Contents

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Editorial

We are pleased to bring to you our April 2015 quarterly newsletter covering the latest developments in financial reporting and other regulatory updates.

Ind AS – Indian Accounting Standards (Ind AS) converged with the IFRS are now a reality. Since the issue of the revised roadmap for implementing Ind AS in January 2015, the Ministry of Corporate Affairs (MCA) has moved quite swiftly and has notified the Companies (Indian Accounting Standards) Rules, 2015 together with 39 standards. Ind AS will be applied based on the listing status and net worth of a company. The first phase of companies will apply Ind AS for the period beginning 1 April 2016, which will also require comparative Ind AS information for the period of 1 April 2015 to 31 March 2016. This leaves little time for impacted companies to put into action an implementation strategy ensuring a successful and smooth transition towards Ind AS. In this newsletter, we have summarised the salient features of the notification, including clarifications to previously open questions and significant carve-outs from the IFRS.

The changes brought in by the Companies Act, 2013 (2013 Act) continue to remain an area of focus for corporate India. One such essential area is the new reporting requirements for fraud. The ICAI has recently issued its Guidance Note on Reporting on Fraud under section 143(12) of the 2013 Act. This is a welcome step since it addresses several facets involving reporting of fraud under the 2013 Act, which we have discussed in this edition.

Continuing with the theme of increased transparency and governance, we have included our analysis on the revised regulatory framework for non-banking finance companies (NBFC) recently introduced by the Reserve Bank of India (RBI). This does have some important implications for NBFCs.

Internationally the IAASB has issued its latest standards on audit reports, with an objective to provide greater transparency on the performance of an audit. These standards bring in a fundamental change in the content of an audit report to include newer aspects such as key audit matters. Users of audit reports will now have to acquaint themselves with a fresh look and feel of an audit report as compared to the existing boiler plate language. In this newsletter, we have highlighted the main changes resulting from this new audit report model.

This edition also attempts to provide an overview of the important provisions of the recently released Staff Alert No 12: Matters related to Auditing Revenue in an Audit of Financial Statements by the Public Company Accounting Oversight Board (PCAOB). This is equally relevant for the management as they continue to evaluate and strengthen their internal control systems and for auditors in identifying, assessing, and responding to the risks of material misstatement associated with revenue recognition.

Finally, we discuss the key highlights of the exposure draft of the Guidance Note on Accounting for Derivatives issued by the ICAI, significant provisions of Union Budget 2015 and other regulatory updates both globally and in India.

We hope you find this newsletter informative and help us remain connected with you in a meaningful manner.

We look forward to your feedback at pwc.update@in.pwc.com.

Ind AS: Indian Accounting Standards converged with IFRS are here!

Consistent with its January 2015 announcement, the Ministry of Corporate Affairs (MCA) has moved swiftly and notified its phase-wise roadmap for the adoption of the Indian Accounting Standards (Ind AS), India's accounting standards converged with the IFRS. After lingering skepticism regarding Ind AS getting notified, this positive development positions India well at the centre of high quality financial reporting. The MCA has issued a notification dated 16 February 2015 announcing the Companies (Indian Accounting Standards) Rules, 2015 for the applicability of the Ind AS.

Applicability

The application of the Ind AS is based on the listing status and net worth of a company. The Ind AS will first apply to companies with a net worth equal to or exceeding 500 crore INR beginning 1 April 2016. This will also require comparative Ind AS information for the period of 1 April 2015 to 31 March 2016. Listed companies as well as others with a net worth equal to or exceeding 250 crore INR will follow 1 April 2017 onwards. From April 2015 companies impacted in the first phase will have to take a closer look at the details of the 39 new Ind ASs presently notified. The Ind AS will also apply to subsidiaries, joint ventures, associates as well as holding companies of the entities covered by the roadmap.

All listed companies (except companies listed on SME exchanges) and companies with a net worth of 250 crore INR or more will be required to adopt the Ind AS. Companies not covered by the rules will continue to apply the existing accounting standards.

The requirement to present comparatives implies that companies impacted in phase one will require an Ind -AS compliant opening balance sheet as of 1 April 2015.

Roadmap to Ind AS adoption

Comparatives for the period ending	31 March 2015 or thereafter	31 March 2016 or thereafter	31 March 2017 or thereafter
	1 April 2015	***1 April 2016***	***1 April 2017***
		Mandatorily applicable for following companies	
Applicable to companies	• Voluntary adoption	• Companies whose net worth is 500 crore INR or more • Holding, subsidiary, joint venture or associate companies of above companies	• Companies whose equity and/ or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than 500 crore INR. • Unlisted companies having net worth of 250 crore INR or more • Holding, subsidiary, joint venture or associate companies of above companies

Clarifications

While the notification has clarified many previously open questions, some have been described below:

- The date and manner of calculation of net worth has been spelled out. It has been clarified that net worth will be determined based on the standalone accounts of the company as on 31 March 2014 or the first audited period ending after that date.
- Net worth has been defined to have the same meaning as per section 2(57) of the Companies Act, 2013. It is the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet. It does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.
- It is now clear that the Ind AS will apply to both consolidated as well as stand-alone financial statements of a company covered by the roadmap. This is helpful as companies will not have to maintain dual accounting systems.
- It is a relief that an overseas subsidiary, associate or joint venture of an Indian company is not required to prepare its stand-alone financial statements as per the Ind AS, and instead, may continue with its jurisdictional requirements. However, these entities will still have to report their Ind AS adjusted numbers for their Indian parent company to prepare consolidated Ind AS accounts.
- Entities not covered by the roadmap can voluntarily adopt the Ind AS. Once having chosen this path, they cannot switch back.
- Insurance, banking and non-banking financial companies shall not be required to apply the Ind AS either voluntarily or mandatorily. However, it appears (though not clarified), that if these entities are subsidiaries, joint venture or associates of a parent company covered by the roadmap, they will have to report Ind AS adjusted numbers for the parent company to prepare consolidated Ind AS accounts.
- There was hope that companies will be given an option to prepare their financial statements as per IFRS issued by the IASB (the true IFRS), which has now been ruled out.
- The rules specify that in case of conflict between the Ind AS and a law, the provisions of the law shall prevail and the financial statements shall be prepared in conformity with it.

The debate on two of the most significant standards, Revenue Recognition and Financial Instruments, has now been settled with them being notified.

Interestingly, India will be one of the first countries to mandatorily adopt these standards from 1 April 2015 while the rest of the world will follow from 2017.

These two standards will have a significant effect on entities, impacting not only their financial results but also catalysing numerous organisational and business changes.

Carve-outs: Differences with IFRS

India has chosen the path of IFRS convergence and not adoption. Accordingly, certain differences have remained between the IFRS as issued by the IASB and our Ind AS carve-outs. Some of these carve-outs diminish the comparability of the Ind AS when compared with the globally accepted IFRS. However, to overcome this, companies must carefully evaluate the Ind AS transition provisions and accounting policy elections so that their Ind AS financial statements are similar to IFRS, if not same. In this regard, some significant carve-outs to be considered, are in the following areas:

- Under Ind AS, long-term loans are not required to be classified as current due to a breach of material debt covenants, if the waiver from the lender is obtained after the year-end but before the approval of the financial statements for issue. Interestingly, though this is not per IFRS, it is in line with US GAAP.
- The option to present other comprehensive income in a separate statement is not available under the Ind AS. So only one statement comprising both profit or loss and other comprehensive income will be presented.
- The Ind AS also does not allow presentation of expenses by function, only classification of expense by 'nature' is permitted. Under IFRS, this is a policy election. This difference continues to create some problems particularly for entities with multiple overseas subsidiaries already using functional expense classification.
- Various options are available to arrive at the cost of fixed assets on the transition date. An entity could fair value its fixed assets, continue to use Indian GAAP values with some adjustments or arrive at the value per the Ind AS by making retrospective adjustments. We expect that in most cases, companies will continue with existing Indian GAAP deemed cost for fixed assets.
- A company can continue its Indian GAAP policy for accounting exchange differences arising from the translation of long-term foreign currency monetary items recognised before the beginning of the first Ind AS financial reporting period.
- Under IFRS, the bargain purchase gain or negative goodwill arising on business combinations is recognised in profit or loss. Under the Ind AS, the bargain purchase gain can be recognised either in other comprehensive income or capital reserve but not in profit or loss.
- On operating leases - Under the Ind AS, where the escalation of operating lease rentals is in line with the expected general inflation, the rentals are not required to be recognised as an expense on a straight-line basis. This is a mandatory carve-out which will significantly reduce comparability with IFRS.
- On derivatives - The equity conversion option embedded in a foreign currency convertible bond is treated as an equity instrument under the Ind AS. Therefore, it will not be required to be fair valued at each balance sheet date. Under IFRS, this conversion option is treated as a derivative liability. This is by far the most significant differences between the Ind AS and IFRS.
- With respect to associates - When it is impracticable, Ind AS 28 allows the exemption from use of uniform accounting policies to perform equity method accounting of associates. Further, similar to business combination, bargain purchase gain is not recognised in profit or loss.

Next steps

Implementing Ind AS is likely to impact key performance metrics and hence requires thoughtful communication with the board of directors, shareholders and other stakeholders. Internally, Ind AS implementation can have a wide-ranging impact on a company's processes, systems, controls, income taxes and contractual arrangement. Its impact is across the board and beyond just accounting.

Successful Ind AS implementation will require a thorough strategic assessment, a robust step-by-step plan, alignment of resources and training, effective project management as well as smooth integration of the various changes into normal business operations. The Ind AS implementation exercise needs to establish sustainable processes so as to continue to produce meaningful information long after the exercise is completed. It needs to become 'business as usual'.

India Inc needs to now get ready to embrace this transformation.

Impact across the board

Significant business and organisational implications beyond accounting

Fraud reporting under the Companies Act 2013

The new requirement

The Companies Act 2013 (the 2013 Act) has brought in a flurry of changes to enhance corporate governance. These changes have increased responsibilities of management, the board of directors and auditors. One of the new requirements under the 2013 Act i.e. section 143 (12) is for an auditor to act as a whistleblower – i.e. "if an auditor in the course of his or her audit has reason to believe that an offence involving fraud is being or has been committed against the company by its officers or employees, the auditor has to immediately report to the central government within a prescribed time", which has been specified as 60 days in the related rules.

Previously, there was already a requirement for auditors to comment on frauds on or by the company which were noticed or reported during the year, as part of the reporting as per the Companies (Auditor's Report) Order, 2003 (as amended) (CARO) in the auditors reports. However, the manner and scope of reporting are quite different under the two requirements. While earlier, the reporting was an annual exercise as a part of the auditors' report, under the 2013 Act, it is now a real-time responsibility since the reporting needs to be done 60 days from the time the auditor becomes aware of the fraud or suspected fraud, and in certain cases directly to the central government. Also, in terms of scope, while the reporting under CARO included the reporting of frauds committed by third parties on the company or vice versa, the 2013 Act restricts it to frauds by officers or employees of the company.

ICAI's new guidance

The ICAI has now issued the Guidance Note on Reporting on Fraud under Section 143(12) of the Companies Act, 2013 (Guidance Note), which clears many open questions providing much-needed guidance on this complex topic.

What to report

It begins by reiterating the requirement of section 143(12) that only fraud by officers or employees of the company and not by third parties such as vendors and customers, needs to be reported. Further, in terms of what would constitute a 'fraud', the guidance note suggests that apart from the definition of fraud given under section 447 of the Act, the auditor needs to also consider the requirements of the standards on auditing in so far as it relates to the risk of fraud, including the definition of fraud. Further, it excludes certain acts the financial effects of which are not reflected in the books of account or financial statements of the company, which is consistent with the responsibilities of an auditor as explained in the auditing standards as well.

The guidance note also mentions that the primary responsibility for the prevention and detection of fraud rests with both the company's board of directors and management. Accordingly, the auditor is to report to the company management or board of directors and thereafter to the central government (in case of material frauds) only those frauds which the auditor first identifies or notes. This is significant, because mostly cases of fraud have either already been reported or detected by the management through its internal control systems, vigil and whistleblower mechanisms. Also, necessary action or remediation is being undertaken or planned by management. Absent, this clarification, the reporting requirements would have become unnecessarily cumbersome without achieving the desired purpose.

The absence of materiality in reporting frauds was another aspect of the 2013 Act which was an issue of concern for both auditors and companies alike. The guidance note clarifies that reporting to the central government is required for material items of fraud and the auditor will apply the concepts of materiality under the auditing standards. This is also in line with the proposed amendments in the Companies (Amendments) Bill, 2014 to section 143(12) (pending approval in one of the Houses of Parliament), the auditor will be required to report to the central government only those frauds where the amount involved is in excess of specified thresholds to be specified by the MCA. Frauds below this threshold will continue to be communicated to the

management or board of directors and will be included in the board's report. However, the auditor needs to ensure that the aggregate of individual frauds are considered in order to determine whether the thresholds have been met or not.

When to report

While section 143(12) requires the auditor to report on frauds, the auditor identifies 'during the course of audit', the guidance note clarifies that even where an offence involving fraud is identified or notified by the auditor in the course of providing other attest or non attest services (tax audit, certification, quarterly reviews, etc) and such offence is expected to be material and would have to be considered while performing audit under the 2013 Act, the auditor should report such offence to the government under section 143(12).

Another significant issue was evaluating the appropriate stage at which the auditor can conclude whether fraud or suspected fraud is required to be reported to the central government. In this context, the guidance note specifies that reporting is required only when the auditor has sufficient reason to believe and has knowledge that a fraud has occurred or is occurring i.e. when the auditor has evidence that a fraud exists. This again brings some certainty, absence of which can result in premature reporting of fraud, which may not actually be concluded to be fraud. This will minimise any unintended confusion.

Consolidated financial statements (CFS)

Another aspect which has been clarified by the guidance note is with respect to the reporting responsibilities of the auditor in case of CFS. The guidance note clarifies that in certain circumstances the need for reporting under section 143(12) by the auditor of the CFS does not arise, for instance in case of foreign subsidiaries or an Indian subsidiary where the auditor of that company has the responsibility for reporting under section 143(12). However, it is essential to note that where the suspected offence involving fraud in a component is being or has been committed by employees or officers of the parent company and is against the parent company, such fraud may need to be reported in certain situations.

In summary

The guidance note further deals with other issues such as reporting frauds committed prior to the notification of section 143(12) of the 2013 Act, non compliances with other laws and regulations, etc. However, it is clear that the role of management and the board of directors is vital in such situations. Per the new law, when a fraud is brought to the attention of the board or audit committee, they are required to evaluate the matter and take appropriate action, including, where necessary, conducting an investigation or forensic audit either by internal specialists or external experts. Basis this evaluation, they will then respond to the auditor within 45 days of the date of the auditor's communication.

The auditors on their part are required to forward their report, the reply and observations of the company's board or audit committee together with the auditor's comments on such reply to the central government within 15 days of receipt. The auditor is also expected to comment whether they are satisfied or not with this reply. Additionally, like in other audit situations, the auditor will also have to consider whether such a matter requires disclosure in the auditor's main report under section 143(3)(f) of the 2013 Act. This is again new, requiring the auditor to state observations on financial transactions and matters, which may have any adverse effect on the functioning of the company.

All these requirements call for auditors and audit committees to increase their engagement and initiate a two-way dialogue on matters related to internal controls and risks. It is expected that this guidance note issued by the ICAI will provide the much-needed guidance in resolving many practical challenges and avoiding unintended implications arising from the provisions of the 2013 Act on this topic.

Squeezing out the arbitrage: The new NBFC regulations

The Reserve Bank of India (RBI) has introduced a new regulatory framework for non-banking finance companies (NBFCs) on 10 November 2014. The objective is to minimise the risks and regulatory gaps while strengthening the governance standards for NBFCs. This new framework now creates a level playing field and squeezes out the arbitrage opportunities between banks and NBFCs. It is expected to also pose certain challenges to NBFCs and may require many to re-visit their business model.

What's new

The new framework has introduced changes in the definition of systematically important (SI) non-deposit (ND) taking NBFCs, the applicability of prudential norms, the requirement of minimum net owned funds (NOFs), minimum Tier 1 capital for CRAR purposes, leverage ratio, provisioning for standard assets, asset classification, board committees, audit partner rotation, fit and proper criteria for directors and financial statement disclosure norms.

Definition of NBFC-ND-SI

NBFCs having assets of 500 crore INR and above are now considered to be systemically important non-deposit taking NBFCs (NBFCs-ND-SI) compared to the earlier threshold of 100 crore INR.

Existing framework
Assets=> 100 crore INR

New framework
Assets=> 500 crore INR

Minimum NOF

Both the existing and new frameworks require NBFC-ND-SI and NDFC-ND to maintain minimum NOF of 2 crore INR at all times. NBFCs already in existence before 21 April 2009 that maintain NOF of 25 lakh INR are required to attain minimum NOF of 2 crore INR in a phased manner.

1 crore INR by March 2016

2 crore INR by March 2017

NBFCs whose NOF falls below 2 crore INR are required to submit a statutory auditor certificate certifying compliance to the revised levels at the end of each of the two financial years as prescribed above. The RBI will initiate procedures for the cancellation of the certificate of registration (CoR) against NBFCs that fail to achieve the prescribed NOF levels within the stipulated time period.

Minimum Tier 1 capital for CRAR purposes

For NBFC-ND-SI, there is no change in the total minimum CRAR requirement of 15%. However, the framework requires increase in minimum Tier 1 capital to 10% in a phased manner.

Existing
Tier 1 capital of 7.5%

2016
Tier 1 capital of 8.5% by March 2016

2017
Tier 1 capital of 10% by March 2017

Provision for standard assets

There is no change for NBFC-ND which are still required to maintain the provision for standard assets at 0.25% of the outstanding assets. However, for NBFC-ND-SI, the provision for standard assets has increased from 0.25 to 0.40% in a phased manner.

March 2016: 0.30%

March 2017: 0.35%

March 2018: 0.40%

Asset classification: Non-performing asset

The new framework stipulates assets to be classified as non-performing assets (NPA) on an accelerated basis. Loan assets will be classified as non-performing assets if the assets are overdue for a period of three months or more in a phased manner, compared to the earlier framework of six months or more. Similarly, lease rental and hire purchase assets will be classified as non-performing assets if overdue for a period of three months or more compared to the earlier framework of 12 months or more. This new framework will significantly impact NBFCs that lend to customers who do not rely on the banking segment. Such NBFCs might find it difficult to comply with the new three-month rule, resulting in classification of such loans as non performing ones. Examples could be NBFCs in tractor financing and commercial vehicle financing segment.

Asset classification: Sub-standard asset

The new framework stipulates that an NPA needs to be classified as a sub-standard asset for a period not exceeding 12 months in a phased manner compared to the earlier framework of 18 months.

Asset classification: Doubtful asset

The new framework stipulates that a sub-standard asset needs to be classified as a doubtful asset for a period not exceeding 12 months in a phased manner compared to the earlier framework of 18 months.

The Ministry of Corporate Affairs has made Indian Accounting Standards (Ind AS) applicable for certain categories of companies but has excluded NBFCs, banking companies and insurance companies. It is likely that, when Ind AS is made applicable to NBFCs, they will be required to comply with Ind AS 109 (based on IFRS 9). It will be interesting to see how the RBI's loan loss provision norms will interact with the requirements of Ind AS 109 which is an expected credit loss model. It is expected that Ind AS 109 model will result in higher loan loss provisioning.

Requirements of Ind AS 109 and its three stages in impairment or loan loss assessment

Stage 1	*Stage 2*	*Stage 3*
Performing on initial recognitions	Under-performing: Assets with significant increase in credit risk since initial recognition	Credit-impaired assets, i.e. objective evidence of impairment (Rebuttable presumption of **90 days past due)**
Interest revenue calculated on gross carrying amount **12-month expected losses** = lifetime expected credit losses associated with the probability of a loss in the 12 months after the reporting date.	Interest revenue calculated on gross carrying amount **Lifetime expected credit loss allowance**	Interest revenue calculated on the **net** carrying amount **Lifetime expected credit loss allowance**

	Existing framework	New framework		
	March 2015	March 2016	March 2017	March 2018
NPA	Overdue => 6 months for loan assets and overdue => 12 months for lease /hire-purchase assets	Overdue => 5 months for loan assets and overdue => 9 months for lease/ hire-purchase assets	Overdue => 4 months for loan assets and overdue => 6 months for lease/ hire-purchase assets	Overdue => 3 months for loan assets and overdue => 3 months for lease/ hire-purchase assets
Sub-standard	NPA for 18 months	NPA for 16 months	NPA for 14 months	NPA for 12 months
Doubtful	sub-standard for 18 months	Sub-standard for 16 months	Sub-standard for 14 months	Sub-standard for 12 months

Leverage ratio

For NBFC-ND, the new framework prescribes a leverage ratio whereby the total outside liabilities is not to exceed seven times the owned funds.

Additional governance requirement and disclosure norms prescribed for NBFC-ND SI and NBFCs-D

Companies are already required to comply with the enhanced governance norms imposed by the Companies Act, 2013 such as the need for independent directors, woman directors, a vigil mechanism, etc. In addition to these, NBFC regulations have also prescribed further requirements.

Board committees

The constitution of the following committees is required:

- Audit committee
- Nomination committee
- Risk management committee

Audit partner rotation

The new framework prescribes partner of the audit firm to rotate every three years.

Information systems audit

The audit committee is required to ensure that information systems audit is conducted at least once in two years.

Fit and proper criteria for directors

NBFCs-ND-SI and NBFCs-D are now required to put in place a policy for ascertaining the 'fit and proper criteria' for directors in accordance with the guidelines that have been prescribed.

There are also increased requirements for directors to provide declaration or undertaking and quarterly filings with the RBI.

Additional disclosures in financial statements

The new framework has significantly increased the disclosure requirements in the financial statements. Additional disclosures to be made in the financial statements of NBFC-ND-SI and NBFC-D include the following:

- Registration, licence, or authorisation obtained from other financial sector regulators
- Ratings assigned by credit rating agencies and migration of ratings during the year
- Penalties, if any, levied by any regulator
- Information i.e. area, country of operation and joint venture partners with regard to joint ventures and overseas subsidiaries
- Asset liability profile, extent of financing of parent company products, NPAs and movement of NPAs, details of all off-balance sheet exposures, structured products issued, securitisation or assignment transactions and other disclosures that have been prescribed

The exhaustive list of the required disclosures and the indicative templates, are provided in the Annexure 4 to the circular DNBR (PD) CC.No.002/03.10.001/2014-15.

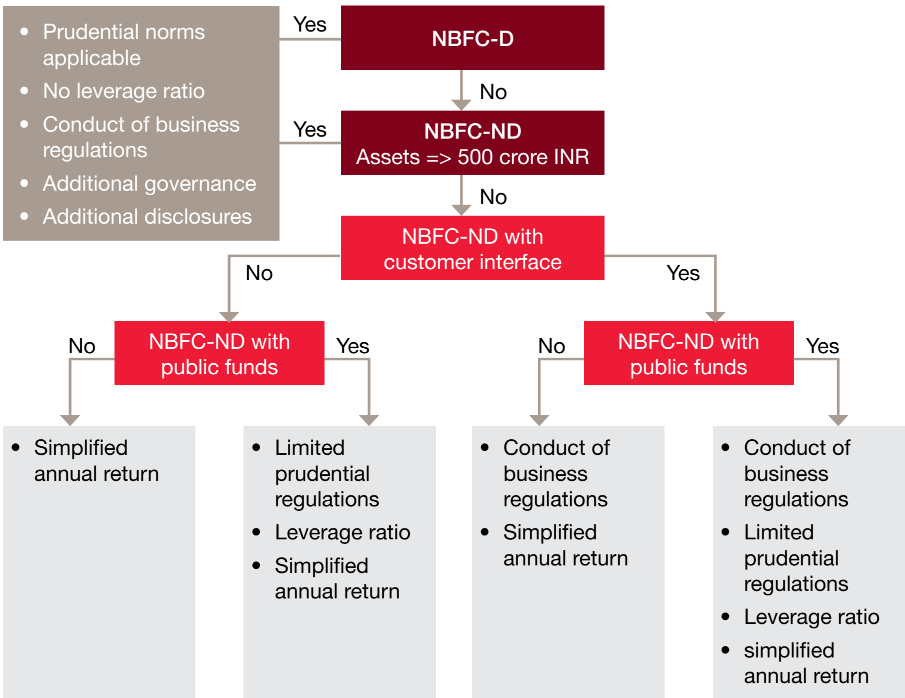
Other matters

- If there are multiple NBFCs in a group, total assets of all NBFCs within it (including NBFC-D) are to be considered for the purposes of NBFC categorisation as NBFC-ND or NBFC-ND-SI. Statutory auditors are required to certify the asset size of all NBFCs in the group.
- NBFC-D to continue to be governed by NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 1998 and NBFC (Deposit Accepting or Holding) Prudential Norms (Reserve Bank) Directions, 2007 and other applicable regulation.
- Only rated asset finance companies (AFC) are permitted to accept deposits. Existing unrated AFCs to obtain a rating by 31 March 2016 in order to continue to accept deposits.
- Limit of acceptance of deposits by AFCs has been reduced from four times of NOF to 1.5 times of NOF.

Applicability of prudential norms

Prudential norms have been made applicable based on the category of NBFC and vary in terms of the extent of applicability.

The applicability of prudential norms as a result of the new NBFC framework



Conclusion

The impact of these regulations is expected to be significant not just on the operations but also financial statements of NBFCs. These NBFCs will have to take a closer look at many of the new requirements such as increased provision for standard assets, requirement for higher Tier 1 capital and compliance with the various governance norms in addition to already existing enhanced requirements under the Companies Act, 2013.

Auditor reporting standards: A move towards greater transparency

Background

In January 2015, the International Auditing and Assurance Standards Board (IAASB) issued its revised auditor reporting standards and related conforming amendments intended to provide greater transparency on how an audit is performed. The standards are applicable for audits conducted per international auditing standards. The final standards, among other matters, require reporting of key audit matters, the inclusion of the name of the engagement partner in the auditors' reports of listed entities, as well as enhanced information about an entity's ability to continue as a going concern for audits of all entities. The suite of revised standards issued is as follows:

- ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements
- ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report (new)
- ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report
- ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
- ISA 570 (Revised), Going Concern
- ISA 260 (Revised), Communication with Those Charged with Governance

The revised ISA 705, ISA 706 and ISA 260 are largely similar to their previous versions with significant changes being made in ISA 700 and ISA 570. The new and revised auditor reporting standards will be effective for audits of financial statements for periods ending on or after 15 December 2016.

Form and content

There are significant changes in the form and content of the auditor's report beginning with the inclusion of the opinion paragraph at the beginning of the report followed by basis of opinion, management's responsibility and auditors' responsibility. Where the auditor is required by the law or a regulation of a specific jurisdiction to utilise a specific layout or wording of the auditor's report, the report will need to include, at a minimum, the specified elements for the report in order to be considered in compliance with ISAs.

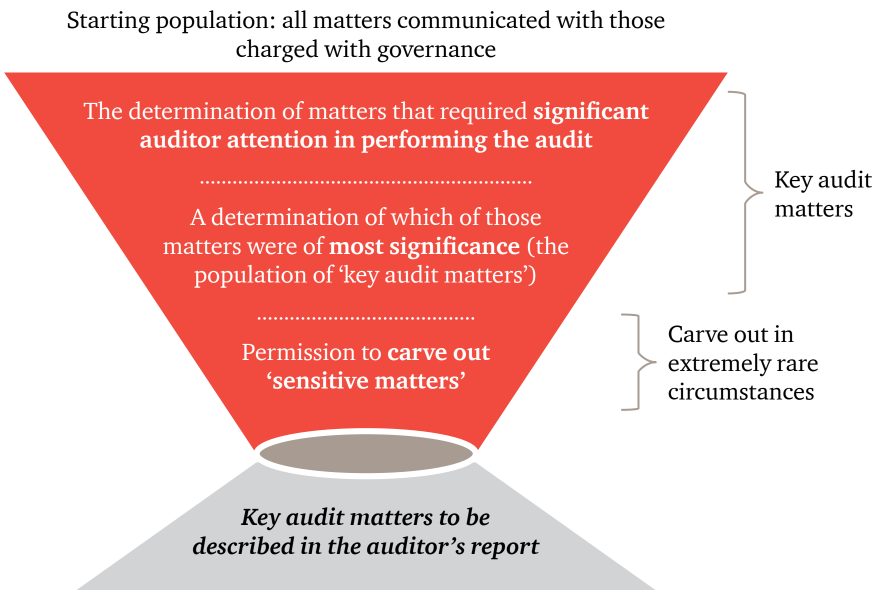
Another significant feature is the inclusion of an affirmative statement about the auditor's independence and the auditor's fulfilment of relevant ethical responsibilities, with disclosure of the jurisdiction of origin of those requirements or reference to the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants. In case of listed entities, the ISA specifically requires the inclusion of the name of the engagement partner within the auditors' report.

Additionally, description of both, the responsibilities of the auditor as well as the key features of an audit has been expanded considerably. In fact, the description of auditor's responsibility is so extensive that the standard itself gives an option of including it as an appendix to the auditors' report. Further, the standard also explains that when a law, regulation or national auditing standards expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including the material in the auditors' report.

Key audit matters (KAM)

The auditors' report now includes a new section on KAM, the subject of the new standard, ISA 701. The purpose of communicating KAM is to enhance the communicative value of the auditor's report by providing greater transparency on the audit that was performed. ISA 701 sets out a decision framework for auditors using the communications with those charged with governance as a starting point. From the matters communicated to those charged with governance, the auditor is require to determine those matters that required significant auditor attention. From thereon, the auditor is required to determine which of these matters were of most significance in the audit of the financial statements of the current period and are therefore to be considered as KAM.

Selecting key audit matters



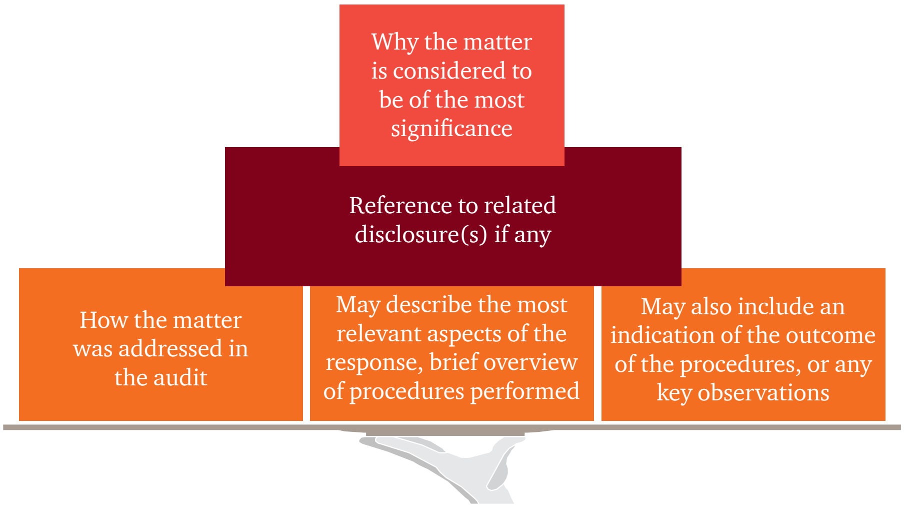
Further, ISA 701 allows for the possibility, in extremely rare circumstances, that the auditor not communicate a matter determined to be a KAM when the adverse consequences of doing so will reasonably be expected to outweigh the public interest benefits of such communication (e.g., consideration that such aspects include harm to the entity's commercial negotiations or competitive position). This exception does not apply if the entity has publically disclosed information about the matter.

It is essential to note that a KAM is not a substitute for expressing a modified opinion. Examples of KAMs can include significant estimates, manner in which the management has carried out impairment assessments, estimates involved in significant business combinations, including purchase price allocations and contingent considerations, fair value estimates, among others.

The description of a KAM in the auditor's report needs to include a reference to the related disclosure (if any) in the financial statements and is always required to include the following:

- Why the matter was considered to be one of most significant in the audit and therefore determined as a KAM
- How the matter was addressed in the audit

Description of key audit matters: Key inclusions



Going concern

Significant changes have been introduced in ISA 570 which applies to audits of all entities. Where a material uncertainty exists and disclosures relating to going concern, including the material uncertainty are considered adequate, a new separate paragraph needs to be included in the auditors' report under the heading 'Material Uncertainty Related to Going Concern', drawing attention to those disclosures. This varies from the previous version of ISA 570 which requires the inclusion of an 'emphasis of matter' paragraph under such circumstances.

Additionally, if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained, the auditor concludes that no material uncertainty exists, ISA 570 requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

In summary

Reporting of key audit matters and inclusion of the name of the engagement partner will apply to audits of financial statements of listed entities that are conducted in accordance with ISAs. Other reporting provisions will apply to all audits conducted in accordance with ISAs.

Readers of audit reports will now have to acquaint themselves with a fresh look and feel of an audit report as compared to the existing boiler plate language.

Considering that the auditing standards in India are aligned to the ISAs, it may not be long before ICAI may also take up a similar project on its agenda.

Importance of revenue assurance

Why was the alert issued? How does it matter?

An auditor is required to evaluate whether the company's selection and application of accounting principles are appropriate for its business and consistent with the applicable financial reporting framework and the accounting principles as relevant for its industry.

The Public Company Accounting Oversight Board (PCAOB) issued its Staff Alert No 12: Matters Related to Auditing Revenue in an Audit of Financial Statements. For companies, revenue is one of the largest financial statement accounts and is an important driver of a company's operating results. Revenue is also an important indicator of the company's growth to the users of financial statements. Despite having such significance in financial statements, improper revenue recognition is one of the most frequent problems in financial statements. Historically, fraudulent financial reporting cases have involved intentional misstatement of revenue. According to the Committee of Sponsoring Organisations (COSO) of the Treadway Commission, improper revenue recognition is the most common method used to falsify financial statement information.

In a 2010 study of the US Securities and Exchange Commission enforcement actions from 1998 to 2007, COSO found that 61% of the companies involved had recorded revenue inappropriately, either by creating fictitious transactions or by recording revenue prematurely.

Due to the significance of revenue in a company's financial results, the audit committee needs to consider taking an enhanced interest around the auditing of revenue including the auditor's approach to auditing revenue.

In audits, revenue typically is a significant account, often involving significant risks that warrant special audit consideration. Because of the importance of auditing revenue, it is often a focus area in PCAOB inspections which have frequently noted significant audit deficiencies wherein auditors failed to carry out sufficient auditing procedures. In order to address the significant audit deficiencies noted in the audit of revenue, the PCAOB issued the Staff Audit Practice (SAP) Alert No 12, Matters Related to Auditing Revenue in an Audit of Financial Statements late in 2014.

Although PCAOB requirements apply to external audit firms, the practice alert is of significance to company management in two ways–one helping them gear up to meet audit requirements and more importantly, providing insights to strengthen their internal control systems in this area to make internal control evaluation and assessment.

Accordingly, it will be useful for company management and audit committees to remain familiar with some of these observations from the regulator.

This alert is intended to strengthen auditor performance requirements for identifying, assessing and responding to the risks of material misstatement associated with revenue recognition.

PCAOB staff observations on revenue recognition, presentation and disclosure

Some frequently observed audit deficiencies with respect to revenue include issues around testing revenue recognition, presentation and disclosure.

Where the company's accounting policy for revenue recognition is more aggressive than its industry peers, the audit committee and the auditors need to evaluate it as it could indicate a risk of material misstatement.

1. **Testing of revenue recognition for contractual arrangements**
   The SAP alert highlights deficiencies observed around revenue recognition with respect to construction or production type contracts and multiple element arrangement. Consequently, some areas that require enhanced focus include the following:

   (a) Evaluating whether the revenue recognition model followed by the company conforms to the applicable financial reporting framework

   (b) Evaluating whether revenue was appropriately recognised under the contractual arrangements. For instance, sufficient procedures were not performed to understand the contractual terms and conditions, such as transfer of title, risk of loss and delivery and acceptance terms

   (c) Evaluating the effect of the nonstandard contractual terms on recognition of revenue

   (d) In relation to construction or production type contracts, testing the management's estimated costs to complete projects; testing the progress of the construction or production contracts or evaluating the reasonableness of the company's approach for applying the percentage-of-completion method of accounting

   (e) Under multiple-element contractual arrangements, evaluating each of the deliverables to determine whether they represent separate units of accounting and testing the value assigned to the undelivered elements

Revenue recognition also involves accounting estimates and therefore auditors need to apply the requirements of the relevant standards which would be AU Section 328, Auditing Fair Value Measurements and Disclosures, if the accounting estimate is a fair value measurement. For other estimates, the requirements of AU Section 342, Auditing Accounting Estimates shall apply.

In this regard, the company's responsibility includes providing to the auditor a detailed understanding of how estimates are developed to assist the auditor in evaluating the appropriateness of the company's methods and the reasonableness of the management's assumptions used in the estimates and related disclosures, as well as the completeness and accuracy of company data used in the estimates.

2. Testing of revenue recognition for contractual arrangements

The SAP alert emphasised that the auditor's evaluation around the presentation of revenue in the financial statements requires to be enhanced. It is important that the auditor understand the contractual terms of sale to evaluate whether the company is a principal or an agent in the transaction to evaluate the presentation of revenue.

This is becoming increasingly complex especially due to evolving and newer business models, where some of the traditional indicators of gross versus net presentation may not be present.

> The company's presentation of revenue – gross basis (as a principal) versus net basis (as an agent) should be in conformity with the applicable financial reporting framework.

3. Recognising revenue in the correct period cut-offs

It is extremely important that sufficient cut-off procedures are performed in order to address the risk of material misstatement. The SAP alert highlights that generally auditors fail to perform adequate procedures around cut-off. Consequently, the auditor shall obtain appropriate audit evidence testing that the company has appropriately recorded revenue. Further, the auditor should not rely on untested company-generated information for such purposes. For example, in case of sales invoices or inventory records, the auditor needs to obtain evidence to test whether the delivery of goods has occurred or the service had been performed.

> The risk of material misstatement due to recognition of revenue in the incorrect period might be a risk of error (problems with related company systems or controls) or a risk of fraud (intentionally recognising revenue prematurely), both resulting in improper revenue recognition.

It is equally important that company management institute adequate internal controls in this area in order to mitigate the risk of improper revenue recognition. This also requires company personnel to have a good understanding of the contractual terms of revenue arrangements.

4. Disclosures

In relation to disclosures, companies are expected to ensure that their revenue recognition policies around multiple-element arrangements including warranty policies are in compliance with GAAP and appropriate disclosures are made with respect to new lines of business. The SAP alert highlights that auditors did not carry out sufficient procedures to evaluate whether the disclosures of revenue in the financial statements were in conformity with the applicable financial reporting framework.

The risk of material misstatement to the financial statements includes consideration of the risk of omitted, incomplete or inaccurate disclosures. Although the evaluation of uncorrected misstatements requires the consideration of both qualitative and quantitative factors, qualitative factors are important in the evaluation of misstatements in disclosures which are more narrative in nature.

Other areas

The SAP alert highlighted other areas that require enhanced efforts from auditors and consequently increased involvement from the company to provide the relevant information and audit evidence. Some of the areas requiring additional focus are as follows:

Other aspects	Enhanced procedures
Fraud risks and revenue	• Perform specific procedures to respond to fraud risk including improper revenue recognition. • Address fraud risk related to side agreements. • Perform substantive procedures that are specifically responsive to assessed fraud risks. • Incorporate an element of unpredictability in audit procedures and appropriate professional skepticism.

Studies have identified a number of fraud schemes involving material misstatement of revenue. Examples of techniques include sham sales, recording sales even though there are unresolved contingencies, round tripping or recording loans as sales, improper cut-off, recording revenue for consignment shipments, etc.

Controls over revenue cycle	The auditor must rely on controls only where such reliance can be supported by: 1. sufficient testing of controls (e.g. testing the entire period) 2. the results of control tests does not identify deficiencies indicating controls were ineffective 3. procedures to test the design and operative effectiveness of the controls are sufficient as they address relevant assertions
Substantive analytics	Perform substantive analytics only where the auditor can develop a sufficiently precise expectation, can perform procedures to obtain evidence to corroborate the management's response regarding unexpected differences or is able to test the completeness and accuracy of the information obtained from the company. Failure in any of these procedures will render procedures ineffective.
Revenue from multiple locations	To consider the specific risks attributable to individual locations or reliance on entity level controls to reduce substantive testing at certain locations only after considering the effect of identified control deficiencies

Way forward

The PCAOB staff practice alert attempts to bring improvements in the audit of revenue by focussing on revenue recognition, presentation and disclosure matters including multiple-elements arrangements. The observations in this alert are also handy for company management as they evaluate and continue to strengthen their internal control systems with respect to their revenue process.

The guidance included in this alert will also be useful for both companies and auditors as they navigate through the significant changes that will result from the new revenue accounting standard under US GAAP and IFRS.

Finally, it will be helpful for the auditors, audit committee and management to discuss early the audit approach in light of observations from this alert.

Accounting for derivative contracts

Background

The ICAI recently issued the long-awaited exposure draft of the Guidance Note on Accounting for Derivative Contracts (the Guidance Note). This exposure draft was open for comments till 21 January 2015. The objective of this Guidance Note is to provide guidance on the recognition, measurement, presentation and disclosure for derivative contracts so as to bring uniformity in the accounting and presentation of financial statements.

Application

The Guidance Note once adopted in its present form will be applicable to all companies including banking, non-banking finance companies and insurance entities unless the guidance for accounting of derivative contracts prescribed in this Guidance Note is in conflict with specific accounting treatment prescribed by the concerned regulators i.e. the Reserve Bank of India, Insurance and Regulatory Development Authority.

Presently, companies are required to follow the guidance provided by the ICAI in its announcement dated 28 March 2008. This announcement permitted companies to adopt the principles of AS 30: Financial Instruments: Recognition and Measurement (AS 30) with respect to accounting for derivatives (to the extent it did not conflict with any of the notified accounting standards) or required mark to market the derivatives with the resultant losses being recognised in the statement of profit or loss. While the announcement required companies to recognise the losses, it did not allow for the recognition of gains.

The mandatory status of the aforesaid accounting standards on financial instruments was kept in abeyance for the last few years as these could neither be made mandatory by way of notification nor could the ICAI extend the recommendatory status of these standards. This is in view of the project undertaken by IASB with an objective to improve and simplify the reporting for financial instruments.

Pending convergence with the new standard on financial instruments (IFRS 9) issued by the IASB and adoption of the Ind AS by companies in India, the ICAI decided to provide interim guidance to the preparers of the financial statement with respect to derivatives contracts and hedging activities. Once this Guidance Note becomes applicable, announcements[1] from the ICAI with respect to accounting, presentation and the disclosure of derivative contracts will be withdrawn. Further, companies will have another option of accounting for derivatives at the fair value as on the balance sheet date (basis the guidance note), apart from the option of recognizing mark to market losses as per the ICAI announcement or the option to follow the principles of AS 30.

In addition to providing guidance on recognition, measurement, presentation and disclosure for derivative contracts, the Guidance Note specifies accounting treatment for such derivatives where the hedged item is covered under any other notified accounting standards, e.g., a commodity, an investment, etc., because except Accounting Standard 11, The Effects of Changes in Foreign Exchange Rates, no other notified accounting standard prescribes any accounting treatment for derivative accounting. This Guidance Note, however, does not cover foreign exchange forward contracts which are within the scope of AS 11 and also does not prescribe any accounting treatment with respect to embedded derivatives.

Synthetic accounting

The Guidance Note does not permit synthetic accounting i.e., accounting by combining a derivative and the underlying together as a single contract. For example, an entity may treat a foreign currency borrowing as INR borrowing by entering a cross-currency swap arrangement to hedge the same. Treating the loan and swap as one single contract is termed as 'synthetic accounting' and this approach will not be permitted under the Guidance Note. Thus, an entity will be required to recognise the loan liability separately from the cross-currency swap and not treat them as INR loan i.e. single contract. Similarly, corporates who have borrowed funds in terms of INR and are treating these loans as foreign currency loans by entering into swap arrangements will not be able to do so.

Hedging

Further, in line with IFRS 9, the guidance note permits but not does not require designation of a derivative contract as a hedging instrument. It gives the management the flexibility to specify their hedge ratio which is effective in meeting their risk management objective and retaining its focus on hedge documentation which can demonstrate how derivatives help meet those objectives. The guidance note also provides guidance with respect to net investment in foreign operations.

[1] Following ICAI announcements stand withdrawn with the issuance of the Guidance Note on Accounting for Derivative Contracts

- Applicability of AS 11 with respect to exchange differences arising on a forward exchange contract entered to hedge the foreign currency risk of a firm commitment or a highly probable transaction
- Announcement in 2005 on disclosures regarding derivative instruments
- Accounting for derivatives dated 29 March 2008 published in 'The Chartered Accountant', May 2008
- Application of AS 30 published in 'The Chartered Accountant', April 2011 to the extent of the guidance covered for accounting for derivatives within the scope of this Guidance Note

The approach to hedge accounting in this guidance note appears to be nearer to IFRS 9. There is no reference to testing hedge effectiveness quantitatively as it is done currently under IAS 39 (at least for the retrospective test). The guidance note has certainly taken several steps in the right direction. However, diversity in practice may still arise in the absence of any explanation on how to monitor the hedge ratio and ability to judge an imbalance between the weighing of the hedged item and the hedging instrument that would create hedge ineffectiveness.

Further, it is not clear whether using the principles of hedge accounting as envisaged in the Guidance Note will be considered as change in accounting policies where a company is already following the principles of AS 30.

Presentation and disclosure

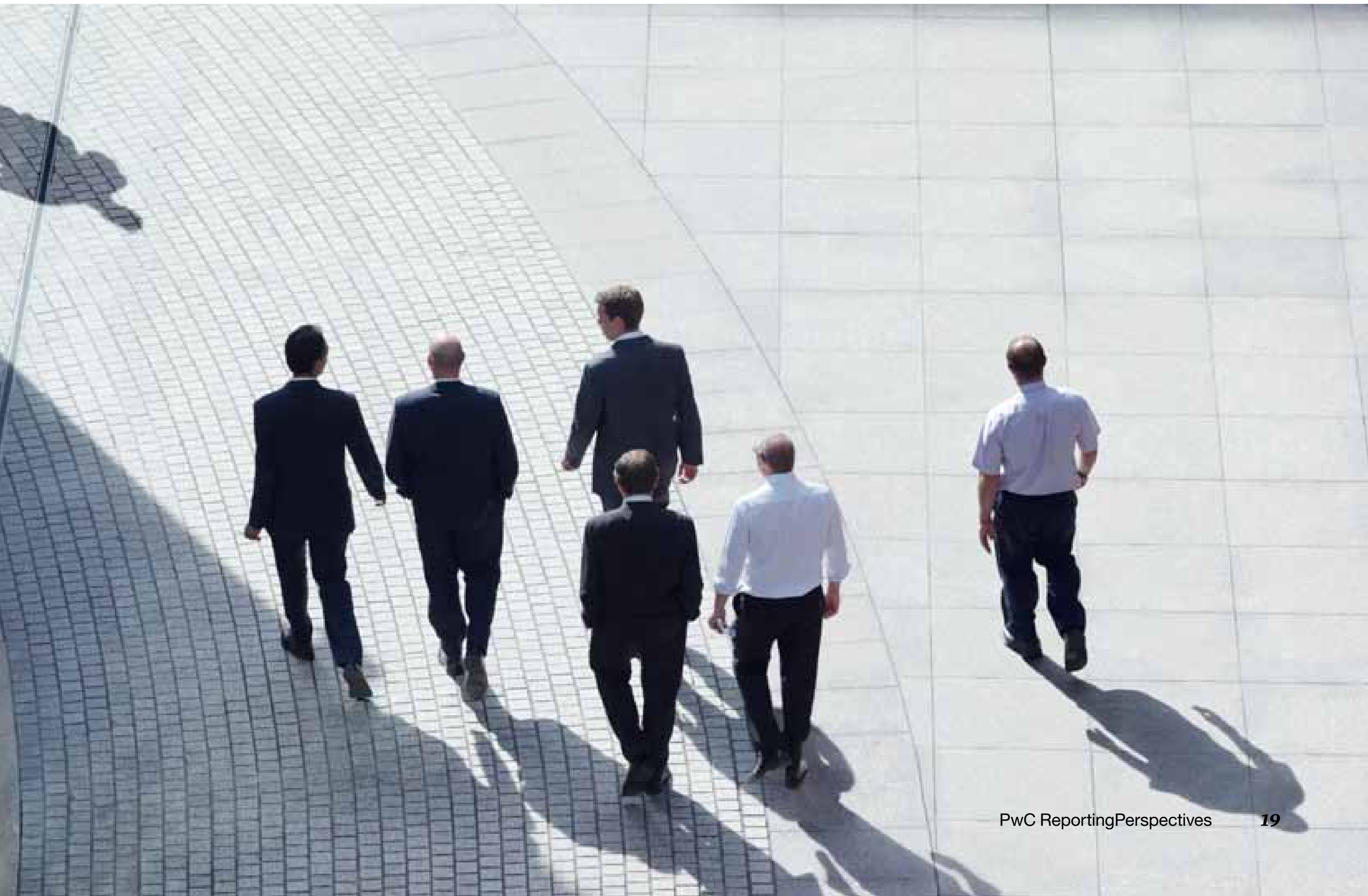
With regard to the presentation of derivative contracts in financial statements, the Guidance Note recommends the presentation of derivative assets and liabilities recognised on the balance sheet at fair value as current and non-current based on the nature of the derivative contracts with certain considerations. For example, derivatives that are hedges of recognised assets or liabilities need to be classified as current or non-current based on the classification of the hedged item. Similarly, derivatives that are hedges of forecasted transactions and firm commitments should be classified as current or non-current based on the settlement or maturity dates of the derivative contracts.

Further, the Guidance Note requires gross disclosure of assets and liabilities, with one exception where basis adjustment is applied under cash flow hedges. Also, it allows amounts recognised in the statement of profit and loss for derivatives not designated as hedges to be presented on a net basis.

The Guidance Note requires the company to disclose its risk management policies along with specific disclosures about its outstanding hedge accounting relationships.

Conclusion

The Guidance Note proposes that it will come into effect with respect to accounting periods beginning on or after 1 April, 2015. It is also interesting that this Guidance Note is being issued by the ICAI as an interim measure to provide recommendatory guidance on accounting for derivative contracts and hedging activities, considering the lack of mandatory guidance in this regard. It is also relevant to consider that the Ind AS have been notified and the first set of companies mandated to follow the Ind AS, will do so for accounting periods commencing 1 April 2016. These companies will need to mandatorily comply with the Ind AS Standards on Financial Instruments on transition. It is, therefore, expected that this Guidance Note provides guidance to those companies which do not transition to the Ind AS in the near future.



Union Budget 2015: Key highlights

Promoting and incentivising Make in India

- Restoration of income tax on royalties and fee for technical services received by non-residents to 10 from 25%.
- Phased reduction of corporate tax rate from 30 to 25% over the next four years.
- Reduction in basic customs duty rate on specific items of inputs to address inverted duty structure concerns and to reduce manufacturing costs.
- Reiteration of government's resolve of rolling out GST from 1 April 2016 and reiteration of presenting the Land Acquisition Ordinance to the current session of the Parliament in order to enact it.
- Reduction of the threshold for weighted deduction from corporate tax for wages of new workmen from 100 to 50, benefit extended to even non-corporate taxpayers.
- Extension in excise duty exemption and concessions for manufacture of cleaner technology vehicles (that is, hybrid and electrically operated vehicles).
- Special additional duty exemption on import of raw materials for use in the manufacture of specific goods (ITA bound goods, LED lights, pacemakers).

Ensuring the much-needed ease of doing business in India

- Introduction of the principle of composite cap (FDI and FPI) in order to simplify the calculation of foreign investment limit in sectors where FDI cap is applicable (e.g. retail, banking, brownfield pharma, etc).
- Powers to make or amend rules related to foreign and outbound investments to be vested with the government, being a policy matter. This simplification,to ensure a faster policymaking process, requires a legislative amendment in the Foreign Exchange Management Act (FEMA).
- Establishment of a business in India to be made easy by prescribing simple compliance with a pre-existing regulatory mechanism instead of prior multiple approvals permissions. An expert committee to be set up in order to examine and make recommendations in this regard.
- Introduction of a comprehensive Bankruptcy Code of global standards in the year 2015-16.
- Implementation of the General Anti Avoidance Rule (GAAR) deferred by two years. GAAR provisions to be applicable from FY 2017-18 onwards.
- Threshold for specified domestic transactions (domestic transfer pricing provisions) has been raised from 5 crore INR to 20 crore INR.
- Advance ruling option for customs, excise and service tax extended to resident firms (including partnership firms, sole proprietorship and one-person companies).

Measures to curb black money

- Introduction of a separate bill for a comprehensive new law for black money parked outside India. Towards this, stringent measures proposed to be introduced for non-disclosure of overseas income and assets, including rigorous imprisonments and steep penalties.
- Introduction of the Benami Transactions (Prohibition) Bill for curbing domestic black money on the anvil.
- Confiscation of overseas assets held by Indian residents in violation of FEMA regulations or equivalent Indian assets held by the resident. FEMA or the Prevention of Money Laundering Act to be amended to this effect.

Indirect transfer rules clarified

- The interest or share in an Indian company to be deemed to derive value substantially from India, if the fair market value of Indian assets (without reduction of liabilities) exceeds 10 crore INR and represents at least 50% of the value of all assets owned by the transferor entity.
- A transaction not to be taxed if the transferor (along with associate enterprises) neither holds the right of control or management nor holds the voting power, share capital or interest exceeding 5%.
- Indirect transfer on account of group reorganisation exempted subject to meeting specified conditions.
- The Indian entity within the chain obligated to furnish information related to the transaction. Failure to report may attract a penalty of up to 2% of the transaction value.
- The Central Board of Direct Taxes to clarify that the dividends declared by a foreign company from its Indian source income not to be subject to indirect transfer rules.

Special benefits to financial investors and financial services sector

- Foreign investments in alternate investment funds (AIFs) to be permitted. Entail the issue of an enabling policy framework.
- In case of eligible offshore funds, fund management activity carried out through independent fund managers in India not to constitute a taxable presence in India albeit subject to conditions.
- Rationalisation of the tax regime of the real estate investment trust (REIT) and infrastructure investment trust (InvIT).
- Concessional rate of 5% withholding tax on interest payable to FIIs and QFIs on their investment in government securities and rupee denominated bonds to be available upto 30 June 2015.
- Benefit of reduced tax rate of 5% on rupee denominated bonds issued to QIP extended upto 30 June 2017.
- Capital gain income of FII (other than short-term capital gain not subject to securities transaction tax) to be excluded from the levy of minimum alternate tax (MAT).
- In case of merger of similar scheme of mutual funds, no capital gains arise in the hands of the unit holder.
- Non-banking finance companies with a minimum asset size of 500 crore INR to be empowered so as to enforce its security interest in non-performing assets. The SARFAESI Act, 2002 to be amended to this effect.
- The Forwards Markets Commission to be merged with the capital markets regulator (Securities Exchange Board of India) in order to strengthen the regulation of commodity forward markets and reduce speculation.
- Any interest payable by an Indian branch of a foreign bank to its head office to be income deemed to accrue or arise in India, also subject to withholding tax.

Direct tax rationalisation measures

- The Wealth Tax Act, 1957 to be abolished and compensated by an increased levy of surcharge on taxpayers earning higher income. Effective increase in the tax rate for the affluent (including corporates) in FY 15-16 on account of this additional 2% surcharge.
- Rationalisation of the criteria for tax residency of companies to include the concept of place of effective management.
- In order to avoid ambiguity, any person responsible for paying any sum, whether chargeable to tax or not, to a non-resident, to be required to furnish the information of such sum in prescribed forms.
- Rationalisation of provisions related to the Income Tax Settlement Commission.

Important indirect tax proposals

- Service tax rate effectively increased from 12.36 to 14%. Enabling provision introduced to empower the imposition of the additional Swach Bharat Cess at the rate of 2%.
- Rationalisation of the general rate of excise duty from 12.36 to 12.5%.
- Rate of clean energy cess increased from 100 INR per tonne to 200 INR per tonne on specific products.
- Increase in additional duty of excise on manufactured HSD and motor spirits (petrol) from 2 INR per litre to 6 INR per litre. However, no change in the effective excise duty rate.
- Service tax net widened by including new services and withdrawal of some exemptions. An indicative list includes the following:
  - Entry to entertainment events and amusement facility
  - Job-work activity for manufacture of alcohol for human consumption
  - Transportation service of food items by rail, vessels, road limited to food grains, including rice and pulses, flour milk and salt
  - Services provided by a mutual fund agent and distributor to an MF or an AMC
- Service tax exemption extended to the following areas:
  - Ambulance services provided to patients
  - Life insurance service provided by way of Varishtha Pension Bima Yojna
  - Services provided by a common effluent treatment plant operator for treatment of effluent
  - Services of pre-conditioning, pre-cooling, ripening, waxing, retail packing, labeling of fruits and vegetables

Recent technical updates

The Companies Act, 2013

Amendment to the Companies (Cost Records and Audit) Rules, 2014

Through this amendment, the MCA has prescribed the maintenance of the cost records for products and services provided by a class of companies, having an overall turnover from all its products and services of 35 crore INR or more during the immediately preceding financial year.

For companies in regulated sectors, the cost audit is mandated for such class of companies where the aggregate annual turnover is 50 crore INR or more on an overall basis and the aggregate turnover of individual products or services for which cost records are required is 25 crore INR or more in the immediately preceding year.

The limits in case of non-regulated sectors are 100 crore INR or more on overall basis, and 35 crore INR or more for the individual products or services.

Amendment to the Companies (Accounts) Rules, 2014

In rule 6, after the third proviso, the following proviso has been inserted:

"Provided also that nothing in this rule shall apply in respect of consolidation of financial statement by a company having subsidiary or subsidiaries incorporated outside India only for the financial year commencing on or after 1 April, 2014."

Accordingly, on the basis of the above amendment, a company having a subsidiary or subsidiaries outside India will not be required to mandatorily prepare its consolidated financial statements for the year ending 31 March 2015.

Amendment to the Companies (Corporate Social Responsibility Policy) Rules, 2014

In the Companies (Corporate Social Responsibility Policy) Rules, 2014, the following changes have been made in rule 4(5):

- For the words 'established by the company or its holding or subsidiary or associate company under section 8 of the Act or otherwise', the words 'established under section 8 of the Act by the company, either singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company' or otherwise" shall be substituted.

- In the proviso, in clause (i), for the words 'not established by the company or its holding or subsidiary or associate company' it', the phrase 'not established by the company, either singly or along with its holding or subsidiary or associate company' or along with any other company or holding or subsidiary or associate company of such other company' shall be substituted.

This change effectively allows companies to collaborate with companies outside their group for undertaking CSR activities through section 8 (companies set up for charitable purposes) companies set up by such companies outside the group.

Companies (Removal of Difficulties) Order, 2015

This order clarifies the following issues:

- **Small company:** The word 'or' as appearing in section 2(85) has been deleted, thereby making both the conditions compulsory for determining if a company can be classified as a 'small company'. In other words, in order to be classified as a 'small company', a company (other than a public company) must have a paid-up capital of 50 lakh INRor less (or such higher amount as may be prescribed which shall not be more than 5 crore INR) and a turnover, as per the last statement of profit and loss, of 2 crore INR or less (or such higher amount as may be prescribed which shall not be more than 20 crore INR). If only one of these conditions is met then the company shall not be treated as a 'small company'.

- **Exemption under section 186:** The order clarifies that requirements of section 186 related to the conditions with respect to loans and investments by a company (except sub-section (1)) will not apply to any acquisition made by a banking, insurance or housing finance company, making an acquisition of securities in the ordinary course of their business.

Applicability of sections 185 and 186 to loans given to employees

The MCA has issued a general circular to clarify that the provisions of sections 185 and 186 which deal with loans extended by the company, do not apply loans or advances given by the companies to their employees (other than the managing directors and whole-time directors), provided the following conditions are met:

- The loans or advances are in accordance with the conditions of service applicable to the employees

- The loans and advances are in accordance with the remuneration policy (where such policy is required to be formulated)

SEBI

Securities and Exchange Board of India (Prohibition Of Insider Trading) Regulations, 2015

SEBI has issued the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 in order to put in place a framework for the prohibition of insider trading in securities and to strengthen the legal framework thereof.

Institute of Chartered Accountants of India

Exposure draft on corporate social responsibility

The ICAI has issued an exposure draft of frequently asked questions on the provisions of corporate social responsibility under section 135 of the Companies Act 2013 and Rules thereon.

Guidance Note on Accounting for Rate Regulated Activities (second edition: February 2015)

The ICAI has issued the second edition to the Guidance Note on Accounting for Rate Regulated Activities to be effective from accounting period beginning on or after 1 April 2015. Early adoption of the Guidance Note is also permitted.

2015 Guidance Note on Audit of Banks released by Auditing and Assurance Standards Board

The Auditing and Assurance Standards Board of the ICAI has issued the Guidance Note on Audit of Banks 2015 edition.

Global updates

IFRS

Exposure Draft: Classification and Measurement of Share-based Payment Transactions (Proposed amendments to IFRS 2)

The International Accounting Standards Board (IASB) has published this exposure draft of proposed amendments to IFRS 2 Share-based Payment to address the following:

- The effects of vesting conditions on the measurement of a cash-settled share-based payment
- The classification of share-based payment transactions with net settlement features
- The accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled

Exposure Draft: Disclosure Initiative (proposed amendments to IAS 7)

The IASB has published this exposure draft to propose amendments to IAS 7: Statement of Cash Flows. The objectives of the proposed amendments are to improve the following:

- Information provided to users of financial statements about an entity's financing activities, excluding equity items
- Disclosures that help users of financial statements to understand the liquidity of an entity

The IASB publishes proposals to clarify the way in which liabilities are classified

The IASB has published an exposure draft on the proposed amendments to IAS 1, which clarifies how entities classify debt, particularly when it is coming up for renewal. The proposed amendments are designed to improve presentation in financial statements by clarifying the criteria for the classification of a liability as either current or non-current:

- Clarifying that the classification of a liability as either current or non-current is based on the entity's rights at the end of the reporting period
- Making clear the link between the settlement of the liability and the outflow of resources from the entity

The exposure draft is open for comment until 10 June 2015.

The FASB and IASB debate potential changes to revenue standard

The FASB and IASB discussed several implementation issues related to the new revenue standard at the February 2015 meeting. The boards were aligned on the need to address stakeholder feedback on licences and performance obligations, but did not agree on the approach to do so. The FASB decided to amend the principle related to licences, whereas the IASB decided to simply clarify it. The FASB also intends to make several changes to the guidance for determining performance obligations. The IASB will instead explore adding additional examples to illustrate the principle of 'distinct in the context of the contract'.

Global updates

US GAAP

Consolidation: FASB issues final standard

On 18 February 2015, the FASB issued the Accounting Standards Update 2015-02, Consolidation (Topic 810):Amendments to the Consolidation Analysis. The new guidance applies to entities in all industries and provides a new scope exception to registered money market funds and similar unregistered money market funds. It makes targeted amendments to the current consolidation guidance, and ends the deferral granted to investment companies from applying the Variable Interest Entity (VIE) guidance.

The standard does not add or remove any of the five characteristics that determine if an entity is a VIE. However, it does change the manner in which a reporting entity assesses one of the characteristics. In particular, when decisionmaking over the entity's most significant activities has been outsourced, the standard changes how a reporting entity assesses if the equity holders at risk lack the decision-making rights.

A precondition to assessing whether an entity needs to be consolidated is that the reporting entity must have a variable interest in the entity. For an outsourced decisionmaker or service provider, current GAAP provides six criteria that must be met for a fee arrangement not to be a variable interest. The standard eliminates three of the six criteria, and as a result, focuses on whether the fees are 'market-based' and 'commensurate' with the services provided. Fewer fee arrangements are expected to be variable interests.

Today, a reporting entity first assesses whether it meets the power and economics test based solely on its own variable interests in the entity. Under the new standard, a reporting entity that meets the power test will also include 'indirect interests', interests held through related parties, on a proportionate basis in order to determine whether it meets the economics test and is the primary beneficiary on a standalone basis.

In addition to incorporating related-party interests earlier in the analysis for a party with power, the standard reduces situations where the 'related party tiebreaker' test is performed. Today, if a reporting entity is not the primary beneficiary on a standalone basis, but together with all of its related parties has the characteristics of the primary beneficiary, the related-party tiebreaker test is performed. The new standard limits the application of the tiebreaker test to when: power is shared among related parties or the power test is met by a single party and related parties that are under common control meet the economics test. The new standard also requires that if a single party meets the power test, but substantially all of the VIE's activities are being conducted on behalf of one party in the related party group, then that party will consolidate.

The FASB proposes two Accounting Standards Updates (ASUs) on income taxes as part of simplification initiative

The FASB issued an exposure draft of two proposed ASUs related to the accounting for income taxes: Intra-Entity Asset Transfers and Balance Sheet Classification of Deferred Taxes. The proposed ASUs are part of the board's simplification initiative aimed at reducing complexity in accounting standards.

Previous publications:

Contents

Ind-AS implementation: A step closer [p4]/New paradigm of reporting on internal financial controls [p6]/ Companies Act, 2013 – Impact on controls of outsourced processes [p9]/ Disclosure of uncertainties about an entity's ability to continue as a going concern [p12]/ Recent technical updates [p16]

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Contents

Adoption of Indian Accounting Standards (Ind-AS) [p4]/Revenue recognition [p6]/Service concession arrangements [p17]/ Fraud and Companies Act, 2013 [p20]/ Related party relationships and transactions [p24]/ Clause 49: A welcome breather but intrigue remains [p26]/ OECD guidance on transfer pricing [p27]/ Recent technical updates [p28]

PwC ReportingPerspectives

October 2014

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Special Editions:

Special Edition: March 2015

Ind AS: India's accounting standards converged with IFRS are here! [p4]/An in-depth analysis: Examining the implications [p7]/What is changing from current Indian GAAP? [p8]/ Ind AS and IFRS: A comparison [p18]/ First-time adoption and transition to Ind AS [p20]/ What this means for your business: A call to action [p22]

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