SKP

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We are pleased to present the December issue of SKP Assurance Insights – our newsletter that aims at providing insights into company law, accounting and assurance related developments in India.

This month, we bring you the decisive block of Intangible Assets which is set to undergo numerous qualitative changes. With a substantive improvement in valuation, amortisation and impairment principles, the new guideline Indian Accounting Standard (Ind AS) 38: Intangible Assets is well ahead of its predecessor, Accounting Standard (AS) 26: Intangible Assets.

We also discuss AS 28: Impairment of Assets. With changes in economic policies in the present dynamic business environment, the possibility of enterprises revisiting their models, in terms of assumptions and testing for impairment, is high. We have therefore provided an overview of AS 28 along with its key requirements.

It is the need of the hour to continuously assess, monitor and mitigate risks relating to third party management due to increased regulatory controls or to take well informed and strategic decisions. Throughout the world, companies want to get their work done without going through needless office tribulation. It is in this domain that outsourcing has caught the attention of many companies. Our article on third party risks will highlight some of important aspects of third-party related management like key risk monitoring solutions and the role of internal auditors in ensuring complete diligence in the process of third party management in the organisation.

Lastly, under The Companies Act, 2013: Key Updates we cover the latest development in regulatory policy.

We hope you find our newsletter useful and look forward to your feedback. You can write into us at skpgrp.info@skpgroup.com.

Warm Regards,

The SKP Assurance Team

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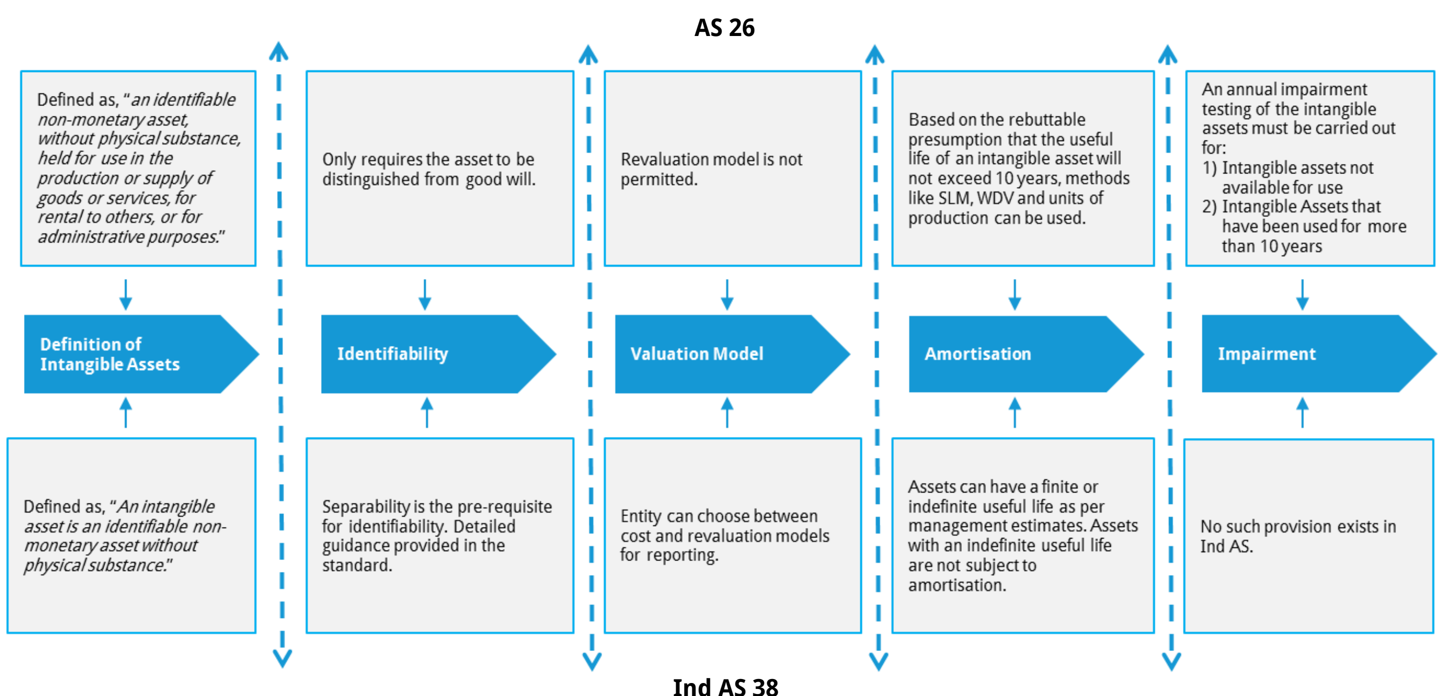
Connect the GAAP: Ind AS 38 – Intangible Assets

In this article we discuss how the adoption of Ind AS 38: Intangible Assets will bring a change in the practices followed by corporates in accounting for intangible assets. The term intangible asset refers to assets which are identifiable non-monetary assets lacking physical substance. Generally, these assets are in the form of formulae, patents, know-how or the like and are derived from distinctive technical or market knowledge. Companies from the same industries may have distinct methods of production of goods or services based on methods they may have developed using such assets. The adoption of Ind AS 38 will have a substantial qualitative impact on the accounting and disclosure of such assets. This impact would be substantial for industries like life sciences and pharmaceuticals, technology and IT-ITeS, automobiles, etc.

In this issue, we discuss:

a) Overview of Ind AS 38 vis-à-vis AS 26
b) Measurement of intangible assets
   – Separately acquired intangible assets
   – Internally generated intangible assets
   – Acquired in business combination
   – Acquired by way of government grants
   – Acquisition of intangible assets in-process R&D project
   – Intangible assets acquired in exchange
c) Revaluation model of measurement
d) Amortisation, impairment and residual value
e) Comparison with IFRS and US GAAP

Overview of Ind AS 38 vis-à-vis AS 26



Measurement of intangible assets

Separately acquired intangible assets

Assets that are acquired separately i.e. for a consideration are initially recognised at cost. Cost should include the purchase price, including import duties and non-refundable purchase taxes and any directly attributable costs of preparing the asset for its intended use. It is implied that the condition for an asset to generate future economic benefits shall always be satisfied irrespective of the timing or amount of inflow. This implied assumption does not exist in AS 26.

Internally generated intangible assets

The generation of the asset is classified into two phases - the research phase and the development phase. Intangible assets arising from the research phase shall not be recognised. Such expenses shall be directly affected, in the statement of profit and loss.

Intangible assets arising from the development phase will be recognised on the fulfilment of all of the criteria mentioned below:

- Technical feasibility of completing the asset and making it available for use.
- Intention of the entity to complete the generation of the asset and in turn use/sell it.
- The overall ability of the management to sell/use the asset.
- The ability of the entity to demonstrate the existence of an active market of the asset from where it can generate future economic benefits for the asset.
- Availability of technical, financial and other resources with the entity supporting the entity's potential to complete the development of the asset and in turn use/sell it.
- Ability to reliably measure all expenses attributed to the asset for its development.

Internally generated brands, mastheads, publishing titles, customer lists and similar items shall not be recognised as intangible assets.

It is pertinent to note that once the costs are expensed out, it cannot be subsequently capitalised, if the project meets recognition criteria at a later date.

Acquisition on business combination

Intangible assets acquired as part of a business combination must be measured at fair value in the books of the acquirer only if they satisfy the recognition criteria. This is irrespective of whether such an intangible asset is recognised in acquiree's books or not. For example, long term customer contracts are ideally not recognised as intangible asset. However, at the time of acquisition, this has to be recognised in the acquirer's books at fair value.

Under Indian GAAP, only intangibles which were appearing in the books of an acquiree were recognised. These again were measured at cost or fair value depending on the method adopted by the acquirer.

Acquisition by government grants

Intangible assets acquired by way of government grants are initially recognised at fair value. Ind AS 20 requires that both the government grant and the intangible asset be recorded at fair value. In some cases, these assets are acquired for a nominal fee or even free of cost. Examples of intangible assets acquired by government grants are airport landing rights, licenses to operate radio or television stations, import licenses or quotas or rights to access other restricted resources.

Under the Indian GAAP, intangible assets acquired free of cost or for a nominal consideration should be recorded at the acquisition cost or the nominal value plus any directly attributable costs.

Acquisition of in-process R&D project

If the company has acquired an in-process R&D project, it has to be recognised separately and any subsequent expenditure is to be accounted as per the principles of intangible assets.

Under the Indian GAAP, there is no specific guidance on accounting for such costs. Such assets are generally recognised at book value. Hence, if the acquiree has not recognised it as a separate asset, the acquirer may not be able to recognise it at all.

Intangible assets acquired by exchange

Intangible assets may be acquired in exchange for a combination of monetary or non-monetary assets. The acquired intangible assets are measured at fair value in cases where:

a) Such a transaction does not lack commercial substance
b) The fair value of such assets given up or acquired can be reliably measured.

Revaluation model of measurement

The company may choose to follow the 'Revaluation model' by which an asset shall be carried at the revalued amount being fair value less any subsequent amortisation and any subsequent impairment losses. The fair value shall be measured by a reference to an active market.

Active markets usually do not exist for intangible assets. (For example, brands). However, for some assets like freely transferable taxi licenses, active markets may exist. In case the active markets are not available, the asset in the revalued class of asset may be carried at a cost less accumulated amortisation and impairment losses.

Frequency of revaluation

This depends on the pace at which the difference between the fair value and the carrying amount becomes material. Assets whose fair value frequently differs from the carrying amount materially are considered volatile. In cases where there is a high volatility, annual revaluation is necessitated.

Accounting under the revaluation model

The first revaluation carried out by the management is important as the treatment of subsequent revaluations would be based on its outcome.

<table>
<tr><th rowspan="2">First Revaluation</th><th colspan="2">Increase in value</th><th colspan="2">Decrease in value</th></tr>
<tr><td colspan="2">Recognise in other comprehensive income under the head revaluation surplus.</td><td colspan="2">Recognise in profit and loss.</td></tr>
<tr><th rowspan="2">Subsequent revaluation</th><th>Increase in value</th><th>Decrease in value</th><th>Increase in value</th><th>Decrease in value</th></tr>
<tr><td>Recognise in other compre-hensive income under the head revaluation surplus, which forms part of the equity.</td><td>Debit to equity to reverse the previous increase. Balance if any available after reversal, debit to profit or loss.</td><td>Credit to profit or loss to reverse previous decrease. Balance if any, credit to equity under revaluation surplus.</td><td>Debit to profit or loss.</td></tr>
</table>

Amortisation, impairment and residual value

Amortisation

An entity will now be required to assess whether the useful life of the intangible asset is finite or indefinite. Intangible assets would be regarded as having an indefinite useful life when the management after analysing all relevant factors foresee no limit to the period over which the asset can generate net cash inflows for the entity. If the useful life is finite, it will have to be amortised over its useful life on a systematic basis. The standard allows a variety of methods for amortisation viz. Straight line method, Diminishing balance method and Unit of production method.

Under the Indian GAAP, amortisation can be over a maximum period of 10 years unless there is persuasive evidence for amortising it over a longer period. Also, it specifically states that there will rarely, if ever, be persuasive evidence to support an amortisation method for intangible assets which results in a lower amount of accumulated amortisation than that under the straight-line method.

The management may change its contention about the intangible asset having an indefinite life. Such a change is considered as a change in accounting estimate in accordance with ***Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors***.

Impairment

Intangible assets with an indefinite useful life are required to be tested for impairment according to Ind AS 36 by comparing the recoverable amount with the carrying amount on:

a) On an annual basis
b) Whenever there is an indication that the carrying amount is greater than the recoverable amount.

The useful lives of such intangible assets have to be reviewed in each period to ensure that all relevant factors support the management's contention of the asset having an indefinite useful life.

Intangible assets with an indefinite useful life are required to be tested whenever there is an indication that the carrying amount is greater than the recoverable amount.

Residual value

Ind AS 38 assumes the residual value of an intangible asset with a finite useful life to be nil. However, it will not be considered nil when:

a) A third party commits to purchase the asset at the end of its useful life.
b) There is an active market which shall exist at the end of the useful life of the asset which helps determine its useful life.

Comparison with IFRS and US GAAP

Particulars	Ind AS	IFRS	US GAAP
Acquisition of intangible assets by way of government grants.	Requires both the grant and the asset to be recorded at fair value to stay in line with Ind AS 20: Accounting for government grants and disclosure of government assistance.	Provides the entity an option to recognise both the asset and the grant either at Fair Value or Nominal Value plus any Directly attributable costs.	No specific guidance in US GAAP.
Treatment of research and development costs.	Development costs may be capitalised on fulfilment of recognition criteria. However, once expensed development costs cannot be capitalised in subsequent accounting periods. All research costs are expensed out as and when incurred.	Similar to Ind AS.	Both research and development costs need to be expensed out on incurrence.
Treatment of advertising costs.	All advertising costs are to be expensed out as and when incurred.	Similar to Ind AS.	Only direct response advertising costs which will generate future economic benefits are to be capitalised. All other advertising costs are to be expensed out.
Measurement of amount of impairment.	The excess of carrying value over recoverable amount is recognised as impairment loss. Recoverable amount is the higher of: a. Fair value *less* costs to sell; b. Present value of all future cash inflows arising from the asset i.e. *Value in Use*	Similar to Ind AS.	The excess of carrying amount over fair value is recognised as impairment loss.
Grouping for measurement and impairment testing.	Intangible assets are to be allocated as a part of cash generating units (CGU) since it is difficult to determine the amount of cash inflows they generate on a standalone basis. Once grouped in a CGU, they are accounted for as a part of the said CGU and impairment testing is carried out.	Similar to Ind AS.	All intangible assets with indefinite useful life are grouped together for accounting and impairment testing purposes. This grouping is irrespective of whether they are acquired assets or internally developed assets.

In retrospect

Introducing qualitative changes like the revaluation model for intangible assets, change in prescriptions for the useful life, recognition of the assets acquired via government grants and amortisation specifications, Ind AS 38 is a more accurate guideline than its predecessor AS 26. These changes echo into how the new Ind AS are a more substance and principle based set of accounting guidelines.

Impairment of Assets

Introduction

Accounting Standard (AS) 28 sets the guidelines for when and how an enterprise should perform impairment testing. Enterprises generally develop models, assumptions and testing procedures for impairment testing. However, the changing macroeconomic environment and increased business opportunities have brought new challenges to these enterprises and have compelled them to reassess their procedures.

This article does not deal with the impairment of goodwill.

Understanding impairment

An asset is impaired when the carrying amount of an asset exceeds its recoverable amount. Hence, it is imperative that an enterprise assesses at each balance sheet date whether there exists any indication that an asset may be impaired.

Impairment Assessment

In assessing whether there exists an indication that an asset may be impaired, an enterprise should consider, as a minimum, the following indicators:

Key external indicators

- A significant decline in the asset's market value by more than the expected rate
- Increase in market interest rates with a likely effect on discount rates used in computing the asset's value in use
- Carrying amount of the asset (net) is more than its market capitalisation
- Technological, market, economic or legal environmental changes causing an adverse effect over the enterprise

Key internal indicators

- Obsolescence or physical damage to the asset
- Evidences indicating economic performance of an asset is/will be worse than expected
- Significant changes which have adverse effects over the enterprise such as, plans to discontinue or restructure the operations
- Operating losses or net cash outflow for the asset
- Significant decline in the budgeted net cash flow or operating profit for the asset

Measurement of impairment loss

Recoverable amount

Recoverable amount is the higher of an asset's net selling price and its value in use. It is not always necessary to determine both, asset's net selling price and value in use. If either of these amounts exceeds the asset's carrying amount then the asset is not impaired and it is not necessary to estimate the other amount. It may be possible to determine the net selling price even if the asset is not traded in the active market. However, sometimes it will not be possible to determine the net selling price because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the recoverable amount of the asset may be taken to be its value in use.

Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows from continuing use that are largely independent of

those from other assets or groups of assets. In this case, the recoverable amount is determined for the cash generating unit (CGU) to which the asset belongs.

A CGU is the smallest identifiable group of assets that generate cash inflows from continuing use. They are largely independent of the cash inflows from other assets or groups of assets.

Net selling price

The best evidence of an asset's net selling price is a price in a binding sale agreement in an arm's length transaction adjusted for incremental costs directly attributable to an asset's disposal.

In the absence of a binding sale agreement where an asset is traded in an active market, the net selling price is the market price reduced by cost of disposal. In the absence of an active market, the net selling price is based on the best information available to reflect the amount that an enterprise could obtain on an asset disposal in an arm's length transaction.

Value in use

The estimation of value in use involves estimating the future cash inflows and outflows from the continuing use of the asset and from its ultimate disposal and applying an appropriate discount rate to the future cash flows.

Cash flow projections should be based on reasonable and supportable assumptions that represent the best estimates of the economic conditions that are expected to exist over the remaining useful life of the asset. The cash flow estimates should be based on the most recent financial budget that has been approved by the management. Projections based on the budgets should cover a period up to five years unless a longer period is justifiable.

Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budget forecast using a growth rate for subsequent years.

The discount rate should be a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the asset. The discount rate should not reflect the risk for which future cash flow estimates have been adjusted.

Recognition of an impairment loss

If the recoverable value of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. This reduction is called impairment loss.

An impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at a revalued amount in accordance with AS 10 (Accounting for Fixed Assets), in which case any impairment loss of a revalued asset should be treated as a revaluation decrease under that Accounting Standard.

When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an enterprise should recognise a liability if, and only if, it is required by another Accounting Standard.

After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Cash Generating Units

If there is any indication that an asset may be impaired, the recoverable amount should be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an enterprise should determine the recoverable amount of the CGU to which the asset belongs (the asset's CGU).

The recoverable amount of an individual asset cannot be determined if the asset's value in use cannot be estimated to be close to its net selling price and the asset does not generate cash inflow from continuing use that is largely independent of those from other assets.

In such cases value in use and recoverable amount can be determined only for assets' CGUs.

If an active market exists for the output produced by an asset or a group of assets, such asset or group of assets should be identified as a separate CGU.

CGUs should be identified consistently from period to period for the same asset or types of assets, unless a change is justified.

The determination of the carrying amount of a CGU should be consistent with the way the recoverable amount of the CGU is determined.

The recoverable amount of a CGU is the higher of the CGU's net selling price and value in use.

In testing a CGU for impairment, an enterprise should consider whether any goodwill relating to the CGU is recognised in the financial statements. In this case, the enterprise should perform a 'bottom-up' test in which an enterprise should identify whether a carrying amount of goodwill can be allocated on a reasonable and consistent basis to the CGU and then compare the recoverable amount to its carrying amount.

If while performing the 'bottom-up' test, the enterprise could not allocate the carrying amount of goodwill, the enterprise should perform a 'top-down' test, where it should identify the smallest CGU that includes the CGU under review, to which the carrying amount of goodwill can be allocated and then compare the recoverable amount of the larger CGU to its carrying amount.

While testing a CGU for impairment, an enterprise should identify all the corporate assets that relate to the CGU under review. For each identified corporate asset, an enterprise should then apply the following principles:

- If the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis to the CGU under review, an enterprise should apply the 'bottom-up' test only; and
- If the carrying amount of the corporate asset cannot be allocated on a reasonable and consistent basis to the CGU under review, an enterprise should apply both the 'bottom-up' and 'top-down' tests.

An impairment loss should be recognised for a CGU if, and only if, its recoverable amount is less than its carrying amount. The impairment loss should be allocated to reduce the carrying amount of the assets of the unit in the following order:

First, to goodwill allocated to the CGU (if any); and then, to the other assets of the unit on a pro-rata basis based on the carrying amount of each asset in the unit.

These reductions in carrying amounts should be treated as impairment losses on individual assets.

In allocating an impairment loss, the carrying amount of an asset should not be reduced below the highest of:

a) Its net selling price (if determinable);
b) Its value in use (if determinable); and
c) Zero.

The amount of impairment loss that would otherwise have been allocated to the asset should be allocated to other assets of the unit on a pro-rata basis.

Reversal

An enterprise should assess at each balance sheet date whether there is any indication that an impairment loss recognised for an asset in prior accounting periods may no longer exist or may have decreased. If any such indication exists, the enterprise should estimate the recoverable amount of that asset.

The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation), had no impairment loss been recognised for the asset in prior accounting periods.

A reversal of an impairment loss for a CGU should be allocated to increase the carrying amount of the assets of the unit in the following order:

a) First, on assets other than goodwill, it should be allocated on a pro-rata basis based on the carrying amount of each asset in the unit; and
b) Then, to goodwill allocated to the CGU (if any), if the following requirements are met:
    - The impairment loss was caused by a specific external event of an exceptional nature that is not expected to recur; and
    - Subsequent external events have occurred that reverse the effect of that event.

These increases in the carrying amounts should be treated as reversals of impairment losses for individual assets.

In allocating a reversal of an impairment loss for a CGU, the carrying amount of an asset should not be increased above the lower of:

a) Its recoverable amount (if determinable); and
b) The carrying amount that would have been determined (net of amortisation or depreciation), had no impairment loss been recognised for the asset in prior accounting periods.

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a pro-rata basis.

Risks related to third-party engagement

In today's scenario, companies across the globe are taking support of third-party services to get their work done without going through needless bureaucratic hassles. This allows them to concentrate on their core processes and have expertise involved in the execution of such processes. In the current complex and highly competitive environment, third parties have become an essential part of business and participate in various activities of the organisation. Organisations rely on third parties for e.g. consultants, advocates, business process outsourcers, cloud providers, data processors, third-party transaction processors and others with whom they share sensitive and significant company information. Therefore, it has become more important for the management to ensure compliance with various security and privacy regulations while entering into agreements with them.

There are various advantages and disadvantages in acquiring third-party support services by any organisation. The following table can serve as a quick reference:

Pros of third-party vendors	Cons of third-party vendors
Enhanced skills, technical expertise and specific equipment/software	Risk of exposing confidential data
Additional time to focus on core processes instead of routine ones	Inappropriate categorisation of responsibilities with third parties
Increased cost benefit, revenue realisation and improved returns on investment	Problems related to quality and turnaround time
Increased speed and quality of delivery to meet timelines	Shortcomings in performance with reference to expectations

Data security risk

Organisations have taken the support of shared service centre vendors to achieve economies of scale and hence there is always a concern regarding whether critical and sensitive customer data is being adequately protected. Data risks are an inherent problem for companies that outsource. Companies that prefer to utilise outsourcing agencies must handle security challenges and risks that are unavoidable whenever they shift business processes outside the boundaries of the company. These issues can take the form of compliance issues, legal liabilities, brand risks, financial risks or customer concerns.

Hence, companies should ensure that outsourced vendors adhere to data privacy through measures that are consistent with internal policies, customer expectations and applicable governing laws.

Third-party risk

As companies try to better understand and recognise the inherent risks with third parties, it is worth noting that exposure will differ with every relationship. The challenge is to set up a framework for risk assessment that is effective yet flexible enough to adequately cover the major risks involved while entering into agreements with vendors. The expectations placed on third parties

and the level of assurance needed by an organisation can and should vary based on a number of factors.

Third-party risks can be found throughout an organisation. These risks can be segregated into the following six categories:

Financial	Foreign exchange, currency risk, tariffs, taxes, product price, mark-ups and rebates.
Information	Accuracy, timeliness, relevance and security of data shared by multiple parties.
Integrity	Fraud, regulatory compliance, conflicts of interest, brand, and reputation.
Operational	Cost, efficiency, contract concerns and supply chain concerns.
Strategic	Strategic issues including social responsibility, environmental principles and the economic impact of third parties.
Technology	Computers, data-storage devices, networks and emerging technologies.

In many organisations, the responsibility falls to risk managers and internal audit professionals to manage, regulate and monitor the risks related to third parties

- Risk managers: Establish controls and procedures to minimise risks.
- Internal auditors: Provide an objective assessment of the controls, recommend improvements and offer assurance to the executive management and the board that risks are addressed appropriately.

It is a difficult task to oversee the management of increasingly complex and interconnected risks that have the potential to devastate organisations overnight. It is upon the company's board and audit committee to ensure that third-party risk management is monitored and that they address these concerns.

Instructions for managing risks related to third-party services

The company's management should have internal policies which manage the risks involved in engaging with third parties:

- Frame a security and privacy policy by which the third-party vendor understands the criticality and sensitivity of the data shared with them.
- Identify parameters for vendor selection.
- Provide education/training on handling sensitive data within and outside the organisation
- Ensure a security audit at regular intervals to ensure compliance with existing policies
- Establish clear and explicit rules to hold vendors accountable and measure performance.
- Create a checklist of factors they want to measure and track in assessing risk. It may contain details such as:
  - Vendor name/vendor type
  - Nature of service provided
  - The amount or type of data shared or intangible property with a vendor
  - The potential magnitude of the financial, reputational or operational loss
  - Degree of management oversight of the services
  - Safeguards to ensure compliance with the Foreign Corrupt Practices Act, UK Bribery Act or other relevant industry, state or country regulations
  - The primary relationship owner within the organisation
  - Scoring in terms of risks (financial, operational, compliance, strategic)

Questions a company's board should consider while seeking third-party support

- Whether third-party risks are considered in the organisation's overall approach to enterprise risk management?
- Whether third-party risk management roles and responsibilities are clearly defined within the organisation?
- Whether appropriate resources are allocated to address third-party risks?
- Whether risk managers and internal auditors consider third-party risks in their risk assessments and audit plans?

Role of internal auditors

A large portion of the responsibility for risk monitoring and control evaluation typically falls to internal audit because of its internal control mindset, expertise in risk management universe, objective evaluation capabilities and ability to reach into multiple business areas across the organisation.

Internal auditors follow this procedure to assess the internal controls established by third parties:

- Obtain an understanding of the service provided by the service provider including internal controls.

- Obtain an understanding of the nature and materiality of the transactions processed or accounts or financial reporting processes affected by the third party.
- Obtain an understanding of the degree of interaction between the activities of the service organisation and those of the third party.
- Obtain an understanding of the nature of the relationship between the user entity and the third party, including the relevant contractual terms for the activities undertaken by the third party.
- The auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organisation, including those that are applied to the transactions processed by the third party.
- The auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the third party and their effect on the user entity's internal control, relevant to the audit, has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

Conclusion

Third-party relationships are a critical area in the context of extensive outsourcing. Organisations should have a constant and comprehensive process defined for evaluating and mitigating the risks inherent with third-party relationships, preferably as an integral part of the ongoing internal audit risk universe and Enterprise Risk Management programmes.

All third parties are different in terms of the types of services they deliver to an organisation. The level of risk assessments to be carried out for a third party is directly related to the scope of work they perform, the type of confidential data or information shared, and may trigger different regulatory compliance obligations depending upon the types of services they render. Establishing comprehensive agreements is a corrective step in this context; however, third-party risk management programmes also need a continuous monitoring mechanism and regular audits in enforcing those contracts.

Companies Act, 2013: Key updates

Relaxation of additional fees and extension for filing forms AOC-4, AOC-4 XBRL and MGT-7

The Ministry of Corporate Affairs (MCA) vide General Circular No. 15/2015 ***has further extended*** the last date of filing forms AOC–4, AOC–4 XBRL and e-form MGT–7. These forms can be filed without any additional fees payable till 30 December 2015.

Source: Extension for filing e-forms

Companies (Amendment) Act, 2015 – Commencement notification

The MCA notified the Companies (Amendment) Act, 2015 in May 2015. There were 23 points in total, however the Central government notified that only 21 points (point number 1 to 12 and 15 to 23) will come into force form 29 May 2015. The Central government has appointed 14 December 2015 as the date when the remaining 2 points (point number 13 and 14) will come into force. The remaining 2 points deal with the following:

- In section 143 – Fraud reporting by auditors
- In section 177 – Omnibus approval for related party transactions

Source: Commencement notification

Ministry of Corporate Affairs, Rules

The MCA has appointed 14 December 2015 as the date on which the amendments pertaining to section 143 and section 177 of the Companies (Amendment) Act, 2015 will come into force. The MCA has notified rules in line with the aforesaid amendments, which are as follows:

Companies (Audit and Auditors) Amendment Rules, 2015

The Companies (Amendment) Act, 2015 states that if the auditor of a company has reason to believe an offence of fraud is being or has been committed in the company by its officers or employees, then, depending on the amount involved, the auditor will have to report to either the Central government or the Audit Committee/Board. The following rules give directions to the auditors as to when and how they should report fraud.

Offence of fraud – INR 10 million or above

- The auditor shall report the matter to the Board or the Audit Committee immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within 45 days.
- On receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments to the Central government within 15 days from the date of receipt of such reply or observations.
- In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations.
- The report shall be on the letterhead of the auditor containing postal address, email address and contact telephone number or mobile number and shall be signed by the auditor with his seal and shall indicate his membership number; and the report shall be in the form of a statement as specified in Form ADT-4.

Offence of fraud - Below 10 million

- The auditor shall report the matter to the Audit Committee or Board immediately but not later than two days of his knowledge of the fraud. The auditor will have to specify the nature, approximate amount and parties involved in the fraud.
- All the frauds reported to the Audit Committee or Board during the year shall be disclosed in the Board's report, which shall include the nature of fraud with the description, approximate amount, parties involved and remedial action taken.

Applicability to other auditors

- The provision of this rule shall also apply, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 of the Companies Act, 2013 respectively.

Source: Companies (Audit and Auditors) Amendment Rules, 2015

Companies (Meetings of Board and its Powers) Second Amendment Rules, 2015

Rule 6A has been inserted in the rules which states that all related party transactions shall require the approval of the Audit Committee and the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to the following conditions:

Criteria to be specified by the Audit Committee for making omnibus approval:

- Maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year.
- The maximum value per transaction which can be allowed.
- Extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval.
- Review, at such intervals as the Audit Committee may deem fit, transaction entered into by the company pursuant to each of the omnibus approvals made.
- Transactions which cannot be subject to the omnibus approval by the Audit Committee.

The Audit Committee shall satisfy itself on the need for omnibus approval for repetitive transactions and transactions for which such approval is in the interest of the company.

Contents for omnibus approval:

- Name of the related parties.
- Nature and duration of the transaction.
- Maximum amount of transaction that can be entered into.
- The indicative base price or current contracted price and the formula for variation in the price, if any, and
- Any other information relevant or important for the Audit Committee to take a decision on the proposed transaction.

Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year. Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

Source: Companies (Meetings of board and its powers) Second Amendment Rules, 2015

About SKP

SKP is a long established and rapidly growing professional services group located in six major cities across India. We specialise in providing sound business and tax guidance and accounting services to international companies that are currently conducting or initiating business in India as well as those expanding overseas. We serve over 1,200 clients including multinational companies, companies listed on exchanges, privately held firms and family-owned businesses from more than 45 countries.

From consulting on entry strategies to implementing business set-up and M&A transactional support, the SKP team assists clients with assurance, domestic and international tax, transfer pricing, corporate services, and finance and accounting outsourcing matters, all under one roof. Our team is dedicated to ensuring clients receive continuity of support, right across the business lifecycle.

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