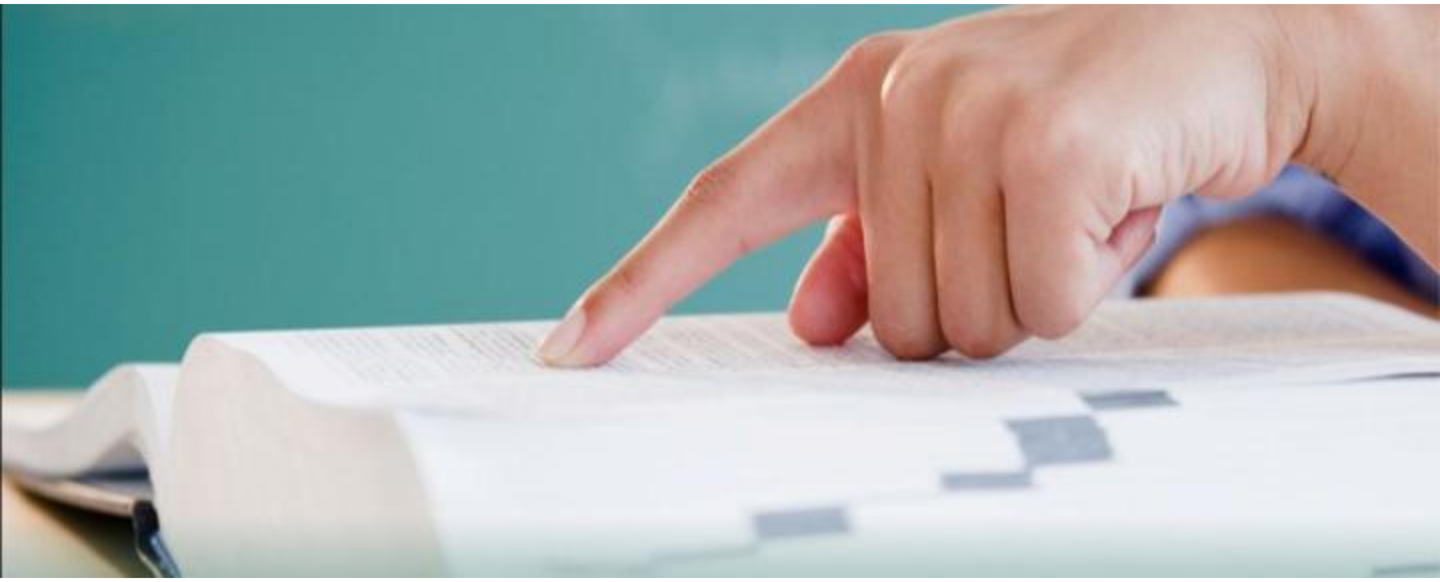
FIRST NOTES
KPMG in India

The MCA rationalises norms relating to consolidated financial statements and internal financial controls system

16 October 2014



First Notes on:

- **Financial Reporting**
- Corporate law updates
- Regulatory and other information
- **Disclosures**

Sector:

- **All**
- Banking and Insurance
- Information, Communication, Entertainment
- Consumer and Industrial Markets
- Infrastructure and Government

Relevant to:

- **All**
- Audit committee
- CFO
- Others

Transition:

- **Immediately**
- Within the next 3 months
- Post 3 months but within 6 months
- Post 6 months

The Companies Act, 2013 (the Act) is largely operationalised from 1 April 2014. The Ministry of Corporate Affairs (MCA) has been issuing various amendments and clarifications to the Act and the corresponding Rules. On 14 October 2014, the MCA has further issued the following clarifications/amendments relating to:

- the preparation of consolidated financial statements (CFS) by an intermediate wholly-owned subsidiary – amended to provide an exemption
- the preparation of CFS by companies having just an associate or a joint venture – amended to grant a transition period
- reporting on the internal financial control systems (IFC) by auditors, mandatory for financial years commencing on or after 1 April 2015 - amended to grant a transition period
- the Schedule III – related disclosures made in stand-alone financial statements which are not to be repeated in CFS.

The amendments would be applicable from the date of their publication in the Official Gazette. This issue of First Notes summarises the important aspects arising from these amendments/clarifications.

Requirements regarding preparation of CFS – background

Section 129(3) of the Act requires a company having a subsidiary, a joint venture or an associate company to present CFS, in addition to its stand-alone financial statements. This requirement implies that there are no exemptions from preparing CFS for:

- an intermediate wholly-owned subsidiary under the Act
- company without a subsidiary but with a joint venture or an associate.

It is important to note that Accounting Standard (AS) 21, *Consolidated Financial Statements*, does not require CFS to be prepared when an entity has no subsidiary but has an associate or a joint venture. The standard intends to present financial information about a parent and its subsidiaries as a single economic entity.

Preparation of CFS by an intermediate wholly-owned subsidiary – amendment to provide an exemption

The MCA has amended the requirement prescribed under Rule 6 of the Companies (Accounts) Rules, 2014 (Rule 6) for intermediate wholly-owned subsidiary companies incorporated in India. As a result, an intermediate wholly-owned subsidiary company incorporated in India would not be required to prepare CFS.

The requirements of the Rule 6 would, however, remain unchanged for those intermediate wholly-owned subsidiary company whose immediate parent is a company incorporated outside India.

Preparation of CFS by companies having just an associate or a joint venture – amended to grant a transition period

The MCA has amended the requirements of Rule 6 (preparation of CFS). The requirements for preparing CFS have been deferred for the financial year commencing 1 April 2014 and ending on 31 March 2015 in the case of a company which does not have any subsidiary but has one or more associates or joint ventures or both. After 31 March 2015, this relief will not be available.

Reporting on the IFC by auditors, mandatory for financial years commencing on or after 1 April 2015 - amended to grant a transition period

Section 143(3)(i) of the Act requires the auditor of every company to comment on the adequacy and operating effectiveness of IFC. The definition of IFC under the Act means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

The Institute of Chartered Accountants of India (ICAI) had made an announcement on 20 June 2014 which, *inter alia*, stated that the above provisions of the Act would apply to the audits of the financial year beginning on or after 1 April 2014.

The MCA has now deferred the applicability date of reporting by the auditors on the IFC by inserting Rule 10A to the Companies (Audit and Auditors) Rules, 2014.

The Rule 10A provides that the report of the auditor shall state the existence and operating effectiveness of adequate IFC for financial years commencing on or after 1 April 2015.

The auditor may voluntarily report on the existence and operating effectiveness of adequate IFC in the financial year commencing on or after 1 April 2014 and ending on or before 31 March 2015.

Schedule III-related disclosures made in the stand-alone financial statements not to be repeated in CFS – clarification

Under the Act, the requirements of Schedule III would apply to preparation of stand-alone financial statements as well as preparation of CFS.

While AS 21, *Consolidated Financial Statements*, *inter alia*, provides that certain information required under Schedule VI of the Companies Act, 1956 (now Schedule III of the Act) given in the notes to the stand-alone financial statements of the parent and/or the subsidiary, need not be included in the CFS.

The MCA has resolved the conflict between the accounting standards and the Act by providing a clarification in this regard after consulting with the ICAI.

The clarification mentions that Schedule III of the Act read with the applicable accounting standards does not envisage that a company while preparing its CFS merely repeats the disclosures made by it under the stand-alone financial statements being consolidated. In the CFS, the company would need to give all disclosures relevant to CFS only.

Our comments

- The amendment signifies that the MCA is continuing to re-look at some of the crucial aspects of financial reporting by corporate India. Providing exemption to intermediate wholly-owned subsidiary companies from preparing CFS signals MCA's effort to align with international practices. This is expected to be cost effective for large groups incorporated in India. Additionally, this clarification would also align with the recent exposure draft of the ICAI on 'Amendments to Indian Accounting Standards – Consideration of carve-outs/ins'.

- The MCA amendment provides temporary relief from the preparation of the CFS and adequate preparation period to the companies which only have an associate/a joint venture.

- The MCA has deferred the auditors' reporting responsibilities on the IFC of a company and no relief has been provided on the Director's reporting requirements on the same matter. The assessment and reporting by the Board of Directors and the auditors would go hand-in-hand, we would expect that the MCA would provide similar relief to the companies as well.

- Earlier it was unclear whether the reporting of the auditors would be restricted to those related to financial control since the scope of the audit is restricted to financial reporting. The wordings of the amendment make it clear that there is no change in the scope of the auditors' reporting responsibility relating to IFC. This would mean that all companies would be required to establish IFC commensurate with their size and nature of their business. Though a robust IFC would improve governance in companies, the compliance cost may prove to be burden for small companies.

The bottom line

The amendments are a clear reflection of the fact that MCA continues to consider the practical challenges faced by corporates in India while implementing the Act, and has responded with amendments to make the law more pragmatic and yet achieve its objective.

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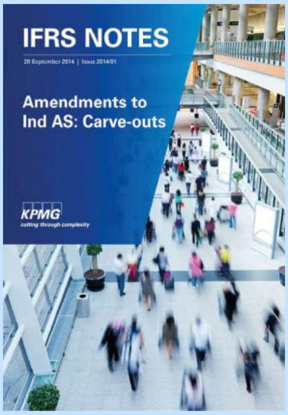
Introducing IFRS Notes



Amendments to Ind AS: Carve-outs

The finance minister in his budget speech recognised the urgent need to converge the existing notified standards under Indian GAAP with the IFRS. Towards this objective, he proposed to make Indian Accounting Standards converged with IFRS (‘Ind AS’) mandatory for Indian companies from the financial year 2016-17, with the option to voluntarily adopt them from the financial year 2015-16. The date of implementation of Ind AS for banks and insurance companies will be notified separately by the respective regulators.

As a part of implementation of this budget announcement, the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) has released two exposure drafts dealing with ‘Amendments to Indian Accounting Standards (Ind AS) – consideration of carve outs/ins’. Through these exposure drafts the ICAI is trying to reduce the differences between Ind AS and IFRS, and substantially reduce the carve-outs. However, at the same time, the ICAI is also assessing the need of any further possible carve-outs considering various new developments under IFRS. The ICAI has also included in these exposure drafts additional areas where it has removed policy choices to enhance comparability and certain other areas where it provides additional guidance. The ICAI has released these exposure drafts for public comments. The last date of comments is 15 October 2014.

Missed an issue of Accounting and Auditing Update or First Notes?

September 2014

The September 2014 edition of the Accounting and Auditing Update provides insights into actions that can be taken by regulators and highlights related accounting and reporting considerations that impact companies primarily in the pharmaceutical sector.

We also cover two articles on the Companies Act, 2013 where we share some practical experience and implementation challenges – one is on corporate social responsibility and second on the related party transactions. Under the International Financial Reporting Standards, we cover the status of the lease accounting project and some of the narrow scope but significant amendments issued by the International Accounting Standards Board. As always, we have also covered key regulatory developments during the recent past.

SEBI’s recent amendments of clause 49

Clause 49 of the Equity Listing Agreement (ELA) was amended by the Securities and Exchange Board of India (SEBI) in April 2014, and the revised requirements were to be applicable from 1 October 2014.

Since then, the SEBI has received various representations from industry associations, companies and other market participants seeking clarifications and interpretation relating to certain of these amended provisions of clause 49. Additionally, SEBI recently sought feedback on the status of preparedness of the top 500 listed companies by market capitalisation for ensuring timely compliance with the clause 49.

To address the concerns and help the listed companies to ensure compliance with the revised provisions of the clause 49, the SEBI has made further amendments to some of the provisions of clause 49.

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On September 24, 2014 we covered two topics:

Amendments relating to tax audit reports in India: There are a number of significant amendments to the Form No. 3CD Due to the amendments made in the Form No. 3CD, the reporting responsibilities of the assessee and the auditor have increased considerably.

Recent amendments to the clause 49 of the Equity Listing Agreement: To address the concerns industry associations, companies and other market participants and to help the listed companies to ensure compliance with the provisions of the revised clause 49, the Securities and Exchange Board of India (SEBI) vide circular dated 15 September 2014 has amended some of the requirements of the revised clause 49.

In our call, we discussed these amendments and developments.

Feedback/Queries can be sent to aaupdate@kpmg.com

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