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Regulatory updates for June 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

Some of the important updates include the issuance of an exposure draft of the Guidance Note on CARO 2020 (Revised 2022 edition) by the Institute of Chartered Accountants of India (ICAI). This exposure draft has proposed key clarifications pertaining to reporting under the CARO 2020. It has highlighted the clauses where the disclosure requirements under Schedule III are different as compared to the CARO 2020.

Additionally, the Reserve Bank of India (RBI), as a part of the Scaled Based Regulatory (SBR) framework has issued guidelines on differential provisioning to be recognised by NBFCs classified in the upper layer towards different classes of standard assets.

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

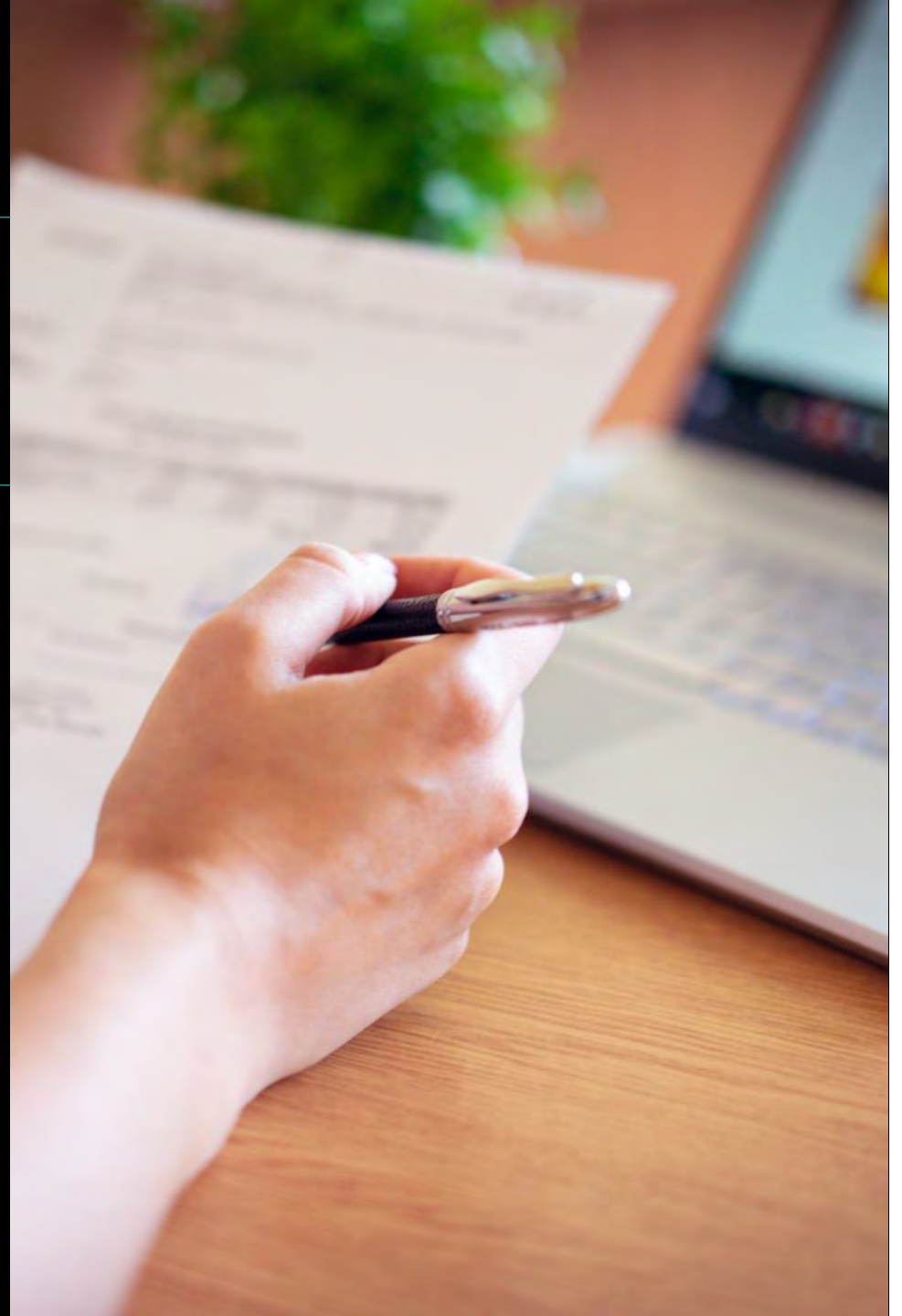


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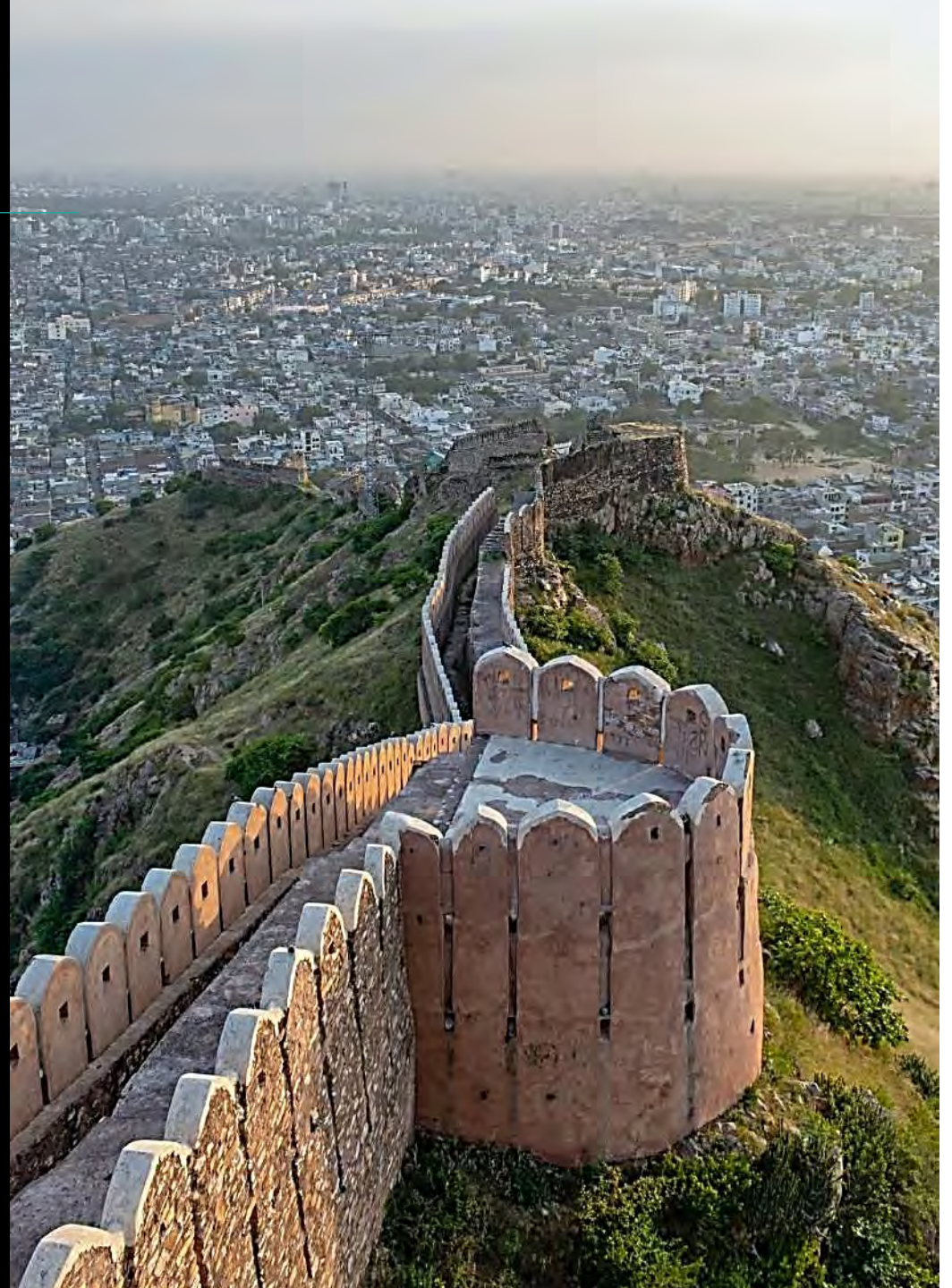


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Updates from ICAI

ICAI issues a Technical Guide on financial statements of Non-Corporate entities

On 9 June 2022, the Institute of Chartered Accountants of India (ICAI) issued a Technical Guide on financial statements for non-corporate entities (Technical Guide). Its objective is to deal with the applicability of Accounting Standards (AS) to the non-corporate entities as well as to prescribe the format of financial statements for the non-corporate entities. The Limited Liability Partnerships (LLPs) are scoped out of this Technical Guide¹.

Meaning of Non-Corporate entities

All business or professional entities, other than the companies incorporated under the Companies Act, 2013 and Limited Liability Partnerships incorporated under the Limited Liability Partnership Act, 2008 are considered as non-corporate entities. Some of the most common structures of non-corporate entities are as follows:

- a. Sole proprietorship firms
- b. Hindu Undivided Family (HUF)
- c. Partnership Firms
 - i. Registered Partnership Firms
 - ii. Unregistered Partnership Firms
- d. Association of Persons
 - i. Partnership firms not covered above

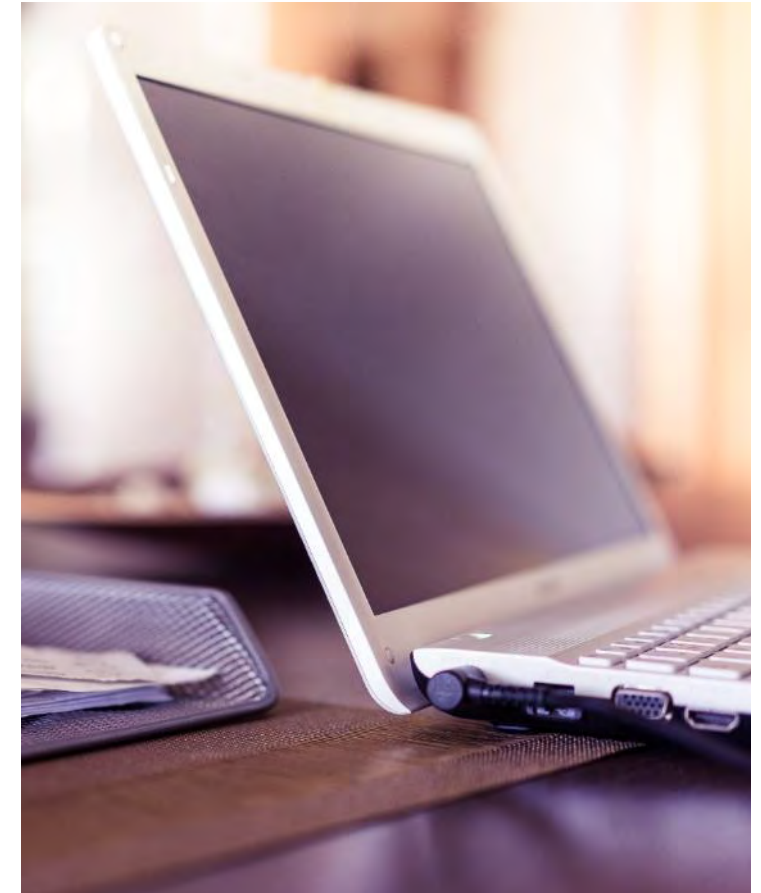
- ii. Body of Individuals
- iii. Resident Welfare Association
- e. Society registered under any law for the time being in force
- f. Trust (private or public) registered or unregistered under any law for the time being in force
- g. Statutory corporations, autonomous bodies and authorities, and
- h. Any form of organisation that is engaged fully or partially in any business or professional activities, unless their activities are fully charitable in nature.

Applicability of the Technical Guide

This Technical Guide is recommended for the purpose of preparation of the financial statements of the above mentioned non-corporate entities unless any formats/principles are specifically prescribed by the relevant Statute or Regulator or any Authority for a particular class of entities. Also, the non-corporate entities which follow Ind AS are not required to follow this Technical Guide.

Key considerations

- **Applicability of AS:** The AS issued by ICAI as on 1 April 2020 are applicable to non-corporate entities. However, for the purpose of determining their applicability, entities have been classified into four levels:
 - i. Level I entities (large size entities),



¹ Limited Liability Partnerships (LLPs) incorporated under the Limited Liability Partnerships Act, 2008, are corporate form of entities, hence, these entities are scoped out of the applicability of the Technical Guide.

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- ii. Level II entities (medium size entities),
- iii. Level III entities (small size entities), and
- iv. Level IV entities (micro entities).

The criteria for entities to be classified as Level I, II, III and IV have been provided in the Annexure I of the Technical Guide and applicability of AS and exemptions/relaxations to entities from applicability of certain as have been given in Annexure 2².

- **Format:** The Technical Guide emphasises that presently, there is diversity in the presentation of financial statements of non-corporate entities, owing to the absence of any specific, well-defined formats. Accordingly, the Technical Guide has prescribed a format for the preparation of financial statements for non-corporate entities. The format seems to be in line with the format provided by Schedule III (Division I) to the Companies Act, 2013³. However, it excludes items which are not relevant for non-corporate entities such as:

- i. Share capital details,
- ii. Details of ageing schedule of trade receivables and payables,
- iii. Details of cost of goods sold are required to be disclosed instead of details of cost of material consumed, purchase of stock in trade, etc.
- iv. Disclosure of ratios, and
- v. Additional regulatory information, etc.

Technical guide on financial statements of LLPs

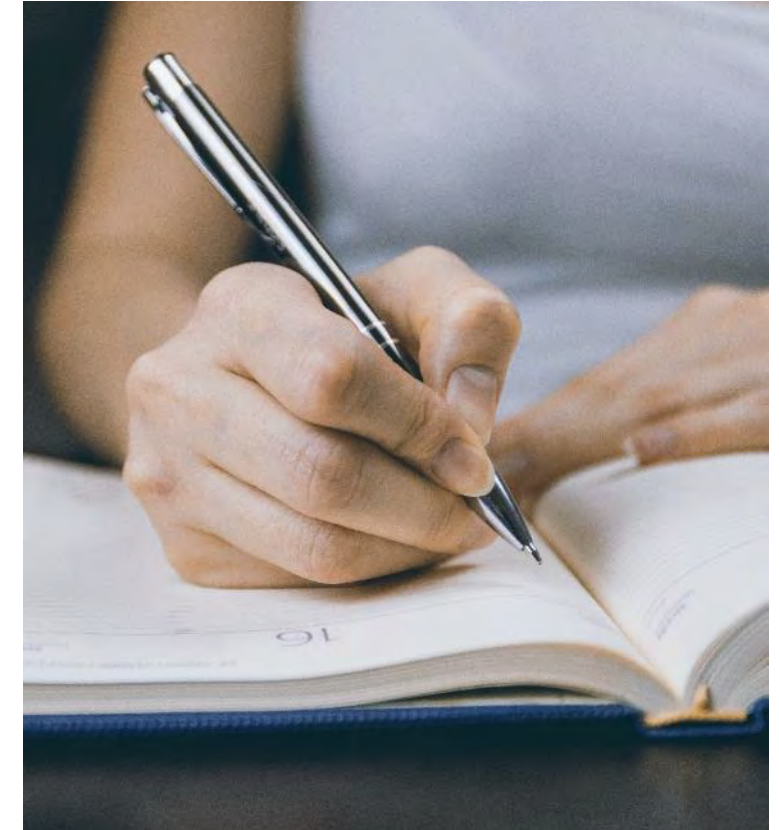
In July 2022, ICAI issued a technical guide on financial statements of LLPs (Technical guide for LLPs). The Technical Guide for LLPs deals with applicability of accounting standards to the LLPs and prescribes formats of the financial statements for the LLPs.

To access the text of the Technical Guide on financial statements of Non-Corporate Entities, please [click here](#).

To access the text of the Technical Guide for LLPs, please [click here](#).

Action Points for Auditors

- The Technical Guide is relevant for the preparation of financial statements of non-corporate entities unless any format or principles are specifically prescribed by the relevant statute or regulator or by any authority for any particular class of entity. For example, public trusts registered in Maharashtra would need to comply with the Maharashtra Public Trust Rules, 1951, similarly, educational institutions, political parties, and other bodies in respect of which guidance has been specifically given by ICAI should comply with the said ICAI guidelines.
- The Technical Guide is recommendatory in nature. However, auditors should actively engage with their non-corporate clients and encourage them to understand and adopt the format for reporting and comply with the applicable accounting standards. This would help in bringing consistency and comparability in the presentation and disclosure of financial information reported by the non-corporate entities.



² Level I entities are required to comply with all the accounting standards. Level II, Level III and Level IV non-corporate entities have been granted certain exemptions/relaxations from compliance with the accounting standards.

³ Division I of Schedule III to the Companies Act, 2013 prescribes the format of financial statements for a company required to comply with the Companies (Accounting Standards) Rules, 2021.

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Updates from IRDAI

IRDAI prescribes accounting of premium, claims and related expenses on estimation basis

Currently, the Insurance Regulatory and Development Authority of India (IRDAI) (Preparation of Financial Statements and Auditors Report of Insurance Companies) Regulations, 2002 (IRDAI FS regulations)⁴ provides the following guidelines with respect to recognition of premium:

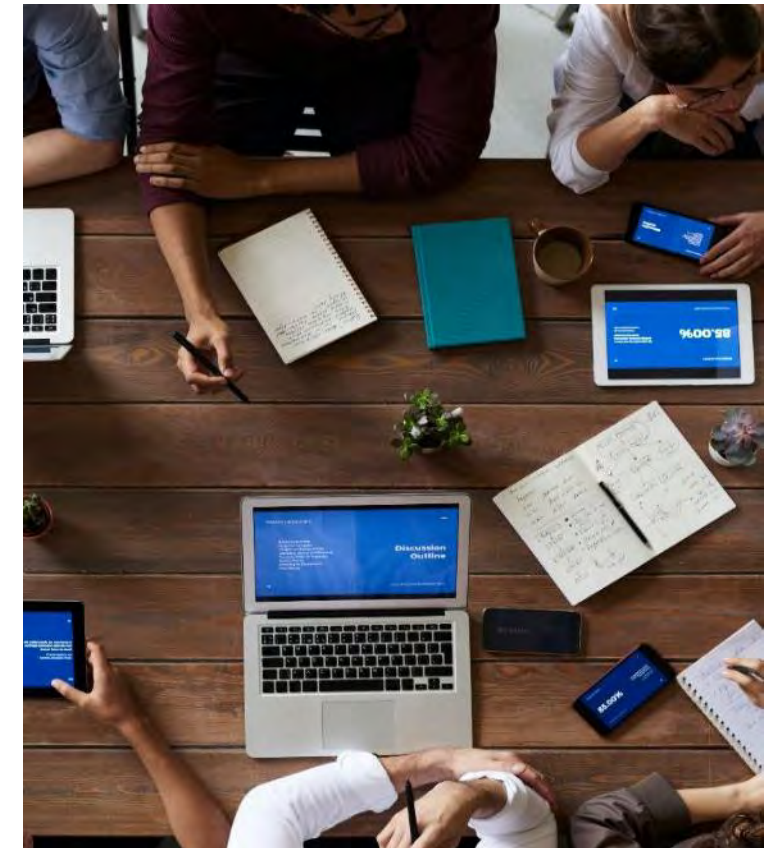
- Premium should be recognised as an income over the contract period or the period of risk, whichever is appropriate,
- Premium received in advance is the premium where the period of inception of the risk is outside the accounting period and is to be shown under 'current liabilities', and
- 'Unallocated premium' includes premium deposit and premium which has been received, but for which the risk has not commenced. It is to be shown under 'current liabilities'.

IRDAI observed that while some of the reinsurers account for the premium received on an 'actual' basis, other reinsurers adopt the 'estimation' basis of accounting⁵.

Given that a significant part of the premium is accounted for on an estimation basis, the IRDAI, vide a circular dated 15 June 2022, has prescribed the guidelines with respect to accounting and disclosure of premium recognised on an estimation basis in the annual report. As per the prescribed guidelines, the reinsurers should ensure that in the annual financial statements, no premium

is accrued/accounted on an estimate basis at least upto the third quarter of each financial year. However, for the fourth quarter ending on 31 March, where the statement of accounts has not been received in time, the premium, losses and related expenses may be accounted on an estimation basis, subject to the following conditions:

- A consistent methodology should be followed across the entire portfolio
- The estimates must be trued up, once the actual values emerge
- A statement should be included in the annual report stating total premium, claims and expenses accounted for during the financial year and premium, claims and expenses accounted on estimation basis
- Complete disclosure should be made for three years (including the current financial year), giving the segment wise break up of premium, claims and expenses accounted on estimation basis and its actual experience as per the prescribed formats, along with management's comments on variation, if any, beyond 10 per cent on a yearly basis under notes to accounts, and



⁴ Part I of Schedule B of the IRDAI FS regulations prescribes the accounting principles for preparation of financial statements. Para 2 of Part I of Schedule B of the IRDAI FS regulations stipulates the accounting provisions for premium received.

⁵ The premium is accounted on estimation basis due to following reasons:
i. Lag or delay in receiving the statement of accounts from the insurer(s), and
ii. Alignment of accounting practices with parent organisation.

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e. If the actual figures are not available at the time of closure of books of accounts for the said financial year:

- Any deviation beyond ± 10 per cent should be reported to IRDAI in the prescribed format, within 15 days from the end of the first quarter of the next financial year
- Disclosures in the notes to accounts as prescribed in point (d) should be made in the annual report for the next financial year.

The new guidelines are effective from financial year 2022-23.

To access the text of the circular, please [click here](#).

Action points for auditors

- As per the IRDAI circular, insurance companies are required to develop a consistent methodology for accounting for premiums on an estimation basis across the entire portfolio. Auditors should verify whether the methodology adopted by the insurance companies, complies with the accounting standards and other relevant regulations applicable to the insurance companies.
- Auditors should discuss with reinsurance companies regarding the requirement to include the prescribed disclosures in the notes to accounts of the financial statements for financial year 2022-23 onwards, and to make stipulated submissions to IRDAI in certain cases.



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Updates from ICAI

ICAI issues Exposure Draft of Guidance Note on CARO 2020 (Revised 2022 Edition)

In July 2020, ICAI had issued the Guidance Note on the Companies (Auditor's Report) Order, 2020 (CARO 2020) to provide detailed guidance to auditors on the reporting requirements of the CARO 2020.

There have been certain amendments to the Schedule III to the Companies Act, 2013 (which include amendments that are in line with the clauses pertaining to the CARO 2020 and various additional disclosure requirements). Therefore, ICAI, in June 2022 released an Exposure Draft of the Guidance Note on CARO 2020 (exposure draft). Some of the key changes suggested in the exposure draft include:

- **Applicability:**
 - For evaluating applicability of CARO 2020, **total income** should be considered as a criteria instead of total revenue, and
 - For evaluating applicability of the CARO 2020 to NBFC companies, definition of Reserves and Surplus has been amended. The revised definition of Reserves and Surplus⁶ for entities following Division III of the Schedule III is now aligned with the definition of Reserves and Surplus for entities following Division II of the Schedule III.

- **Clause (iii) - Reporting on loans, investments, guarantees, securities and advances in nature of Loan:** The exposure draft has recommended the following changes while reporting under clause (iii) of the CARO 2020:
 - **Clause 3(iii)(a)(A) and (B)⁷:** The exposure draft has introduced changes in the reporting format of clause (iii)(a), relating to granting of loans and advances in the nature of loans. As per the proposed format, the reporting for loans and advances in the nature of loans would be split into secured and unsecured portions. The revised format proposed by the exposure draft is given below:

	Guarantees	Security	Loans-secured	Loans-unsecured	Advances in nature of loans - secured	Advances in nature of loans - unsecured
Aggregate amount granted/ provided during the year						
- Subsidiaries - Joint Ventures - Associates - Others						
Balance outstanding as at balance sheet date in respect of above cases - Subsidiaries - Joint Ventures - Associates - Others						

⁶ As per the revised definition, Reserves and Surplus comprise of:
a. Capital Reserve, b. Retained Earnings, c. Securities Premium, and d. Other Reserves

⁷ Clause 3(iii)(a)(A) and (B) requires specific reporting by auditor, where a company has provided loans, advances in the nature of loans, stood guarantee or provided security to any entity.

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- **Clause 3(iii)(c)⁸:** Where repayment of principal and payment of interest is not regular, the auditor is required to report in a prescribed format. The exposure draft has now proposed reporting non-payment of principal and/or interest in two separate tabular formats, as given below:

- **For companies whose principal business is NOT to give loans:** Additional column for actual date of payment has been included in the existing format- the revised format is given below:

Name of the Entity	Amount	Due date	Date of payment	Extent of delay	Remarks, if any

- **For companies whose principal business is to give loans:** New format has been proposed for companies whose principal business is to give loans, in which only summarised information is required to be given pertaining to:
 - No. of cases where repayments were not regular
 - Principal amount outstanding as of the reporting date, and
 - Overdue amount including interest on reporting date.
 (Name of the entity is not required to be provided by entities whose principal business is to give loans).

The new format introduced by the exposure draft is given below:

No. of cases where repayments were not regular	Principal amount outstanding on the reporting date	Overdue amount including interest on the reporting date

- **Clause 3(iii)(e)⁹:** The exposure draft has amended the suggested format for reporting under this clause by adding a column for gross amount of loans/advances in nature of loan granted during the year to those parties where the overdue amount was settled by renewal or extension of a fresh loan.

Accordingly, percentage of loans renewed or extended will be computed as a percentage of total loans or advances in the nature of loans granted during the relevant year to the party where there is a renewal or extension of a loan. Earlier, the requirement was to compute the percentage of loans renewed with respect to the total loans or advances in the nature of loan granted during the year (cumulative amount for all parties).



⁸ Clause 3(iii)(c) requires reporting by auditor on whether the schedule for repayment of principal and payment of interest has been stipulated and whether the repayments or receipts of principal and interest respectively are regular.

⁹ Clause 3(iii)(e) requires auditors to report instances of evergreening of loans.

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The revised reporting format proposed by the exposure draft is given below:

Name of the parties	Aggregate amount of loans or advances in the nature of loans granted during the year	Aggregate overdue amount settled by renewal or extension or by fresh loans granted to the same parties	Percentage of the aggregate to the total loans or advances in the nature of loans granted during the year

- Clause (ix)(f) -Reporting on raising of loans against pledge of securities held in subsidiaries, etc.:** Auditors are currently required to report the loans raised by a company against a pledge of securities held in its subsidiaries, associates and joint ventures. As per the exposure draft, companies would now be required to disclose the nature and carrying amount of the securities pledged, and cross reference it to the relevant note in the financial statements.
- Clause (xix)- Reporting on material uncertainty:** Currently, auditors are required to review the liquidity ratios computed by the company and report on whether any material uncertainty exists as on the date of the audit report. However, as per the revised requirements, auditors should now use the **financial ratios**¹⁰ as computed and disclosed by companies in accordance with the

requirement of the Schedule III to the Companies Act, 2013, instead of the liquidity ratios for reporting under this clause.

Apart from the aforementioned changes, other changes in the exposure draft are clarificatory in nature and provide reference to the Schedule III disclosures including the fact where the reporting requirement under CARO 2020 is different from that in the Schedule III.

To access the text of the exposure draft, please [click here](#).

Action Points for Auditors

In many clauses, the exposure draft stipulates that auditors should review the disclosures given in the financial statements pertaining to the respective CARO clause, and accordingly provide their comment in CARO 2020. However, in certain clauses, the reporting requirement under the CARO 2020 is different from that in the Schedule III, therefore professional judgement needs to be applied.



¹⁰ Schedule III (Division I and II) requires disclosure of the following financial ratios in the financial statements:

- Current ratio
- Debt-equity ratio
- Debt service coverage ratio
- Return on equity ratio
- Inventory turnover ratio
- Trade receivables turnover ratio
- Trade payables turnover ratio
- Net capital turnover ratio
- Net profit ratio
- Return on capital employed
- Return on investment

Schedule III (Division III) requires disclosure of the following financial ratios in the financial statements:

- Capital to risk-weighted asset ratio (CRAR)
- Tier I CRAR
- Tier II CRAR
- Liquidity Coverage Ratios

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Updates from MCA

MCA permits restoration of names of independent directors in the databank of independent directors

Rule 6 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 (Directors Rules) specifies the compliance requirements for a person who is eligible and willing to be appointed as an independent director of a company. As per Rule 6 of the Directors Rules, every individual who intends to get appointed as an independent director should apply to the Indian Institute of Corporate Affairs at Manesar (IICA) for inclusion of his/her name in the data bank of independent directors for a period of one year, five years, or for life-time, and renew such application in a prescribed manner.

Additionally, sub-rule 4 of Rule 6 of the Directors Rules requires certain individuals whose name is included in the data bank of the independent directors to pass an online proficiency self-assessment test conducted by IICA within a prescribed period, failing which, his/her name would be removed from the databank of independent directors.

The Ministry of Corporate Affairs (MCA), vide a notification dated 10 June 2022 issued the Companies (Appointment and Qualifications of Directors) Second Amendment Rules, 2022. The amended rules have inserted a new sub-rule 5 in Rule 6 of the Directors Rules. As per sub-rule 5, any individual whose name has been removed from the data bank of the independent directors under sub-rule 4, may apply for restoration of his/her name on payment of the prescribed fees, subject to the following conditions:

- The name would be shown in a separate restored category for a period of one year from the date of restoration within which, the person must pass the online proficiency self-assessment test and thereafter his/her name would be included in the data bank of the independent directors, and
- If the person fails to pass the online proficiency self-assessment test within one year from the date of restoration, his/her name would be removed from the data bank, and he/she would be required to apply afresh for inclusion of his/her name in the databank of the independent directors.

The amendment is effective from the date of its publication in the Official Gazette (i.e., 10 June 2022).

To access the text of the notification, please [click here](#).

MCA permits companies to re-submit a form for removal of name of companies from the register of companies

Under the Companies Act, 2013, there are two ways of removing the name of a company from the register of companies. They are as follows:

- **Removal on suo moto basis:** Where companies do not comply with certain provisions¹¹, the Registrar of Companies (ROC) may, on a suo moto basis remove the names of such companies from the register of companies. For this purpose, the ROC will give a notice in writing in form STK-1
- **Application for removal of name:** After extinguishing all its liabilities, a company may, post approval of shareholders by a special resolution, file an application in Form STK-2 in a prescribed



11. Names of companies may be removed from the register in the following cases:

- The company has failed to commence its business within one year of its incorporation;
- The company is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455 of the Companies Act, 2013
- The subscribers to the memorandum have not paid the subscription which they had undertaken to pay at the time of incorporation of a company and a declaration to this effect has not been filed within 180 days of its incorporation under sub-section (1) of section 10A of the Companies Act, 2013.

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manner on certain grounds¹¹ for removing the name of the company from the register of companies.

Where a notice has been issued by the ROC or an application has been received from a company for removal of the name of the company, a public notice will be placed on the official website of MCA or in the official gazette in form STK-5, and in an English language newspaper and at least one vernacular language newspaper in form STK-5A.

The MCA, vide a notification dated 9 June 2022, issued the Companies (Removal of Names of Companies from the Register of Companies) Amendment Rules, 2022 (Removal of Name Amendment Rules). The amended rules permit companies to re-submit form STK-2 in certain cases and amend certain forms. These provisions are discussed below:

- **Resubmission of form STK-2:** If the ROC on examination of the application made in Form STK-2 finds it necessary to call for further information or finds the application defective or incomplete in any respect, he/she should inform the applicant to remove such defects and re-submit the application within 15 days from the date of such information, and After the company has re-submitted the application, if the ROC finds that it is still defective or incomplete in any respect, he/she would give a further time of 15 days to remove such defects or complete the application, failing which the ROC would treat the application as invalid.

The MCA has also clarified that any re-submission of application in form STK-2 made prior to the commencement of the Removal of Name Amendment Rules, should not be counted for the purposes of reckoning the maximum number of re-submissions of such form.

- **Amendment of certain forms:** Revised formats of Form STK-1, STK-5 and STK-5A respectively have been issued by the MCA.

The amendments are applicable from the date of their publication in the Official Gazette (i.e., 9 June 2022).

To access the text of the notification, please [click here](#).

Action Points for Auditors

An application made by a company in Form STK-2 is required to be certified by a Chartered Accountant/Company Secretary/Cost Accountant in whole time practice, as the case may be. Additionally, Form STK-2 should be accompanied with a statement of accounts comprising assets and liabilities of the company made up to a day, not exceeding 30 days before the date of application and certified by a Chartered Accountant. Since the ROC is empowered to call for any further information contained in or annexed to Form STK-2, Chartered Accountants and other professionals are expected to maintain sufficient documentation with regard to the information contained in and annexed to the application.



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MCA issues the National Financial Reporting Authority Amendment Rules, 2022

Rule 13 of the National Financial Reporting Authority (NFRA) Rules, 2018 (NFRA Rules) states that if a company or any officer of a company or an auditor or any other person contravenes any of the provisions of the NFRA Rules, the company and every officer of the company who is in default, or the auditor or such other person would be punishable as per the provisions of section 450¹² of the Companies Act, 2013.

The MCA, vide a notification dated 17 June 2022 has issued the NFRA Amendment Rules, 2022 (NFRA Amendment Rules). The NFRA Amendment Rules have now substituted Rule 13 of the NFRA Rules, stating that anyone who contravenes any of the provisions of these Rules, would be punishable with a fine not exceeding INR5,000, and where the contravention is a continuing one, with a further fine not exceeding INR500 for every day after the first day during which the contravention continues.

The amendments are effective from the date of publication in the Official Gazette (i.e., 17 June 2022).

To access the text of the notification, please [click here](#).

¹² Section 450 of the Companies Act, 2013 states that if a company or any officer of a company or any other person contravenes any of the provisions of this Act or the Rules made thereunder, and for which no penalty or punishment is provided elsewhere in this Act, the company and every officer of the company who is in default or such other person would be liable to a penalty of INR10,000, and in case of continuing contravention, with a further penalty of INR1,000 for each day after the first during which the contravention continues, subject to a maximum of INR2 lakh in case of a company and INR50,000 in case of an officer who is in default or any other person.



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Updates from SEBI

Extension of facility for conducting annual meeting and other meetings of unitholders of REITs and InvITs through Video Conferencing (VC) or Other Audio-Visual means (OAVM)

Recently, MCA, vide circular dated 5 May 2022 had extended the facility of holding Annual General Meeting (AGM) and Extraordinary General Meetings (EGMs) through VC/OAVM till 31 December 2022. In line with this, The Securities and Exchange Board of India (SEBI), had also been receiving various representations from the stakeholders of Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) with respect to the extension of facilities to conduct annual meetings and other meetings of unitholders through VC/OAVM.

Accordingly, SEBI, through its circular dated 3 June 2022 has extended the facility for conducting annual meeting and other meetings of unitholders of REITs and InvITs through VC/OAVM till **31 December 2022** (Earlier: 30 June 2022).

To access the text of the circular, please [click here](#)

Action point for auditors

While companies have now been permitted to conduct annual and other meetings in the calendar year 2022 vide video conference or other audio-visual means, this does not imply any extension in timeline for conducting the meetings. Accordingly, provisions of SA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* should be considered by auditors, in case of any delay in holding such meetings.

SEBI has issued a circular, revising disclosure requirements for holding of specified securities

Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 (LODR Regulations) require listed entities to submit to the stock exchange a statement showing holding of securities and shareholding pattern separately for each class of securities, in a format and manner prescribed by SEBI.

SEBI, vide a circular dated 30 November 2015 (the circular) has *inter alia* stipulated the manner of representation of holding of specified securities and the format for disclosure of holding of specified securities. As per the circular, the holding of the specified securities, will be divided into the following three categories, namely (a) promoter and promoter group, (b) public and (c) non-promoter non-public. While disclosing 'Public shareholding', the circular requires companies to consider the following:

1. For disclosure under category 'Institution', the shareholder should fall under the category 'Qualified Institutional Buyer' as defined under Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.
2. All other Public Shareholding shall be displayed under Categories 'Central Government/State Government(s)/President of India' or 'Non-Institutions'.
3. Names of the shareholders holding 1 per cent or more than 1 per cent of shares of listed entity is to be disclosed.
4. Names of the shareholders who are persons acting in concert, if available, shall be disclosed separately.



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The circular has also prescribed the format for disclosure of shareholding of specified securities as below:

- Table I: Summary statement holding of specified securities
- Table II: Statement showing shareholding pattern of the promoter and promoter group
- Table III: Statement showing shareholding pattern of the public shareholder
- Table IV: Statement showing shareholding pattern of the non-promoter non-public shareholder
- Table V: Statement showing details of significant beneficial Owners.

The SEBI, vide circular dated 30 June 2022 has modified the circular as below (amendment circular):

- **Amendments while disclosing public shareholding:** Companies will no longer need to consider points (1) and (2) (above) while disclosing public shareholding under the LODR regulations read with the circular.
- **Revised formats:** Revised formats of Table III and Table IV have been prescribed by the amendment circular.
- **Disclosure of foreign ownership limits:** Listed entities are required to disclose details pertaining to foreign ownership limits in a prescribed format (which will be considered as Table VI under clause 5 of the circular).

The amendment circular would be effective from the quarter ending 30 September 2022.

To access the text of the amendment circular, please [click here](#).

To access the text of the circular, please [click here](#).

Action point for auditors

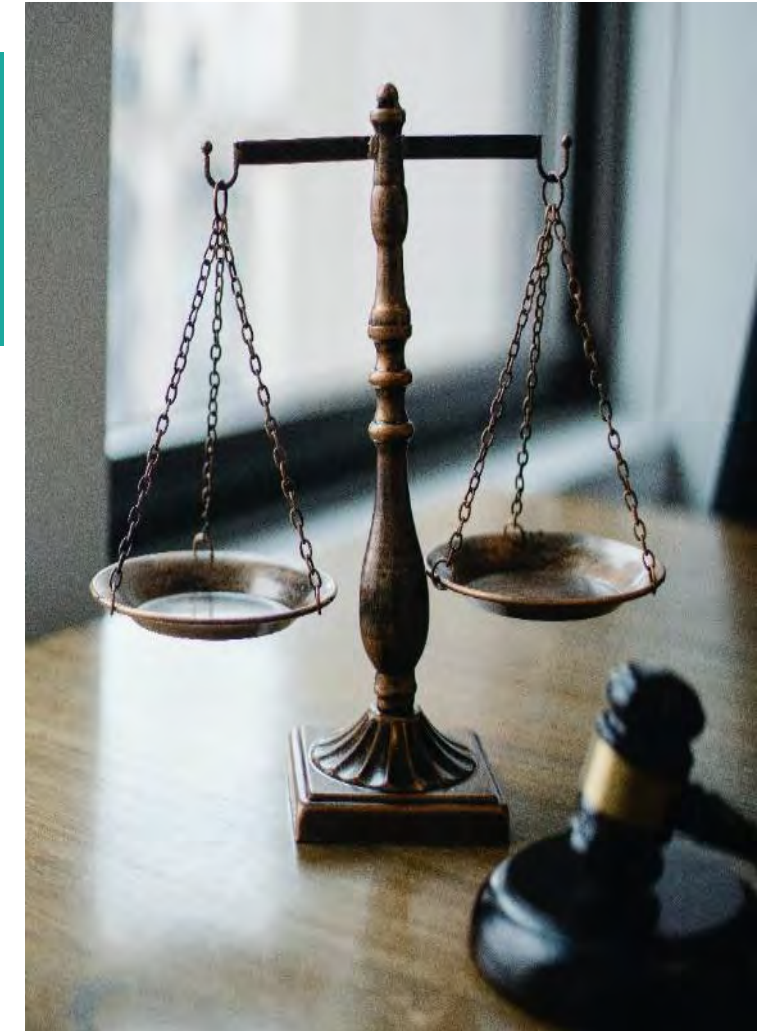
The information submitted by listed entities under Regulation 31 of the LODR regulations to the stock exchanges would be relevant to auditors as they are required to verify the information pertaining to 'distribution of shareholding' disclosed under the corporate governance section of the annual report.

Updates from RBI

Provisioning for Standard assets by Non-Banking Financial Company – Upper Layer

The Reserve Bank of India (RBI), vide a notification dated 22 October 2021 (SBR notification) had introduced the Scale Based Regulatory (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. The SBR framework classified the NBFCs into the following four layers:

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



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Vide the SBR framework (circular issued in October 2021), RBI had stipulated that NBFCs in the upper layer would be required to follow differential standard asset provisioning. The RBI vide a circular dated 6 June 2022 has issued detailed guidelines on differential provisioning to be held by NBFCs classified as NBFC-UL towards different classes of standard assets. NBFCs classified as NBFC-UL would be required to maintain provisions in respect of 'standard' assets at the following rates for the funded amount outstanding:

Category of standard assets	Rate of provision on standard assets
Individual housing loans and loans to Small and Micro Enterprises (SMEs) ¹³	0.25 per cent
Housing loans extended at teaser rates ¹⁴	2 per cent, which would decrease to 0.4 per cent after one year from the date on which the rates are reset at higher rates (if the accounts remain standard)
Advances to Commercial Real Estate ¹⁵ – Residential Housing (CRE - RH) ¹⁶ sector	0.75 per cent
Advances to Commercial Real Estate (CRE) sector (other than CRE-RH)	1 per cent
Restructured advances	As stipulated in the applicable prudential norms for restructuring of advances
All other loans and advances not included above, including loans to Medium Enterprises ¹³	0.4 per cent

¹³ Definition of the terms Micro Enterprises, Small Enterprises, and Medium Enterprises shall be as per the circular FIDD.MSME & NFS.BC.No.3/06.02.31/2020-21 dated July 2, 2020, on 'Credit flow to Micro, Small and Medium Enterprises Sector' as updated from time to time.

¹⁴ Housing loans extended at teaser rates shall mean housing loans having comparatively lower rates of interest in the first few years after which the rates of interest are reset at higher rates.

¹⁵ Commercial Real Estate (CRE) would consist of loans to builders/ developers/ others for creation/acquisition of commercial real estate (such as office building, retail space, multi-purpose commercial premises, multi- tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction etc.) where the prospects for repayment, or recovery in case of default, would depend primarily on the cash flows generated by the asset by way of lease/rental payments, sale etc. Further, loans for third dwelling unit onwards to an individual will be treated as CRE exposure.

¹⁶ Commercial Real Estate – Residential Housing (CRE–RH) is a sub-category of CRE that consist of loans to builders/ developers for residential housing projects (except for captive consumption). Such projects should ordinarily not include non-residential commercial real estate. However integrated housing project comprising of some commercial spaces (e.g., shopping complex, school etc.) can also be specified under CRE-RH, provided that the commercial area in the residential housing project does not exceed 10 per cent of the total Floor Space Index (FSI) of the project. In case the FSI of the commercial area in the predominantly residential housing complex exceed the ceiling of 10 per cent, the entire loan should be classified as CRE and not CRE-RH.

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Further, current credit exposures¹⁷ arising on account of the permitted derivative transactions would also attract provisioning requirement as applicable to the loan assets in the 'standard' category, of the concerned counterparties. All conditions applicable for treatment of the provisions for standard assets would also apply to the aforesaid provisions for permitted derivative transactions.

These revised provisions will be applied while computing the prudential floor with effect from 1 October 2022.

To access the text of the notification, please [click here](#).

Action point for auditors

Auditors should discuss this circular with their clients, and emphasise that the provisioning requirements prescribed in the RBI circular is for the purpose of computing provisions as per the regulatory requirement and the prudential floor for the purpose of accounting. NBFCs required to comply with Ind AS will compute the provisions for Non-Performing Assets (NPAs) as per Ind AS, and the difference between the provision as computed as per Ind AS and the prudential floor will be transferred to the 'impairment reserve'.

RBI has issued guidelines on provisioning for investments in security receipts

In September 2021, RBI had issued the Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 (MD-TLE), thereby laying down a comprehensive, self-contained set of regulatory guidelines governing transfer of stressed loan exposures¹⁸.

Clause 77 of the MD-TLE, *inter alia* states that investments in Security Receipts (SRs)/Pass Through Certificates (PTCs)/other securities issued by Asset Reconstruction Companies (ARCs) shall be valued periodically by reckoning the Net Asset Value (NAV) declared by the ARC based on the recovery ratings received for such instruments.

Provided that when transferors invest in the SRs/PTCs issued by ARCs in respect of the stressed loans transferred by them to the ARC, the transferors shall carry the investment in their books on an ongoing basis, until its transfer or realisation, at the lower of the redemption value of SRs arrived based on the NAV as above, and the Net Book Value (NBV) of the transferred stressed loan at the time of transfer.

The RBI, vide a circular dated 30 June 2022 (the 2022 circular) has provided a glide path for entities to ensure smooth implementation of clause 77 of the MD-TLE. In respect of valuation of investments in SRs outstanding on the date of issuance of MD-TLE (September 24, 2021), the difference between the carrying value of such SRs and the valuation arrived at as on the next financial reporting date after the date of issuance of MD-TLE, in terms of clause 77 of the MD-TLE, may be provided over a five-year period starting with the financial year ending 31 March 2022 - i.e. from FY2021-22 till FY2025-26.



¹⁷ Current credit exposure is defined as the sum of the gross positive mark-to-market value of all derivative contracts with respect to a single counterparty, without adjusting against any negative marked-to-market values of contracts with the same counterparty.

¹⁸ Stressed loans are loans classified as NPAs or as Special Mention Accounts (SMAs).

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Subsequent valuations of investments in such SRs on an ongoing basis shall, however, be strictly in terms of the provisions of MD-TLE.

All lending institutions are required to put in place a board approved plan to ensure that the provisioning made in each of the financial years as per the guidelines above is not less than one fifth of the required provisioning on this count.

All other provisions of the MD-TLE shall continue to be applicable, as hitherto.

This circular is applicable to all India financial institutions, NBFCs, urban, state and district central cooperative banks, local area banks and regional rural banks.

To access the text of the circular, please [click here](#).

To access the text of MD-TLE, please [click here](#).



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Updates from FASB

FASB issues ASU on Topic 820: Fair Value Measurement

On 30 June 2022, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) for improving financial reporting for investors and other financial statement users by increasing comparability of financial information across reporting entities that have investments in equity securities measured at fair value and are subject to contractual restrictions preventing the sale of those securities.

Topic 820, *Fair Value Measurement*, states that for measuring the fair value of an asset or a liability, a reporting entity should consider the characteristics of the asset or liability, (including restrictions on the sale of the asset or liability), if such characteristics are taken into account by a market participant. An important consideration in this regard is the unit of account for the asset or liability being measured at fair value.

Based on the feedback received from different stakeholders, FASB noted that Topic 820 contains conflicting guidance with respect to the unit of account, when measuring the fair value of an equity security. This has resulted in diversity in practice on whether the effects of a contractual restriction that prohibits the sale of an equity security should be considered in measuring that equity security's fair value.

Therefore, the amendments in the ASU have clarified that a contractual restriction on the sale of an equity security would not be considered as a part of the unit of account of the equity,

security and therefore would not be considered in measuring the fair value. The ASU has also introduced certain new disclosure requirements for equity securities which are subject to contractual sale restrictions¹⁹:

- The fair value of equity securities subject to contractual sale restriction(s),
- The nature and remaining duration of the restriction(s), and
- Circumstances that could cause a lapse in the restriction(s).

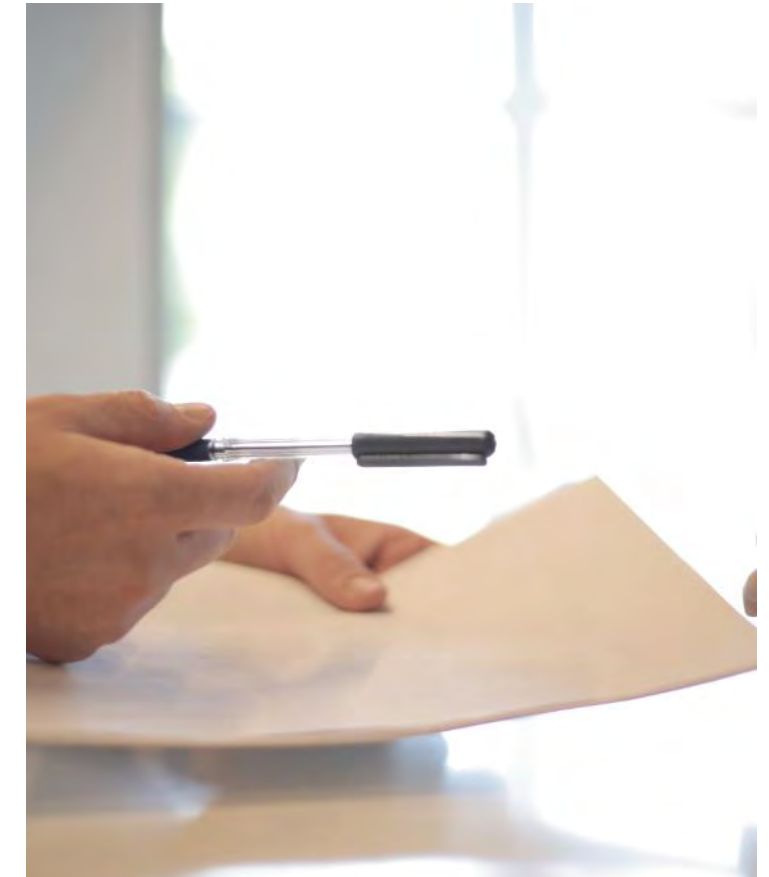
Effective date: The amendments in this update are effective for public business entities for fiscal years beginning after 15 December 2023, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after 15 December 2024, and interim periods within those fiscal years.

FASB also decided to permit early adoption for both interim and annual financial statements that have not yet been issued or made available for issuance.

To access the text of the ASU, please [click here](#)

Action points for auditors

Auditors that are performing audits under the US Generally Accepted Accounting Principles (GAAP) should take note of clarification and disclosure requirements issued by FASB and should refer the various illustrations and implementation guidance given in the ASU. These clarifications will be applicable for fiscal years beginning after 15 December 2023 and 15 December 2024 and interim periods within those fiscal years, as the case may be.



¹⁹ Equity securities which are restricted from sale due to being pledged as collateral and included in other disclosures required by other Topics would not be included in the information required to be disclosed as per the new requirements.



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Registered office: J 98, Second Floor, J Block, Mayfield Gardens, Sector 51, Gurgaon, Haryana 122018



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