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Regulatory updates for the month of April 2022

16 May 2022

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Regulatory updates for April 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 Company Law Committee (CLC) constituted by the Ministry of Corporate Affairs (MCA) submitted its latest report to the Government, proposing various important amendments to the Companies Act, 2013.

The Institute of Chartered Accounts of India (ICAI) issued an implementation guide on reporting under Rules 11(e) and 11(f) of the Companies (Audit and Auditors) Rules, 2014.

This issue of our regulatory updates publication covers some of the important updates on accounting, auditing and regulatory matters for the period from **1 April 2022 to 30 April 2022**. It also highlights some of the action points that auditors may consider when applying the relevant provisions.

01 **Indian updates**

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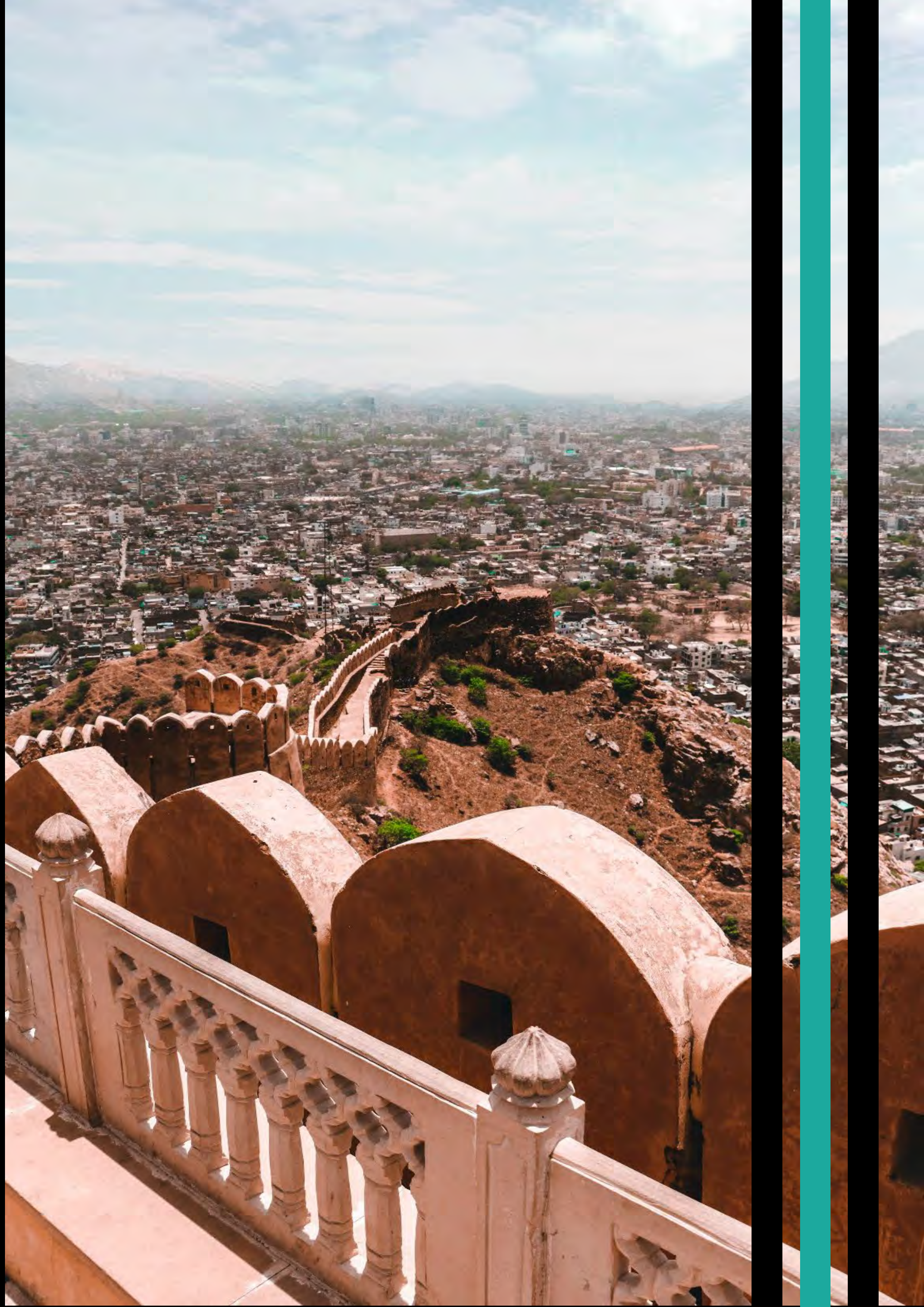
01

Indian updates

- **Accounting updates**
- **Auditing updates**
- **Regulatory updates**



Accounting updates

Updates from ICAI

Exposure Draft of AS 108, Segment Reporting

Accounting Standards notified under Companies (Accounting Standards) Rules, 2021 and those issued by the Institute of Chartered Accountants of India (ICAI) are applicable to entities to whom Ind AS are not applicable. However, on the basis of the discussions held at various standard setting forums, it has been decided to revise Accounting Standards (AS). Accordingly, the Accounting Standard Board (ASB) is working on the project of revision of these standards which will be applicable to entities to whom Ind AS are not applicable.

In this regard, ICAI has issued an Exposure Draft (ED) on AS 108, *Segment Reporting*, keeping existing AS 17, *Segment Reporting* as the base. Since AS 108 (proposed) is based on existing AS 17, there are no major differences between the two. Amendments proposed to AS 108 (proposed) are pursuant to the issue of revised AS 1, *Presentation of Financial Statements*, and revised AS 8, *Accounting Policies, Changes in Accounting estimates and Errors*. The key amendments proposed include:

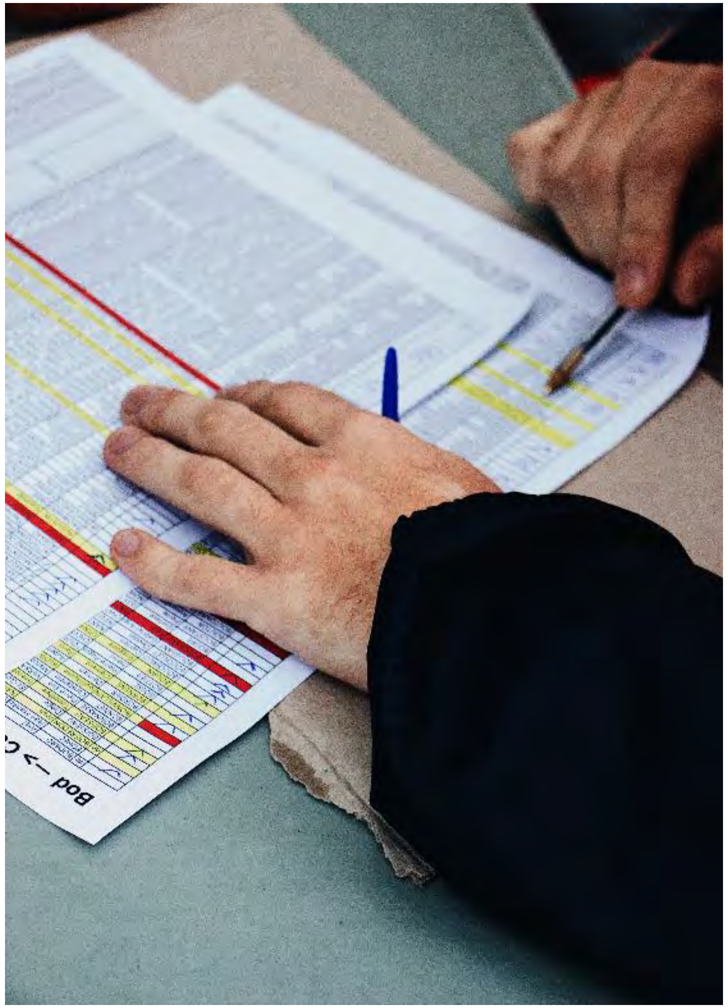
- **Extraordinary item:** Currently, as per AS 17, the definition of segment revenue and segment expense specifically excludes extraordinary items as defined in AS 5, *Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies*. Since there is no concept of 'extraordinary items' in revised AS 8, the definition of segment revenue and segment expense under AS 108 (proposed) does not include extraordinary items.
- **Reporting material line items separately:** Currently, AS 17 encourages (but does not require) entities to disclose the nature and amount of any items of segment revenue and segment expense that are of such size, nature or incidence that their disclosure is relevant to explain the performance of the segment for the period. AS 108 (proposed) now requires entities to disclose the nature and amount of material items of segment revenue and segment expense in accordance with revised AS 1[1].
- **Changes in accounting policies:** Currently AS 17 requires entities to refer AS 5 when determining whether they should make changes to accounting policies, and make appropriate disclosures as per AS 5. AS 108 (proposed) requires these assessments and disclosures to be made in accordance with revised AS 8.

ICAI has invited comments on the ED up to 28 May 2022

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

Action point for auditors

AS 108 (proposed) mandates specific disclosures of material items in the segment reports. Auditors should have discussions and engage with their clients to whom Ind AS is not yet applicable and evaluate the impact of AS 108 (proposed) on their financial disclosures. Auditors could send their queries and comments on the ED prior to the comment period.



[1] As per revised AS 1, when items of income and expense are material, the entity shall disclose their nature and amount separately.

Auditing updates

Updates from ICAI

Implementation Guide on reporting under Rule 11(e) and Rule 11(f) of the Companies (Audit and Auditors) Rules, 2014

The Ministry of Corporate Affairs (MCA) issued the Companies (Audit and Auditors) Amendment Rules, 2021 on 24 March 2021 introducing *inter alia* a new Rule 11(e) and a new Rule 11(f) in the Companies (Audit and Auditors) Rules, 2014.

Rule 11(e) deals with reporting on lending or receiving funds through pass through entities marked for an ultimate beneficiary and Rule 11(f) deals with reporting on the payment/declaration of dividend.

The Rules are effective for audits of companies for FY 2021-22 onwards.

The Institute of Chartered Accountants of India (ICAI) on 26 April 2022 has issued an 'Implementation Guide (IG) on Reporting under Rule 11(e) and Rule 11(f) of the Companies (Audit and Auditors) Rules, 2014'. The IG provides detailed guidance and provides practical illustrations on different scenarios with regard to various aspects of reporting like analysis of rules, management's responsibilities in respect of disclosures in financial statements, illustrative format of confirmation letters and management representation letters.

The IG provides the following guidelines with regard to reporting under both, Rules 11(e) and 11(f):

a. **Applicability to consolidated financial statements:** Reporting on compliance with Rules 11(e) and 11(f) for subsidiaries, joint ventures and associates that are Indian companies (together termed as components) will be on the basis of the reports of their statutory auditors. The auditors of the parent company may request such information from the component auditors as part of group reporting instructions[2]. The auditors of the parent company would need to apply professional judgement and comply with Standards on Auditing (SA) 600, *Using the Work of Another Auditor* while assessing the matters reported by component auditors.

b. **Transactions eliminated in consolidation procedures (intra-group transactions) and consequently not forming part of consolidated financial statements:** Guidance note on Schedule III indicated that disclosure in consolidated financial statements would be provided after applying the principles of consolidation i.e., only the funds provided or invested outside the group would be required to be disclosed. However, the IG suggests that even if transactions are eliminated on consolidation, such transactions would continue to be covered by an auditor's reporting obligations.

c. **Reporting language in the audit reports on standalone and consolidated financial statements:** The IG provides illustrative language that can be referred to for reporting under Rule 11 (e) and Rule 11(f) in standalone and consolidated financial statements.

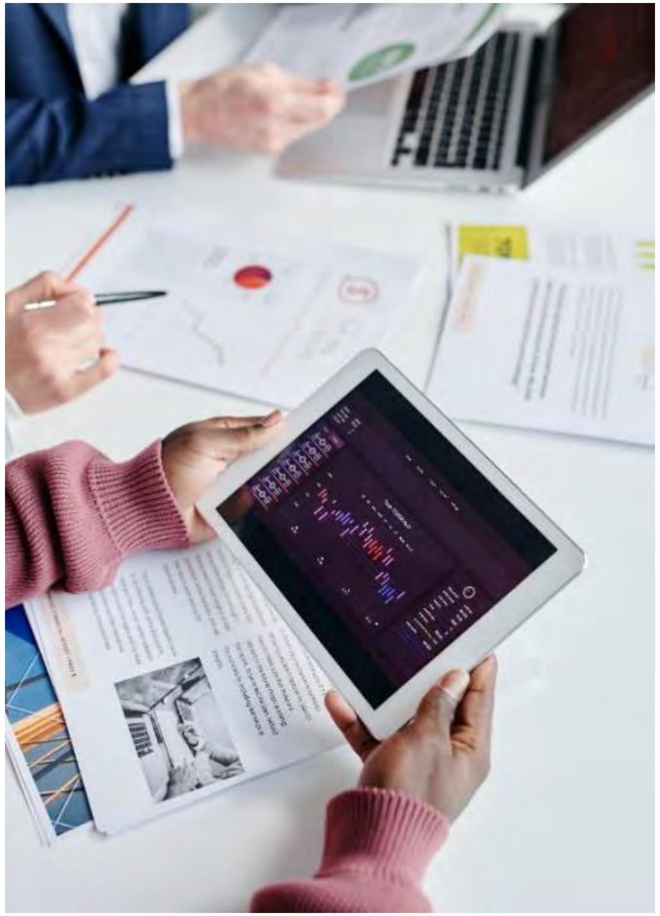
[2] This will be the case where the statutory audit of the unlisted components, (and thus reporting on these clauses) would be finalised post the statutory audit of the listed entity, since unlisted components have time till six months from year-end to conduct their annual general meeting.

Auditing updates

Key guidelines to consider while reporting under Rule 11(e)

The IG has provided the following guidelines and clarifications while reporting under Rule 11(e):

- **Scope of reporting:** Reporting under Rule 11(e) in substance requires an auditor to report whether the disclosures in the notes to the financial statements (in respect of certain types of funding arrangements as specified in these rules) have been appropriately provided by the management. Auditor also needs to bring out the material misstatements[3] identified.
- **When there are no transactions that require reporting under Rule 11(e):** The IG specifies that in a situation wherein there is no transaction that requires reporting, a statement to that effect should be provided in the financial statements.
- **Reporting based on fund and non-fund based transactions:** Reporting under Rule 11(e)(i) would be required when the funding party transfers funds to the intermediary (i.e., no reporting would be required under this rule in case of a non-funding arrangement between the funding party and the intermediary). However, reporting under Rule 11(e)(ii) would be required irrespective of whether the intermediary enters into a funding or a non-funding arrangement with the ultimate beneficiary.
- **Importance of determining 'timing of cash flows':** The IG brings out the importance of determining the timing of cash flows from a funding party to the intermediary and from the intermediary to the ultimate beneficiary. It is also important to determine when an understanding for onward lending or investment of funds on behalf of the funding party is reached. This will determine the financial period in which reporting will be done under Schedule III of the Companies Act, 2013 and consequently in the audit report.
- **Sources of funds:** For the purpose of reporting under Rule 11(e), a funding party may advance, loan or invest funds from any source. Therefore, sources of funds for a company may include share capital, securities premium, grants, profits, borrowings, etc.
- **Indirect lending:** There may be cases where there is more than one intermediary as a pass-through entity. In such a case, reporting for intermediaries who pass on the funds further to other intermediaries will be under Rule 11(e)(i) (i.e., as a funding party who further advances, loans or invests funds to another intermediary) and under Rule 11(e)(ii) (i.e., as an intermediary who receives funds from the funding party).
- **Management responsibility:** The IG states that management should implement internal controls that would ensure all transactions are appropriately captured and reported.



[3] While determining what is a 'material' misstatement, the auditor should consider both, the quantitative and the qualitative aspects of the misstatement.

Auditing updates

Further each transaction of lending or investing should be carefully evaluated and supported by a formal written agreement which includes the nature and purpose of such funding. Management should also obtain end-use certificates from parties that receive the funds.

- **Auditor's responsibility:** Some of the key audit procedures to be planned and performed by an auditor, as mentioned in the IG, include:
    - Auditors should ensure completeness of reporting of all arrangements covering funding and utilisation of funds under Rule 11(e).
    - Internal controls implemented by management should be tested for appropriate identification and reporting of transactions.
    - Compare the list of loans and investments made by companies with statutory records maintained by the company as per the requirements of the Companies Act, 2013.
    - Obtain minutes of board meeting where the funding of amounts was approved, and which will enable an auditor to determine whether the company was acting as a funding party or as an intermediary.
    - Obtain a separate and specific management representation letter with regard to disclosures in the financial statements from those charged with governance duly taken on record by the board of directors.

Key guidelines to consider while reporting under Rule 11(f)

The IG discusses scenarios in which auditor reporting is required, considering the date of declaration and payment of interim and/or final dividend. It also provides guidance on auditor responsibility. Key provisions discussed in the IG are given below:

- Auditors should determine adequacy of profits, including if management has considered the effect of any audit qualification when determining the adequacy of profits.
- Certified copy of resolutions declaring dividend by board of directors should be obtained.
- Auditors should check whether dividend has been transferred to a separate bank account within the time prescribed under the Companies Act, 2013.
- Where dividend is paid through the Registrar and Transfer Agent (RTA), confirmation regarding payment to registered shareholders can be obtained from the RTA.
- Investor complaints with regard to dividend should be examined to determine if any of them indicate any non-compliance by the company with the Companies Act, 2013.
- A written representation from management regarding compliance with section 123 of the Companies Act, 2013 should be obtained from the management.
- Auditor should ensure compliance with rules pertaining to dividend declaration and payment as per any other law (i.e. apart from the Companies Act, 2013).

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

Action points for auditors

Reporting under Rules 11(e) and 11(f) of the Companies (Audit and Auditors) Rules, 2014 are applicable for audits of companies for financial years 2021-22 and onwards. These rules cast an extensive responsibility on auditors due to wide scope of reporting under these rules. The auditors should refer to the guidance given in the IG including the illustrative formats of audit reports, confirmation letters and management representation letters.

They should also communicate the areas of responsibilities of the management with those charged with governance, and require adequate documentation in the notes to the financial statements regarding the types of funding arrangements.

Regulatory updates

Updates from MCA

Companies (Registration of Charges) Amendment Rules, 2022

Rule 3 of the Companies (Registration of Charges) Rules, 2014 (Registration of Charges Rules) requires companies to register the creation or modification of charges and pay stipulated amount for such registration. In case of delay of such registration, additional fees are charged.

MCA, vide a notification dated 27 April 2022 has stated that nothing contained in Rule 3 of the Registration of Charges Rules would apply to any charge required to be created or modified by a banking company under section 77[4] of the Companies Act, 2013 in favour of the Reserve Bank of India (RBI) when any loan or advance has been provided to it under clause 4(d) of section 17 of RBI Act, 1934.

Effective date: The Rules would be effective from the date of publication in the Official Gazette i.e., 27 April 2022

To access the text of the notification, please click here

Action Point for Auditors

Auditors of banking companies should take note of this amendment and consider it while auditing charges created against loans or advances received by the banking company post the date of the notification.

The Company Law Committee report

The Ministry of Corporate Affairs (MCA) constituted the Company Law Committee (CLC) to make recommendations to the Government *inter alia* on changes aimed at facilitating and promoting greater ease of doing business in India and effective implementation of the Companies Act, 2013, the Limited Liability Partnership Act, 2008 and the Rules made thereunder.

The CLC submitted its latest report to the Government on 21 March 2022. The report has proposed various important amendments to the Companies Act, 2013 and the Limited Liability Partnership Act, 2008. The suggestions aim to ensure ease of compliances, laying strong emphasis on digitisation and also building a robust corporate governance framework including alignment of the law with the provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations). Some of the key recommendations pertaining to the Companies Act, 2013 are:

A. **Revised provisions relating to directors and committees of the board**

- **Provisions pertaining to Independent Directors (ID)**
  - **Period of appointment:** The CLC reiterated that an ID cannot be appointed for more than two consecutive terms. Further, the period of appointment of IDs cannot exceed the prescribed period of five years for a single term or ten years for two consecutive terms. While calculating this period, any tenure held as an additional director would also be considered.

[4] As per section 77 of the Companies Act, 2013, it is the duty of every company creating a charge within or outside India, on its property or assets or any of its undertakings (tangible or intangible) situated in or outside India, to register the particulars of the charge created by the company and pay prescribed amount of fees within the prescribed time.

Regulatory updates

- Engagement of IDs as a legal / consulting firm during cooling-off period: Currently, an employee, proprietor or partner of a legal or consulting firm, transacting with a company, could be appointed as an ID in such a company provided that such a transaction amounted to less than 10 per cent of the gross turnover of that firm (threshold). However, upon ceasing to hold office of an ID, there would be a blanket prohibition on the firm to function as a legal or consulting firm regardless of the threshold being met.

  The CLC recommended that the relevant legal or consulting firm should be permitted to continue to render its services as per thresholds even after the ID completed his/her term. Further, CLC recommended to reduce the threshold to 5 per cent instead of the existing limit of 10 per cent of gross turnover of the firm.

- **Provisions on disqualification of directors:** The Companies Act, 2013 lays down provisions relating to the disqualification and vacation of office of directors of a company. The CLC recommendations are as follows:
  - **Vacancy of directorship** should only arise due to disqualification under personal capacity, under section 164(1) of the Companies Act, 2013 (and not on account of defaults made by a company under section 164(2)[5] of the Companies Act, 2013)
  - **Extend the period of exemption** for newly appointed directors from the default made by a company under section 164(2) of the Companies Act, 2013 to two years (instead of the current six months).
  - **Rights of nominee directors** appointed pursuant to nomination by debenture trustees registered with SEBI should be safeguarded from disqualification under section 164(2) of the Companies Act, 2013.

- **Cooling off period for directors and auditors**
  - **Cooling off period before an auditor becomes a director:** There should be a mandatory one-year cooling-off period, from the date of cessation of office, after which an auditor of a company may be permitted to hold the position of a director in the same company or group of companies. Such a restriction would only apply to the concerned partner of an audit firm/LLP that audited the company.
  - **Cooling off period before an ID becomes a managerial personnel:** There should be a mandatory one-year cooling-off period, from the date of cessation of office, after which an ID may be permitted to hold the position of a managing director, whole-time director, or manager in the same company or group of companies.

- **Resignation of Key Managerial Personnel (KMPs)** Procedure of resignation of certain KMPs (whose appointments were filed with the RoC) should be aligned with the procedure of resignation of directors under Section 168 of the Companies Act, 2013. This means that a company should file the notice of resignation within 30 days of receipt of such notice, failing which KMPs may directly file the same with the RoC.

[5] Section 164(2) deals with the disqualification of directors on account of lapses made by a company in filing its annual returns and financial statements or default in repayment of deposits or debentures.

Regulatory updates

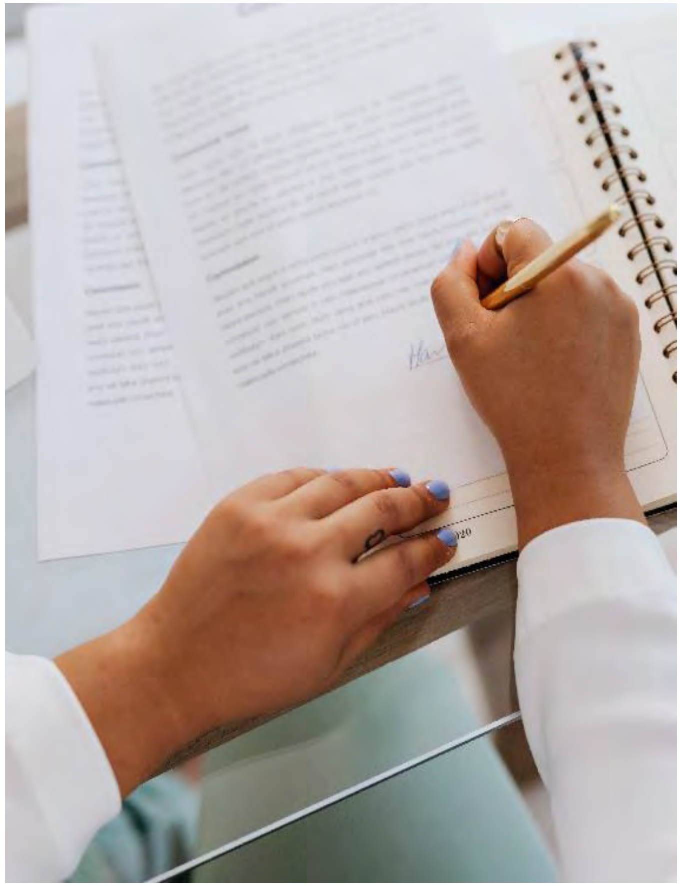
- **Setting up Risk Management Committee (RMC):** To include new provisions in the Companies Act, 2013, for constitution of an RMC for such class of companies, as the CG may prescribe.

B. Reviewing and strengthening the audit framework

- **Amendments relating to NFRA:** The Central Government has constituted the National Financial Reporting Authority (NFRA) for matters relating to accounting and auditing standards for companies. CLC recommendations are as follows:
  - **Empower NFRA to take an appropriate action:** Empower NFRA to take appropriate action against individuals or firms for non-compliance with the Companies Act, 2013 and requirements thereunder in addition to its existing powers to take action against 'professional or other misconduct'.
  - **Constitution of NFRA fund:** An NFRA Fund should be constituted to provide financial autonomy to NFRA.
  - **Regulations and supervisory powers:** NFRA should be enabled to make certain regulations[6] and supervisory powers should be granted to the NFRA Chairperson.

- **Reviewing and strengthening the audit framework and introducing mechanisms to ensure the independence of auditors**

  The CLC recommendations are as follows:
  - **Non-audit services:** Enabling provisions should be introduced for the CG to prescribe a differential list of prohibitions on availing non-audit services or total prohibition on availing non-audit services for such class or classes of companies where public interest is inherent.
  - **Punishment under Section 143:** Section 147 of the Companies Act, 2013 to be amended to cover penal consequences for contravention of Section 143 of the Companies Act, 2013 regarding sub-sections other than sub-section (12). Penal consequences of such sub-sections except sub-section (12) are currently not covered under the Companies Act, 2013.
  - **Obligations of the resigning auditor:** A resigning auditor should be under an explicit obligation to provide detailed disclosures before resignation and should specifically mention whether such resignation is due to non-cooperation from the company, fraud, severe non-compliance or diversion of funds. However, if the auditor fails to make such disclosures in the resignation statement, then suitable action would be taken against such an auditor. Additionally, the auditor should assure shareholders and stakeholders that in his/her opinion there is nothing in the company's accounts which needs to brought to their notice, and that his/her decision to resign is an independent decision.
  - **Mandatory joint audit for certain companies:** The Central Government should have powers to mandate joint audits for such class or classes of companies as it may deem necessary.



[6] Regulations that NFRA should be empowered to make include:
- Form and manner of filing information with NFRA,
- Place, timing, and procedure to be followed for NFRA meetings.

Regulatory updates

- o **Auditor of holding company to comment on the true and fair view of each subsidiary company:** To amend the Companies Act, 2013 after further examination and public consultation so as to ensure that the auditor of a holding company has been given assurance about the fairness of audit of each subsidiary company by respective auditors. In addition, the auditor of the holding company may be empowered to independently verify the accounts or part of accounts of any subsidiary company.
- o **Forensic Audit:** The Companies Act, 2013 should enable the CG to prescribe detailed Rules relating to forensic audit through subordinate legislation.

- **Standardisation of qualifications by auditors:** Enabling provisions should be introduced for the CG to issue a format for auditors to provide the impact of every qualification or an adverse remark on a company's financial statements for circulation to the board of directors before the financial statements are circulated to the shareholders of a company.

C. Reviewing provisions relating to mergers and acquisitions

- **Treasury stock:** Companies holding treasury stock would be required to report to CG through a declaration in a prescribed form. Additionally, such a company should dispose off the treasury stock within a period of three years.

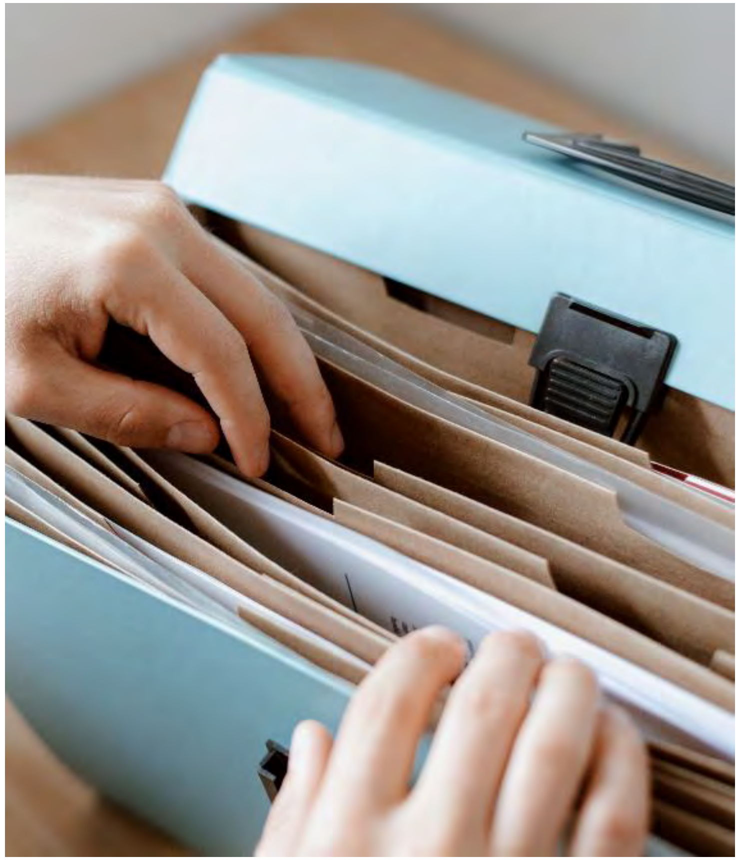
  In case, the company fails to dispose off the treasury shares, then such shares would be considered as cancelled and share capital of the company would be reduced in a prescribed manner and penal action can be initiated against such a company.

- **Fast-track mergers:** Permit fast-track mergers between a holding company and its subsidiary company or companies other than wholly-owned subsidiaries, if such companies are not listed and meet prescribed conditions .

D. Other matters

The CLC recommendations are as follows:

- Companies, which cease to be associated with a foreign entity, should be allowed to file a fresh application with the CG in a prescribed form to allow them to **revert back to the financial year** followed under the Companies Act, 2013.
- Enable companies to hold general meetings, i.e., AGMs and EGMs **physically, virtually, and in hybrid mode**. Where EGM is to be conducted entirely in electronic mode, the notice period for such a meeting should be reduced.
- The CG will prescribe rules for class or classes of companies mandatorily required to **serve certain documents in electronic mode** only (however, physical documents to be delivered where requested by a shareholder).
- Mandatorily require prescribed class or classes of companies to maintain their **statutory registers on an electronic platform** in the manner laid down by the CG.



Regulatory updates

- **Free reserves** are to be included in the calculation of **buy-back** of equity shares even though the term has not been specifically included in the proviso to section 68(2)(c) (which clarifies the manner in which the limits for buy back of shares is calculated). Further, only shares on which the shareholders have exercised the stock option should be allowed to be bought back.
- Company law should be amended to enable issuance, holding, transfer of **fractional shares, in dematerialised form**, for prescribed class or classes of companies in consultation with SEBI (for listed companies), as may be required. Further, Restricted Stock Units (RSUs) and Stock Appreciation Rights (SARs) should be recognised under the Companies Act, 2013, and their issuance should be sufficiently encumbered.
- **Distressed companies**[7] should be allowed to issue shares at a discount in such a manner as prescribed by the CG.
- Introduction of an enabling provision to recognise **Special Purpose Acquisition Companies (SPACs)** under the Companies Act, 2013 and allow entrepreneurs to list a SPAC incorporated in India on domestic and global exchanges.
- Amendments relating to the **Investor Education and Protection Fund (IEPF)** such as
  - Enabling dividend pertaining to shares that are transferred to IEPF to also be transferred to IEPF at the time of transfer of shares irrespective of the year they pertain to.
  - Purpose for which IEPF may be utilised includes 'redemption amount towards unclaimed or unpaid preference shares'.
  - Unclaimed money pertaining to shares or securities that have been bought back or cancelled should be allowed to be transferred to IEPF.

Action points for auditors:

CLC has suggested certain key amendments to the corporate governance provisions, to the erstwhile audit framework, to certain provisions pertaining to mergers and acquisitions, and various other provisions of the Companies Act, 2013. There are various recommendations that are likely to impact the auditors and their practice; thus, auditors should watch this space for further developments in this area. Some of the significant points to consider for auditors include:

- Strengthening of the NFRA
- Prohibition on non-audit services
- Obligations of resigning auditors
- Standardisation qualifications by auditors
- Cooling-off period before auditors become directors
- Mandatory joint audit for companies involving public interest with recognition of liability of individual auditors
- Provisions pertaining to directors
- Forensic audit

7. Distressed companies may be categorised as such class or classes of companies that have cash losses (other than those arising out of depreciation or revaluation) for previous three consecutive years or more and fulfil such terms and conditions.

Regulatory updates

Updates from SEBI

SEBI amends certain regulations

SEBI, vide notification dated 11 April 2022, has issued the following regulations:

A. SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2022

According to regulation 54 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations), a listed entity which has issued listed non-convertible debt securities should maintain 100 per cent asset cover or higher asset cover as per terms of offer document and/or debenture trust deed, sufficient to discharge, at all times, the principal amount of the non-convertible debt securities issued.

Regulation 56 of the LODR Regulations specifies the list of documents and intimations which are required to be provided by a listed entity to the debenture trustees. Under this, a listed entity is required to submit to the debenture trustees a half-yearly certificate by the statutory auditor for maintenance of 100 per cent asset cover or higher asset cover, as per terms of offer document and/or debenture trust deed in respect of listed non-convertible debt securities.

On 11 April 2022, SEBI issued the SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2022 thereby making the following amendments to the LODR Regulations:

- Term ‘asset cover’ has been substituted with the term ‘security cover’ in Regulations 54 and 56 of the LODR regulations.
- According to Regulation 54, a listed entity would now be required to maintain 100 percent security cover sufficient to discharge **both principal and interest** *(earlier, only principal)*, in respect of **secured** listed non-convertible debt securities *(earlier, listed non-convertible debt securities).*

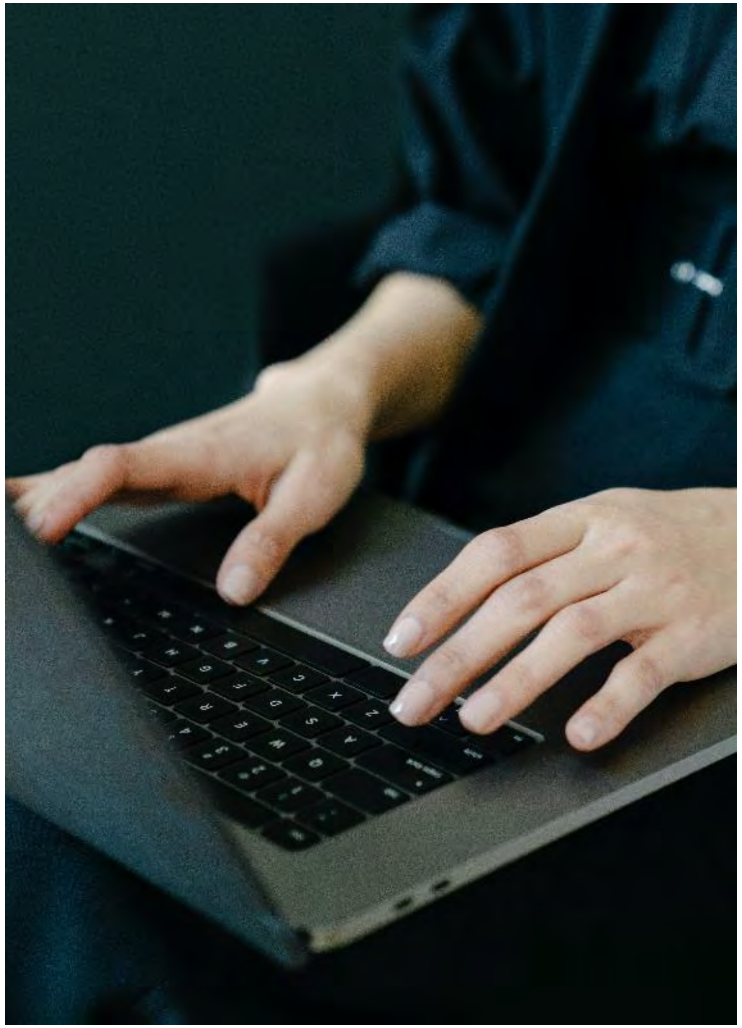
(Emphasis added to highlight the change.)

To access the text of the SEBI (LODR) (Third Amendment) Regulations, 2022, please click here.

B. SEBI (Debenture Trustees) (Amendment) Regulations, 2022

Regulation 15 of the SEBI (Debenture Trustees) Regulations, 1993 (DT Regulations) prescribes the duties of debenture trustees. In case of secured listed debt securities, debenture trustees are required to:

- Carry out the required due diligence and monitor the **asset cover** on a quarterly basis, and
- Obtain a certificate from the statutory auditor with respect to **asset cover** maintained by the issuer on a half-yearly basis.



Regulatory updates

On 11 April 2022, SEBI issued the SEBI (Debenture Trustees) Amendment Regulations, 2022 thereby making the following amendments in Regulation 15:

- Substitute the term 'asset cover' with the term 'security cover'
- Before the amendment, the DT Regulations specified that debt securities should be secured by way of receivables/book debts. The amendment has now removed the term 'receivables/book debts'. Accordingly, debt securities can be secured by way of **any asset.**

To access the text of the SEBI (Debenture Trustees) (Amendment) Regulations, 2022, please click here

C. SEBI (Issue and Listing of Non-Convertible Securities) (Amendment) Regulations, 2022

On 11 April 2022, SEBI made certain amendments to the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS regulations)[8]. A summary of the amendments is as follows:

- Regulations 23 and 38 of the NCS Regulations discuss the obligations of the issuer and lead manager on NCS respectively. The issuer and lead manager should ensure that the secured debt securities are secured by 100 per cent security cover **or higher security cover** as per the terms of the offer document and/or Debenture Trust Deed, **sufficient to discharge the principal amount and the interest thereon at all times** for the issued debt securities (earlier, the issuer and lead manager were required to ensure that secured debt securities are secured by 100 per cent security cover).

  (Emphasis has been added to highlight the change.)

- Regulations 40 and 44 of the NCS Regulations prescribe that debenture trustees should issue a due diligence certificate to the stock exchange and SEBI (in case of public issue) prior to opening of public issue of debt securities or prior to a private placement of debt securities. Due Diligence carried out by the debenture trustees would now be submitted to the stock exchange and to SEBI (in case of public issue) in the formats prescribed for **secured debt securities (Schedule IV) and unsecured debt securities (Schedule IVA)**. Further a format of Schedule IV A has been provided. (Earlier all due diligence certificates were required to be issued in the format prescribed in Schedule IV.)

  (Emphasis added to highlight the change.)

- Rationalised references with respect to disclosure of credit ratings have been stated in Schedules I (Disclosures in prospectus) and II (Disclosures for private placement of NCS) of the NCS Regulations.

To access the text of the SEBI (Issue and Listing of NCS) (Amendment) Regulations, 2022 regulations, please click here.

Action points for auditors

As per regulation 56 of the LODR regulations, statutory auditors of issuers of NCS are required to provide a half-yearly certificate, which is to be submitted to the debenture trustee regarding maintenance of prescribed asset cover (now security cover), including compliance with all the covenants, in respect of secured listed non-convertible debt securities. Auditors should take note of the increase in the limit of the security cover (i.e. it should be sufficient to discharge both, principal and interest thereon) when such certificates are being issued.

[8] Amendments to the NCS regulations have been made by issuance of the SEBI (Issue and Listing of Non-Convertible Securities) (Amendment) Regulations, 2022

Regulatory updates

Updates from RBI

RBI issues clarification on revised regulatory framework for NBFCs – Scale Based Regulation

Background

RBI, vide a notification dated 22 October 2021 (SBR notification) had introduced the Scale Based Regulation (SBR) framework for NBFCs. The approach renders the regulation and supervision of the NBFCs to be a function of their size, activity, and perceived riskiness. As per the SBR framework, NBFCs that have greater size and complexity, and which pose a higher risk for the financial system would be made subject to a higher degree of regulation, and NBFCs that pose a lower risk for the financial system would be made subject to a lower degree of regulation.

SBR framework comprised of the following four layers:

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

The SBR notification prescribed certain regulatory revisions that would be applicable to various layers of NBFCs. Most of these provisions would be applicable from 1 October 2022.

Vide the SBR framework, RBI mentioned that it would provide further clarifications on certain regulatory revisions subsequently. Consequently, in April'22, RBI has issued various circulars providing clarifications on regulatory revisions. Table 1 below provides a synopsis of regulatory revisions for which clarification was awaited, and for which a clarification has now been issued.

Table 1: Regulatory revisions for which clarifications has been provided

Regulatory revision	Regulatory revisions applicable to			Clarifications provided by RBI
	NBFC-BL	NBFC-ML	NBFC-UL	
Revision in capital guidelines				
Common equity tier-1 capital	Not applicable	Not applicable	✔	Yes (Refer Note A)
Leverage	Not applicable	Not applicable	✔	-
Differential standard asset provisioning	Not applicable	Not applicable	✔	-

Regulatory updates

Table 1: Regulatory revisions for which clarifications has been provided

Regulatory revision	Regulatory revisions applicable to			Clarifications provided by RBI
	NBFC-BL	NBFC-ML	NBFC-UL	
Revision in prudential guidelines				
Board approved policies on loans to directors, senior officers and relatives of directors	✔	✔	✔	Yes (Refer Note C)
Regulatory restrictions on loans to directors, senior officers and on appraising loan proposals involving real estate	Not applicable	✔	✔	Yes (Refer Note C)
Large Exposure Framework	Not applicable	Not applicable	✔	Yes (Refer Note D)
Revision in governance guidelines				
Expanded disclosures for NBFCs	✔	✔	✔	Yes (Refer Note B)
Appointment of chief compliance officer	Not applicable	✔	✔	Yes (Refer Note E)
Compensation guidelines	Not applicable	✔	✔	Yes (Refer Note F)
Additional governance matters (such as formulating whistle-blower mechanism, etc.)	Not applicable	✔	✔	-
Introduction of core-banking solution	Not applicable	✔	✔	-

(Source: Foundation for Audit Quality's analysis, 2022)

Regulatory updates

An overview of the clarifications issued by RBI are given in the notes below:

A. Capital requirements for NBFC-UL

RBI, vide a notification dated 19 April 2022 has specified the capital requirements for NBFCs-UL. As per the SBR framework, NBFC-UL should maintain, on an on-going basis, Common Equity Tier 1 (CET1) capital of at least **9 per cent** of Risk Weighted Assets. The circular specifies the formula for the calculation of CET 1 ratio as:

$$\text{CET 1 ratio} = \frac{\text{Common Equity Tier 1 Capital (CET 1 Capital) (Note 1)}}{\text{Total Risk Weighted Assets (Total RWAs) (Note 2)}}$$

Note 1: As per the circular, elements of CET 1 Capital will comprise the following:

- Paid-up equity share capital issued by the NBFC
- Share premium resulting from the issue of equity shares
- Capital reserves representing surplus arising out of sale proceeds of assets
- Statutory reserves
- Revaluation reserves that meet prescribed conditions
- Other disclosed free reserves, if any
- Retained earnings at the end of the previous financial year (accumulated losses would be reduced from CET 1)
- Profits in current financial year that have been subject to quarterly review or audit may be included on a quarterly basis. Certain adjustments would be made to such profits.

RBI has also prescribed certain regulatory adjustments/ deductions to be applied in calculation of CET 1 Capital.

Note 2: The Total RWAs to be used in computation of CET 1 ratio would be the same as the Total RWAs computed under the relevant directions of the concerned NBFC category.

Applicability: These clarifications are applicable to all NBFCs identified as NBFC-UL, except Core Investment Companies (CICs)[9]

To access the text of the notification, please click here

B. Disclosures in Financial Statements – Notes to Accounts of NBFCs

NBFCs are required to make disclosures in the financial statements in accordance with the existing prudential guidelines, applicable accounting standards, laws, and regulations. RBI, vide a notification dated 19 April 2022 has issued certain additional disclosure requirements for NBFCs in line with the SBR framework. Comprehensive disclosures that help in the understanding of financial position and performance of the company have been encouraged.

The RBI notification is applicable to all NBFCs and specifies the applicability of specific disclosure requirements to specific NBFC layers as per SBR framework. The disclosure requirements applicable to lower layers of NBFCs would be applicable to NBFCs in higher layers.

9. CICs identified as NBFC-UL would continue to maintain, on an on-going basis, adjusted net worth as per the Master Direction DoR(NBFC).PD.003/03.10.119/2016-17 - Core Investment Companies (Reserve Bank) Directions, 2016 dated August 25, 2016.

Regulatory updates

The disclosure templates have been categorised into following three sections:

- **Section I:** Applicable for annual financial statements of NBFC-BL, NBFC-ML and NBFC-UL
- **Section II:** Applicable for annual financial statements of NBFC-ML and NBFC-UL
- **Section III:** Applicable for annual financial statements of NBFC-UL

Section I: Disclosures applicable to NBFC-BL, NBFC-ML and NBFC-UL

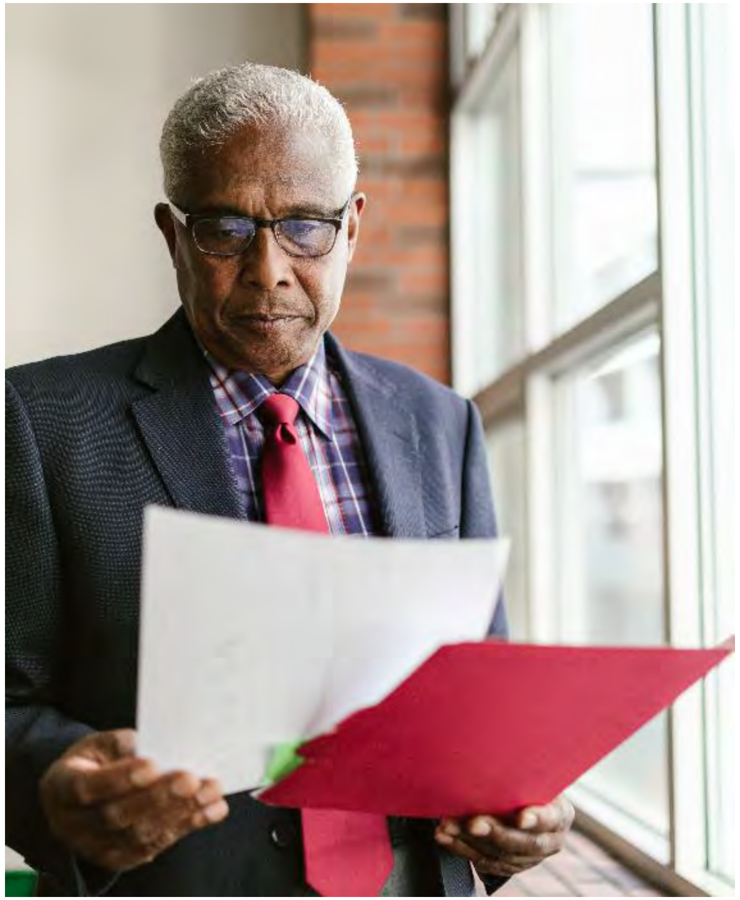
The following disclosures have been prescribed for NBFCs classified as NBFC-BL, NBFC-ML and NBFC-UL:

- **Exposure of the NBFCs:** This includes direct and indirect exposure to the real estate sector, exposure to capital market, sectoral exposures, intra-group exposures and unhedged foreign currency exposure.
- **Related party disclosures:** NBFCs are required to disclose the following with regard to RPTs:
  - Transactions entered into with related parties during the year
  - Amounts outstanding at the year-end[10]
  - Maximum amount outstanding during the year[10]

  Further, transactions with parent, subsidiaries, associates/joint ventures, KMPs and relatives of KMPs are required to be disclosed. For the definition of related parties, KMPs and relatives of KMPs, reference should be made to the Companies Act, 2013.
- **Disclosure of complaints:** NBFCs should provide summary information on complaints received from customers and from the Offices of Ombudsman. Disclosure should also be made of top five grounds of complaints received by the NBFCs from customers.

Section II: Disclosures applicable to NBFC-ML and NBFC-UL

- **Corporate governance disclosures:** With respect to corporate governance report, non-listed NBFCs should endeavour to make full disclosure in accordance with the requirements of the LODR regulations[11]. At the minimum, the following disclosures should be made
  - ***Composition of the board of directors:*** This includes, composition of the board of directors, details of change in composition of the board of directors, where an independent director resigns before expiry of his/her term, the reasons for resignation as given by him/her should be disclosed, and details of relationship amongst the directors. Formats in which such disclosures are required have been prescribed in the circular.
  - ***Committees of the board and their composition:*** Mention the names of the committees of the board and for each committee, mention the summarised terms of reference and prescribed details in the format provided.
  - ***General body meetings:*** Give details of date, place and special resolutions passed at the general body meetings in the prescribed format.



[10] Pertaining to borrowings, deposits, placement of deposits, advances, etc.
[11] Paragraph C of Schedule V of the LODR regulations prescribes disclosures to be made in the section on corporate governance in the annual report.

Regulatory updates

- o ***Details of non-compliances with requirements of the Companies Act, 2013***: Give details and reasons of any default in compliance with the requirements of Companies Act, 2013, including with respect to compliance with accounting and secretarial standards.
- o ***Details of penalties and strictures***: Details of penalties or strictures imposed on NBFCs by RBI or any other statutory authority.

- **Breach of a covenant:** NBFCs should disclose all instances of breach of a covenant of loans availed or debt securities issued.

- **Divergence in asset classification and provisioning:** NBFCs are required to disclose details of divergence in asset classification and provisioning where additional provisioning requirements assessed by RBI or National Housing Bank (NHB) or additional gross Non-Performing Assets (NPAs) identified by RBI/NHB exceed a prescribed threshold.

Section III: Disclosures applicable for annual financial statement of NBFC-UL

As per the SBR framework issued by RBI, NBFC-UL should be mandatorily listed within three years of identification as NBFC-UL. Accordingly, upon being identified as NBFC-UL, unlisted NBFC-ULs shall draw up a Board approved road map for compliance with the disclosure requirements of a listed company under the LODR Regulations.

Effective date: These guidelines are effective for annual financial statements for the year ending 31 March 2023, and onwards.

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

C. Regulatory restrictions in relation to loans and advances

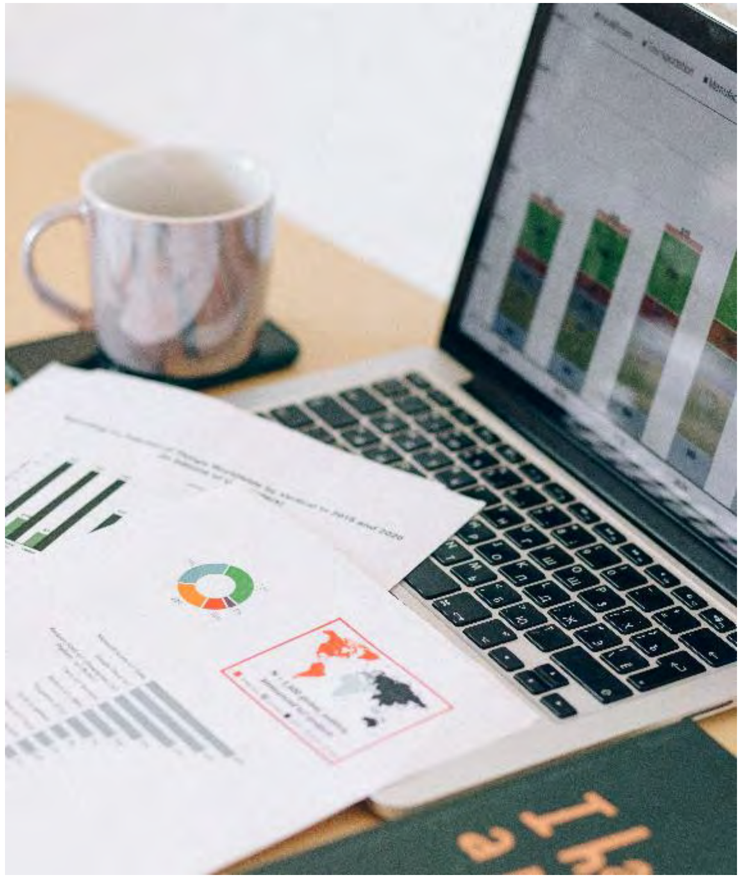
RBI, vide a notification dated 19 April 2022 has provided detailed guidelines on regulatory restrictions on lending in respect of NBFCs across different layers as per the SBR framework. Some of the key provisions mentioned in the guidelines is given below:

Guidelines applicable to NBFC-ML and NBFC-UL

- **Loans and advances to Directors**[12]**:** With regard to loans and advances to directors, NBFCs should take following steps:
  - o Obtain appropriate sanctions from the board of directors/committee of directors for grant of any loans or advances aggregating **INR five crore and above**[13] to:
    - Their directors (including the Chairman / Managing Director) or relatives of directors.
    - Any firm in which any of their directors or their relatives is interested as a partner, manager, employee, or guarantor.
    - Any company in which any of their directors, or their relatives is interested as a major shareholder, director, manager, employee, or guarantor.

    The interested director should disclose the nature of his/her interest and abstain from voting on such proposal.

  - o Obtain appropriate declaration from borrower giving details of the relationship of the borrower to the director for loans and advances aggregating INR5 crore and above,



[12] Similar norms would apply while awarding contracts to directors or senior officers
[13] Proposals for credit facilities of an amount less than INR5 crores to such borrowers may be sanctioned by the appropriate authority in the NBFC, however, the matter should be reported to the Board of Directors.

Regulatory updates

- Make disclosures in the annual financial statements of aggregate amount of such loans and advances sanctioned in the format prescribed.

- **Loans and advances to senior officers of the NBFC[12]:** With regard to loans and advances to senior officers of NBFC, the NBFC should ensure:
  - All loans and advances sanctioned to senior officers are reported to the board of directors.
  - A senior officer or a committee comprising of a senior officer should not sanction any credit to a relative of that senior officer. Such a facility has to be sanctioned by the next higher sanctioning authority under the delegation of powers.
  - Appropriate declarations from borrower giving details of the relationship of the borrower to the senior officer for loans and advances aggregating INR5 crore and above is obtained,
  - Disclosures have been made in the annual financial statements of aggregate amount of such loans and advances sanctioned in the format prescribed.

- **Loans and advances to real estate sector:** The borrowers from the real estate sector are required to obtain prior permission from government/local government/other statutory authorities for the project, wherever required. The disbursements of loans and advances should be made only after the borrower has obtained requisite clearances from the government/other statutory authorities.

Guidelines for NBFC-BL

In its notification, RBI has mentioned that NBFC-BL should have a board approved policy[14] in place for grant of loans to directors, senior officers, and relatives of directors and to the entities where directors or their relatives have major shareholding. The policy should prescribe a threshold beyond which loans to the above-mentioned persons would be reported to the board of directors. A disclosure is required in the annual financial statements stating the aggregate amount of such sanctioned loans and advances.

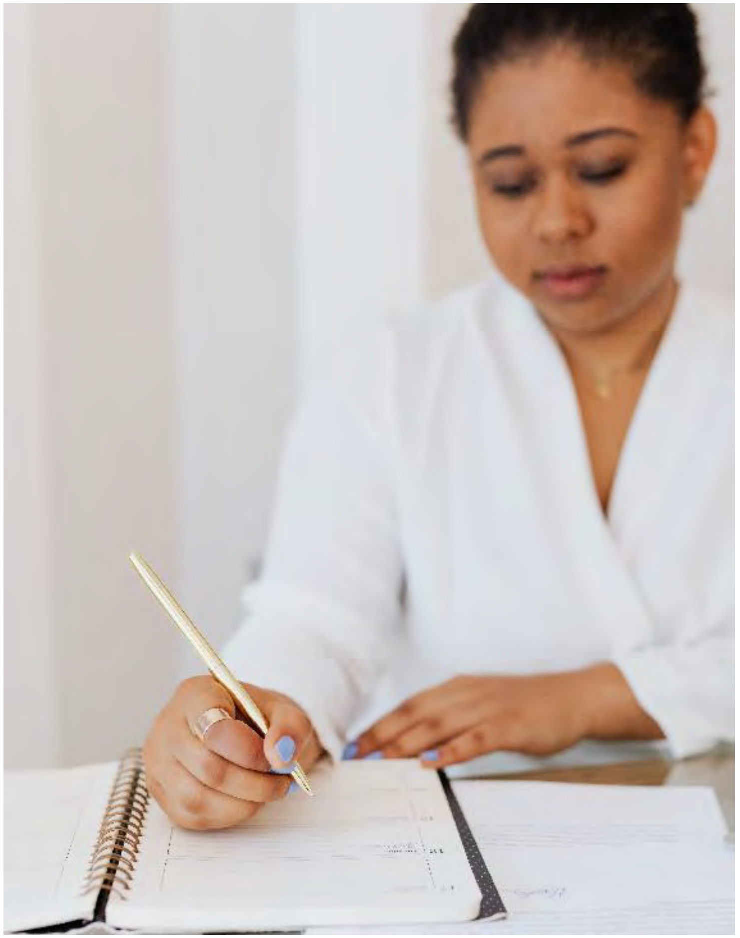
Effective date: These guidelines will be effective from 1 October 2022.

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

D. Large Exposures Framework for NBFC-UL

Large Exposure (LE) refers to the sum of all exposure values of an NBFC-UL to a counterparty and / or a group of connected counterparties, if it is equal to or above 10 percent of the NBFC-UL's eligible capital base.

RBI, vide a notification dated 19 April 2022 has issued certain guidelines with respect to Large Exposure Framework (LEF) for NBFC-UL, which aims at addressing credit risk concentration in NBFC-UL. The guidelines set out to identify large exposures, refine the criteria for grouping of connected counterparties and put in place reporting norms for large exposures. The guidelines would be applicable to NBFC-UL, both at the solo and consolidated (group) level, comprising of both on and off-balance sheet exposures.



14 Policy approved by the board of directors

Regulatory updates

Few key details specified in the guidelines are:

Table 2: LEF limits for NBFC-UL

	NBFC-UL (Other than IFC*)	NBFC-UL (IFC)
Single counterparty	• 20 per cent • Additional 5 per cent with board of directors' approval • Additional 5 per cent if exposure towards infrastructure loan / investment (Single counterparty limit should not exceed 25 per cent in any case)	• 25 per cent • Additional 5 per cent with board of directors' approval
Group of connected counterparties	• 25 per cent • Additional 10 per cent if exposure towards infrastructure loan / investment	35 per cent

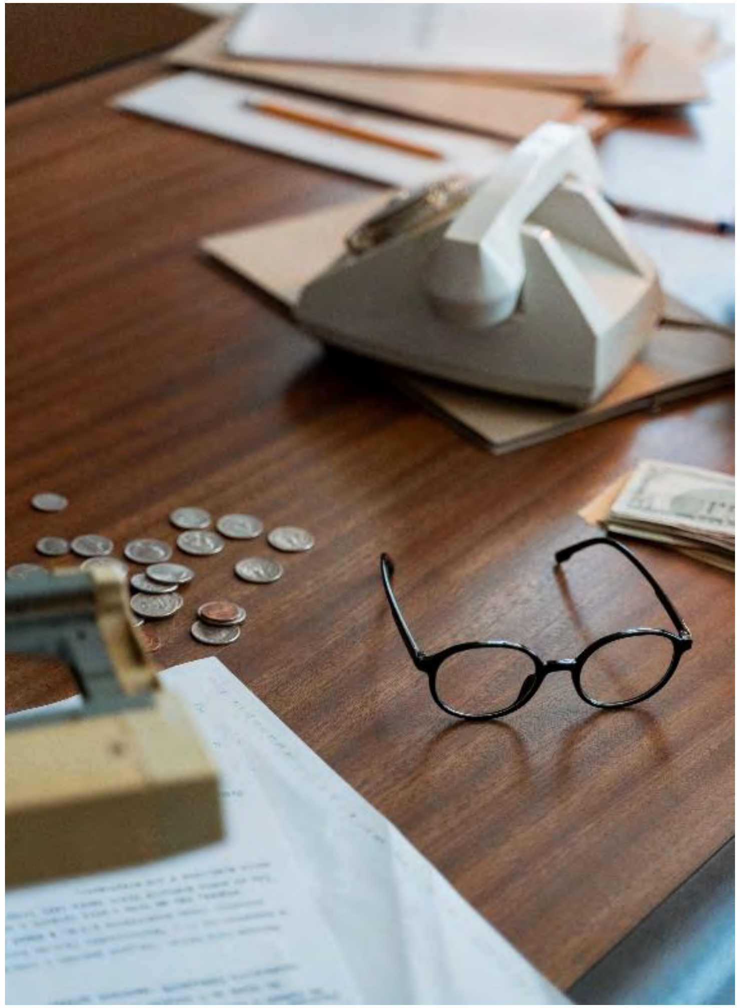
(*Infrastructure Finance Company)

(Source: RBI notification on Large Exposures Framework for Non-Banking Financial Company - Upper Layer, issued on 19 April 2022)

- **Reporting considerations:** NBFC-UL would report its large exposures to RBI as per the reporting template prescribed in the LEF framework. LEF reporting should cover the following:
  a. All exposures, meeting the definition of large exposure.
  b. All other exposures, measured in a prescribed manner.
  c. Exempted exposures with values equal to or above 10 per cent of NBFC-UL's eligible capital base.
  d. 10 largest exposures to counterparties (irrespective of their values relative to NBFC-UL's eligible capital base).

Effective date: These instructions will be applicable from 1 October 2022.

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



Regulatory updates

E. Compliance function and role of Chief Compliance Officer

Compliance risk is 'the risk of legal or regulatory sanctions, material financial loss or loss of reputation an NBFC may suffer, as a result of its failure to comply with laws, regulations, rules and codes of conduct, etc. applicable to its activities. Thus, it is essential to monitor and mitigate compliance risk.

Accordingly, as per the SBR, NBFCs in the Upper Layer (NBFC-UL) and Middle Layer (NBFC-ML), are required to have an independent Compliance Function and a Chief Compliance Officer (CCO).

Taking this requirement into consideration, RBI, vide circular dated 11 April 2022 has prescribed a set of **minimum** guidelines with respect to the compliance function and role of the CCO. According to the guidelines introduced, the Board / Board Committee[15] must ensure that an appropriate compliance policy[16] is put in place, implemented and periodicity of review of compliance risk determined. The circular has also prescribed an active role for the senior management with respect to carrying out compliance risk identification and assessment exercise, at least once a year (annual review) and submitting to the Board / Board Committee its review of the compliance failures identified, consequential losses, regulatory actions taken, etc.

Some of the key guidelines with regard to compliance policy, framework for compliance function and role of Chief Compliance Officer (CCO) include:

Compliance policy : NBFCs should lay down a compliance policy that is approved by the board of directors of the NBFC. It should clearly spell out the NBFCs' compliance philosophy, expectations on compliance culture, structure and role of compliance function, role of CCO, reviewing and reporting on compliance risk.

Responsibilities of Compliance Function: The compliance function would be responsible for undertaking the following activities at the minimum:

- Assisting the board of directors and senior management in overseeing the implementation of compliance policy.
- Playing the central role in identifying the level of compliance risk in the organisation and ensuring that appropriate risk mitigants are put in place. It might also serve as a reference point for the staff from operational departments for seeking clarifications and interpretation of various regulatory and statutory guidelines.
- Monitoring and testing compliance by performing sufficient and representative compliance testing and reporting its results to the senior management
- Ensuring compliance of regulatory and supervisory directions given by RBI and other regulators[17] in a time bound and sustainable manner.

[15] Board Committee means 'Audit Committee of the Board', wherever applicable under extant regulations

[16] Compliance policy should be reviewed at least once a year

[17] Directions issued by other regulators should be complied with, in cases where the activities of the entity are not limited to the regulation / supervision of RBI. Any discomfort conveyed to the NBFC, or action taken, if any by other authorities should be brought to the notice of RBI.

Regulatory updates

Table 3: Chief Compliance Officer

Tenure	CCO to be appointed for a minimum tenure of not less than three years In exceptional cases, the board of directors/board committee could relax the minimum tenure by one year, provided appropriate succession planning has been put in place.
Removal	CCO to be transferred / removed before completion of the tenure only in exceptional circumstances, with the prior approval of the board of directors/board committee.
Reporting Line	CCO to have direct reporting lines to the MD & CEO and/board of directors/board committee[18] If CCO reports to the MD & CEO, the board of directors/board committee should meet the CCO at quarterly intervals on a one-to-one basis, without the presence of senior management, including MD & CEO.
Roles and responsibilities of CCO	Some of the key roles and responsibilities of the CCO include: • CCO is the head of the compliance department of the NBFC. • CCO is a member of the 'new product' committee/s and the nodal point of contact between the NBFC and the regulators / supervisors. • CCO has authority to communicate with the staff members and have access to all records and information, necessary to enable her / him in carrying out the entrusted responsibilities[19] • CCO can participate in the structured and other routine discussions with RBI and other regulators.

(Source: Foundation for Audit Quality's analysis, 2022 read with RBI notification on Compliance Function and Role of Chief Compliance Officer (CCO) - NBFCs issued on 11 April 2022)

[18] CCO would not have any reporting relationship with the business verticals.
[19] Dual Hatting' must be avoided, i.e., the CCO should not be given any responsibility that brings elements of conflict of interest. CCO should not be a member of any committee which conflicts her / his role as CCO with responsibility as a member of the committee. In case CCO is a member of any such committee, it should only be an advisory role.

Regulatory updates

Effective date: NBFC-UL and NBFC-ML should put in place a board of directors approved policy and a compliance function, including the appointment of a CCO latest by 1 April 2023 and 1 October 2023 respectively.

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

F. Guidelines on compensation of Key Managerial Personnel (KMP) and senior management in NBFCs

In order to address issues arising out of excessive risk-taking approach caused by misaligned compensation packages, the SBR required NBFCs classified in the Middle (NBFC-ML) and Upper Layer (NBFC-UL) of the SBR framework to put in place a compensation policy that is approved by the board of directors.

In this regard, RBI, vide a notification dated 29 April 2022, has issued broad guidelines for formulating compensation policies of KMP and members of senior management. As per the guidelines, the compensation policy of an NBFC should at the minimum include the following provisions:

- **Constitutions of Nomination and Remuneration Committee (NRC):** NBFC-ML and NBFC-UL should constitute an NRC, which will have the constitution, powers, functions and duties as laid down in the Companies Act, 2013. The NRC may work in close coordination with the Risk Management Committee of the NBFC to achieve effective alignment between compensation and risks. The NRC may also ensure 'fit and proper' status of proposed/existing directors and that there is no conflict of interest in appointment of directors in the board of directors of the NBFC.
- **Principles for fixed/variable pay structures:** The proportion of variable pay in total compensation of a director or KMP should be commensurate with the role and prudent risk-taking profile of KMPs/senior management.
- **Malus[20] /clawback[21] provisions:** The deferred compensation to directors/KMP/members of senior management may be subject to malus/clawback arrangements in the event of subdued or negative financial performance of the company and/or the relevant line of business or employee misconduct in any year.

Effective date: These guidelines will come into effect from 1 April 2023.

To access the text of RBI notification, please click here

[20] A malus arrangement permits the NBFC to prevent vesting of all or part of the amount of a deferred remuneration. Malus arrangement does not reverse vesting after it has already occurred

[21] A clawback arrangement is a contractual agreement between the employees and the NBFC in which the employee agrees to return previously paid or vested remuneration to the NBFC under certain circumstances

Regulatory updates

Action points for auditors

- **Guidelines on CET 1 capital:** While reviewing the CET 1 ratio, auditors should take note of the various adjustments that are required to be made to the elements comprising the CET 1 capital. These adjustments should be discussed with the management.

- **Disclosures in financial statements:** The additional disclosures are effective for annual financial statements for the year ending 31 March 2023. Accordingly, auditors should make use of the time they have to determine the formats in which disclosures are required. They should also ascertain whether such disclosures were already being made by their clients. Timely discussions should be initiated with clients on these disclosures, and auditors should encourage clients to provide more comprehensive disclosures than the minimum required, especially if such disclosures significantly aid in the understanding of the financial position and performance of the NBFC.

- **Regulatory restrictions on loans and advances:** Auditors should take note of the various requirements when advancing loans to directors or senior officers- such as specific approvals, declarations from directors and disclosures in financial statements. While performing audit procedures on loans and advances, auditors should ensure these requirements are in place.

- **Large exposure framework:** As per the LEF framework, while computing the eligible capital base, in case of any addition to capital funds, the entity is required to obtain an external auditor's certificate with respect to augmentation of capital and submit the same to RBI. This certificate can be issued by an external auditor; thus, auditors should engage with their clients for the purpose of issue of this certificate.

- **Compliance function:** Auditors should perform the necessary audit procedures in order to identify compliance issues and deficiencies, if any. The compliance deficiencies so identified should be brought to the notice of the compliance function (once that has been set up) and ensure that the recommendations get implemented across entity's compliance structure.

  Since entity's compliance function would be subject to regular internal audit, the statutory auditors should refer the report published by the internal auditors for identifying the compliance risks and deficiencies.

02

International update

- **Auditing updates**

Auditing updates

Updates from IAASB

Revised International Standard on Auditing (ISA) 600

On 7 April 2022, the International Auditing and Assurance Standards Board (IAASB) released ISA 600 (Revised): *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)*. ISA 600 (Revised) includes new and revised requirements that align the standard with the recently revised standards, such as:

- International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*,
- ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, and
- ISA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*.

ISA 600 (Revised) intends to encourage proactive management of quality at the group management and component level, reinforce the need for robust communication and interactions during the group audit and foster an appropriately independent and challenging mindset of the auditor.

Some of the significant changes and clarifications specified in ISA 600 (Revised) include:

- **Risk-based approach:** IAASB has introduced the risk-based approach framework for planning and performing a group audit engagement in order to lay greater emphasis on identifying and assessing the risks of material misstatement and performing further audit procedures in response to the assessed risks. Under the risk-based approach, component auditors can be, and often are, involved in all phases of the group audit.
- **Restrictions on access to information and people:** ISA 600 (Revised) clarifies the various types of restrictions that might exist, such as restrictions on access to people and information (e.g., access to component management, those charged with governance of the component, component auditors, or information at the component) and component auditor audit documentation. The revised standard also provides guidance on ways to overcome such restrictions.
- **Materiality considerations:** ISA 600 (Revised) clarifies how the concepts of materiality and aggregation risk apply in a group audit.
- **Documentation:** ISA 600 (Revised) prescribes enhanced documentation requirements and application material to emphasise the linkage to the requirements in ISA 230, *Audit Documentation*, and the documentation requirements in other relevant ISAs. It also highlights the importance of the group auditor's review of component auditor's audit documentation. Clarification is also provided on what the group auditor may need to document in different situations, including when there are restrictions on access to component auditor audit documentation.
- **Communication and Interactions:** ISA 600 (Revised) strengthens and clarifies the importance of two-way communications between the group auditor and component auditor. It includes various aspects of the group auditor's interaction with component auditors, such as communicating

Auditing updates

relevant ethical requirements, determining competence and capabilities of the component auditor, and determining the appropriate nature, timing, and extent of involvement by the group auditor in the work of the component auditor.

Effective date: ISA 600 (Revised) will be effective for audits of group financial statements for periods beginning on or after December 15, 2023.

To access the text of ISA 600 (Revised), please click here.

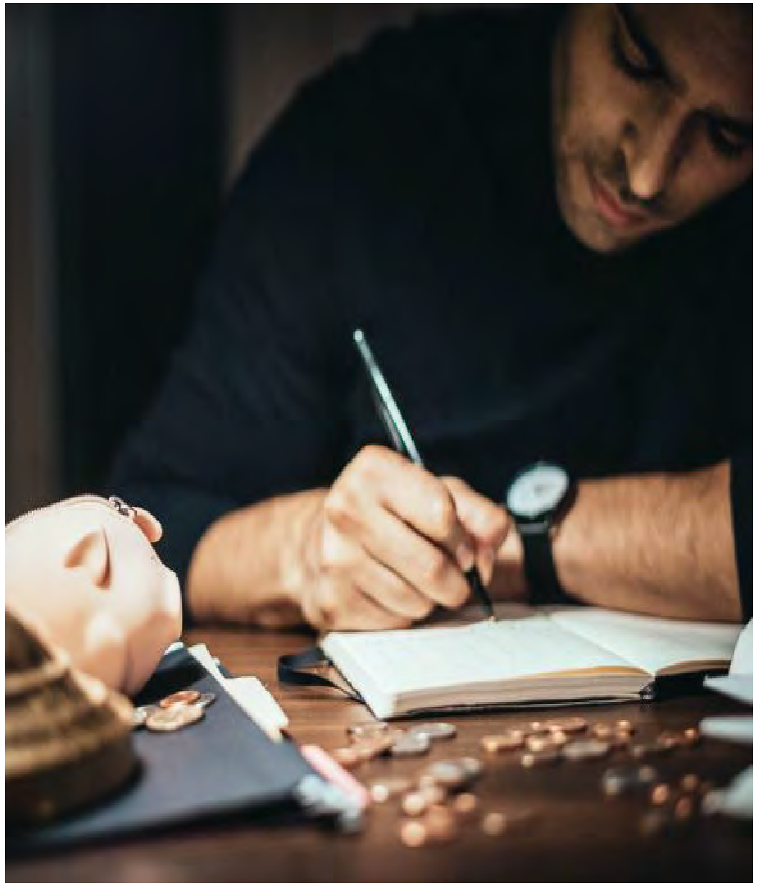
Action points for auditors

- Auditors acting as component auditors of subsidiary companies based in India of an overseas parent would need to comply with the provisions of ISA 600 (Revised). Auditors of such group entities should take note of these changes, as there would be enhanced involvement of the component auditors in all phases of the group audit.
- Under the risk-based approach, component auditors could be, and often are, involved in all phases of the group audit. Thus, component auditors should assist the group engagement team in assessing the risks of material misstatement at the group financial statement level and assertion level and in determining the nature, timing, and extent of audit procedures, as required under ISA 330, *The Auditor's Responses to Assessed Risks.*
- Auditors should refer the guidance specified in the standard on ways to overcome various types of restrictions that might exist. If the group engagement partner concludes that group management cannot provide the engagement team with access to information or unrestricted access to persons within the group due to restrictions that are outside the control of group management, the group engagement partner should consider the possible effects on the audit opinion.

Updates from IESBA

Expanded Public Interest Entity (PIE) definition complements recently strengthened International Independence Standards (IIS) on non-assurance services and fees paid by audit clients

On 11 April 2022, the International Ethics Standards Board for Accountants (IESBA) released a revised definition of a PIE together with other revised provisions in the International Code of Ethics for Professional Accountants (including International Independence Standards) (the Code). The revised provisions specify a broader list of categories of entities as PIEs whose audits should be subject to additional independence requirements to meet stakeholders' heightened expectations concerning auditor independence.



Auditing updates

Accordingly, an entity would be treated as a Public Interest Entity (PIE) when it falls within any of the following categories:

a. A publicly traded entity;

b. An entity one of whose main functions is to take deposits from the public

c. An entity one of whose main functions is to provide insurance to the public or

d. An entity specified as such by law, regulation, or professional standards.

Further, a public traded entity is defined as an entity that issues financial instruments that are transferrable and traded through a publicly accessible market mechanism, including through listing on a stock exchange, for example, a listed entity as defined by relevant securities law or regulation.

To recognise diversity in jurisdictional contexts, IESBA has taken a novel approach of expanding the PIE definition globally at a high level while providing guidance to regulators, national standard setters and other relevant local bodies on tailoring the broad definition for jurisdictional specificities.

Effective date: The pronouncement will be effective for audits of financial statements for periods beginning on or after 15 December 2024. Early adoption is permitted and encouraged.

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

Action points for auditors

- The ICAI Code of Ethics applicable to all chartered accountants in India has been aligned with the International Code of Ethics issued by IESBA. Thus, the proposals issued by IESBA are likely to be considered by ICAI. The proposals suggested by IESBA would be effective for audits of financial statements for periods beginning on or after 15 December 2024. Thus, in order to ensure smooth transition to the new requirements, auditors must engage with the management and those charged with governance of their clients regarding the potential impacts of the proposals on independence requirements of the entity.
- The IESBA coordinated the development of these revisions closely with the IAASB, given that some of the terms and concepts that were considered are common to both Boards' standards. The IAASB is pursuing a project to consider a number of matters relevant to its standards arising from the finalisation of the IESBA's PIE provisions, including whether and how to address the transparency requirement noted above in the IAASB's standards. Auditors should watch this space for further updates in ISQMs and ISAs.

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