgement to determine when the economic benefits from the carbon credits are consumed. For example, if the economic benefits are of the ability to offset, then they are typically consumed when the company retires the credits – i.e. the credits are derecognised when they are retired. Similarly, if the credits are retired immediately on purchase, then the economic benefits are consumed immediately and the expenditure is recognised as an expense.

Vendor's perspective: company incorporates carbon credits into revenue arrangements

Carbon credits could be incorporated into a revenue contract by transferring them to a customer when they purchase a green widget (i.e. an attribute of the asset) or by retiring carbon credits on customer's behalf. In order to recognise revenue as per IFRS 15, *Revenue from Contracts with Customers,* the company should have a separate performance obligation related to the carbon credit. In such scenarios, the company should allocate a portion of the transaction price to the carbon credits or related service (assuming control does not transfer at the same time) and recognise revenue when the performance obligation is satisfied. There may also be an impact on revenue recognition disclosures (e.g. disaggregation of revenue).

Bottom Line

As corporates are announcing their commitments to reduce their carbon emissions, there has been an increase in demand relating to corporate sustainability disclosures and demonstrate progress towards net zero commitments. Considering this the regulators around the globe are working on developing requirements relating to the same. This is an emerging area, and the scope of formal regulation is increasing.

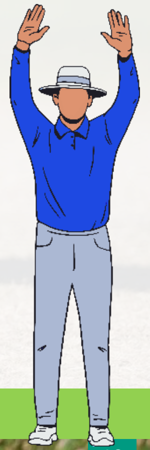
The recently released IFRS Sustainability Disclosure Standards and European Sustainability Reporting Standards (ESRS) also provide disclosure requirements relating to carbon credits. Therefore, it is important to track regulatory announcements in this area. Also, as there is no specific accounting guidance it is critical to understand the substance of an arrangement to apply and determine the appropriate accounting standards.

Sources

- Insights into IFRS publication, KPMG IFRG Limited, 2023 edition
- Carbon offsets and credits under IFRS Accounting Standards article, KPMG LLP US, March 2023







CHAPTER 2

Key accounting and financial reporting issues- Fair valuation and financial instruments

This article aims to:

- Provide an overview of the key observations highlighted by the regulators relating to disclosure and accounting of fair value measurement and financial instruments.

Introduction

Financial reporting enables companies to recount the transactions and events that have taken place in a company during a reporting period. It provides insight and transparency regarding the operations of the company, and thus facilitates users to make financial decisions, such as investing, lending, etc.

High-quality financial reporting, which complies with relevant accounting and reporting standards, has been at the forefront of regulators' priorities. Accordingly, regulators are globally undertaking reviews of financial statements of companies and highlighting non-compliances or improvement points.

In our series of key accounting and financial reporting issues, we will touch upon some of the key areas that regulators have highlighted and provided improvement points in the area of **fair value measurement and financial instruments**, and will also provide illustrations of disclosures from thematic reviews performed by the Financial Reporting Council (FRC) and illustrative disclosures issued by KPMG IFRG Limited in 2023.

While preparing this article, we have referred to:

- The recent observations of the National Financial Reporting Authority (NFRA),
- The Ind AS observations of the Financial Reporting Review Board (FRRB) of the Institute of Chartered Accountants of India (ICAI),
- The report- Annual Review of Corporate Reporting (2022/23) issued by the Financial Reporting Council, and
- Recent ESMA[1] enforcement directions.

1. European Securities and Markets Authority

Key issues and recommendations pertaining to fair value measurement and financial instruments

Expected Credit Loss (ECL) and credit risk

- ***Use of forward-looking information:*** As per IFRS 9, *Financial Instruments,* while computing ECL, an entity should *inter alia* consider reasonable and supportable information about past events, current conditions and forecasts of future economic conditions (or Forward-Looking Information (FLI)). In this regard, the following was observed:

  ECL on Trade receivables: In making ECL assessments for trade receivables and contract assets using a provision matrix, historical default rates should be reviewed and adjusted for FLI.

  Disclosures of FLI: While explaining the inputs, assumptions and estimation techniques used to compute ECL (as required by IFRS 7, *Financial Instruments: Disclosures*), disclosures should be made on how FLI and other macroeconomic conditions have been incorporated in computing ECL. (Refer illustrative disclosures)

Illustrative disclosure: Adjustment of historical loss rates with FLI

Exposures within each credit risk grade are segmented by geographic region and industry classification and an ECL rate is calculated for each segment based on delinquency status and actual credit loss experience over the past seven years. These rates are multiplied by scalar factors to reflect differences between economic conditions during the period over which the historical data has been collected, current conditions and the Group's view of economic conditions over the expected lives of the receivables.

Scalar factors are based on GDP forecast and industry outlook and include the following: 1.3 (2022: 1.2) for [Country X], 0.9 (2022: 0.2) for [Country Y] and 1.1 (2022: 1.2) for [Industry A].

(Source: KPMG in India's analysis, read with Guide to annual financial statements – Illustrative disclosures issued by KPMG IFRG Limited in 2023)

- ***Reconciliation of ECL:*** As per IFRS 7, companies are required to provide a reconciliation from the opening balance to the closing balance of the loss allowance to explain the changes in the loss allowance. Such a reconciliation should also include how significant changes to the gross carrying amount of the financial instruments[2] during the period contributed to the changes in loss allowance. (Refer illustrative disclosure)

Illustrative disclosure: reconciliation of ECL

Movements in the allowance for impairment in respect of trade receivables and contract assets

The movement in the allowance for impairment in respect of trade receivables and contract assets during the year was as follows:

In thousands of INR	**2023**	**2022**
Balance at 1 January	**214**	26
Amounts written off	**(80)**	(5)
Amounts derecognised due to discontinued operation	**(25)**	-
Net remeasurement of loss allowance	**211**	193
Balance at 31 December	**320**	214

The following significant changes in the gross carrying amounts of trade receivables contributed to the changes in the impairment loss allowance during 2023:

- The growth of the business in [*Countries A, B, X and Y*] resulted in increases in trade receivables of INR 4,984 thousand (2022: INR 2,356 thousand) and INR 4,556 thousand (2022: INR 2,587 thousand) respectively and increases in impairment allowances of INR 30 thousand (2022: INR 14 thousand) and INR 44 thousand (2022: INR 23 thousand) respectively;
- Increases in credit-impaired balances in [*Countries D and Z*] of INR 143 thousand (2022: INR 98 thousand) resulted in increases in impairment allowances of INR 47 thousand (2022: INR 44 thousand); and
- A decrease in trade receivables of INR 3,970 thousand attributed to the Packaging segment, which was sold in February 2023, resulted in a decrease in the loss allowance in 2023 of INR 25 thousand.

(Source: KPMG in India's analysis, read with Guide to annual financial statements – Illustrative disclosures issued by KPMG IFRG Limited in 2023)

2. For example:
   a. Changes because of financial instruments originated or acquired during the reporting period
   b. The modification of contractual cash flows on financial assets that do not result in a derecognition of those financial assets
   c. Changes because of financial instruments that were derecognised during the reporting period, etc.

- ***Disclosures of credit risk:*** To enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows, companies should *inter alia* disclose the approach and significant assumptions applied in the measurement of ECL, such as what is considered as significant increase in credit risk, default, etc., quantitative criteria applied to stage transfers (i.e. from stage 1 to 2) and probation period for transfer back (i.e. from stage 2 to 1) should be disclosed. Concentrations of risks, details of probability of default and loss given default, where these are used in computation of ECL and are considered material, should be provided. (Refer illustrative disclosures)

Illustrative disclosure: Credit risk pertaining to debt securities

The Group monitors changes in credit risk by tracking published external credit ratings. To determine whether published ratings remain up to date and to assess whether there has been a significant increase in credit risk at the reporting date that has not been reflected in published ratings, the Group supplements this by reviewing changes in bond yields and, where available, Credit Default Swap (CDS) prices together with available press and regulatory information about debtors.

12-month and lifetime probabilities of default are based on historical data supplied by [*Rating Agency X*] for each credit rating and are recalibrated based on current bond yields and CDS prices. Loss given default parameters generally reflect an assumed recovery rate of 40 per cent, except when a security is credit-impaired, in which case the estimate of loss is based on the instrument's current market price and original effective interest rate.

(Source: KPMG in India's analysis, read with Guide to annual financial statements – Illustrative disclosures issued by KPMG IFRG Limited in 2023)

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Disclosure pertaining to financial instruments

- ***Risks arising from financial instruments:*** IFRS 7 requires qualitative[3] and quantitative disclosures of the nature and extent of risks arising from financial instruments to which an entity is exposed at the reporting date, and how the entity has managed them. Corporates should consider whether inflation and rising interest rates would be material risks, and *inter alia* disclose:
  - The methods used to measure exposure to risks and whether there are any changes in these methods as compared to the previous period (as required by IFRS 7). Also, the sensitivity analysis of the risks should be disclosed
  - Any hedging arrangements have been put in place to fix interest rates or hedge against the effects of inflation[4]
  - Information about collateral held as security and other credit enhancements should be disclosed as part of credit risk. (Refer illustrative disclosure)

Illustrative disclosure: Company does not hold collateral for trade and other receivables

The Group does not require collateral in respect of trade and other receivables. The Group does not have trade receivable and contract assets for which no loss allowance is recognised because of collateral.

(Source: KPMG in India's analysis, read with Guide to annual financial statements – Illustrative disclosures issued by KPMG IFRG Limited in 2023)

3. For each type of risk arising from financial instruments, a company should disclose the following:
   - The exposure to the risk and how it arises
   - The methods used to measure the risk, and
   - The entity's objectives, policies and processes for managing the risk.
4. Where inflationary features are embedded in contracts, they may be separated and accounted for as derivatives. Companies need to disclose relevant information for users to understand such contractual features.

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- ***Derecognition of equity instruments measured at FVOCI:*** When an entity derecognises investments in equity instruments measured at Fair Value through Other Comprehensive Income (FVOCI) during a reporting period, it should disclose the following in accordance with IFRS 7:
  - The reasons for disposing the investments
  - The fair value of the investment at the date of derecognition, and
  - The cumulative gain or loss on disposal.
- ***Reclassification of financial assets:*** An entity may reclassify a financial asset (say from amortised cost to FVOCI) only when there is a change in the business model for managing financial assets. As per IFRS 9, *Financial Instruments*, changes in the business model are expected to be very infrequent. Such a change is determined by the entity's senior management, must be significant to the entity's operations, demonstrable to external parties and is only possible if the entity begins or ceases to perform an activity that is significant to its operations. Changes in management of financial assets (for example, a revised investment strategy developed by a new management) does not meet this criterion and therefore, the condition for reclassification of financial assets is not fulfilled.

  However, in specific circumstances, where the condition for reclassification is fulfilled, entities should provide prescribed disclosures in accordance with IFRS 7 i.e.
  - Date of reclassification
  - A detailed explanation of the change in the business model and a qualitative description of its effect on the entity's financial statements
  - The amount reclassified into and out of each category.

Offsetting of financial instruments

- As per IAS 32, *Financial Instruments: Presentation*, financial instruments should be offset and a net amount presented in the balance sheet when an entity has a legal right to offset the financial asset and financial liability and the intention is either to settle on a net basis, or to realise the asset and settle the liability simultaneously. Accordingly, for the purpose of presentation in the cash flow statement, cash and overdraft balances should be offset only when the qualifying criteria is met.

Disclosures of fair value measurement

IFRS 13, *Fair Value Measurement*, requires companies to disclose the fair value hierarchy, that categorises into three levels the inputs to valuation techniques used to measure fair value.

- Some of the observations pertaining to recurring[5] level 3 measurements include the following:
  - While significant unobservable inputs and adjustments were disclosed, quantitative information regarding these inputs and adjustments is required,
  - Along with a narrative description, a quantitative sensitivity analysis for financial instruments categorised within level 3 of the fair value hierarchy would give a sense of the potential variability of the measurement (refer the illustrative disclosure), and
  - A reconciliation of movements in fair value.

5. Those measurements that other IFRSs require or permit in the balance sheet **at the end of each reporting period**- e.g. financial liability in respect of contingent consideration on acquisition of a business

Illustrative disclosure: Quantitative sensitivity disclosure for financial instruments within level 3

The fair value of the Group's investments is INRX (20XX: INRY). The following analysis is provided to illustrate the sensitivity of the fair value of investments to a change in an individual input, while all other variables remain constant. The Board considers these changes in inputs to be within reasonable expected ranges. This is not intended to imply the likelihood of change or that possible changes in value would be restricted to this range

Input	Base case[1*]	Change in input[1*]	Change in fair value of investments (in INR)
Discount rate	6-7%	+ 0.5% - 0.5%	(69,667) 74,206
Energy yield	P50	10 – year P90 10 – year P10	(128,748) 127,684
Power price	Forecast by leading consultant[2*]	-10% +10%	(135,947) 130,850
Inflation rate	2% long term	-0.5% +0.5%	(60,757) 64,581
Asset life	30 years onshore/ 35 years offshore	- 5 years + 5 years	(148,179) 102,394

The sensitivities above are assumed to be independent of each other[3*].

Combined sensitivities are not presented.

Notes for consideration:

1*: The company should separately explain how the base case and reasonably possible changes in inputs were determined

2*: The Company should explain how frequently the forecasts provided by consultants are updated and may be adjusted where the investment manager considers that more conservative assumptions are appropriate.

3*: Sensitivities are provided separately for each significant level 3 input.

(Source: KPMG in India's analysis, read with CRR Thematic Review: IFRS 13 *'Fair Value Measurement'* issued by FRC in June 2023)

Climate-related matters

Investors have started factoring climate related matters – i.e. both physical risks (such as, rising sea levels) and transition risks (such as, changes in relevant legislations) into their valuations. These will impact fair value measurements in different ways.
Where such information is material, companies should explain how the impact of climate-related matters has been incorporated in fair value measurements and quantify the significant estimation uncertainty. Where such risks have not been considered, however, it would impact the valuation in the future, such disclosure should also be made. (Refer illustrative disclosure)

Illustrative disclosure: Extract of valuation methodology for investment properties

Other factors that are taken into account include structural and environmental conditions. With regard to the latter factor, the valuers made no explicit adjustment to their valuations as at 31 December 20XX in respect of ESG matters. However, both the Group and the valuers anticipate that ESG will have a greater influence on valuations in the future as investment markets place a greater emphasis on this topic.

(Source: KPMG in India's analysis, read with CRR Thematic Review: IFRS 13 *'Fair Value Measurement'* issued by FRC in June 2023)

Borrowing related disclosures

Information about banking covenants should be provided unless the likelihood of any breach is considered remote. Additionally, the effect of refinancing and changes to covenant arrangements should be explained (refer illustrative disclosure). Borrowers should recognise interest expense on the borrowing irrespective of whether or not the lender correspondingly recognizes interest income on that loan. For example, certain lenders, such as banks, do not recognise interest on Non-Performing Assets (NPAs) in accordance with the regulations applicable to them. However, the borrowers considered as NPA, should continue to recognise the interest expense.

Illustrative disclosure: Loan covenant waiver

As explained in [Note X], the Group exceeded its maximum leverage threshold (loan covenant ratio, calculated as debt to quarterly revenue for continuing operations) associated with a bank loan in the third quarter of 2023. The Group obtained a waiver of the breach of covenant in October 2023 for a period of 18 months. Subsequent to 31 December 2023, the bank revised the loan covenant ratio from 2.5 to 3.5 times and the waiver was lifted. On the basis of the new covenant and its forecasts, management believes that the risk of the new covenant being breached is low.

(Source: KPMG in India's analysis, read with Guide to annual financial statements – illustrative disclosures issued by KPMG IFRG Limited in 2023)

Significant estimation uncertainty

As per IAS 1, *Presentation of Financial Statements*, an entity should disclose information about assumptions it makes about the future or other major sources of estimation uncertainty that would significantly adjust the carrying amounts of assets or liabilities. With regard to fair value measurement, companies should disclose any significant estimation uncertainty in relation to fair value measurements (refer illustrative disclosure). Companies should also consider obtaining specialist third party advice, when the fair valuation is likely to be material and where no internal expertise exists. For example, third party specialists in valuation of land or property, etc.

Illustrative disclosure: Significant estimation uncertainty on fair value measurements (timber industry)

The Group assessed the impact of climate-related risks and opportunities on the estimated yields per hectare for younger standing timber while computing the fair value. By considering the impact of higher temperatures (an increase of 2ºC by 2050) on the growth rate of pine trees and on the intensity and frequency of storms, the Group concluded that, overall, the positive effects (accelerated growth) and negative effects (increase in the frequency of storms) would have an immaterial impact on yields. Due to the high degree of estimation uncertainty around the impact of climate change on the intensity and frequency of storms, this conclusion may change in the future.

(Source: KPMG in India's analysis, read with Guide to annual financial statements – illustrative disclosures issued by KPMG IFRG Limited in 2023)

Other observations

- **Accounting policies:** Accounting policies should be provided for all material transactions to enable users to understand how these transactions have been accounted. This includes initial recognition and subsequent measurement, financing (including factoring and reverse factoring) and hedging arrangements, and any changes in the arrangements.
- **Consistent information:** Companies should ensure that information in the annual report is consistent across the report. For example, where the management commentary includes inflationary risks, climate related risks, etc. as significant risks faced by the entity, the disclosures pertaining to financial instruments and fair value measurement should reflect these as significant risks impacting the business and how the management is dealing with the same.
- **Market participant assumption:** Companies should ensure that in accordance with IFRS 13, represent market participant[6], rather than company-specific assumptions. These assumptions should be based on the **current** market conditions at the **measurement date**. For example, the fair value of related party transactions should be computed using market participant's assumptions about the associated risk[7].
- **Company specific disclosures:** Companies should provide additional information where it is necessary to meet the overall disclosure objective of the standard, not just the specific requirements, and avoid boilerplate and immaterial information.
- **Aggregation of information:** Fair value hierarchy disclosures are required to be made for each class of assets and liabilities, where the class is determined on the basis of the nature, characteristics and risks. Further disaggregation might be required for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity. Companies should ensure that the level of aggregation of information on fair value measurements results in useful disclosures.

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6. 'Market participants' are buyers and sellers in the principal or most advantageous market. Market participants are assumed to be knowledgeable about the asset or liability, using all available information, including information that would be expected to become available in customary and usual due diligence. To the extent that additional uncertainty exists, it is factored into the fair value measurement.

7. In certain cases, there could be an off-market element (i.e. the difference between the fair value and the transaction value). This off-market element may represent a capital contribution or a deemed distribution.

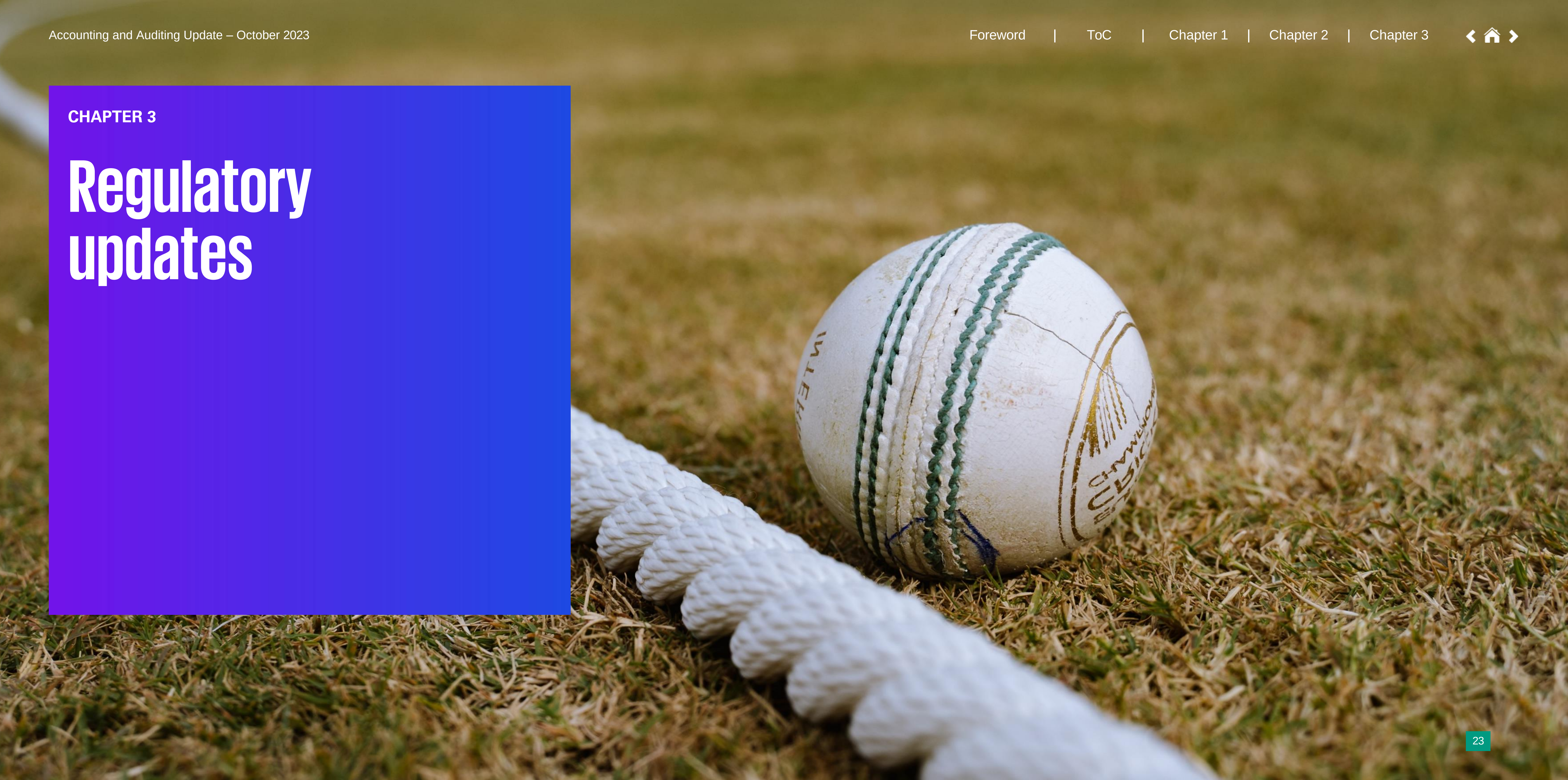
- **Derecognition of financial liabilities:** As per IFRS 9, a financial liability is derecognised when it is extinguished, i.e. it is discharged or cancelled or expires. This *inter alia* includes when the borrower is legally released from the primary responsibility for the financial liability. However, interest on the liability would continue to be recognised till the financial liability is derecognised from the financial statements, for example, even when there are negotiations with the lender to waive off the liability, etc.
- **Interest on financial assets:** Interest income on financial assets measured at amortised cost should be recognised using the effective interest method.

Where it is expected that amounts would not be received, an impairment would be created on the financial asset using the ECL method.

- **Schedule III disclosures:** As per Division II to Schedule III of the Companies Act, 2013:
  - ***Loans to related parties*** should be bifurcated into the current and non-current component. Additionally, it should also be disclosed whether such loans are secured or unsecured and what amount is considered good or considered doubtful.
  - ***Investments*** should be bifurcated as quoted or unquoted and market value of quoted investments should be disclosed.

Conclusion

The article highlights observations of the regulators pertaining to certain key areas of the standards. Therefore, companies should take note of these requirements of the accounting standards and provide adequate disclosures.



CHAPTER 3

Regulatory updates

Extension of timeline for verification of market rumours

In June 2023, the Securities and Exchange Board of India (SEBI) amended Regulation 30(11) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulation) which requires certain listed companies, to confirm, deny or clarify market rumours. This requirement is applicable to the top 100 listed entities[1] by market capitalisation from 1 October 2023 and the top 250 listed entities with effect from 1 April 2024.

However, on 30 September 2023, SEBI issued a circular to extend the timeline for compliance. Thus, the revised timelines for compliance are as follows:

Top 100 listed entities	From 1 February 2024 *(earlier 1 October 2023)*
Top 250 listed entities[1]	From 1 August 2024 *(earlier 1 April 2024)*

(Source: SEBI circular no. SEBI/HO/CFD/CFD-PoD-1/P/CIR/2023/162 dated 30 September 2023)

Revised framework for borrowings by Large Corporates (LCs)

As per the SEBI (Issue and Listing of Non-convertible Securities) Regulations, 2021 (NCS Regulations) read with NCS Master Circular[2], LCs are required to raise minimum of 25 per cent of their incremental borrowing during a Financial Year (FY) by issuing debt securities. This requirement has to be met over a contiguous block of three years from FY 2022 onwards. However, in order to facilitate ease in doing business and development of corporate bond markets, SEBI issued a circular on 19 October 2023 to revise the framework for LCs with respect to raising funds by issuance of debt securities.

The key takeaways from the circular are as follows:

- **Applicability:** The framework is applicable to all listed entities (except for Scheduled Commercial Banks (SCB)) which fulfil the following criteria as on last day of the FY (i.e. 31 March or 31 December):
  a. Have specified securities or debt securities or non-convertible redeemable preference shares listed on a recognised stock exchange(s)
  b. have **outstanding long term borrowings of INR1,000 crore or above** *(earlier it was 100 crore or above).*
  c. have a credit rating of 'AA'/'AA+'/'AAA', where the credit rating relates to the unsupported bank borrowing or plain vanilla bonds of an entity, which have no structuring/support built in.

  The term 'outstanding long term borrowings' means outstanding borrowings with an original maturity of more than one year.
- **Requisite borrowing criteria:** An LC (determined as per the above applicability criteria) should raise at least 25 per cent of its **qualified borrowings** *(earlier termed as incremental borrowings)* by issuing debt securities[3] in the financial years subsequent to the financial year in which it is identified as an LC.

1. The top 100 and 250 listed entities shall be determined on the basis of market capitalisation, as at the end of the immediately preceding financial year
2. Chapter XII of the Master Circular for issue and listing of NCS, Securitised Debt Instruments, Security Receipts, Municipal Debt Securities and Commercial Paper dated 10 August 2021 as amended from time to time.
3. Debt securities as defined under SEBI (Issue and Listing of Non- Convertible Securities) Regulations, 2021

The term ‘qualified borrowings’ means incremental borrowing between two balance sheet dates having original maturity of more than one year. However, outstanding long-term borrowings and qualified borrowings should exclude the following:

i. External Commercial Borrowings (ECBs)

ii. Inter-corporate borrowings involving the holding company and/or subsidiary and/or associate companies

iii. Grants, deposits or any other funds received as per the guidelines or directions of Government of India

iv. Borrowings arising on account of interest capitalisation and

v. Borrowings for the purpose of schemes of arrangement involving mergers, acquisitions and takeovers.

Further, it is clarified that the qualified borrowings for a FY should be determined as per the audited accounts for the year filed with the stock exchanges.

- **Incentives in case of surplus in the requisite borrowings:** If at the end of three years, there is a surplus in the requisite borrowings, the following incentives would be available to an LC:

  i. Reduction in the annual listing fees pertaining to debt securities or non-convertible redeemable preference shares, and

  ii. Credit in the form of reduction in contribution to the Core Settlement Guarantee Fund (SGF) of Limited Purpose Clearing Corporations (LPCC).

  The basis of computation of the incentive is specified in the annexure to the circular.

- **Disincentive in case of shortfall in the requisite borrowings:** If at the end of three years, there is a shortfall in the requisite borrowings, as a disincentive, additional contribution is required to the core SGF in the manner as specified in the annexure to the circular.

- **Identification of LC by the stock exchange:** Based on the financial results submitted by the listed entities[4], the stock exchanges would determine the LCs for the financial year and release a uniform list which would be placed on their websites. The stock exchanges are also required to notify the listed entities identified as LCs, by email to enable them to comply with the requirements. The timeline within which the stock exchanges should determine the LCs are as follows:

For LCs following April-March as their financial year	By 30 June
For LCs following January-December as their financial year	By 31 March

Further, the stock exchange would also calculate the incentive and disincentive and would intimate the same to the LCs.

- **Effective date:** This revision to the framework is applicable with effect from 1 April 2024 for LCs following April-March as their financial year. For LCs following January-December as their financial year, the framework is effective form 1 January 2024.

4. As per Regulation 33 of the Listing Regulation, for a listed entity that has listed its specified securities and non-convertible debt securities and as per Regulation 52 of the Listed Regulation for a listed entity that has listed its non-convertible securities.

- **Requirements for LCs identified based on the erstwhile criteria:** Listed entities already identified as LCs based on the erstwhile criteria[5] for FY 2020-21, FY 2021-22 and FY 2022-23, should comply with the requirement of raising 25 percent of their incremental borrowings by way of issuance of debt securities till 31 March 2024.
In case of any failure to comply with the requirement, such LCs should provide a one-time explanation in their Annual Report for FY 2024. Further the requirement as per erstwhile circular relating to penalties and annual disclosure regarding the details of incremental borrowing and mandatory borrowing have been removed. Hence, under the revised framework penalties would not be levied on the listed entities.

(Source: SEBI circular no. SEBI/HO/DDHS/DDHS-RACPOD1/P/CIR/2023/172 dated 19 October 2023)

Mandatory listing of NCDs

On 19 September 2023, SEBI amended the Listing Regulations to introduce a new regulation (Regulation 62A) for listing subsequent issuances of Non-Convertible Debt Securities (NCDs). Regulation 62A provides following provision relating to listing of NCDs:

a. If existing NCDs are listed, then list all NCDs proposed to be issued on or after 1 January 2024.

b. If subsequent issues of unlisted NCDs are made on or before 31 December 2023 and are outstanding on the said date, then such NCDs may be listed

c. If NCDs are proposed to be listed on or after 1 January 2024, then all outstanding unlisted NCDs previously issued on or after 1 January 2024 should also be listed on the stock exchange(s) within three months from the date of the listing of the NCDs proposed to be listed.

The following securities are exempted from the above mandatory listing provision:

i. Bonds issued under Section 54EC of the Income-tax Act, 1961

ii. NCDs issued pursuant to an agreement between the listed entity and multilateral institutions

iii. NCDs issued pursuant to an order of any court or Tribunal or on account of a regulatory requirement stipulated by a financial sector regulator.

The above amendment is effective from 19 September 2023.

(Source: SEBI notification no. No. SEBI/LAD-NRO/GN/2023/151 dated 19 September 2023)

5. All listed entities (except for Scheduled Commercial Banks), which as on last day of the FY(i.e. 31 March or 31 December):

   a. have their specified securities or debt securities or non-convertible redeemable preference shares, listed on a recognised stock exchange(s) in terms of Listing Regulations; and

   b. have an outstanding long term borrowing of Rs. 100 crore or above, where outstanding long-term borrowings shall mean any outstanding borrowing with original maturity of more than one year and shall exclude external commercial borrowings and inter-corporate borrowings between a parent and subsidiary(ies);and

   c. have a credit rating of "AA and above", where credit rating shall be of the unsupported bank borrowing or plain vanilla bonds of an entity, which have no structuring/ support built in; and in case, where an issuer has multiple ratings from multiple rating agencies, the highest of such ratings shall be considered for the purpose of applicability of this framework.

Relaxations for AGMs and EGM through VC

On 25 September 2023, the Ministry of Corporate Affairs (MCA) issued a circular to allow companies to hold their Annual General Meeting (AGM) which are due in years 2023 and 2024, and EGM through Video Conference (VC) or Other Audio Visual Means (OVAM) till 30 September 2024 *(earlier till 30 September 2023).* Additionally, copies of the financial statements (including Board's report, Auditor's report or other such documents required to be attached), are to be sent only by email to the members, trustees for the debenture-holder of any debentures issued by the company, and to all other entitled persons. However, statutory timelines and other provisions provided in the Companies Act, 2013 are required to be complied.

Considering the relaxations provided by the MCA, SEBI also provided the similar relaxation.

As per the provisions of the Listing Regulations, listed entities[6] are required to dispatch hard copy of the statement containing the salient features of all the documents prescribed in Section 136 of the Companies Act, 2013 (2013 Act) or rules made thereunder (i.e. financial statements, board's report, auditor's report etc.) to the shareholder(s) who have not registered their email address.

Recently, SEBI has issued a circular to exempt such listed entities from sending the hard copies of the statement of salient features till 30 September *2024 (earlier 30 September 2023).* Further, listed entities that have listed their specified securities, the requirement of sending proxy forms under Regulation 44(4) of the Listing Regulations is dispensed with till 30 September 2024 *(earlier 30 September 2023)* for AGMs held only through electronic mode.

(Source: SEBI circular no SEBI/HO/CFD/CFD-PoD-2/P/CIR/2023/167 dated 7 October 2023, SEBI circular no. SEBI/HO/DDHS/P/CIR/2023/0164 dated 6 October 2023 and MCA general circular no. 09/2023 dated 25 September 2023)

Disclosure of secured assets by banks and financial institutions

With an aim to enhance transparency in disclosure of information, RBI issued a notification on 25 September 2023 requiring Regulated Entities[7] (REs) to display information of secured assets under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

As per the notification, the REs which are secured creditors as per SARFAESI Act are required to display information, in the prescribed format, with respect to the borrowers whose secured assets are taken into possession. REs should display the first list on their website within six months from the date of mentioned circular (i.e. 25 March 2024) and the same should be updated on monthly basis.

(Source: RBI notification RBI/2023-24/63 DoR.FIN.REC.41/20.16.003/2023-24 dated 25 September 2023)

6. Regulation 36(1)(b) of Listing Regulation applicable to listed entities that have issued specified securities and Regulation 58(1)(b) of Listing Regulation applicable to issuers of listed Non-Convertible Securities.
7. REs include all commercial banks including small finance banks, local area banks and regional rural banks and excluding payment banks, primary (urban) co-operative banks/state co-operative banks/ central co-operative banks, All India Financial Institutions (Exim Bank, NABARD, NHB, SIDBI and NaBFID), Non-Banking Financial Companies (NBFCs) including housing finance companies, Asset Reconstruction Companies (ARCs).

Technical guide on internal audit of pharmaceutical industry

On 11 October 2023, the Board on Internal Audit and Management Accounting of the Institute of Chartered Accountants of India (ICAI) issued a technical guide on internal audit of pharmaceutical industry to provide guidance to internal auditors operating in the pharmaceutical industry.

The guide provides guidance on structure, history, regulatory framework, key drivers of this industry. It, *inter alia,* provides guidance on aspects involved in various stages of pharmaceutical industry and regulatory framework. This guide also describes risks associated with pharmaceutical industry and internal controls checklist for various processes. It also contains illustrative checklist for internal audit of major areas of the pharmaceutical industry.

(Source: ICAI announcement dated 11 October 2023)

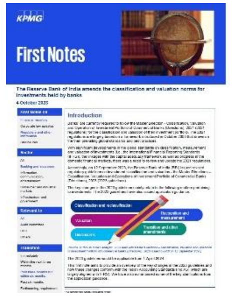
IAASB requires auditors to disclose their independence

The International Ethics Standards Board for Accountants (IESBA) amended the International Code of Ethics for Professional Accountants (the Code) in April 2022. It requires firms to publicly disclose when the firm has applied the independence requirements for public interest entities in an audit of the financial statements of an entity.

In this regard, on 12 October 2023, the International Auditing and Assurance Standards Board (IAASB) issued narrow scope amendments to International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* and ISA 260 (Revised), *Communication with Those Charged with Governance.* These amendments aim to provide a clear and practical framework for implementing IESBA's requirement through appropriate communication in the auditor's report and with those charged with governance. The amendment is effective for audits of financial statements for periods beginning on or after 15 December 2024.

(Source: IAASB news dated 12 October 2023)

First Notes



The Reserve Bank of India amends the classification and valuation norms for investments held by banks

Banks are currently required to follow the Master Direction - Classification, Valuation and Operation of Investment Portfolio of Commercial Banks (Directions), 2021 (2021 regulations) for the classification and valuation of their investment portfolio. With significant developments in the global standards on classification, measurement and valuation of investments (i.e. IFRS), the linkages with the capital adequacy framework as well as progress in the domestic financial markets, there was a need to review and update the 2021 regulations.

Accordingly, on 12 September 2023, the Reserve Bank of India (RBI) issued revised regulatory guidelines on investment classification and valuation - the Master Directions - Classification, Valuation and Operations of Investment Portfolio of Commercial Banks (Directions), 2023 (2023 guidelines).

This issue of the First Notes provides an overview of the of the key changes in the 2023 guidelines and how these changes conform with Ind AS (which are largely aligned with IFRS).

To access the First Notes, please click here.

Voices on Reporting – Quarterly updates publication

On 26 October 2023, KPMG in India released its Voices on Reporting – Quarterly updates publication (for the quarter ended 30 September 2023) which provides a summary of key financial reporting, Environment, Social and Governance (ESG) and regulatory updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Reserve Bank of India (RBI) and the Institute of Chartered Accountants of India (ICAI).

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