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Regulatory updates for the month of October 2022

16 November 2022

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Regulatory updates for October 2022

The regulatory updates publication issued by the Foundation for Audit Quality (FAQ) highlights the latest developments in accounting, auditing and regulatory developments in India and internationally.

In this edition

Recently, the National Financial Reporting Authority (NFRA) issued guidance with respect to the accounting treatment of interest on borrowings undertaken by companies. The guidance provides detailed explanation on the various procedures that auditors should perform with respect to recognition of interest on the loans undertaken by companies and the appropriate accounting treatment, as required by Ind AS 109, *Financial Instruments*

Additionally, the Reserve Bank of India (RBI) has issued a concept note on Central Bank Digital Currency (CBDC). It explains the objectives, benefits, types, technology framework and other policy implications of issuing CBDC in India, referred to as e₹ (digital Rupee). The e₹ would provide an additional option to the currently available forms of money. RBI is currently engaged in working towards a phased implementation strategy for smooth and effective roll out of CBDC framework across the country. Thus, further developments are expected around this space in the near future.

This issue of the regulatory updates publication covers some of the important updates on accounting and regulatory matters for the period from **1 October 2022 to 31 October 2022**. It also highlights some of the action points that auditors may consider when applying the relevant provisions.

India update

International update

Publications

India update

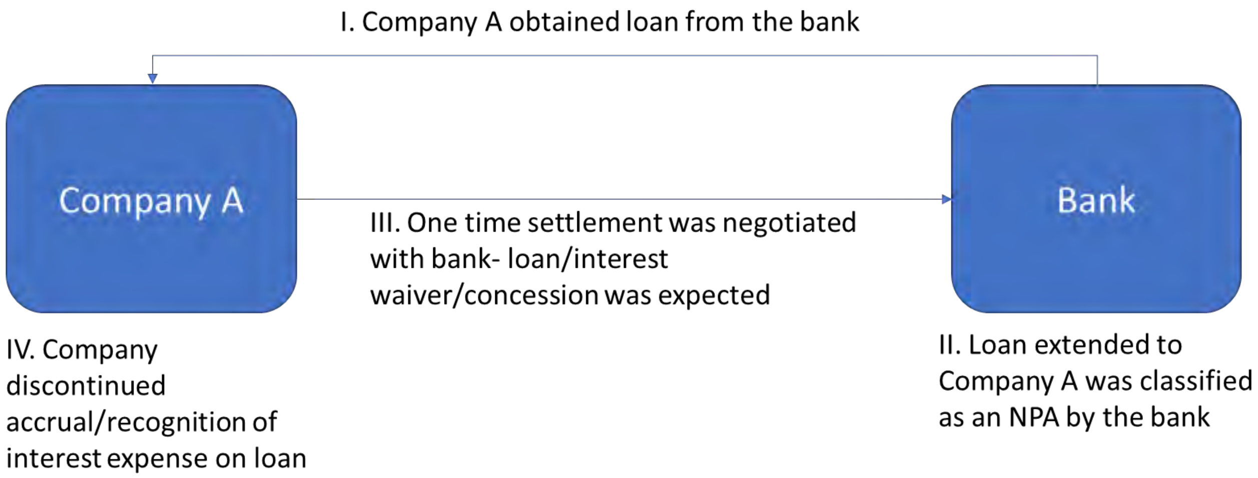
- Accounting updates
- Regulatory updates

Updates from NFRA

Non-accrual of interest on borrowings by companies in violation of Ind AS

Section 132(2)(b)[1] of the Companies Act, 2013, read with Rule 4(2)(c)[2] of the National Financial Reporting Authority Rules, 2018 (NFRA Rules, 2018) mandates the National Financial Reporting Authority (NFRA) to monitor and enforce compliance with the Accounting Standards (AS) and Standards on Auditing (SA).

In this regard, NFRA, vide a circular dated 20 October 2022 issued guidance with respect to the accounting treatment of interest on borrowings undertaken by companies. This was based on NFRA's observations during the course of its proceedings initiated against an auditor of a listed company (say Company A). The facts of the case are given below:



(Source: Foundation for Audit Quality's analysis, 2022 read with NFRA circular number NF-25011/5/2022-O/o Secy-NFRA dated 20 October 2022)

1. Section 132 of the Companies Act, 2013 specifies provisions with respect to constitution of NFRA.
2. Rule 4 of the NFRA Rules, 2018 lays down provisions regarding the functions and duties of NFRA.

Accounting updates

The NFRA observed that a bank had extended a loan to Company A, however, it subsequently classified the loan as an NPA. Company A was negotiating a one-time settlement with the bank, wherein it expected loan/interest waiver/concession from the bank, however, as at the balance sheet date a one-time settlement was not finalised. Based on its expectation of an interest waiver, Company A discontinued the accrual and recognition of interest expense on its bank borrowings. The NFRA determined that the accounting treatment followed by the company was in contravention of the provisions of the Indian Accounting Standards (Ind AS).

The NFRA in its analysis stated that Ind AS 109, *Financial Instruments* mandates classification and measurement of financial liabilities at amortised cost[3], till the time such financial liabilities get extinguished[4]. A financial liability is considered to have been extinguished only when the borrower has been legally released from the primary responsibility for the liability, or part of it, either due to process of law, or by the creditor. In the present case, even though the bank had classified the loan as an NPA and had discontinued recognising interest income thereon[5], it had not legally released Company A from its contractual obligations. Accordingly, as per the principles of Ind AS 109, Company A should continue to measure and present the amortised cost of the financial liability and the related interest expense in the balance sheet and statement of profit and loss respectively.

To access the text of the NFRA circular, please [click here.]

Action Points for Auditors

- NFRA is scrutinising financial statements prepared by companies and the audit performed by the auditors. Consequently, NFRA has issued various Financial Reporting Quality Review Reports (FRQRR) and Audit Quality Review Reports (AQRRs). Some of the key recommendations of the FRQRR and AQRs include:
  - Independence of auditors is critical to achieve audit quality
  - Audit professionals should exercise enhanced professional skepticism during the course of an audit
  - Materiality is an important aspect in an audit and auditors should ensure that they consider all facts and circumstances of a company and select appropriate benchmark and percentage while computing materiality
  - Companies should ensure completeness and robustness of accounting policies
  - Going concern assessments should be appropriately performed by management and reviewed by auditors
  - Auditors should make sure that they have timely and regular communication with Those Charged With Governance (TCWG)
  - Auditors should ensure robust documentation in an audit
  - Focus on certain aspects of accounting of financial instruments, revenue recognition, and other key matters

3. Ind AS 109 prescribes specific exemptions to this requirement.
4. For computing the amortised cost of a financial liability, an entity needs to adopt the Effective Interest Method (EIM).
5. As per the Reserve Bank of India (RBI) prudential norms on income recognition, asset classification and provisioning pertaining to advances, on an account becoming an NPA, the banks must discontinue the recognition of the related interest income and accordingly reverse the interest amount already charged but not collected. However, banks must continue to maintain a memorandum record of accrued interest on such NPAs, thereby not legally releasing the borrowers from their contractual obligations.

Updates from SEBI

SEBI prescribes details about Social Stock Exchange Governing Council

In July 2022, the Securities and Exchange Board of India (SEBI) had introduced regulations pertaining to the Social Stock Exchange (SSE), It issued amendments to the following regulations:

a. The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations)[6],
b. The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations)[7], and
c. The SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations)[8]

Regulation 292D of the ICDR Regulations lays down the requirement for an SSE to constitute a Social Stock Exchange Governing Council (SGC)[9]. In this regard, SEBI, vide a circular dated 13 October 2022 has prescribed details with respect to the composition and other terms of reference of the SGC. Some of the key guidelines issued include:

- **Composition:** The SGC must have a minimum of seven members, having representation from **each of the seven prescribed categories**[10] in order to contribute to the functions and development of the SSE.
- **Meetings of the SGC:** The SGC would be required to have a minimum of four meetings in a financial year. The Board of the stock exchange should prescribe the procedure, frequency, quorum and other details for the meetings of the SGC.
- **Other terms of reference:** The main objective of establishing the SGC is to provide an oversight and guidance for facilitating smooth functioning of the operations of the SSE. A few important considerations in this regard include:

  - **Development of SSE:** The SGC should provide expertise on matters relating to the listing function of SSE, growth of registration/listing of Social Enterprises (SEs) and the number of investors and the related procedures regarding their onboarding.
  - **Disclosures by SE:** Oversee the adequacy of disclosures made by the SEs and facilitate development of the appropriate systems and processes towards the same.
  - **Review functioning of SSE:** Review the functioning of the SSE by taking into consideration the feedback received from various stakeholders, and
  - **Other matters:** Other matters regarding governance and development of the SSE.

To access the text of the circular, please click here.

Action Points for Auditors

The guidelines have provided for adequate representation from *inter alia* the members of the social audit profession/self-regulatory organisation for social auditors in the SGC. Members of the profession are encouraged to watch this space for further updates in this area.

6. The amendments were issued by the SEBI (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2022 (ICDR Amendment Regulations).
7. The amendments were issued by the SEBI LODR (Fifth Amendment) Regulations, 2022 (LODR Amendment Regulations)
8. The amendments were issued by the SEBI AIF (Third Amendment) Regulations, 2022 (AIF Amendment Regulations)
9. SGC is required to be constituted prior to seeking final approval from SEBI regarding introduction of SSE as a separate segment
10. The categories include:

    i. Philanthropic and social sectors including public/private sector donors,
    ii. Not for Profit Organisations (NPOs),
    iii. Information repositories,
    iv. Social impact investors,
    v. Social audit profession/self-regulatory organisation for social auditors,
    vi. Capacity building fund, and
    vii. Stock exchange.

Updates from RBI

RBI's concept note on Central Bank Digital Currency (CBDC)

Central Bank Digital Currency (CBDC) refers to a digital form of currency notes issued by a central bank. Many central banks across the globe are exploring the issuance of CBDC. Recently, RBI through its press release dated 7 October 2022 issued a concept note on CBDC (the concept note). It explains the key motivations and objectives, benefits, types and other related considerations of issuing a CBDC in India, referred to as **e₹ (digital Rupee)**. The e₹ would provide an additional option to the currently available forms of money.

The concept note comprises of the following eight chapters:

i. Introduction
ii. CBDC-Conceptual Framework
iii. Motivations for issuance of CBDC
iv. Design considerations for CBDC
v. Technology considerations for CBDC
vi. Other considerations
vii. Policy implications of introduction of CBDC, and
viii. Way forward.

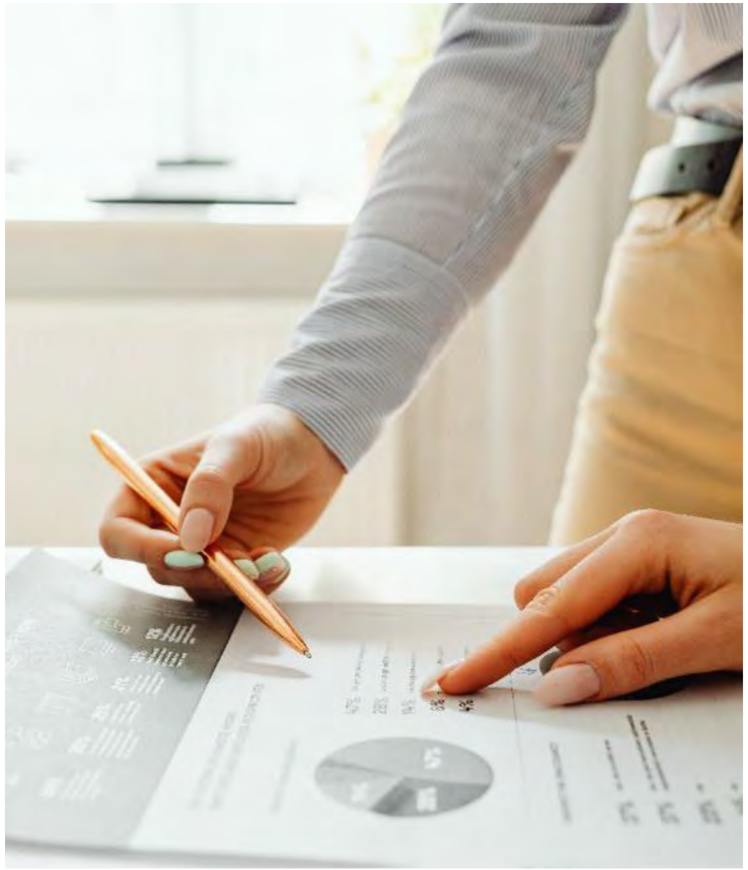
Some of the key aspects specified in the Concept Note include:

- **CBDC – Meaning:** RBI defines CBDC as a legal tender issued by a central bank in a digital form. It is akin to sovereign paper currency but takes a different form, exchangeable at par with the existing paper currency and would be accepted as a medium of payment, legal tender and a safe store of value.

- **Objective:** The main objectives of introducing CBDCs are:
  - Reduction in cost of physical cash management[11].
  - To further the cause of digitisation to achieve a less cash dependent economy.
  - Supporting competition, efficiency and innovation in payments.
  - Exploring the use of CBDCs for improvement in cross-border transactions.
  - Supporting financial inclusion[12], and
  - Enhancing and restoring trust in central bank currency vis-à-vis proliferation of crypto assets.

- **Types of CBDC:** Based on the usage and functions performed by the CBDCs and considering the different levels of accessibility, CBDC can be classified into following two types:

  - **CBDC Wholesale (CBDC-W):** CBDC-W would be broadly used for improving the efficiency of interbank payments and securities settlement. These would be designed for restricted access by the financial institutions, and
  - **CBDC Retail (CBDC-R):** CBDC-R would be potentially available for use to all private sector, non-financial consumers and businesses (retail consumers for day-to-day transactions).



11. Cost of physical cash management includes printing, storage transportation and replacement of bank notes, etc.

12. By making financial services more accessible to the unbanked and underbanked population.

- **Administration of CBDCs:** RBI would create and issue CBDC tokens to authorised entities (Token Service Providers – TSPs) who would further distribute it to the end users for retail transactions. Many customer facing activities such as customer onboarding, KYC, etc. could be performed by intermediaries/ TSPs, instead of the RBI. In this regard, the concept paper has proposed three models for issuing CBDCs. These are **Direct, Indirect and Hybrid models**. The following table illustrates the overall administration of CBDCs and the roles of various parties involved:

Aspect	Direct model	Indirect model	Hybrid model
Liability	Central bank	Central bank	Central bank
Issuer	Central bank	Central bank issues and intermediaries distribute it	Central bank issues and intermediaries distribute it for retail use
Operations	Central bank	Intermediaries	Intermediaries
Ledger	Central bank	Intermediaries	Intermediaries as well as Central bank
Settlement finality	Yes	No	Yes

(Source: RBI concept note on CBDCs)

- **Design considerations:** With regard to the design of the CBDCs, the concept paper discussed the following:
  - The RBI is exploring the option of implementation of account based[13] CBDC in CBDC – W and token based[14] CBDC in CBDC – R.
  - CBDC would be an alternative to cash, and it should imbibe all elements of cash. Thus, CBDCs should be non-remunerative (therefore, it should not be interest bearing)
  - Some level of anonymity should be incorporated in the design of the CBDCs, however, it would be restricted to prevent illegal and shadow economy transactions.

13. Account based system would require maintaining a record of balances and transactions of all account holders to indicate the ownership of the monetary balances. In this case, exchange of CBDCs would be transfer of balance from one account to another.
14. Token based CDBCs would involve a type of a digital token issued by the central bank with a unique token number (representing a claim on the bank), like a bank note. It would be a bearer instrument, i.e., whoever holds the token would be considered to be the owner.

Regulatory updates

- **Technology considerations:** There are two types of technology platforms – Conventional system and the Distributed Ledger Technology (DLT). In the conventional system, data is stored over multiple physical nodes, being ultimately controlled by one authoritative central entity i.e., the top node of the hierarchy. However, in a DLT system (Blockchain technology), data is managed jointly by multiple entities in a decentralised manner and each update has to be harmonised amongst the nodes of all entities without the requirement of any top node.

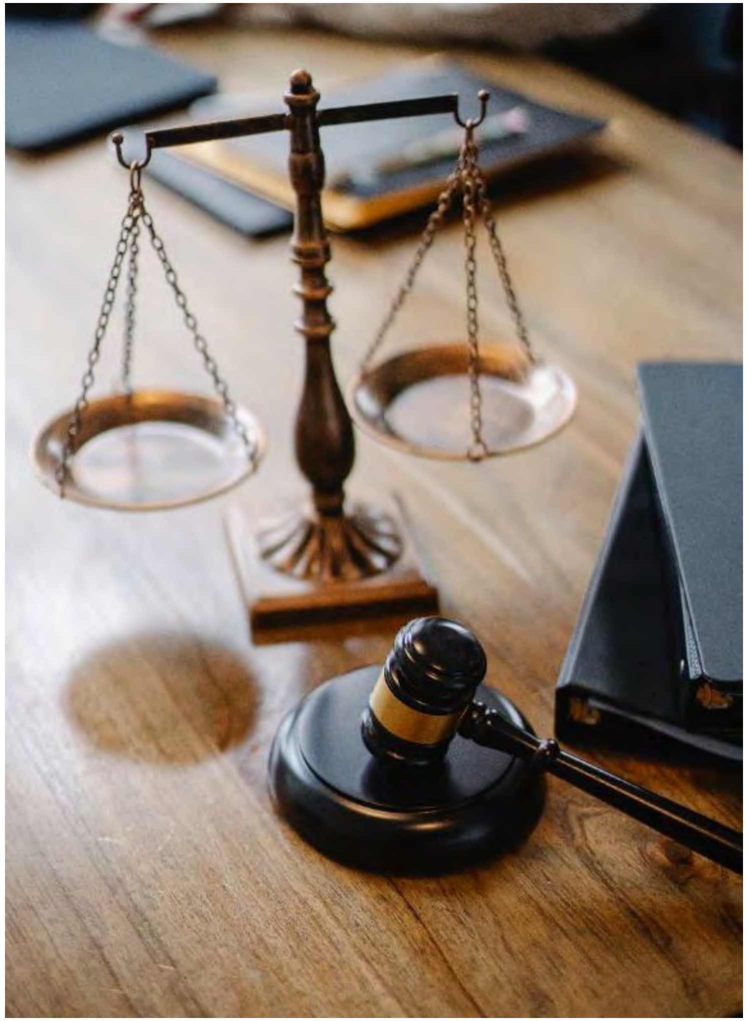
  RBI, through the concept note has highlighted the fact that DLT system, at this point in time, owing to the low volume of transactions and other scalability issues would not be suitable for implementing the CBDC framework across the country.

- **Next steps:** RBI has been exploring the pros and cons of introduction of CBDCs for some time. As mentioned above, since there are multiple compelling objectives for introducing CBDCs, RBI is currently engaged in working towards a phased implementation strategy, going step by step through the various stages of pilots followed by the final launch. Thus, further developments are expected around this space in near future.

To access the text of the concept note, please click here.

Action Points for Auditors

CBDCs are a form of digital assets. However, considering that currently no accounting standards specifically address digital assets, preparers of financial information (preparers) and auditors should watch this space as it evolves and track developments in relation to digital assets.



RBI (Unhedged Foreign Currency Exposure) Directions, 2022

Unhedged Foreign Currency Exposure (UFCE) of an entity is a significant area of concern not just for the individual entity, but for the entire financial system as well. This is largely due to the fact that entities which do not hedge their foreign currency exposures can incur high losses during the period of heightened volatility in foreign exchange rates. These losses may reduce their capacity to service the loans taken from the banking system and increase their probability of default thereby affecting the health of the banking system. Consequently, RBI has, from time to time issued various guidelines and instructions to the banks on UFCE of the entities which have borrowed from the banks[15].

Consequent to banks seeking various clarifications on certain aspects related to UFCE, RBI undertook a review of the extant guidelines on UFCE, thereby clarifying and amending few aspects of the guidelines, and has also consolidated the existing instructions on the subject into the RBI (Unhedged Foreign Currency Exposure) Directions, 2022 (the Directions).

The Directions were issued on 11 October 2022 and would be applicable to all commercial banks[16] (excluding payments banks and regional rural banks). Some of the key changes that have been introduced are stated below:

- **Definition of Entity:** Presently, banks are required to assess UFCE of all the entities. The term ‘entities’ has been defined as ‘those entities which have borrowed from banks including borrowing in INR and other currencies, irrespective of the size of exposure/entity’.

  This definition has now been amended. The revised definition of ‘entity’ states that ‘an entity means a counterparty to which bank has exposure in any currency’.

- **Exemption from UFCE guidelines:** At present, UFCE guidelines exclude a bank’s exposure to an entity arising from derivative transactions. This exemption has now been extended to include **factoring transactions** as well.

- **Alternative method for exposure to smaller entities:** Currently, banks have an option to follow an alternative method for exposure to ‘smaller entities’ which have:

  a. UFCE, and
  b. Are not in a position to provide information on their UFCE to the bank.

  The Directions have now revised the applicability criteria of the alternative method. It would be applicable for exposure to ‘smaller entities’ which have Foreign Currency Exposure (FCE) (instead of UFCE), and are not in a position to provide information on their UFCE.

  Additionally, the definition of smaller entities has been amended to include those entities on which total exposure of the banking system is INR50 crore or less (earlier INR25 crore or less).

15. As per these instructions, guidelines and directives, banks were required to maintain incremental provisioning and capital requirements for their exposures to entities with UFCE.

16. The Directions would also be applicable to overseas branches and subsidiaries of banks incorporated in India.

Regulatory updates

- **Incremental capital requirement:** Banks are required to apply incremental capital requirement for certain exposures as given below:

Potential Loss / EBID[17] (%)	Incremental provisioning requirement	Incremental capital requirement
Upto 15 per cent	0	0
More than 15 per cent and upto 30 per cent	20bps	0
More than 30 per cent and upto 50 per cent	40bps	0
More than 50 per cent and upto 75 per cent	60bps	0
More than 75 per cent	80 bps	25 per centage increase in the risk weight

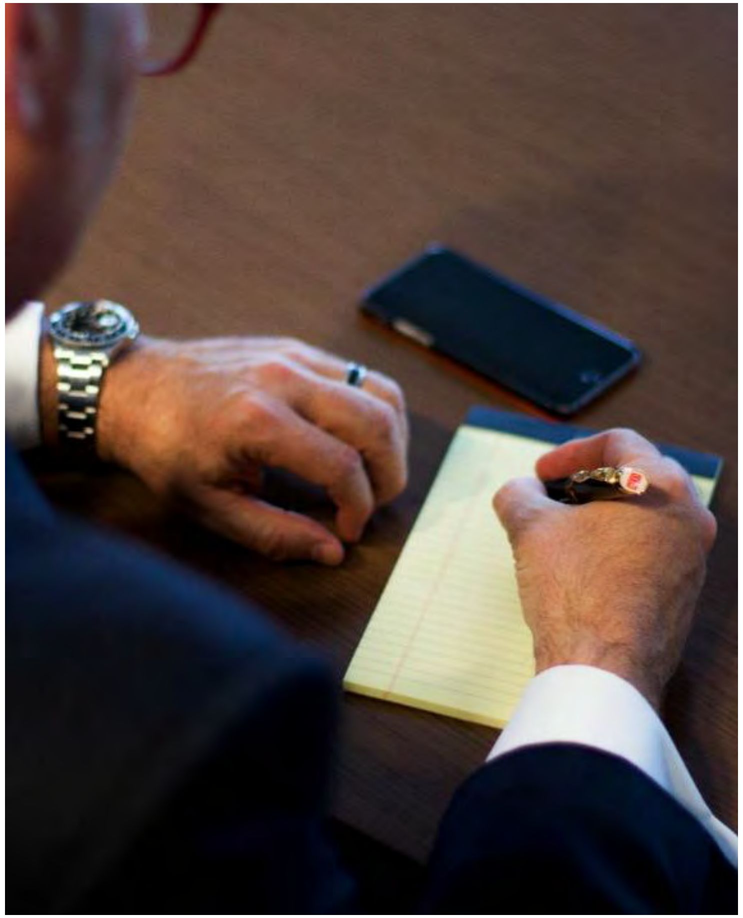
It has been clarified that the incremental capital requirement for exposures in the last bucket is 25 percentage points increase in the risk weight. For example, if an entity which otherwise attracts a risk weight of 50 per cent falls in the last bucket, the applicable risk weight would be 75 per cent (50 per cent +25 per cent).

Effective date: The Directions would come into effect from 1 January 2023.

To access the text of the Directions, please click here

Action Points for Auditors

As per the extant guidelines, auditors need to audit and certify the UFCE information submitted by the entity to the banks at least on an annual basis. This requirement remains unchanged in the Directions. Accordingly, auditors should take note of the amendments and clarifications while performing their certification engagements.



17. Earnings Before Interest and Depreciation – EBID is computed as Profit after tax + Interest on debt + Depreciation + Lease rentals (if any).

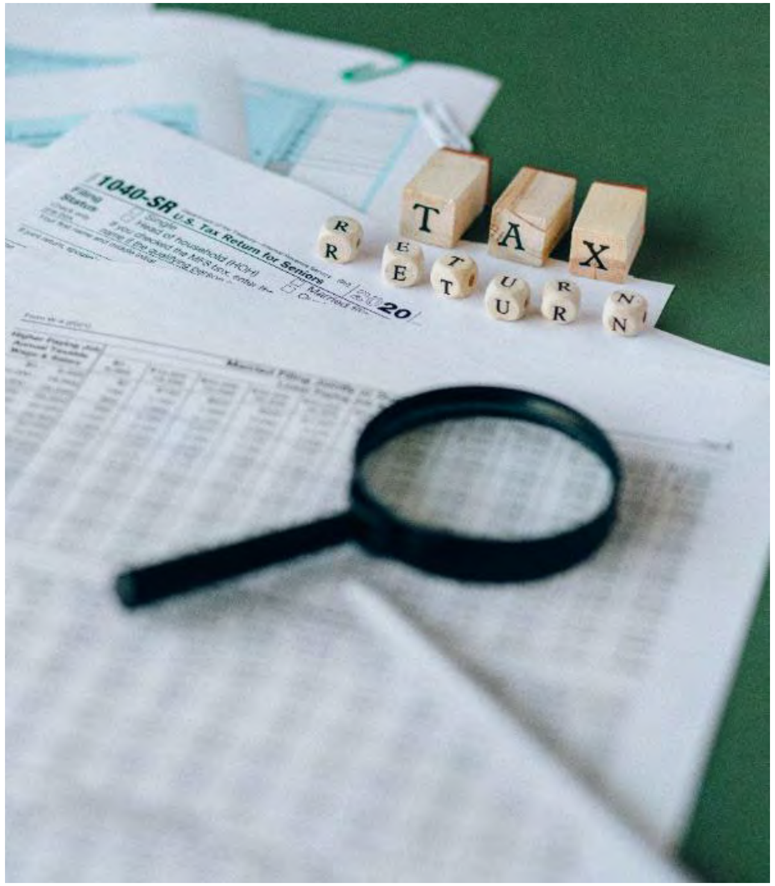
Regulatory updates

RBI (Financial Statements – Presentation and Disclosures) Directions, 2021 – Disclosure of divergence in asset classification and provisioning

As per the guidelines enunciated in the RBI (Financial Statements – Presentation and Disclosures) Directions, 2021 (RBI disclosure guidelines), all commercial banks, other than the Regional Rural Banks (RRBs) are required to provide certain disclosures with respect to divergence in asset classification and provisioning[18]. The disclosures relate to the following areas:

Sr.	Particulars	Amount (in crore)
1	Gross NPAs as on 31 March 20XX as reported by the bank	
2	Gross NPAs as on 31 March 20XX as assessed by RBI	
3	Divergence in Gross NPAs (2-1)	
4	Net NPAs as on 31 March 20XX as reported by the bank	
5	Net NPAs as on 31 March 20XX as assessed by RBI	
6	Divergence in Net NPAs (5-4)	
7	Provisions for NPAs as on 31 March 20XX as reported by the bank	
8	Provisions for NPAs as on 31 March 20XX as assessed by RBI	
9	Divergence in provisioning (8-7)	
10	Reported Profit before provisions and contingencies for the year ended 31 March 20XX	
11	Reported Net Profit After Tax (PAT) for the year ended 31 March 20XX	
12	Adjusted (notional) Net Profit after Tax (PAT) for the year ended 31 March 20XX after considering the divergence in provisioning	

The above mentioned disclosures are required to be provided in the notes to accounts in the annual financial statements, published immediately following the communication of such divergence by RBI to the bank.



18. Paragraph C.4(e) of Annexure III to the RBI (Financial Statements- Presentation and Disclosures) Directions, 2021 specifies disclosure requirements with respect to divergence in asset classification and provisioning

Regulatory updates

With an aim to further strengthen compliance with the prudential norms on income recognition, asset classification and provisioning, RBI, vide a notification dated 11 October 2022 has expanded the purview of these disclosure requirements for Primary (Urban) Co-operative Banks (UCBs). Additionally, the existing thresholds specified for the commercial banks have also been revised. The key guidelines issued in this regard include:

- **Applicability:** Banks should provide the disclosures (as stipulated in the previous page) in the financial statements for the year ending 31 March 2023, if either or both of the following conditions are satisfied:
  a. The additional provisioning with regard to the NPAs, as assessed by the RBI exceeds 10 per cent of the reported profit before provisions and contingencies for the period
  b. The additional Gross NPAs, as identified by RBI exceeds 10 per cent of the reported incremental Gross NPAs[19] for the period.

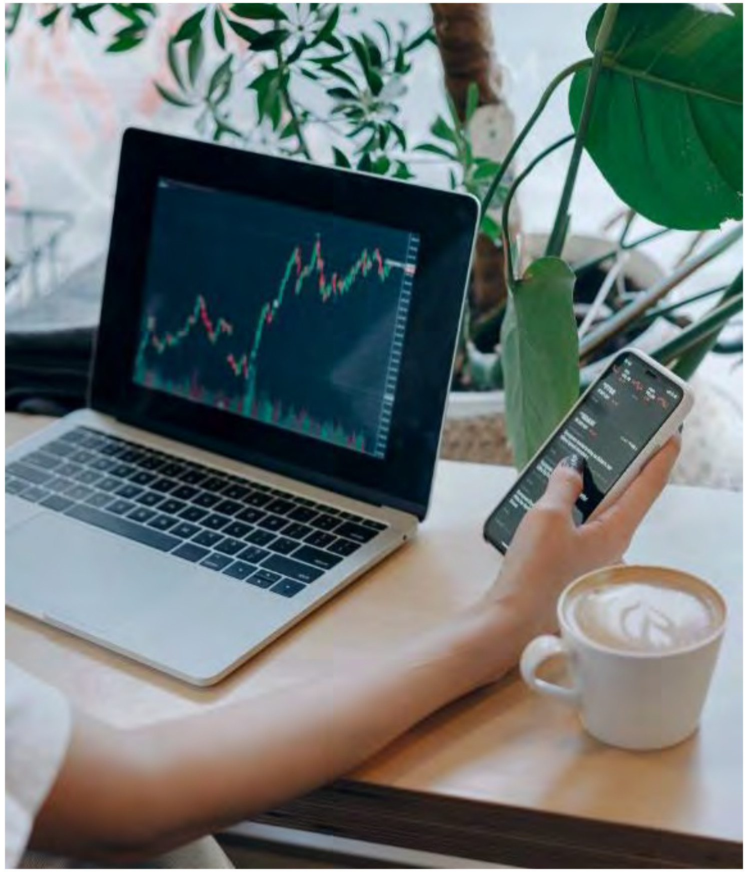
  Note: In case of UCBs, the threshold for the reported incremental Gross NPAs would be 15 per cent, which would be reduced subsequently, after review by the RBI.

- **Revised thresholds for the year ending 31 March 2024:** The thresholds pertaining to profit before provisions and contingencies and Gross NPAs (as mentioned in 'Applicability' section above) would be revised in the annual financial statements for the year ending 31 March 2024, and onwards, as mentioned below:

Threshold linked to	Commercial banks (%)	UCBs (%)
Reported Profit before provisions and contingencies	5	5
Reported incremental Gross NPA	5	15[20]

To access the text of the notification, please click here.

To access the text of the updated RBI (Financial Statements – Presentation and Disclosures) Directions, 2021, please click here.



19. Reported incremental Gross NPAs refers to additions made during the year to the Gross NPAs, as disclosed in the notes to financial statements of the year.

20. Threshold may be subsequently reduced, after review by the RBI.

Action Points for Auditors

Auditors should actively engage with banking companies to discuss the requirements and discuss appropriate modifications in their systems in order to implement the new requirements and revised disclosures required in the financial statements for the year ending 31 March 2023 and onwards.

RBI issues classification on multiple NBFCs in a group – classification in the Middle Layer

In October 2021, RBI had introduced the Scale Based Regulatory framework (SBR framework) for NBFCs, which renders the regulation and supervision of the NBFCs to be a function of their size, activity, and perceived riskiness. The SBR framework classified the NBFCs into the following four layers:

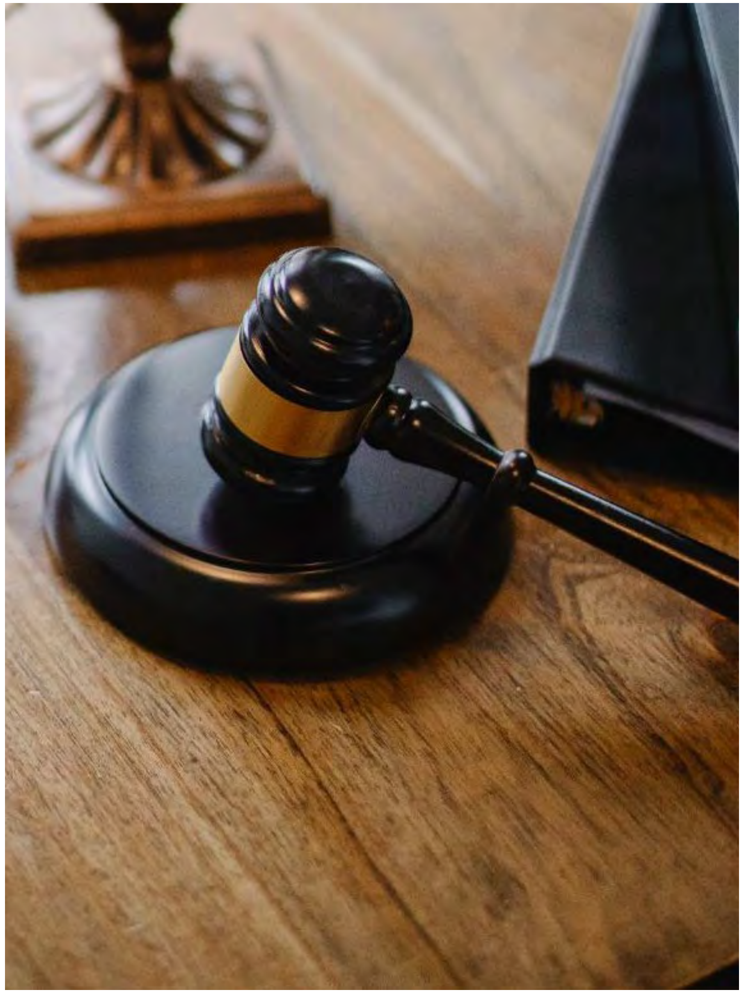
- NBFC-Base Layer (NBFC-BL)
- NBFC-Middle Layer (NBFC-ML)
- NBFC-Upper Layer (NBFC-UL) and
- NBFC-Top Layer (NBFC-TL).

As per the SBR framework, NBFC-BL should inter alia comprise of non-deposit taking NBFCs below the asset size of INR1,000 crore, and NBFC-ML should inter alia comprise of non-deposit taking NBFCs with asset size of INR1,000 crore and above.

Paragraph 16 of the Master Direction – NBFC-Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions 2016 (Master Directions) states that applicable NBFCs that are part of a corporate group or are floated by a common set of promoters should not be viewed on a standalone basis. Instead, the total assets of all the NBFCs in a group would be consolidated in order to determine the threshold for their appropriate classification.

With a view to comply with the regulations stipulated by the SBR framework and the Master Directions, RBI, vide a notification dated 11 October 2022 (the notification) clarified on the grouping of NBFCs within the SBR framework. As per the notification, if the consolidated asset size of a group of NBFCs is **INR1,000 crore and above**, then certain entities in the group of NBFCs would be classified as an NBFC-ML. Consequently, regulations as applicable to the middle layer would become applicable to them. Following is the list of those entities:

a. Investment and Credit Company (NBFC-ICC)
b. Micro Finance Institution (NBFC-MFI)
c. NBFC-Factor and Mortgage Guarantee Company (NBFC-MGC).



Regulatory updates

Further, it has also been specified that statutory auditors would be required to certify the asset size (as on 31 March) of all the NBFCs in the group each year and the same would be furnished to the Department of Supervision, RBI, under whose jurisdiction the NBFCs are registered.

It is to be noted that the provisions of the notification would not be applicable for classifying an NBFC in the upper layer, as that would be based on the supervisory filtering process.

Effective date: The guidelines are effective from 1 October 2022.

To access the text of the notification, please click here

Action Points for Auditors

Statutory auditors would be required to certify the asset size of all the NBFCs in a group from 31 March 2023 and onwards. This being a new requirement, auditors should actively engage with the companies to discuss various matters on the certificate to be issued.

Updates from CBDT

CBDT extends the due date for filing TDS statement in Form 26Q for the second quarter of FY 2022-23

Difficulties have been observed in filing of TDS statement in the revised and updated Form 26Q. The CBDT received requests from different stakeholders, therefore, vide a circular dated 27 October 2022 it extended the due date of filing of Form 26Q for the second quarter of Financial Year 2022-23 from 31 October 2022 to **30 November 2022**

To access the text of the circular, please click here

Action Points for Auditors

All members of the profession are advised to take note of the revised timelines.

International update

- Accounting updates
- Regulatory updates

Updates from IASB

IASB issues amendments to IAS 1, *Presentation of Financial Statements*

In January 2020, the International Accounting Standards Board (IASB) issued amendments to International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, thereby clarifying how an entity classifies its debt and other financial liabilities as current or non-current in certain circumstances (2020 amendments). This amendment was applicable from 1 January 2023.

However, stakeholders raised concerns regarding 2020 amendments and IASB reviewed those amendments. To improve the information provided by companies regarding a long-term debt (with attached covenants) undertaken by companies, IASB issued additional amendments to IAS 1 in October 2022 (2022 amendments). Some of the key changes introduced in the 2022 amendments include:

a. **Liabilities with covenants – Classification criteria:** Under the existing requirements of IAS 1, companies classify a liability as current when they do not have an **unconditional right** to defer settlement for at least 12 months after the reporting date. Through the 2022 amendments, IASB has now removed the requirement for a right to be unconditional, i.e., a liability would be classified as non-current, even if the right to defer settlement is subject to some underlying conditions (covenants).

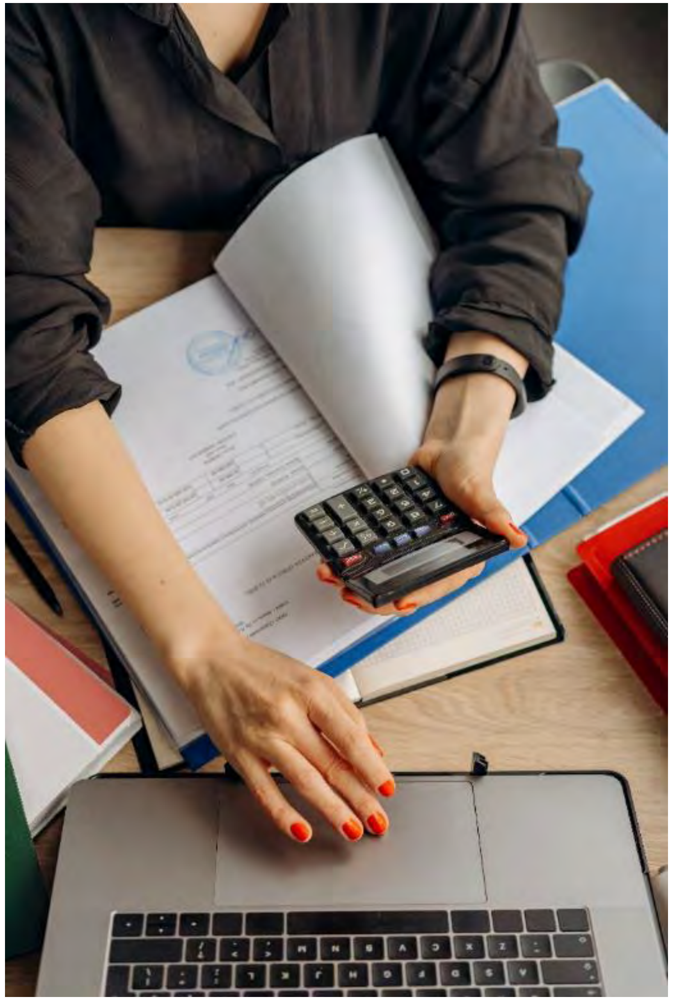
However, such right must exist at the reporting date and have substance.

It has also been clarified that only such covenants with which a company must comply on or before the reporting date would affect the classification of a liability as current or non-current. Any covenants with which the company must comply after the reporting date (i.e., future covenants) would not affect a liability's classification at that date. The same can be explained with the help of an example below:

Example: Company ABC Ltd. (the company) has a loan which is repayable in five years. Other facts of the case are:

- Loan is subject to a covenant which requires the company to maintain an EBITDA of at least 10 per cent on 31 December 20X2 and 14 per cent on 30 June 20X3 respectively. The loan becomes repayable on demand if the target EBITDA is not met on any of the specified dates

- The company is preparing its annual financial statements for the year ending 31 December 20X2. The EBITDA is 11 per cent as on 31 December 20X2. Also, the company expects an EBITDA of 12.5 per cent as on 30 June 20X3.

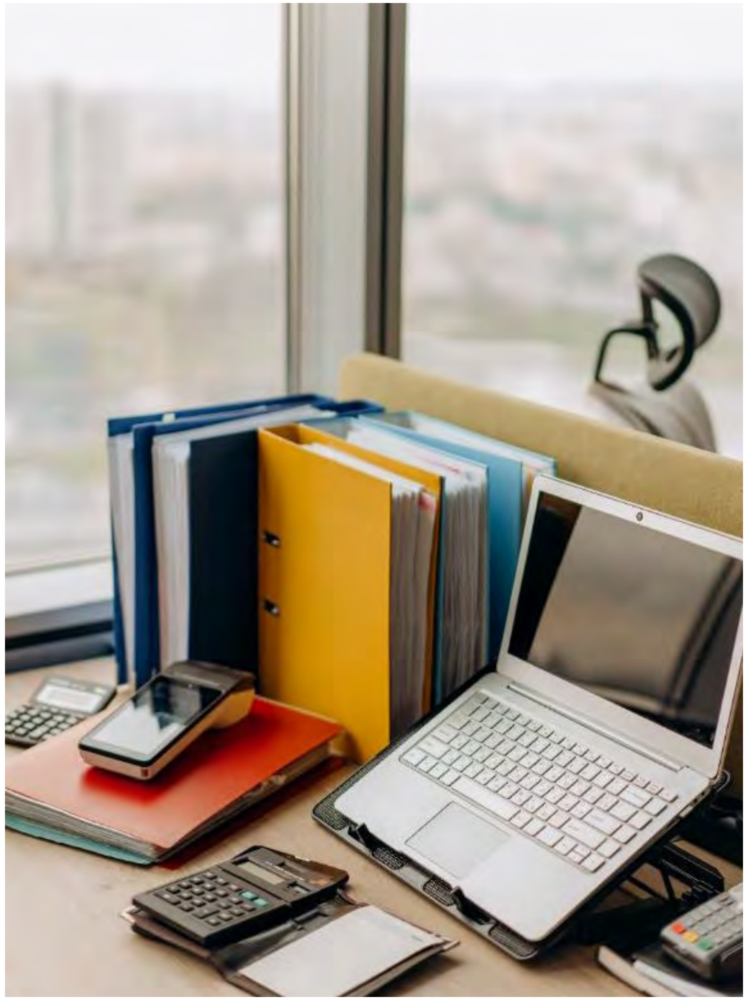


Accounting updates

Particulars	Loan covenant	Impacts classification of loan as on 31 December 20X2
Reporting date	EBITDA of at least 10 per cent (tested on 31 December 20X2)	Yes, as the company satisfies the covenant condition as on the reporting date. Thus, the loan would be classified as 'non-current'
Future covenant	EBITDA of at least 14 per cent (tested on 30 June 20X3)	No, as a future covenant would not affect the classification of the loan as on the reporting date. Thus, the loan would be classified as 'non-current'
Future expectation	Expected EBITDA of 12.5 per cent as on 30 June 20X3 (which is not expected to meet the prescribed covenant)	No, as management's expectation of compliance with the future covenant is irrelevant for classification purpose. Thus, the loan would be classified as 'non-current'.

b. **Additional disclosure requirements:** When non-current liabilities are subject to future covenants, a company would be required to disclose appropriate information for helping the users of financial information understand the risk that those liabilities could become repayable within 12 months after the reporting date

c. **Clarification on convertible liability:** The amendments have also provided a clarification on classification of a convertible liability – e.g., convertible debt. When a liability comprises of a conversion option, involving transfer of a company's own equity instruments, the conversion option is recognised as either equity or a liability separately from the host liability under IAS 32, *Financial Instruments: Presentation*.



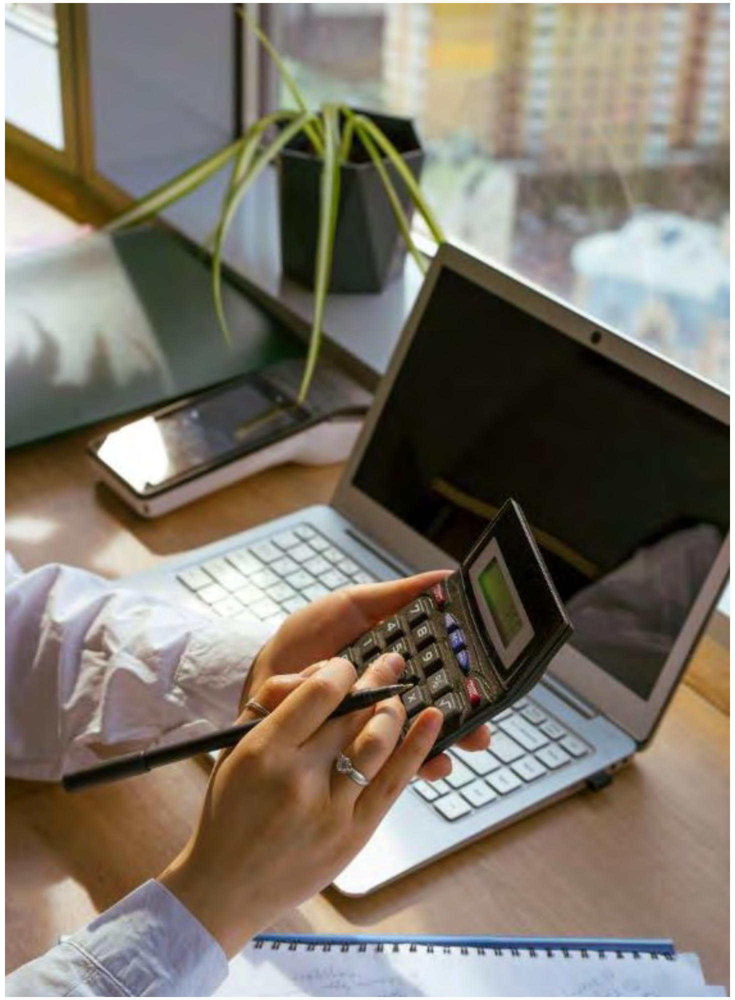
In this regard, the IASB has now clarified that when a company classifies the host liability as current or non-current, it can ignore only those conversion options that are recognised as equity. In simple terms, if the conversion option is recognised as a liability under IAS 32, the same would affect current or non-current classification of the host liability.

Effective date: The amendments would apply retrospectively for annual reporting periods beginning on or after 1 January 2024, with early application permitted. They also specify the transition requirements for companies that may have early-adopted the previously issued but not yet effective 2020 amendments.

To access the text of the IASB announcement, please click here.

Action Points for Auditors

- Auditors should note that this amendment is currently not applicable to Ind AS. Accordingly, while determining the current and non-current classification of long-term loan arrangements under Ind AS, companies and auditors should refer to paragraphs 74 and 75 of Ind AS 1, *Presentation of Financial Statements*.
- This amendment would be relevant to auditors when they are performing audit engagements under IFRS. In this case, auditors should note that though the 2022 amendments would apply from 1 January 2024, they should evaluate disclosures under IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. Thus, auditors should engage with the companies to which these amendments would be applicable and discuss the reporting requirement and transition options available to the companies.



Updates from IESBA

IESBA issues Q&A publication highlighting the relevance and applicability of the IESBA Code in combatting greenwashing

Over the last few years, investors and other stakeholders have increased their focus on non-financial information and other metrics that provide a better understanding of a company's long-term value creation. Consequently, financial markets have witnessed accelerated growth in the disclosure of sustainability and Environmental, Social and Governance (ESG) information.

The accountancy profession plays an important role in preparation, presentation and assurance of the sustainability reporting. However, in recent years, there has been a rise in concerns regarding reporting of false or misleading sustainability information (i.e., greenwashing). In this regard, on 21 October 2022, the International Ethics Standards Board for Accountants (IESBA) released a Questions and Answers (Q&A) publication highlighting the relevance and applicability of the International Code of Ethics for Professional Accountants (including International Independence Standards) (the Code) in combatting greenwashing. The Q&As discuss various ethics-related challenges arising from Professional Accountants' (PAs) involvement in sustainability reporting and assurance. Some of the key concepts and metrics discussed in the publication include:

- **Greenwashing – Meaning:** The term 'greenwashing' hasn't been used or defined in the Code. However, this term usually refers to practices that involve misleading the intended users of information, or intentionally giving them a false impression about how well an organisation or an investment is aligned with its sustainability goals. There are various factors which could contribute to greenwashing, including:

    - Availability and quality of corporate sustainability data
    - Lack of integration and connectivity between the financial and non-financial sustainability information
    - Incentives and opportunities (e.g., financial or reputational) to promote more sustainability-aligned products, or to promote the business as being aligned to sustainability goals and trends
    - Lack of regulation or regulation which is at the nascent stage of development, etc.

- **Applicability of the Code to sustainability information** : The Code lays down various principles with respect to the preparation and presentation of information. In addition to preparing and presenting financial information, the PAs must comply with these principles for non-financial information as well, including sustainability information presented in the form of standalone sustainability reports, annual or integrated reports, or information presented on a company's website. This includes complying with the five fundamental principles of the Code, namely – **integrity, objectivity, professional competence and due care, confidentiality and professional behavior.**

In particular, the following overarching requirements in the Conceptual Framework of the Code are relevant in producing sustainability information:

- Having an inquiring mind
- Exercising professional judgement, and
- Using a reasonable and informed third-party test.

- **Professional competence and experience:** A PA should be professionally competent and should have the relevant expertise and experience when dealing with sustainability reporting requirements. If the PA does not have the relevant sufficient expertise, it would result in creation of a self-interest threat. In order to address this self-interest threat, PAs should consider obtaining assistance or training from someone with the necessary expertise. However, if the self-interest threat cannot be addressed, paragraph R230.4 of the Code requires the PA to consider declining the performance of his/her duties in question, in such cases the reasons for such decline should be communicated.

- **Verifying sustainability information:** The application of the Conceptual Framework of the Code requires the PAs to not accept the sustainability information at face-value. He/she should:

  - Consider the source, relevance and sufficiency of the information obtained, taking into account the nature, scope and outputs of the professional activity being undertaken
  - Being open and alert to a need for further investigation or other action
  - Consider other factors such as the emergence of any new information, changes in facts and circumstances, any inconsistency between the known facts and circumstances, and so on.

- **Responsibility of the PA in case of NOCLAR:** If a PA becomes aware of any information which suggests that there has been any Non-Compliance with Laws and Regulations (NOCLAR), he/she should comply with the NOCLAR[21] provisions set out in Section 260 of the Code.

- **Misleading sustainability information:** When a PA knows, or has reason to believe, that the sustainability information they are associated with is misleading, the Code requires the accountant to take appropriate actions to resolve the matter. Following points should be considered as per paragraph 220.8 A1 of the Code:

  - Discussing concerns with his/her superior and/or the appropriate level(s) of management within the employing organisation or TCWG, and requesting such individuals to take appropriate action to resolve the matter
  - Consulting the policies and procedures of the employing organisation, such as an ethics or whistleblowing policy, on how to address such matters internally

21. NOCLAR comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations. The non-compliance could be committed by any of the following parties:
    - The professional accountant's employing organisation,
    - Those Charged With Governance (TCWG) of the employing organisation,
    - Management of the employing organisation, or
    - Other individuals working for or under the direction of the employing organisation.

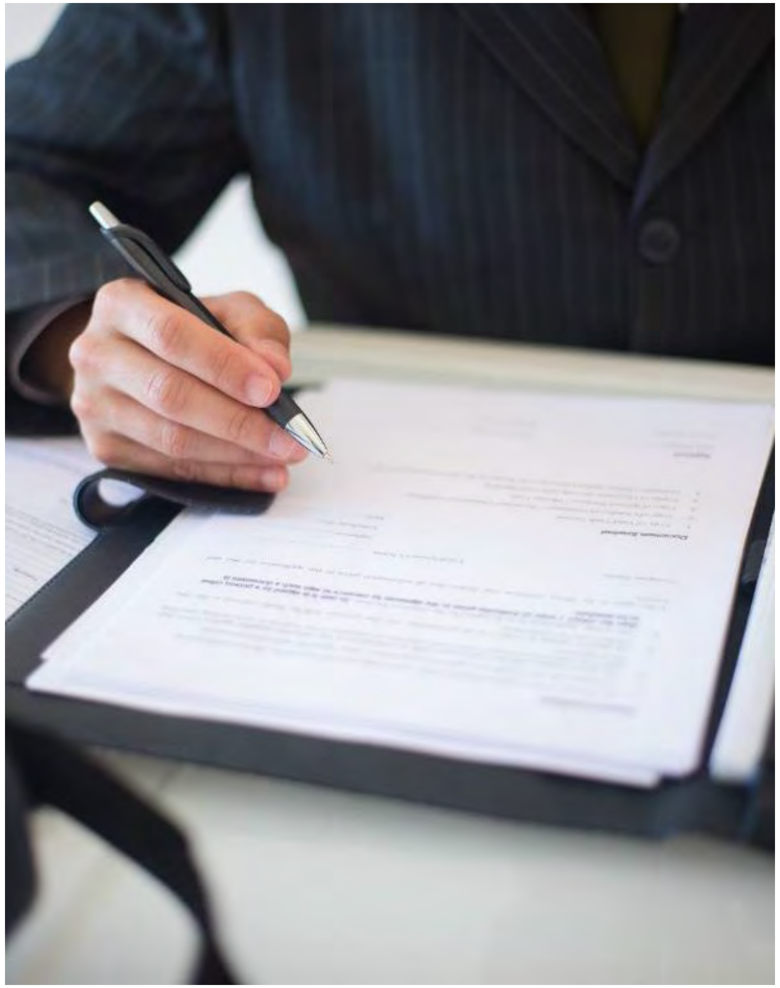
- If after taking the above action, no corrections have been made in the sustainability information, then the PA should take further actions which might be appropriate, such as:
  a. Consulting with the relevant professional body, the internal or external auditor of the employing organisation, or the legal counsel,
  b. Determining if there's any requirement to communicate to the third parties, including users of the information, regulators and other oversight authorities,
  c. If, after exhausting all other options, the PA determines that appropriate action has not been taken and there is a reason to believe that the sustainability information is misleading, he/she must refuse to remain associated with the information. In such circumstances, the Code notes that it might be appropriate for the PA to resign from the employing organisation.

- **Pressures to meet ESG goals:** Individuals involved in preparation, presentation and reporting of sustainability information might experience pressure to report misleading sustainability information or make false claims regarding certain products or projects, etc. to meet investors' and other stakeholders' expectations. Pressure could be explicit or implicit and might come from within the employing organisation or be driven by internal and external expectations.

  In such cases, the PA should understand and consider discussing the circumstances creating the pressure in order to evaluate the level of threats to compliance with the fundamental principles and obtain consultations from superiors, legal counsels, or relevant professional or regulatory bodies. Appropriate disclosures may also be made as per the employing organisations' ethics and whistle-blowing policies.

- **Communication with TCWG:** Effective communication with TCWG provides enhanced transparency and contributes to promoting an ethical culture in an organisation, especially when leaders within the organisation hold themselves and others accountable for demonstrating ethical values. PAs should determine the appropriate individual(s) within an organisation with whom they can communicate, especially pertaining to situations where there are increased risks of greenwashing, such as:
  - Pressure to breach the fundamental principles of ethics
  - Association with misleading information
  - Actual or suspected NOCLAR.

To access the text of the publication, please click here



Action Points for Auditors

- The Code of Ethics issued by Institute of Chartered Accountants of India (ICAI) are aligned with the Code. Accordingly, this publication would be relevant to PAs preparing sustainability information as per the Indian regulations.

- It is to be noted that with effect from 1 April 2022, Regulation 34 of the LODR Regulations requires the top 1,000 listed entities, based on market capitalisation[22] to mandatorily submit a Business Responsibility and Sustainability Report (BRSR) to SEBI in the prescribed format. In view of these requirements, it is essential that the PAs who prepare such information consider their ethical responsibilities and obligations as highlighted in this publication.

- While this publication is intended to assist PAs, especially those in business or in preparing sustainability reports or disclosures, it would be relevant to PAs in public practice.

- Apart from PAs, regulators and audit oversight bodies, policy makers, investors, TCWG, national standard setters, professional accountancy organizations, and others with an interest in the work of PAs and in sustainability reporting and assurance would also find this publication useful.

22. Market capitalisation is calculated as on the 31st day of March of every financial year.

Regulatory updates

IESBA alert highlighting key ethics and independence considerations for Professional Accountants in relation to Russia-Ukraine war

Russia's military invasion of Ukraine in February 2022 has given rise to unprecedented challenges for businesses and organisations in the public, private and non-profit sectors across the globe. This has resulted in significant increase in volatility and uncertainty in the financial markets. Additionally, various jurisdictions have imposed wide-ranging economic sanctions on Russia and Belarus and certain Russian entities and individuals. Owing to the potential of further market disruptions and uncertainties, and in order to highlight the PA's responsibility with regard to the sanctioned entities/individuals, on 3 October 2022, IESBA issued an alert highlighting the key ethics and independence considerations for Professional Accountants (PAs) in relation to Russia-Ukraine war.

The alert draws attention of the Professional Accountants in Business (PAIBs) and Professional Accountants in Public Practice (PAPPs) to key principles of the Code, which are important to enable them in complying with the ethical obligations and meet their responsibility to act in public interest. Some of the key considerations issued in this regard include:

- **Understanding and complying with the sanctions:** In the present context, PAs whose employing organisations or clients have, or are likely to have, business dealings with entities or individuals in Russia and Belarus must keep abreast with the scope and impact of any applicable sanctions. PAIBs should keep their employing organisations' client base under review and take appropriate steps, if required to avoid breaching sanctions, including potentially ending business or client relationships. PAs should also keep an eye for any new sanctions that may be imposed and evaluate how it would impact the PAPP's clients or the PAIB's business transactions.
- **Inquiries:** PAs should have an inquiring mind when applying the Conceptual Framework of the Code. This involves considering the source, relevance and sufficiency of information obtained, taking into account the nature, scope and outputs of the professional activity, and being alert to a need for further investigation or other action by the regulators. PAs may encounter situations where they are asked for assistance in moving assets abroad. In such situations, PAs should apply professional skepticism and consider questions regarding the background of the customer or client, the nature and purpose of the business transaction, identity of the ultimate beneficiaries of the transaction, and so on.
- **NOCLAR instances:** The economic disruptions and social upheaval caused by the Russia-Ukraine war have created numerous opportunities for fraud, money laundering and other criminal activities. This may further result in instances of NOCLAR or suspected NOCLAR through a breach of sanctions laws and regulations by the employing organisations or clients. Thus, both PAIBs and PAPPs must ensure compliance with the provisions of Section 260[23] and 360[24] of the Code respectively.

23. Section 260 of the Code specifies provisions with regard to instances of NOCLAR or suspected NOCLAR in case of PAIBs.

24. Section 360 of the Code specifies provisions with regard to instances of NOCLAR or suspected NOCLAR in case of PAPPs.

Regulatory updates

- **Client and engagement acceptance:** Section 320[25] of the Code highlights the importance of understanding and knowing a proposed client before accepting a professional appointment. It also explains that threats to compliance with the principles of integrity or professional behavior might be created from questionable issues associated with a client (its owners, management, or activities). Thus, in the context of the present scenario, such threats might be created in circumstances that involve a professional service to a potential client in Russia or Belarus or a client with business interests in those countries to evade sanctions, laws and regulations.

- **Inducements:** PAs should be aware that there is an increased risk of bribery and corruption due to the sanctions imposed on certain Russian entities and oligarchs. Sanctioned entities/individuals might be tempted to offer bribes to PAs in jurisdictions where they have moved significant capital and acquired significant assets to conceal their existence or otherwise seek to avoid their seizure. PAIBs and PAPPs should refer to appropriate guidance in the Code in navigating situations involving inducements.

- **Preparation and presentation of information:** While preparing the employing organisation's financial statements, PAIBs should ensure that the impact of the Ukraine conflict on their employing organisation's business is appropriately accounted for and disclosed even when doing so leads to reporting unfavorable information.

  When a PAIB knows or has reason to believe that the information disclosed by their employing organisation is misleading, the PAIB should take appropriate action as prescribed by the Code.

- **Overdue fees:** In the context of an audit of financial statements, firms having audit clients based in Russia or Belarus or clients with significant business in those countries must take into consideration the overdue fees provisions, as enunciated in Section 410[26] of the Code. It also explains that the level of the self-interest threat to independence might be impacted if fees payable by an audit client for the audit or other services are overdue during the period of the audit engagement. In cases where a significant part of the fees due from an audit client remains unpaid for a long time, it must be determined whether:

  - The overdue fees might be equivalent to a loan to the client, or
  - It is appropriate for the PA's firm to be re-appointed or continue the audit engagement.

To access the text of the IESBA alert, please click here.

25. Section 320 of the Code specifies provisions with regard to professional appointments

26. Section 410 (Revised), Fees (effective for audits of financial statements for periods beginning on or after 15 December 2022)

Action Points for Auditors

- Given the dynamic situation of the conflict and other related developments taking place in this regard, the IESBA alert reiterates the existing requirements of the Code for PAs rendering audit or other services to companies which are either situated in the affected countries or have business relationships with entities in the affected countries. Owing to the rapidly changing regulatory landscape of the sanctions, they must remain alert to the potential compliance threats, if any, and evaluate and address them.

- Many multi-national companies having subsidiaries, joint ventures and other investees in Russia have taken action to withdraw from the market, sell off businesses or scale down business operations. In most cases, the need for such action has not been foreseen, leading to an abrupt exit. Such uncertainties may have implications for the timely preparation and audit of the companies' financial statements, creating risks to meeting the regulatory filing requirements. Thus, auditors should actively engage with such companies in order to determine the future course of action and plan timely audit of financial statements.

- IESBA, in its alert has highlighted that in the present circumstances, there is an increased risk of assuming management responsibility in relation to non-assurance services that clients with significant business operations in Russia or Ukraine may approach firms to undertake. In this regard, members of the profession are advised to refrain from assuming any such management responsibilities and ensure compliance with the principles of the Code.

Publications

Publications

The table below provides an overview of some important publications released by various regulators during this month:

Regulator	Publication	Particulars
ICAI	**Study on compliance of financial reporting requirements (Ind AS framework) – Volume II**	The Financial Reporting Review Board (FRRB) of the ICAI has issued Volume II of the Study on compliance of financial reporting requirements (Ind AS framework). Apart from carrying out the review of general-purpose financial statements to determine the compliance with financial reporting standards, rules and regulations issued by the relevant regulatory authorities, FRRB also ventures towards spreading awareness amongst the members as well as other stakeholders about the pertinent issues in the areas of reporting. The publication contains FRRB's findings from the review of general-purpose financial statements prepared under Ind AS framework. The observations have been categorised into following eight categories: • Observations related to assets • Observations related to equity • Observations related to liabilities • Observations related to Statement of Profit and Loss • Observations related to Statement of Cash Flows • Observations related to other disclosures • Observations related to auditor's report • Observations related to CARO, 2016. To access the text of the publication, please click here

Publications

Regulator	Publication	Particulars
ICAI	**Guidance Note on report under section 92E of the Income Tax Act, 1961 (Transfer pricing) (Revised 2022)**	The obligation of the members of ICAI is to express opinion on the accounts, records and documentation pertaining to international transactions and specified domestic transactions and therefore, they are expected to have a thorough knowledge of transfer pricing regulations and other recent developments. Over the years, ICAI, through the Committee on International Taxation (the Committee) has been issuing guidance for its members in respect of the report under Section 92E of the Income-tax Act, 1961. In this regard, the Committee has issued the ninth edition of the Guidance Note on Report under Section 92E of the Income-tax Act, 1961, thereby incorporating all the amendments made up to Finance Act, 2022. To access the text of the publication, please click here
SEBI	**Compilation of Informal Guidance – SEBI (Prohibition of Insider Trading) Regulations, 2015** **(Period: October 2015-September 2022)**	In order to enable the users to have access to all the informal guidance sought/given relating to SEBI (Prohibition of Insider Trading) (PIT) Regulations, 2015 at one place, SEBI has released a Compilation of Informal Guidance – SEBI (Prohibition of Insider Trading) Regulations, 2015. The publication consolidates all the informal guidance issued in this regard during the period 14 October 2015 to 30 September 2022. To access the text of the publication, please click here

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