

# ASSURANCE INSIGHTS

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

The convergence of Indian accounting and IFRS is set to take place either by voluntarily adopting the newly notified Indian Accounting Standards or mandatorily converging them as per the Ministry of Corporate Affairs (MCA) guidelines. Indian Accounting Standard 110: Consolidated financial statements will be of keen interest in the days to come. This standard shifts the existing paradigm of control recognition. The essence of this shift is to ensure the prevalence of substance over form in accounting. It is through a qualitative amend that the true driver of an investee entity shall consolidate it. Mere voting rights will no longer be deemed synonymous to controllership of entities. Indian accounting will now examine the very fabric of structure and operations of an entity and present financial information which is at par with international standards.

Section 134 of the Companies Act, 2013 requires the directors of listed companies to lay down internal financial controls to be followed by the company and comment upon their sufficiency in the Directors Report. The Companies Act, 2013 is silent on the mode of implementation and in the absence of a prescribed framework to implement these controls, this has been a topic of keen interest to directors, managers and CFOs. The Internal Control – Integrated Framework prescribed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), may be implemented as one of the frameworks out of globally accepted other frameworks prescribed by the Turnbull Report and the Canadian Institute of Chartered Accountants.

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 to us at [skpgrp.info@skpgroup.com](mailto:skpgrp.info@skpgroup.com).

Warm regards,

The SKP Assurance Team

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## Connect the GAAP: Ind AS 110

What if we were to say that the very structure of your business group would undergo a change and some or maybe all of your subsidiaries may no longer be your subsidiaries? You wouldn't believe us, would you? You made investments in some companies, enabling your company to hold a stake less than majority but still a significant one to influence decisions. What if this would result in such investments being consolidated in your group? What if the age-old theory of control over entities being judged based on voting power were to be re-written? What if the time has come to look beyond voting rights and assess who in substance is the true controller of investee entities? Would this surprise you?

The Indian Accounting Standard 110: Consolidated Financial Statements (Ind AS 110) goes beyond just 'form and rule' based criteria to 'substance and principle' based criteria for identifying control. With the very basis of identifying control set to qualitatively evolve, we foresee a new beginning in the discipline of consolidation and group reporting. Now, control will be established based on power over the investee, the exposure/right to variable returns from the investee and the ability to use power over it. Mere voting rights, which were synonymous with control and helped determine which entity to consolidate, shall now be one of the many decisive factors in determining what to consolidate. Considering that this decision is rather subjective, we anticipate the new guidance to face some implementation issues.

In this month's issue, we discuss some key aspects of Ind AS 110 (Consolidated Financial Statements):

- a) Control: Substance over form
  - Power over the investee
  - Exposure to variable returns
  - Link between power and variable returns
- b) Other key aspects of Ind AS 110

- c) Key differences between AS 21, Ind AS 110 and US GAAP
- d) Carve-outs from IFRS 10
- e) Impact analysis

### Who has control: Substance or form?

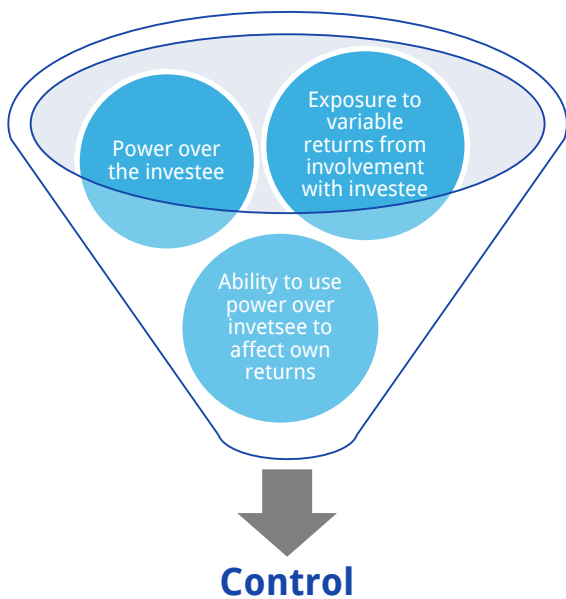
Under Indian GAAP, the principles of consolidation of financial information are laid down in Accounting Standard (AS) 21: Consolidated Financial Statements. The ability of an entity to control another is basis of consolidation. This was solely ascertained based on the following parameters:

- More than one-half of the voting power, or
- Control over the composition of the Board.



Under AS 21, entities in which the investor held below 51% but close to 50% (say 40–49%) were not consolidated into the group despite the ability of the investor to dominate the passing of resolutions and other decision-making mechanisms by virtue of strong equity holding.

Ind AS 110: Consolidated Financial Statements (the standard) bases 'control' as the trigger of consolidation. However, the existence of control according to the standard does not rely on a mere legal relationship. The standard bases the existence of control by going into the very essence of who actually drives and shifts gears in the functioning of the investee enterprise. By going beyond just the existing holding-sub subsidiary basis of consolidation, the standard places its focus more on substance than on form. It determines the ability of an investor to have control over an investee enterprise. Once there exists control that an investor can exercise over the investee, the investor shall prepare consolidated financial statements featuring all such investees over whom it has control.



### Impact

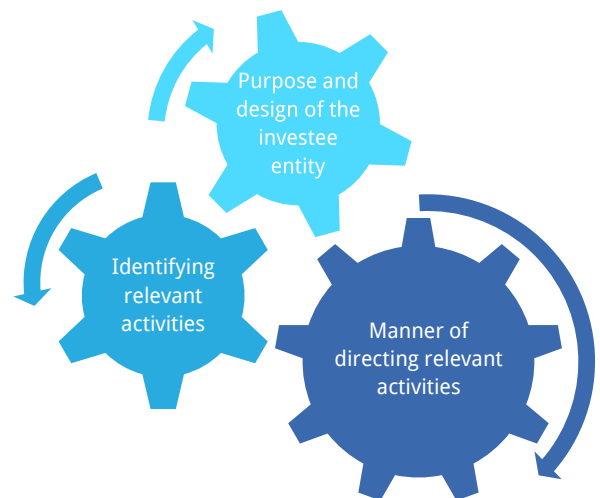
- Equity majority may no longer determine the size of business groups
- Power as a concept will play a more decisive role over most other factors in determining group structuring
- Consolidation may be required even on holding minority shares in companies
- Investments structured adhering to Indian GAAP may have to be revisited to maintain control of the investee entity within the group

### Power over the investee

The existence of power is the first step in determining whether or not the investor has control over the investee. Power arises from rights that enable an investor to control and direct the activities of an investee as well as derive benefits from it. The current ability of the investor to direct relevant activities of the investee enterprise by exercising rights granted by the investee is the litmus test of power existence.

In Indian accounting, power has always been synonymous with voting rights. Ind AS 110 recognises that there exist numerous ways other than majority voting power to control an enterprise. Though power is widely discussed in the standard, the determination of its existence is highly subjective and based on judgment.

The following points need to be considered for assessing the presence and degree of power that an investor may exercise over the investee:



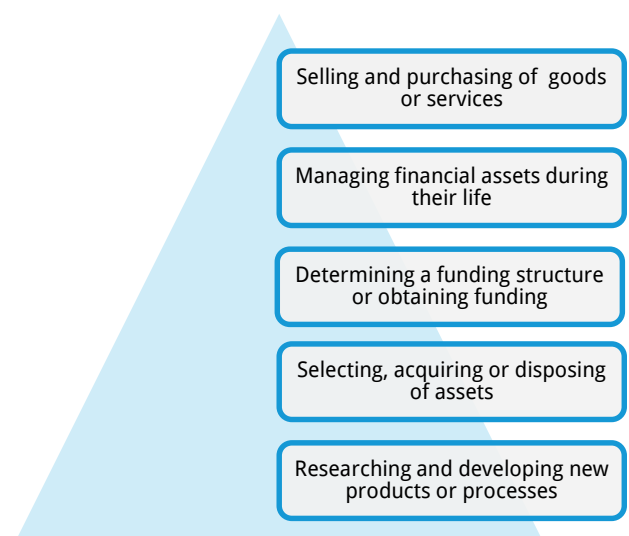
### Investee's purpose and design

The first step in assessing power is to consider the purpose and design of the investee. The following questions could be addressed for assessing the same:

- What is the purpose of incorporation of the entity?
- What is the capital structure of the entity?
- What are the rights of the shareholders and other stakeholders?
- Who are the beneficiaries of the entity?
- Who has the ability to direct key activities?

### Identifying relevant activities

Once the purpose and design of the investee is established, the next step is to define the relevant activities. Relevant activities are those that significantly affect the investee's returns. The following is an indicative list of relevant activities:





Relevant activities can be different for different entities even if they are in the same industry. For example, the manufacturing process would be a relevant activity for a low-cost manufacturer whereas effective marketing would be a relevant activity for a high-end, branded product manufacturer.

### How are the relevant activities directed?

Having considered how relevant activities are to be identified, one must assess how decisions in their regard are made. In most cases, the ability to make decisions about an investee's relevant activities comes from voting rights. However, there could be a few cases where the relationship between the investor and investee is designed in such a manner that voting rights are not the dominant factor in deciding who directs relevant activities. Some factors that may individually or in combination give an investor power over the investee are:

- Rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;
- Rights to appoint or remove another entity that directs the relevant activities;
- Rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor;
- Ability to dominate the nomination of members to the investee's governing body or obtain proxies from other vote holders;
- If the investee's key management or a majority of its governing body are related parties of the investor;
- Other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

Other indicators of power may include presence of a **'special relationship'** by which an investor may have more than just a passive interest in the investee. For example:

- The investee's key management personnel are current or previous employees of the investor.
- The investee's operations are dependent on the investor, such as funding, guarantees, critical services (e.g. head office administrative support), technology, supplies or raw materials, licences or trademarks, specialised knowledge, etc.
- A significant portion of the investee's activities either involve or are conducted on behalf of the investor.
- The investor's exposure, or rights, to returns from its involvement with the investee is disproportionately greater than its voting or other similar rights.

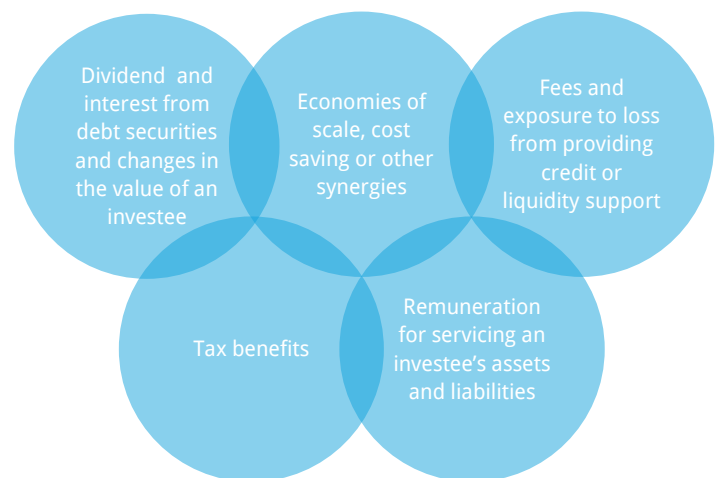
When the factors decisive of giving an investor power and indicators of its presence are considered in combination, **greater weight should be given to the factors than to indicators.**



In the case of an insurance company, while 76% of the voting rights were held by an Indian investor company and 24% by an overseas company, all decisions relating to relevant activities were taken by the minority investor granted by contract. Also, the decisions of key managerial personnel and their roles were taken by the minority investor. In such cases, decision-making rights give the minority investor substantial power compared to voting rights in controlling the investee enterprise.

### Exposure/rights to variable returns

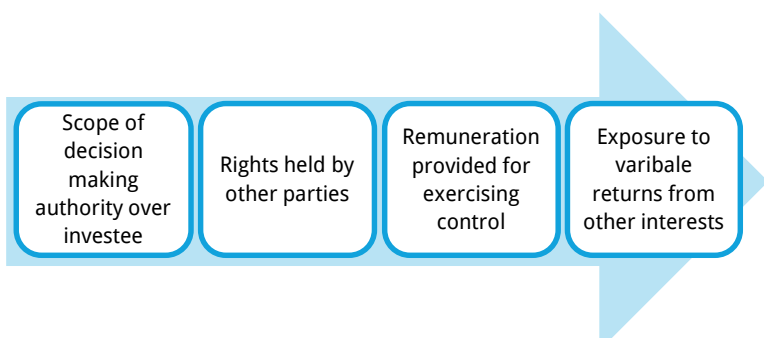
In assessing whether the investor has control over the investee, the investor must determine whether he has exposure or rights to variable returns from his involvement with the investee. Variable returns can be positive, negative or both. Variability of return is assessed on the basis of substance as against the legal form. For example, fixed interest payments on bonds are considered variable returns as they are subject to default risk of the issuer. Some examples of sources of returns are shown below:



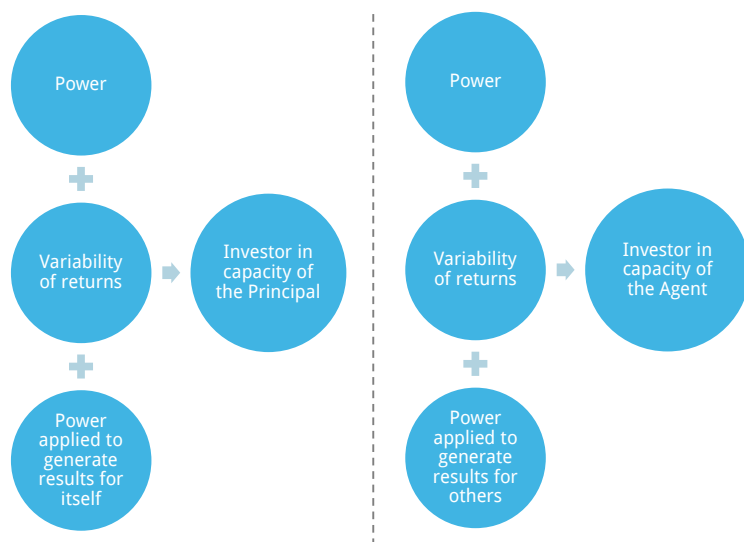
Entities also need to assess whether they are **absorbing** variability or **creating** variability. For example, if an entity is obtaining a loan from an investee company, it adds credit risk to the entity. This in turn will create variability in returns. If an entity is holding equity shares of the investee company, it is absorbing risks of the investee company. The investor's involvement in the investee must absorb variability and not create it.

## Ability to use power over the investee to affect returns

After arriving at the conclusion that the investor has power over the investee and is exposed to variable returns, the next step is to determine whether the investor has the ability to use the power to affect its own returns. If not, the investor is acting as an agent and accordingly, the investee cannot be consolidated. In the context of the standard, an agent is a party empowered to primarily act on behalf and for the benefit of other parties (investor and its beneficiaries). Agents do not control the investee when they exercise any decision-making authority over the investee. They merely hold and exercise the power of the principal entity on its behalf. However, it must be noted that a decision maker cannot be deemed to be an agent simply because the other parties may benefit from the decisions taken by it. Before being termed as an agent, the following factors may be considered:



Entity A is appointed by shareholders of Entity B for providing management services.	
Scope of decision-maker's authority	The entity has to make decisions in interest of the company and as laid down in the agreement. Despite this, Entity A has extensive decision-making authority in Entity B.
Rights held by other parties	Entity C is holding 40% in Entity B. Shareholders have the right to remove Entity A at any time by convening a general meeting.
Remuneration to decision maker	Entity A gets a fixed remuneration on an arm's length basis
Exposure to variable returns	Entity A holds 2% investment in Entity B
Entity A is exercising power as an agent of other shareholders. The 2% investment does not create sufficient exposure. Accordingly, Entity A shall be considered as an agent and will not be required to consolidate Entity B.	



## Key points of power

### Substantive and protective rights

Exercising certain rights can have a direct impact on the direction of the relevant activities of the enterprise. Some rights intend to give an investor a say in and some autonomy in decision making. On the other hand, some rights may primarily be granted to protect the interests of investors. The degree of power granted to an investor by these distinct types of rights is again a judgmental decision.

#### Substantive rights

While assessing whether an investor has power, only those rights that have the practical ability of being exercised are considered. Such rights are called substantive rights. Determining whether or not rights are substantive requires judgment based on the facts and circumstances of the case at hand. Hence, determining the practical ability of exercising the rights is a subjective decision.

Entity A is in the business of high-end technology research. Entity B has voting power of 55% in Entity A, while 45% is held by key managerial personnel (KMP). In case Entity B exercises its rights, it is likely that KMP will leave the entity and owing to the type of industry, it is difficult to replace the existing management after gaining control. In such a case, rights held by Entity A may not be substantive. However, other factors still need to be assessed to arrive at a conclusion.

#### Protective rights

In exceptional situations, investors may be given rights which are exercisable with respect to the fundamental functioning of the investee. These rights are designed

with the intent of protecting the interests of investors without giving them power over the investee. For example, rights given to a lender to seize assets if the borrower fails to repay. Investor protection and the ability to control an enterprise by exercising rights are contradictory in spirit.

### *Potential voting rights*

Potential voting rights are rights that can affect the composition of equity holding and ownership in the future. Simply put, a right that enables an investor to increase his equity holding, which results in an increase in proportionate voting rights in the investee is a potential voting right. For example, call options, convertible instruments, share warrants, etc. In cases where voting rights are the relevant factor in determining power, the exercisability of potential voting rights may determine the course of consolidation.



In respect of call options, if the options are deeply out of money, they are generally not considered as substantive. However, in case they are not deeply out of money (say, slightly out of money) and after considering other factors, there is a possibility that they are considered substantive rights after considering other factors.

### **De facto control**

De facto control describes the situation where an entity owning less than 50% of the voting shares in another entity that is controlled by voting rights has the practical ability to direct the relevant activities.

Factors to be considered:

- The size of the investor's voting rights relative to the holdings of other vote holders
- The potential voting rights held by other parties and the investor
- Any rights arising from contractual arrangements
- Any other additional facts and circumstances that indicate that the investor has the ability or does not have the ability to direct the relevant activities. E.g. voting patterns at previous shareholder meetings.



In case of a company where voting rights determine the control of relevant activities, an investor holds 45% of voting rights and the other 55% is held by numerous shareholders without any agreement about the majority acting together. This 45% shareholder enjoys the power to affect relevant activities and influence the shareholder resolutions regarding the same. So despite the absence of a controlling majority, the 45% shareholder has the power to control the investee entity.

### **Other key aspects of Ind AS 110:**

- Just as in AS 21, consolidation should be done on a line-by-line basis.
- Investment entities are not required to prepare consolidated financial statements as per the standard for the interests acquired by it in its regular course of investment activities. However, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities, it shall be required to consolidate that subsidiary. An investment entity is defined as an entity that:
  - obtains funds from others for providing investment management services,
  - commits to its investors that the sole purpose of its business is to earn capital appreciation and/or investment income,
  - uses fair value basis for the measurement and evaluation of substantially all of its investments.
- Financial information of the parent and subsidiaries should be of the same reporting date unless it is impracticable to do so.
- For the purpose of consolidation, subsidiaries should have uniform accounting policies with that of the parent.
- In case the parent loses control of a subsidiary, the standard gives explicit guidance. Any retained interest in the former subsidiary is re-measured at fair value and any gain/loss is recognised in profit or loss.



## Key differences between Indian GAAP, Ind AS and US GAAP

Point of Comparison	AS 21	IND AS 110	US GAAP (ASC 810-10)
<b>Exclusion of subsidiaries</b>	Subsidiaries, when control is temporary or when they operate under severe restrictions, are to be excluded.	No such exception is available	No such exception is available
<b>Uniformity in accounting</b>	Where it is not practicable to disclose information using uniform accounting policies, different accounting policies could be used.	Similar transactions and like events have to be reported using uniform accounting policies	Similar to Ind AS. However, US GAAP allows use of different accounting policies within a single set of consolidated financial statements.
<b>Reporting dates</b>	Reporting date of the parent and subsidiary should be the same. If it is impracticable, a six-month difference in reporting dates of the parent and subsidiary is permitted, after adjusting for significant transactions or events between the two dates.	Similar to AS 21, except the difference can be a maximum of three months	Similar to Ind AS
<b>Definition of control</b>	Control is based on: <ul style="list-style-type: none"> <li>▪ Ownership of equity interests;</li> <li>▪ Ability to control Board composition.</li> </ul> <p>The meaning of control here is more rule based.</p>	Control is based on: <ul style="list-style-type: none"> <li>▪ Power over the investee;</li> <li>▪ Exposure or rights to variable returns from the involvement with the investee;</li> <li>▪ Ability to use power over the investee to influence returns.</li> </ul> <p>The meaning control assumes here goes beyond the mere form of the term by using concepts such as de facto control, potential voting rights, control of relevant activities, etc.</p>	Two models are prescribed: <ul style="list-style-type: none"> <li>▪ Voting interest model – Based on majority voting interest unless the control does not rest with the majority owner.</li> <li>▪ VIE model – Similar to Ind AS with a few exceptions.</li> </ul>
<b>Potential voting rights</b>	Not considered in assessing control	To be considered if they are substantive	Not considered under voting interest model. No specific guidance for potential voting rights under VIE model.
<b>De facto control</b>	No such concept exists	Specifically covered	No such concept exists
<b>Losses applicable to non-controlling (minority) interest</b>	Losses applicable to minority in excess of the minority interest in the equity of subsidiary are generally adjusted against the majority interest	No such exception is provided	No such exception is provided
<b>Disclosure of minority interest</b>	To be disclosed on the face of the balance sheet, separate from equity and liabilities	To be disclosed within equity apart from the parent's equity	Similar to Ind AS
<b>Loss of control</b>	Any retained interest in the former subsidiary is not to be re-measured	Any retained interest in the former subsidiary is to be re-measured at fair value and consequent impact given in profit or loss	Similar to Ind AS except for a few transactions

## Key carve outs: Ind AS – IFRS

Carve out	Ind AS	IFRS
<b>Measurement of investment properties</b>	All investment properties to be measured at cost initially. Subsequently at cost less depreciation.	As per IFRS, all investment properties are recorded at fair value.
<b>Transitional provisions</b>	All provisions regarding transition are laid down in Ind AS 101.	All provisions regarding transition are laid down in IFRS 101.

## Impact analysis

### Performance and capital ratios

- Loss-making investments where existence of control is proven will have to be consolidated. This will impact all performance ratios.
- Investments, relying on heavy debt for financing, where control is proven will have to be consolidated. This will have an impact on debt-Equity and other capital ratios.

- Each contract entered into by the enterprise shall have to be assessed. The presence of de facto control and potential voting rights may lead to consolidation being effected.
- Companies would have to measure if control would arise by acquiring rights and stakes in other enterprises. Hence, the decisions of making investments and granting rights have to be assessed upfront.
- Investor companies would have to gauge the existence of power as minority interests too can result into control.

### Re-examination of existing contracts

### Group size and structure

- Investee enterprises where holding of equity is below 51% may get consolidated if the ability to exert power over it is proven by the investor.
- This may result in groups getting either smaller or bigger.

## In retrospect

Consolidation of financial information is poised to move from a rule-based to a principle-based rationale. With the very concept of what comprises control being re-defined, the basis of consolidation has evolved from a formative process to a substance-centric one. In the times to come, consolidation shall move from a mere holding-subsidiary relationship to a controlled-controller relationship. However, the determination of control is judgmental subject to a host of factors. The first step that the parent and investee entities may take is to re-assess all existing investments and contracts and gauge how empowering voting rights truly are. Factors such as de facto control and potential voting power, which were previously only theoretical

concepts, may now be real-time indicators of power and in turn, control. Ind AS 110 examines the core structure of control by establishing whether it is derived in principle or merely granted for use. Group structure and dynamics being re-laid is inevitable. For some group structures, this standard shall be an impactful one.





## Implementing COSO: Internal control framework for statutory compliance with Internal Financial Controls

The Companies Act, 2013 (the Act) has introduced new requirements relating to the reporting responsibilities of the directors, audit committee and auditors with regard to IFC; the two main requirements are:

Section 134(5)(e) of the Act requires the Directors' Responsibility Statement forming part of the Board's report in the annual report to include, in the case of a **publicly listed company**, that directors have laid down the **Internal Financial Controls (IFC)** to be followed by the company and that such IFC are adequate and were operating effectively.

Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the Board report of **all companies** to state the details in respect of adequacy and operating effectiveness of **Internal Financial Controls with reference to the financial statements (ICFR)**.

The Act lays great emphasis on internal control and casts a responsibility on the Board for overseeing it. IFC are defined in a very wide sense to encompass anything and everything that a company does. Boards of listed companies and specified unlisted companies are required to affirm in the Directors' Responsibility

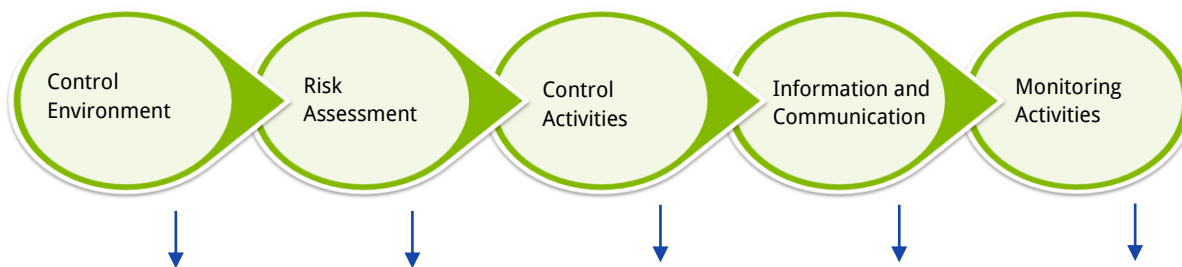
Statements within annual reports that the IFC systems in the companies are adequate and operationally effective. Statutory auditors too are required, in section 143, to report on the adequacy and operational effectiveness of IFC.

### Technical guidance on the implementation of IFC

The Ministry of Corporate Affairs (MCA) has not specified a framework that a company's management can follow to comply with the IFC requirement. In the new Act, there are a few provisions that relate more or less to the components of The Committee of Sponsoring Organizations of the Treadway Commission (COSO)'s Internal Control – Integrated Framework. The following diagram depicts the relationship between the COSO framework components and the provisions specified under the Act. Therefore, the COSO framework can be considered as one of the frameworks for implementation of IFC within an organisation to comply with the statutory provisions.

### COSO framework adoption

#### COSO elements



References provided in Companies Act 2013

As per section 134(3)(n), develop and implement a risk management policy

As per section 177(4)(vii), function level risk assessment (internal and external) besides internal controls relevant for financial reporting

Assess the level of controls associated with information technology

As per section 134(3)(n), regulatory reporting and Board reporting on risk management

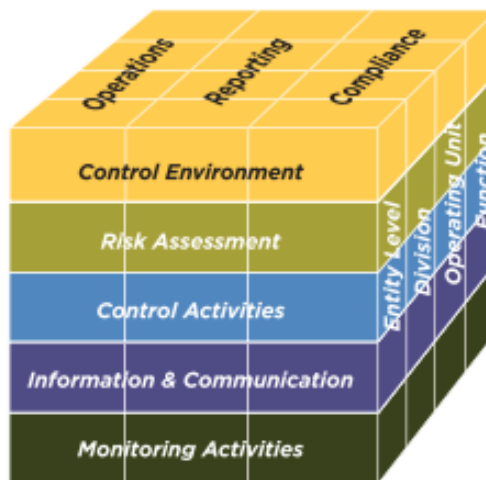
As per sections 134(5) and 143(3)(i), Board and auditor oversight on adequacy and effectiveness of controls

## Overview of the COSO Internal Control – Integrated Framework

The Internal Control – Integrated Framework released by the COSO is widely accepted by organisations in designing and implementing internal controls. COSO believes that this framework will enable organisations to effectively and efficiently develop and maintain systems of internal control that can enhance the likelihood of achieving the entity's objectives and adapt to changes in the business and operating environments.

### What is the COSO framework? How does it work?

COSO's framework guidance can be better understood as illustrated in the form of a cube. The cube begins with objectives along the top relating to operations, reporting and compliance. Every organisation establishes relevant objectives, formulates strategies and plans for achieving them. The side of the cube illustrates that objectives may be set for the entity as a whole, or be targeted to specific divisions, operating units and functions within the entity (including business processes such as sales, purchasing and production), depicting the hierarchical top-down structure of most organisations.



Source: COSO, Internal Control – Integrated Framework, 2013

On the face of the cube are the five components of internal control representing the rows of the cube. These components support the organisation in its efforts to achieve its objectives. The five components are Control Environment, Risk Assessment, Control Activities, Information and Communication and Monitoring Activities. They are relevant to an entire entity, meaning they operate at the entity level, as well as at all divisions, operating units, functions, subsidiaries or other subsets of the entity.

The cube depicts the links between objectives that are shown on the top and its components shown on the front, which represent what is needed to achieve the objectives.

## COSO components and principles

The five components of internal control have 17 principles associated with it. These principles are essential in assessing whether the five components are present and functioning. Each principle adds value, is suitable to all entities, and therefore, is presumed relevant. The principles and the associated components of internal control are listed below.

Components	Principles
Control environment	<ol style="list-style-type: none"> <li>1) The organisation demonstrates a commitment to integrity and ethical values.</li> <li>2) The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal controls.</li> <li>3) Management establishes, with board oversight, structure, reporting lines, appropriate authority and responsibilities in the pursuit of objectives.</li> <li>4) The organisation demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.</li> <li>5) The organisation holds individuals accountable for their internal control responsibilities in the pursuit of objectives.</li> </ol>
Risk assessment	<ol style="list-style-type: none"> <li>6) The organisation specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.</li> <li>7) The organisation identifies risks to the achievement of its objectives across the entity and analyses risks as a basis for determining how they should be managed.</li> <li>8) The organisation considers the potential for fraud in assessing risks to the achievement of objectives.</li> <li>9) The organisation identifies and assesses changes that could significantly impact the system of internal control.</li> </ol>

Control activities	<p>10) The organisation selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.</p> <p>11) The organisation selects and develops general control activities over technology to support the achievement of objectives.</p> <p>12) The organisation deploys control activities through policies that establish what is expected and procedures that put policies into action</p>
Information and communication	<p>13) The organisation obtains or generates and uses relevant, qualitative information to support the functioning of internal controls.</p> <p>14) The organisation internally communicates information, including objectives and responsibilities for internal controls and necessary to support the function of internal control.</p> <p>15) The organisation communicates with external parties regarding matters affecting the functioning of internal control.</p>
Monitoring activities	<p>16) The organisation selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.</p> <p>17) The organisation evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.</p>

To enhance the rigor of understanding of each principle, points of focus are provided in the COSO framework. Points of focus represent important characteristics associated with principles and, as such, provide support to principles to which they pertain.

Some points of focus may not be relevant and others may be identified based on specific circumstances. The points of focus may facilitate designing, implementing and conducting internal controls and assessing its effectiveness.

For example, the first principle provided for control environment component is: "The organisation demonstrates a commitment to integrity and ethical values". The framework provides four points of focus for this principle:

- Sets the 'tone at the top'
- Establishes standards of conduct
- Evaluates adherence to standard of conduct
- Addresses deviations in a timely manner

## COSO framework implementation

Implementing the COSO framework provides an organisation with an opportunity to create value and improve the effectiveness of its internal control systems. Indicative steps that an organisation can follow for the implementation of the COSO framework are as follows:

### **Step 1: Creating awareness and planning**

- Develop awareness, expertise and alignment of the senior management
- Develop a detailed approach and timeline
- Conduct preliminary impact assessment

### **Step 2: Mapping**

- Undertake risk assessment
- Mapping (top-down and/or bottom-up)
- Link COSO principles to the controls
- Consider points of focus
- Coordinate with other service providers

### **Step 3: Assess**

- Facilitate broad awareness, training and comprehensive assessment
- Identify deficiencies
- Evaluate deficiencies
- Determine controls requiring remediation
- Consider eliminating obsolete and orphan controls

### **Step 4: Implement**

- Develop and execute the COSO implementation plan
- Train control owners
- Schedule testing the operating effectiveness of such controls determined

### **Step 5: Testing and Remediation**

- Testing operating effectiveness of controls
- Recommendation and remediation testing
- Year-end close, financial audits

We trust that these observations will assist the senior management in setting the context as they embark on the journey to comply with the regulatory provisions mentioned in the Act.



## Companies Act, 2013: Key updates

### The Companies (Acceptance of Deposits) Second Amendment Rules, 2015

- The Ministry of Corporate Affairs (MCA) has made additions to the list of amounts that shall not be considered as 'deposits':
  - Amounts received from the director of the company were excluded from being 'deposits', provided that the director furnishes to the company at the time of giving 'deposits', a declaration in writing, that the amount so given is not out of funds acquired by him by borrowing or accepting loans or 'deposits' from others.
  - Amounts received from the relative of the director of the private company, provided that the relative of the director of the private company furnishes to the company at the time of giving 'deposits', a declaration in writing, that the amount so given is not out of funds acquired by him by borrowing or accepting loans or 'deposits' from others.

The company shall disclose the details of money accepted from the director of the company or the relative of the director of the private company in the Board's report.

- Rule 3 of the Companies (Acceptance of Deposits) Rules, 2014 relates to "Terms and conditions of acceptance of deposits by companies". The words "paid-up share capital and free reserves" wherever they appear in Rule 3 shall be substituted with "paid-up share capital, free reserves and securities premium account" as per the amendment.
- Every eligible company who accepts 'deposits' shall get their credit rating done at least once a year and the copy of the rating shall be filed along with Form DPT-3 to the Registrar of Companies. In

accordance with this, the MCA had notified six agencies and their minimum investment grade ratings. The minimum investment grade ratings of Brickwork Ratings India Pvt Ltd has been changed from "BWR FA" to "BWR FBBB"

[Source: The Ministry of Corporate Affairs vide notification dated 15 September 2015](#)

### CSR - High Level Committee Report

A High Level Committee (Committee) was constituted by the MCA under the chairmanship of Mr Anil Bajjal, former secretary to the Government of India, to suggest measures for improved monitoring of the implementation of Corporate Social Responsibility (CSR) policies by the companies under section 135 of the Companies Act, 2013, certain recommendations made by the Committee are stated below:

- The rationale behind CSR legislation is not to generate financial resources for social and human development since the resource gap, if any, for such development or social infrastructure, could as well have been met by levying additional taxes/cess on these corporates. The objective of this provision is indeed to involve the corporates in discharging their social responsibilities with their innovative ideas and management skills and with greater efficiency and better outcomes.
- The Committee is prima facie of the view that the existing provisions of the Act and Rules based on general principles of "comply and explain" are, for the time being, sufficient for ensuring compliance of the law.
- As regards to penalty for non-compliance with CSR provisions of the Companies Act, the present provisions in the law appear to be sufficient. However, the Committee is of the view that leniency may be shown against the companies for non-compliance in the initial two/three years to

enable them to graduate to a culture of compliance.

- Differential tax treatment for expenditure on various activities covered under Schedule VII may create unforeseen distortions in the allocation of CSR funds across development sectors. The Board's decision could be guided more by tax savings implications rather than compelling community social needs. The Committee therefore feels that there should be uniformity in tax treatment for CSR expenditure across all eligible activities.
- The Committee concluded that the ceiling on administrative overhead costs should be increased from the present 5% to not more than 10% of the CSR expenditure of the company, for which the amendment to the Companies Act and/or CSR Policy Rules, 2014 would be required.
- The Committee feels that CSR provisions should not be applicable to section 8 companies.
- There is a need for further clarity on applicability of section 135 of the Companies Act, 2013 to foreign companies.

- The Committee also felt that there is a need to clarify the definition of the term 'Net Profit' used under section 135(1) and section 135(5) of the Act and Rule 2(f) of Companies (CSR Policy) Rules, 2014, by making necessary amendments to section 135 of the Act and the Rules made thereunder.
- The Committee feels that all information relating to the implementation of CSR by companies including amount spent, activities undertaken, geographical areas covered, etc., as reported by the companies in their annual disclosure need to be compiled by the MCA and placed in the public domain.
- With a view to incentivising the corporates to undertake their CSR mandate in right earnest, the Committee recommends setting up of annual awards – one each for the two categories of companies – large and small.

[Source: High Level Committee Report dated September 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 50 countries.

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