Accounting and Auditing Update

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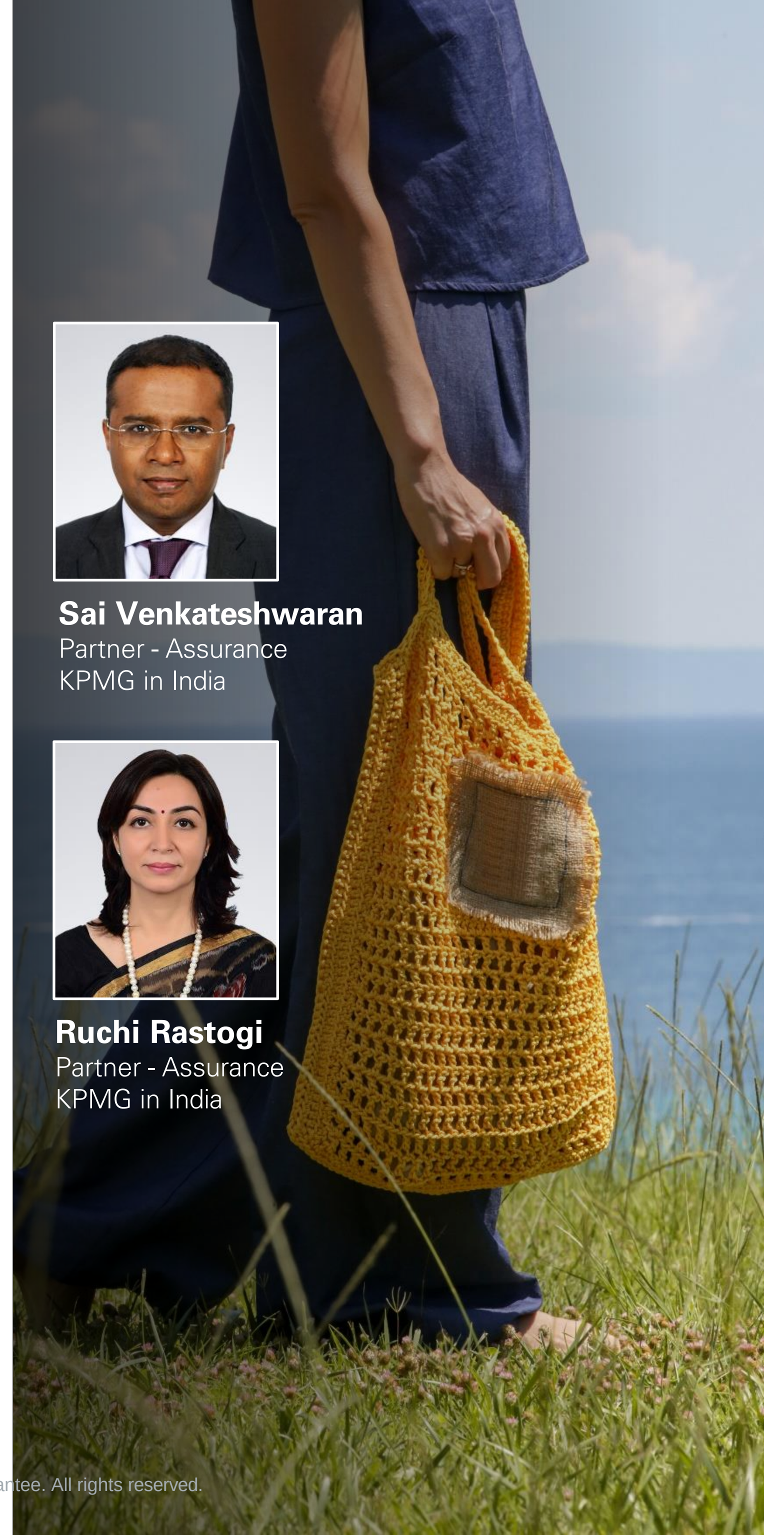
Editorial

The current economic environment in the world poses several geopolitical challenges and is facing the weaning effects of the pandemic. These challenges could have (or have already had) an adverse effect on companies. It would be essential to understand this impact on the assets of the companies. There could be indicators of impairment and which may require companies to perform impairment testing and provide disclosures. Thus, impairment testing of non-financial assets and disclosures of impairment testing become imperative. This edition of our Accounting and Auditing Update (AAU) carries an article on the topic of impairment of non-financial assets which highlights key areas that regulators have provided improvement points in this area. The article also provides illustrations of disclosures from thematic reviews performed by the Financial Reporting Council (FRC).

Determination of transaction price is a critical step while accounting for revenue under Ind AS 115, *Revenue from Contracts with Customers*. Transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, certain sales taxes). An entity needs to consider multiple factors while determining the transaction price of a contract, for example, the inclusion of a variable consideration, a financing component, etc. Delayed Payment Charges (DPC) is one of such factors that should be considered by companies while determining the transaction price. Recently, the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) deliberated on the accounting and presentation of the DPC collected by a company from its customers. Our article on this topic aims to discuss some of the key factors considered by the EAC while opining on the accounting and presentation of DPC in the statement of profit and loss and statement of cash flows.

There have been various regulatory developments in India and internationally during the month. Recently, the Ministry of Corporate Affairs (MCA) notified amendments to Section 23 of the Companies Act, 2013 with effect from 30 October 2023 to enable certain class of public companies to issue certain class of securities for listing in identified stock exchanges in permissible foreign jurisdictions. However, MCA is yet to notify the class or classes of public companies and class of securities to be covered under these provisions. Further, MCA notified amendments to furnishing of information regarding beneficial interest in the shares of the company; dematerialisation of share warrants issued by public companies; and of securities by private companies. Additionally, the Reserve Bank of India (RBI) issued a circular on 25 October 2023 to notify provisions relating to establishment of effective senior management team. 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.



Sai Venkateshwaran
Partner - Assurance
KPMG in India

Ruchi Rastogi
Partner - Assurance
KPMG in India

CHAPTER 1

Key accounting and financial reporting issues - Impairment of non-financial assets

CHAPTER 2

Presentation of delayed payment charges in the financial statements

CHAPTER 3

Regulatory updates

CHAPTER 1

Key accounting and financial reporting issues - Impairment of non-financial assets

The current economic environment in the world poses several geopolitical challenges and is facing the weaning effects of the pandemic. These challenges are expected to have (or have already had) an adverse effect on companies. It would be essential to understand the impact on the assets of the companies. There could be indicators of impairment and which may require companies to perform impairment testing and provide disclosures. Thus, impairment testing of nonfinancial assets and disclosures of impairment testing become imperative.

With this background, in this issue of key accounting and financial reporting issues, this article highlights key areas that regulators have provided improvement points in the area of **impairment of non-financial assets**, and will also provide illustrations of disclosures from thematic reviews performed by the Financial Reporting Council (FRC).

Source

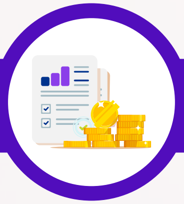
While preparing this article, we have referred to:

- 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 impairment of non-financial assets

Some of the key issues and recommendations pertaining to impairment of non-financial assets is given below:



Disclosures

- ***Key inputs and assumptions:*** IAS 36, *Impairment of Assets* requires an entity to provide disclosures in respect of each individual Cash Generating Unit (CGU) on which the carrying amount of the goodwill or intangible asset with indefinite useful lives allocated to the CGU is significant in comparison to its carrying amount. These disclosures *inter alia* include the key inputs and assumptions used in impairment testing[2], such as key assumptions and period on which cash flow projections are based, growth rates used to extrapolate cash flow projections, discount rates applied, etc.

IAS 36 also states that management may use cash-flow projections/budgets over a period of five years, provided it is confident about its reliability. In such a case, appropriate disclosures which justify the use of such long-term budgets should be made.

- ***Disclosures of impairment loss and reversals:*** As per IAS 36, companies are *inter alia* required to disclose:
  - The amount of impairment losses recognised in profit or loss during the period and the line item(s) in which they have been recorded
  - The amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) in which these amounts have been reversed
  - For each material impairment loss recognised or reversed during the period, the events or circumstances that led to the recognition or reversal of the impairment loss.

In this regard, it has been clarified that an impairment reversal should not be considered as a prior year adjustment.

2. Key assumptions are those to which the unit's (or group of units') recoverable amount is most sensitive.

Example 1: An entity discloses the events and circumstances that led to the recognition of the impairment loss (a regulatory change as a trigger)

In May 2018, the DCMS concluded its Triennial Review of stakes and prizes and announced maximum stakes on B2 gaming products are to be reduced from GBP100 to GBP2, with the change being brought into effect from 1 April 2019. A regulatory change of this nature is unprecedented and its impact on customer behaviour will not be known until some years after implementation. Based on a series of assumptions, preliminary estimates suggest that this could reduce the Retail segment's annualised adjusted operating profit following mitigation measures by GBP70-100m, based on the size of the retail estate at the time of the announcement in May 2018.

Example 2: An entity discloses the events and circumstances that led to the recognition of the impairment loss (description of industry challenges and external market trends)

During 2018, the UK New car market declined by 6.8% (source: SMMT), continuing the weak trend from 2017, with the sale of diesel vehicles down 29.6%. In addition, the supply imbalance and the elevated level of pre-registration activity resulted in pressure on both New and Used margins. In light of this and the recent performance of the Retail business in the UK, the Board has reassessed its short and medium-term forecasts and has updated the impairment test for the UK Retail CGU group based on a value in use calculation.

(Source: Thematic review- Impairment of non-financial assets, issued by FRC in October 2019)

- ***Disclosure of accounting policies:*** IAS 36 requires entities to test goodwill acquired in a business combination for impairment annually, irrespective of whether there is any indication of impairment. This should be appropriately disclosed in the accounting policy of the company (refer example policy).

Example policy

The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired. Any goodwill that arises is tested annually for impairment (see Note X)…

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

Consistency

- ***Consistency of assumptions:*** As per IAS 36, estimates of future cash flows and the discount rate should be consistently used throughout the report[3] and reflect consistent assumptions about price increases attributable to general inflation. Thus, discount rates used for computing the Value In Use (VIU) should be consistent with other information in the annual report and with the general economic environment.

  Further, cash flow assumptions should be consistent with the way the discount rate is determined, otherwise the effect of some assumptions would be counted twice or ignored.

  For example, nominal cash flows, which include the effect of inflation, should be discounted at a nominal discount rate, and real cash flows, which exclude the effect of inflation, should be discounted at a real discount rate ***(Refer example- risk adjustment for cash flows)***.

Risk adjustment for cash flow

Suppose an asset is expected to give rise to one of the following possible cash inflows in three years' time and that the risk-free rate of return is 5 per cent.

Likelihood of cash flow (A)	Cash flow (B)	Expected value (C) = (A)*(B)
25 per cent	GBP100	GBP25
50 per cent	GBP150	GBP75
25 per cent	GBP200	GBP50
Total		**GBP150**

Discussion

The expected value[4] of the cash inflow in three years' time is GBP150. However, there is the possibility that the cash flow will not be GBP150, but GBP100 or GBP200. Market participants are risk-averse and would accept a certain promise of, say, GBP140 in three year's time. We can express the effect of the uncertainty (risk) in calculating the present value by:

a. Discounting the certainty equivalent of GBP140 at the risk-free rate of 5 per cent, giving a present value of GBP121, or

b. Discounting the expected cash flow of GBP150 at a risk-adjusted rate that will give the present value of GBP121, i.e. a rate of 7.4 per cent.

(Source: Thematic Review: Discount Rates, issued by the Financial Reporting Council issued in May 2022)

3. Assumptions used for impairment should be consistent with those in the going concern and viability assessments.
4. The expected value of GBP150 in this example is the probability weighted calculation of the estimated future cash flows. It is not risk-adjusted.

- ***Consistency of information:*** Where information elsewhere in the annual report and accounts include details of events or circumstances that are indicators of potential impairment, this should be appropriately included in the impairment assessment and disclosures.

  For example, when net assets or carrying amount of subsidiaries in their parent company accounts exceeds their market capitalisation it is an indicator of impairment.

  Similarly, where a company identified significant climate related risks to certain parts of its businesses, then these should be considered as indicators of impairment[5] (refer case study).

Case Study

ESMA, in its 27th extract of its enforcement decisions has issued a case study on how climate risk disclosures would impact the impairment tests and disclosures. This is given below.

An entity which manages airports in several locations, was highly exposed to climate change because of high amounts of Carbon dioxide (CO2) emissions. In the non-financial information section of its annual financial report, the entity included detailed information on how climate change affects its business and also provided its commitment to reduce CO2 emissions by 2025.

Impact on impairment tests

In accordance with IAS 36, the entity should disclose more information on how climate change and the financial impact of the commitment to reduce CO2 emissions were factored in the impairment tests – i.e. how these were taken into account in the determination of the VIU of the CGU.

More specifically to comply with the requirements of IAS 36 and IAS 1, *Presentation of Financial Statements*, the entity should:

- Specify that the costs of the carbon emission commitments are considered in its free cash flows projections as they are not considered to be linked to future restructuring and will not improve or enhance the asset's performance
- Explain the modification of the airport traffic hypothesis (one of the key assumptions considered by the entity) and the external sources used with further explanations on the expected impacts of environmental transition on the traffic, and
- Explain how the modification of the airport traffic affects the growth rate, and
- Disclose a sensitivity analysis of the recoverable amounts to a reasonable variation of the assumptions used which were related to climate change (mainly airport traffic and annual growth rate).

(Source: 27th extract from the EECS's Database of Enforcement issued by ESMA on 29 March 2023)

5. It is better to provide a single, thorough explanation – cross-referenced from the Strategic Report and other sections – than scattered superficial or repetitive commentary.

- ***Assets to be considered in current condition:*** As per IAS 36, future cash flows should be estimated for the asset in its current condition. Estimates of future cash flows should not include estimated future cash inflows or outflows expected to arise from a future restructuring to which an entity is not yet committed or improving or enhancing an asset's performance[6].

  Accordingly, estimated future cash outflows for meeting carbon reduction targets or restructuring programmes should not be considered. Further, when VIU disclosures cross refer to forecasts used in going concern and viability assessments, it should be made clear how any costs and benefits in those forecasts that related to future improvement to assets or restructuring activities have been addressed for the VIU calculation.

- ***Details of CGUs to be consistent with other information:*** Descriptions of CGU and explanations of how they have been determined should be consistent with information about the company's operations which is mentioned elsewhere in the report and accounts (refer CGU disclosure 1).

  For example, a retailer which operates through an online platform and has physical stores as well should clearly define how it identifies its CGU (refer CGU disclosure 2).

CGU disclosure 1: Explanation by a restaurant on how it has determined CGUs

Cash generating units are deemed to be individual units or a cluster of units depending on the nature of the trading environment in which they operate. We only consider sites as a cluster of units, i.e. as a single CGU, where they are in a single, shared location, such as an airport, such that demand at one unit can directly affect that of other units in the same location.

CGU disclosure 2: Allocation of sales by a retailer having both physical and online stores

Judgement is required as to whether E-commerce sales (and associated costs) could be attributed to stores for the purposes of impairment testing when calculating the value in use of each store CGU. While management believes that a proportion of E-commerce sales could be attributed to stores, the basis of such attribution was difficult to determine, due to insufficient evidence to reliably estimate. For this reason, only iKiosk and Click & Collect E-commerce sales have been deemed directly attributable to a store within the individual store CGU value in use calculations. Attributing 10% of unallocated e-commerce sales and the related costs, would decrease the impairment and onerous lease charge by GBP1.5m and GBP7.7m respectively.

(Source: Thematic review- Impairment of non-financial assets, issued by FRC in October 2019)

6. The cash inflows referred to in IAS 36 would reflect the benefits that are expected to arise from a future restructuring to which an entity is not yet committed or that are expected to arise from enhancements to assets.

Sensitivity

Performing a sensitivity analysis: The requirement for sensitivity analysis is given below:

For impairment losses recognised or reversed, there is no requirement in IAS 36 paragraph 130 for a sensitivity analysis. However, as per IAS 1, paragraphs 125 and 129, the entity should disclose estimation uncertainty where there is a significant risk of a material adjustment in the following year. However, regulators expect such disclosures to include sensitivity analysis or the range of reasonably possible outcomes.

For CGUs with goodwill or indefinite life intangibles, sensitivity is only required by IAS 36 when a reasonably possible change would completely erode headroom. However, voluntary disclosures would be helpful in other cases. Disclosure of estimation uncertainty may be required by IAS 1, for example where changing the assumptions could erode headroom and give rise to a material impairment loss in the following year[7].

A sensitivity analysis should disclose the impact of reasonably possible changes of assumptions, such as key cash flow assumptions, terminal value growth rates and discount rates. This should be appropriately disclosed in the financial statements. This becomes particularly important where increased economic uncertainty has widened the range of possible outcomes and there is a lower amount of the headroom[8].

When reasonably possible changes in assumptions would result in a recoverable amount below the carrying amount, companies should provide quantitative disclosures about the amount of headroom, the key assumptions, or the sensitivity of the headroom to changes in the key assumptions (refer example disclosure).

Example: Headroom sensitivity to changes in key assumptions

The Directors performed sensitivity analysis on the estimates of recoverable amounts and found that the excess of recoverable amount over the carrying amount of the ABC group of CGUs would be reduced to nil as a result of a reasonably possible change in the key assumption of sales growth in the cash flow forecasts*. The Directors do not consider that the relevant change in this assumption would have a consequential effect on other key assumptions[#].

The excess of the ABC group of CGUs' recoverable amount over its carrying value is GBPXm. The value assigned to the sales growth assumption is 5% in years 1-3 of the forecast period and 3% in years 4-5. The recoverable amount would equal the carrying value if sales growth were reduced by 1.5% throughout the forecasting period[$].

For the XYZ group of CGUs, the Directors do not consider that any reasonably possible changes to the key assumptions would reduce the recoverable amount to its carrying value[@].

Note

*: This identifies the key assumption whose change in value causes the erosion of headroom.

#: This shows that management has considered consequential effects of the change on other assumptions.

$: This provides the information required by IAS 36. Additional information may be helpful to users, but it should not displace the required disclosures.

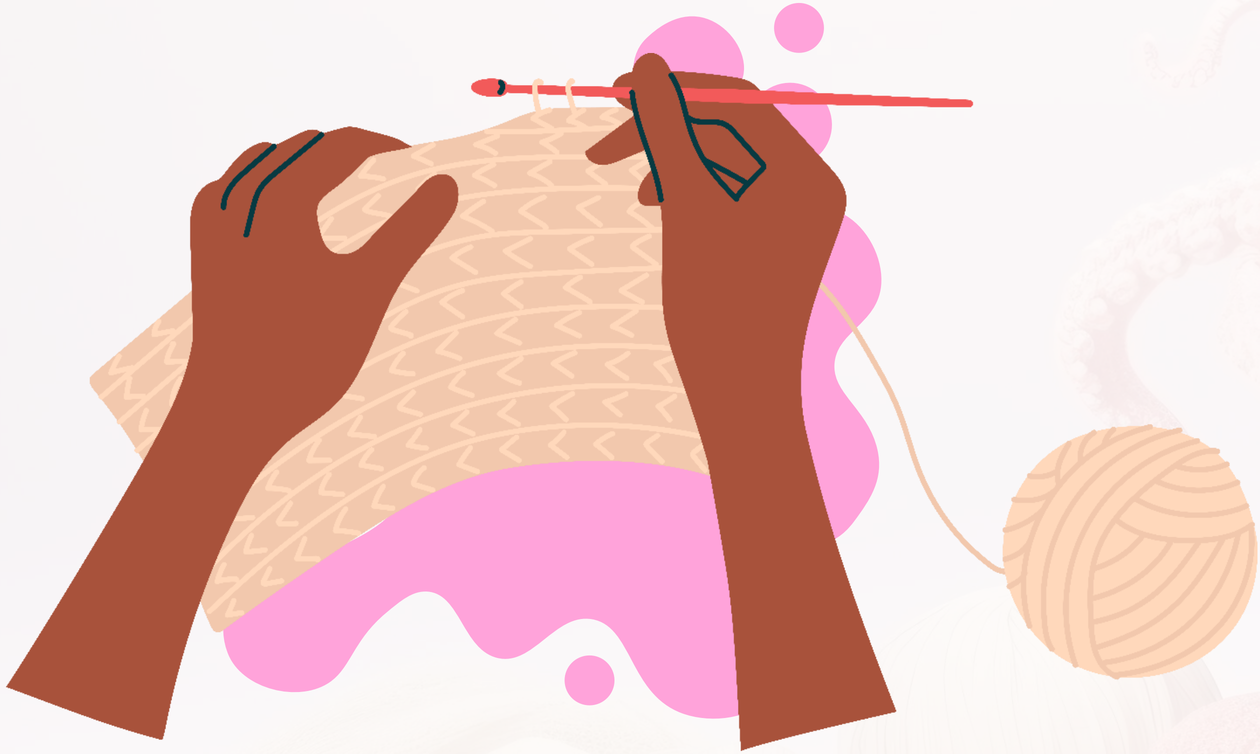
@: This confirms the comprehensiveness of management's review.

(Source: Thematic review- Impairment of non-financial assets, issued by FRC in October 2019)

7. Source: Thematic review- Impairment of non-financial assets, issued by FRC in October 2019
8. Headroom is the excess of the recoverable amount of a CGU or asset over the carrying amount of that unit.

Other

Indicators of impairment: IAS 36 provides an indicative list of impairment indicators, which entities should consider, as a minimum, when assessing whether an asset is impaired. However, when an entity incurs consistent losses, there is erosion of the net worth and default in the payment of loans taken from financial institutions, these are also impairment indicators.



CHAPTER 2

Presentation of delayed payment charges in the financial statements

This article aims to:

Provide guidance on accounting for Delayed Payment Charges (DPC) and covers a recent EAC opinion issued on the same topic.

Overview

Determination of transaction price is a critical step while accounting for revenue under Ind AS 115, *Revenue from Contracts with Customers*. Transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, certain sales taxes). An entity needs to consider multiple factors while determining the transaction price of a contract, for example, the inclusion of a variable consideration, a financing component, etc.

As businesses and contracts evolve, further analysis would be needed for an entity to apply the requirements of Ind AS 115 to its own facts and circumstances and individual transactions.

In this context, recently, the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) deliberated on the accounting for Delayed Payment Charges[1] (DPC) collected by a company from its customers[2].

This article aims to discuss some of the key factors considered by the EAC while opining on the accounting and presentation of DPC in the statement of profit and loss and the statement of cash flows.

Facts of the case

Company A (the Company) is engaged in the business of distribution of electric power to consumers. While charging tariff to its consumers, the company also collects DPC in case the consumers pay the tariff post the due date. The DPC is charged as per the tariff order of the State Electricity Regulatory Commission (SERC) Regulations.

The management of the Company believes that DPC is in the nature of penalty and is charged to customers in the normal course of business. It accounts for DPC in the year of its realisation, as 'Income from other operating activity' under Revenue from Operations and 'Cash flows from operating activities' in the statement of cash flows.

Considering these facts, the EAC opined on the presentation and disclosure of the DPCs received by the Company, in the statement of profit and loss and the statement of cash flows of the Company.

1. A delayed payment is a charge imposed by an entity on its customers on account of failure to meet the due date of payment for the supply of goods/services. Such payments costs an entity time and money that impacts its financial forecasts.
2. Query 12- Volume XLII- Accounting treatment of delayed payment charges

Overview of the EAC opinion - DPC on the basis of number of days of delay

The EAC considered the facts of the case and opined on the (1) presentation and disclosure of DPC in the statement of profit and loss, and (2) presentation of DPC in the statement of cash flows.

Presentation of DPC in the Statement of Profit and Loss

The EAC clarified that the accounting treatment including presentation and disclosure of an item of income/expense depends on its nature and not the nomenclature used for the same. Based on this, EAC evaluated the requirements of Ind AS 115 with regard to determination of transaction price of a contract, and assessed whether DPC would be presented and disclosed as a variable consideration or as a significant financial component in the contract. Please refer figure 1 on the next column for further deliberation on the same:

Figure 1

Presentation of DPC in the statement of profit and loss

Variable consideration
Considered as a part of operating revenue

- DPC is a charge to be paid by the customers towards delay in payment and is not towards exchange of promised goods and services to the customer
- DPC cannot be considered as a penalty, which is a variable consideration covered under paragraph 51AA of Ind AS 115

DPC is not variable consideration

Significant financing component
Considered as other income

- DPC are charges to the customers who have not paid the bill within due date as per the tariff schedule
- DPC are defined in terms of percentage per annum, which indicates that the same is directly linked with the passage of time and the quantum of the same depends on the timing of payment by the customers.

DPC would be a significant financing component in the contract*

* This would be the case if the financing component in the contract is significant and the practical expedient is not applied where time period between transfer of goods or services and payment being made is one year or less.

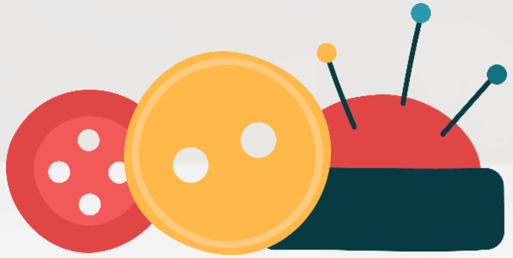
(Source: KPMG in India's analysis, 2023, read with EAC opinion- Query 12- Volume XLII- Accounting treatment of delayed payment charges)

Analysis

DPC as a variable consideration

Ind AS 115 provides that while determining the transaction price, an entity should adjust the promised amount of consideration for the effects of *inter alia*, variable consideration, such as discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalty, or other similar items. With regard to penalty clause in a contract, paragraph 51AA of Ind AS 115 states that in cases where penalty is inherent in the determination of transaction price, it should form a part of variable consideration.

In this case it was noted that the transaction price was fixed at the rate or price specified by the SERC for the electricity supplied. DPC is a charge paid by the customers towards delay in payment based on the number of days of delay and is not towards exchange of promised goods and services to the customer.



Additionally, penalty covered in paragraph 51AA refers to the penalty paid by an entity to its customers based on its own performance of the contract. However, since DPC is a levy on customers for default on their part, it cannot be considered as a penalty covered under variable consideration as per the requirements of Ind AS 115.

Accordingly, the DPC would not be accounted for as a variable consideration that would need to be incorporated in the transaction price of the contract.

Significant financing component in a contract

Part A- Financing component should be separated or included as a part of revenue

A contract contains a significant financing component if the timing of payments agreed upon by the parties to the contract, provides either of them with a significant benefit of financing the transfer of goods or services to the customer. A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract. As per Ind AS 115, the consideration amount should be adjusted for the effect of significant financing component to determine the transaction price.

Ind AS 115 provides a practical expedient, which if availed, does not require an entity to adjust the transaction price for the effects of a significant financing component if the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less. Additionally, it is clarified that the significance of a financing component should be considered at a contract level and not at a portfolio level.

A contract with significant financing component has two distinct economic characteristics –

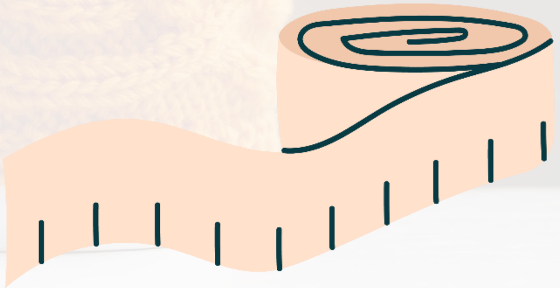
Figure 2: Economic characteristics of a contract with a significant financing component

Total transaction price

Consideration for transfer of goods or services + Consideration for the financing arrangement

(Source: KPMG in India's analysis, 2023 read with Ind AS 115)

Basis the above bifurcation, such contracts need to be accounted for and presented separately[3].



3. A contract with a customer that has a significant financing component would be separated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred or advance payment terms)- as an interest expense or interest income.

In the current case, the terms for late payment from the due date of payment are expressly provided in the tariff schedule, which is binding on both the buyer as well as the Company. Further, the DPC is defined in terms of percentage per annum (and varies with the number of days of delay), which indicates that the same is directly linked with the passage of time and the quantum of the same depends on the timing of payment by the customers. Thus, the amount of consideration varies due to difference in timing of payments (as the consideration will increase with increase in timing of payment). Therefore, considering the requirements of Ind AS 115, EAC was of the view that the DPC was of the nature of financing component and if such component is significant at the contract level, considering the facts and circumstances of the Company and specific requirements of Ind AS 115, the Company should not consider the same as part of its transaction price and revenue.

However, as a practical expedient, if the Company expects, at contract inception, that the period between when it transfers the promised good or service to a customer and when the customer pays for that good or service will be one year or less, it **need not make adjustments** for the effects of significant financing component while recognising revenue.

Part B- Presentation and disclosure of financing component

As per the guidance note on Schedule III-Division II, whether a particular income constitutes "other operating revenue" or "other income" is based on the facts of each case and detailed understanding of a company's activities. It would also depend on the purpose for which the asset is acquired or held[4].

In this regard, EAC considered that the business of the Company is distribution of power. Accordingly, levy and collection of DPC is not the intended or ancillary activity of the Company. Thus, although income from DPC arises during the course of normal operating activities of the Company of sale of goods and services, the same cannot be considered to arise from or on account of such goods or services or from other operating activities as these are essentially due to delay in payment for such goods or services (viz., receivables) and therefore DPC is over and above the receivables for goods or services or the output of other operating activities.

DPC being a financing component, if it is significant and the practical expedient is either not applied or not applicable as per the requirements of Ind AS 115, the same cannot be considered as 'Other Operating Revenue' under the head 'Revenue from Operations' in the Statement of Profit and Loss; rather the same should be presented as **'other income' in the Statement of Profit and Loss**.

4. For example, lease of property does not fall under the category of operating activities for a manufacturing company and hence the income on such a transaction should be classified as other income and not other operating revenue. However, in case of a real estate company the lease of one of its properties should be treated as other operating revenue since the same arises on account of the company's main operating activity.

Presentation of DPC in the Statement of Cash Flows

Ind AS 7, *Statement of Cash Flows* establishes the principles for classification of interest and dividend in case of financial institutions and other entities. From the perspective of a financial institution, cash flows arising from interest paid and interest and dividends received should be classified as cash flows arising from operating activities. However, there is no consensus in classification of these cash flows for other entities. For such entities, it is appropriate that cash flows arising from interest paid should be classified as cash flows from financing activities[5] while interest and dividends received should be classified as cash flows from investing activities[6].

Further, Ind AS 7 clarifies that a single transaction may include cash flows that are classified differently.

Figure 3: Bifurcation of cash flows of a transaction including a significant financing component

Total transaction price

Consideration for transfer of goods or services + Consideration for the financing arrangement

Consideration for transfer of goods or services → Cash flow from operating activities

Consideration for the financing arrangement → Cash flow from investing activities

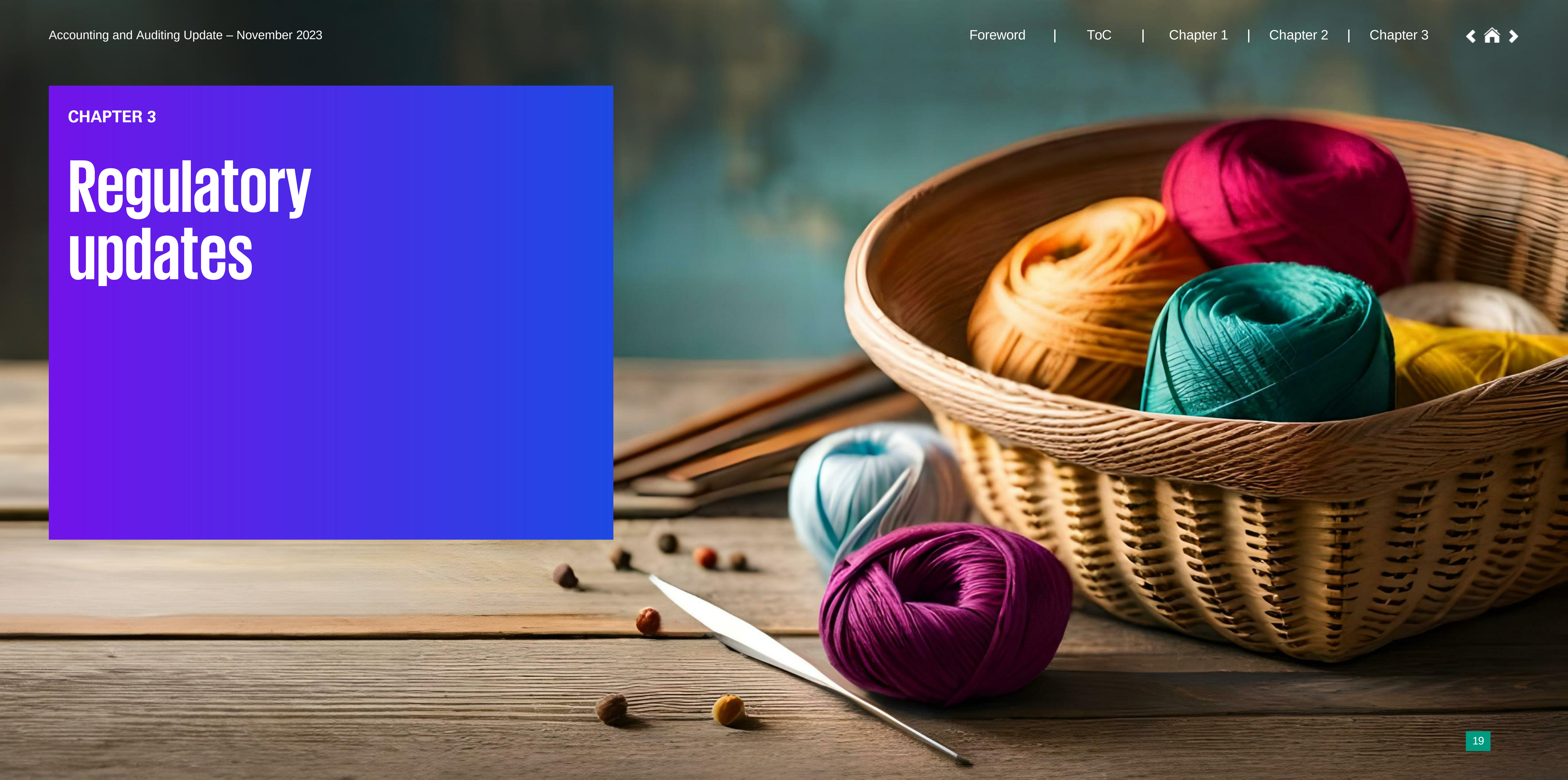
(Source: KPMG in India's analysis, 2023, read with Ind AS 7)

Accordingly, in the current case, as given in Figure 3 above, the cash flows arising from the customers on account of sale of goods and services would form part of cash flows from operating activities, whereas cash flows on account of DPC need not necessarily be cash flows from operating activities. Since DPC represents the financing component of the contract, it would be akin to return earned on the Company's resources that it has unintentionally invested (i.e. return on its receivables)[7]. Accordingly, this would be classified as cash flows from investing activities.

Disclosure of DPC which is a flat charge, in the cash flow statement

In a separate query[8], EAC clarified that delayed payment charges which are fixed, irrespective of the number of days of delay should be further evaluated by the company while determining their presentation in the cash flow statement. Where such charges in substance represent a compensation for time value of money, they should be presented as 'cash flows from investing activities', and where it represents compensation for some other element (say penalty), it should be considered and presented as 'cash flows from operating activities'.

5. This is because they are costs of obtaining financial resources
6. This is because they are returns on investments
7. It is to be noted that Ind AS 7 does not differentiate between investments made by the entity out of its own will or intent and those which are circumstantial, i.e., arising out of circumstances, as is in the current case.
8. EAC query 18- Volume XXXIX- Disclosure/classification of late payment interest charges collected from customers in the statement of cash flows.



CHAPTER 3

Regulatory updates

Declaration of beneficial interest in any shares

Rule 9 of the Companies (Management and Administration) Rules, 2014 (Management and Administration Rules) stipulates the provisions for declaration of beneficial interest in any shares of a company. On 27 October 2023, the Ministry of Corporate Affairs (MCA) issued a notification, mandating every company to designate a person who would be responsible for furnishing information regarding beneficial interest in the shares of the company to the Registrar of Companies (RoC) or any other authorised officer and accordingly extend necessary cooperation.

The other key takeaways from the circular are as follows:

- **Eligibility:** A company could designate a Company Secretary (CS) or a Key Managerial Personnel (KMP) or every director if the company does not have CS or KMP.
- **Deemed designated person:** Until a person has not been appointed the deemed designated person would be:
  a. CS or
  b. Every managing director or manager, in case CS is not appointed
  c. Every director, if there is no CS or managing director, or manager.
- **Submission in annual return:** A company should furnish the details of the designated person in the annual return.
- **Change in designated person:** In case of change in the designated person at any point in time, the company should intimate to RoC in e-form GNL-2 under the Companies (Registration Offices and Fees) Rules, 2014.

The above provisions are applicable from 27 October 2023.

(Source: MCA notification no. G.S.R.(E) dated 27 October 2023)

Dematerialisation of securities

On 27 October 2023, MCA amended the Companies (Prospectus and Allotment of Securities) Rules, 2014 (Prospectus and Allotment of Securities Rules) and introduced a provision for dematerialisation of share warrants issued by public companies and of securities by private companies.

The key takeaways are as follows:

- **Issue of share warrants by public companies:** The notification has amended Rule 9 of the Prospectus and Allotment of Securities Rules pertaining to dematerialisation of securities. As per the amendment, if a public company has issued share warrants prior to the commencement of the Companies Act, 2013 (2013 Act) and the same have not been converted into shares then such a public company should:
  i. Inform RoC about such share warrant details in (Form PAS-7) within a period of three months from the date of the notification.
  ii. Issue a notice (Form PAS-8), to the bearer of the share warrants to surrender such warrants and dematerialise the shares, within a period of six months from the date of the notification. The notice should be placed on the website of the company and circulated through the newspaper.
  iii. In case the bearer of share warrants does not surrender the warrants within the above-mentioned time period, the share warrants should be dematerialised and should be transferred to the Investor Education and Protection Fund (IPEF).
- **Issue of securities by private companies:** The notification has inserted a new rule – Rule 9B to provide requirements relating to issue of securities in dematerialised form by private companies. The key considerations are as follows:
  i. Every private company should issue securities only in dematerialised form and should facilitate dematerialisation of all its securities within 18 months commencing from 31 March 2023.
  ii. Such private companies should ensure that the entire holding of securities of their promoters, directors, KMP have been dematerialised before making any offer for issue of any securities, buyback of securities, issue of bonus shares, or right offer.
  iii. The above provisions are not applicable to a company which is a small company as per the audited financial statements as on the financial year ending on are after 31 March 2023 and a Government company.

The abovementioned amendments for dematerialisation of share warrants issued by public companies and of securities by private companies are effective from 27 October 2023.

(Source: MCA notification no. G.S.R. (E) dated 27 October 2023)

Listing of securities in foreign jurisdictions

In 2020, MCA amended Section 23 of the 2013 Act thereby enabling certain class of public companies to issue certain class of securities for listing in identified stock exchanges in permissible foreign jurisdictions. Further, the Central Government could exempt any class or classes of public companies from this amendment to Section 23, Chapter IV, section 89, section 90, or section 127[1].

On 30 October 2023, MCA issued a notification stating that the effective date for applicability of the above provision is 30 October 2023. The MCA is yet to notify the class or classes of public companies and class of securities to be covered under these provisions.

(Source: MCA notification no. S.O. 4744(E) dated 30 October 2023)

1. Chapter IV stipulates provisions regarding Share Capital and Debentures, Section 89 stipulates provisions regarding Declaration in Respect of Beneficial Interest in any Share, Section 90 stipulates provisions regards Register of significant beneficial owners in a company and Section 127 stipulates provisions regarding Punishment for failure to distribute dividends.

RBI mandates appointment of whole-time directors by banks

The Reserve Bank of India (RBI) issued a notification in April 2021 on 'Corporate Governance in Banks - Appointment of Directors and Constitution of Committees of the Board' which laid down instructions with respect to the chair and meetings of the board of directors, composition of certain committees of the board, age, tenure and remuneration of directors, and appointment of the Whole-Time Directors (WTDs).

However, on account of the increasing complexity in the banking sector, RBI issued a circular on 25 October 2023 to notify provisions relating to establishment of effective senior management team.

The key considerations from the circular are as follows:

- Banks are advised to ensure the presence of at least two WTDs, including the Managing Director and Chief Executive Officer (MD&CEO), on their Boards.
- The number of WTDs should be decided by the Board by taking into account factors such as the size of operations, business complexity, and other relevant aspects.
- Banks that currently do not meet above mentioned minimum requirement, are advised to submit their proposals to the RBI for the appointment of WTD(s) as per Section 35B(1)(b)[2] of the Banking Regulation Act, 1949 (Banking Regulation Act) within a period of four months from the date of issuance of this notification.
- In case banks do not have enabling provisions regarding appointment of WTDs in their Articles of Association (AOA), then necessary approvals should be sought under Section 35B(1)(a)[3] under the Banking Regulation Act, expeditiously.

The provisions of the above notification are applicable to all private sector banks and wholly-owned subsidiaries of foreign banks (excluding payment banks and local area banks).

(Source: RBI notification no. RBI/2023-24/70 DOR.HGG.GOV.REC.46/29.67.001/2023-24 dated 25 October 2023)

2. Section 35(1)(b) of the Banking Regulation Act states that no appointment or re-appointment or termination of appointment of a chairman, a managing or whole-time director, manager or chief executive officer by whatever name called, shall have effect unless such appointment, re-appointment or termination of appointment is made with the previous approval of the Reserve Bank.

3. Section 35(1)(a) of the Banking Regulation Act states that no amendment of any provision relating to [the maximum permissible number of directors or] the [appointment or re-appointment or termination of appointment or remuneration of a chairman, [managing director or any other director, whole-time or otherwise] or of a manager or a chief executive officer by whatever name called, whether that provision be contained in the company's memorandum or articles of association, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or by its Board of directors shall have effect unless approved by the Reserve Bank.

Presentation of unclaimed liabilities by commercial and cooperative banks

RBI issued a notification on 25 October 2023 to update the RBI (Financial Statements - Presentation and Disclosures) Directions, 2021 (Master Direction) to ensure consistency in the presentation of financial statements.

As per the notification, every commercial and cooperative bank is advised to present all unclaimed liabilities (where the amount due has been transferred to Depositor Education and Awareness (DEA) Fund) under ‘Contingent Liabilities – Others’ *(earlier presented under Schedule 12- Contingent Liabilities - Other items for which the bank is contingently liable)*.

This is applicable for preparation of financial statements for the financial year ending 31 March 2024 and onwards.

It is further stated that banks should specify in the disclosures[4] to the financial statements that balances of the amount transferred to DEA Fund are included under 'Schedule 12 - Contingent Liabilities - Other items for which the bank is contingently liable' or 'Contingent Liabilities - Others,' as the case may be.

(Source: RBI notification no. RBI/2023-24/71 DOR.ACC.47/21.04.018/2023-24 dated 25 October 2023)

Exposure draft on Ind AS 21

In August 2023, the International Accounting Standards Board (IASB) issued amendments to IAS 21, *The Effects of Changes in Foreign Exchange Rate* requiring companies to provide more useful information in their financial statements when a currency cannot be exchanged into another currency.

In this regard, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) issued an exposure draft to Ind AS 21, *The Effects of Changes in Foreign Exchange Rate*. The exposure draft aims to help entities assess whether a currency is exchangeable and estimate the spot exchange rate when a currency is not exchangeable

The key takeaways from the exposure draft are as follows:

- **Definition of exchangeable currency:** A currency is exchangeable into another currency when an entity is able to obtain the other currency within a time frame that allows for a normal administrative delay and through a market or exchange mechanism in which an exchange transaction would create enforceable rights and obligations. Therefore, an entity should assess whether a currency is exchangeable into another currency at a measurement date **and** for a specified purpose. Thus, if an entity is able to obtain no more than an insignificant amount of the other currency at the measurement date for the specified purpose, the currency is not exchangeable into the other currency.

4. Clause C.10 of Annex III to the Maser Direction ibid on ‘Transfers to DEA Fund’

- **Determination of spot exchange rate when a currency is not exchangeable:** The spot exchange rate should be estimated as at the measurement date when a currency is not exchangeable into another currency. The objective to estimate the spot exchange rate is to reflect the rate at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic circumstances.
- **Disclosure requirements:** When the currency is not exchangeable, the entity should disclose the nature and financial effects of the currency not being exchangeable into the other currency, the spot exchange rate(s) used, the estimation process and the risks to which the entity is exposed because of the currency not being exchangeable into the other currency.

The comment period for the above-mentioned exposure drafts ends on 1 December 2023.

(Source: ICAI ED/Ind AS 21/2023/3 issued on 1 November 2023)

IAASB issued FAQs relation to ISSA 5000

In August 2023, the International Auditing and Assurance Standards Board (IAASB) issued proposed International Standard on Sustainability Assurance (ISSA) 5000, *General Requirements for Sustainability Assurance Engagements*, which deals with assurance engagements on sustainability information.

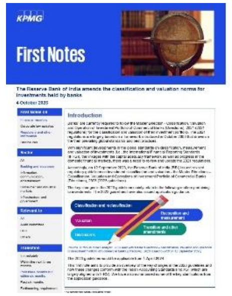
Subsequently on 25 October 2023, IAASB has issued a compilation of Frequently Asked Questions (FAQs) with an aim to address a variety of questions such as:

- How the concept of materiality applies to sustainability reporting and assurance
- The definition of double materiality
- How an assurance practitioner considers an organisation's materiality process during a sustainability assurance engagement.

The comment period for proposed ISSA 5000 ends on 1 December 2023.

(Source: IAASB news 'Explore ISSA 5000 FAQ on materiality' dated 25 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).

To access the publication, please click here.