ASSURANCE INSIGHTS

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

The Ministry of Corporate Affairs (MCA) has recently paved the way for converging Indian Generally Accepted Accounting Principles (I-GAAP) with the International Financial Reporting Standards (IFRS) by notifying the Indian Accounting Standards (Ind AS) on 16 February 2015 along with a roadmap for its implementation. The convergence with IFRS is a three phased process which will begin with the voluntary adoption of Ind AS for the financial year beginning on or after 1 April 2015. This momentous shift in corporate accounting shall be pervasive across companies, sectors, and industries. The accounting fraternity is currently in the process of drawing up financial statements for the current reporting period of 2015-16 as per Ind AS. Revising the comparative financial information for the period 2014-15 is a task that shall engage accountants across the country. With shifts and changes in the prevailing method of presenting financial information underway, the focus point for companies will be gauging the impact of these modifications and training their personnel to adapt to the same.

The MCA has amended Schedule II with respect to accounting for fixed assets by mandating the adoption of component accounting from 1 April 2015. There are a few aspects of this impactful amendment which will require further clarification from regulatory bodies.

With a partial reinvention of the accounting system underway and eventful times ahead, our newsletter covers India's efforts to create an investor friendly environment. As part of SEBI's continuous efforts towards investor protection, the long-awaited SEBI (Prohibition on Insider Trading) Regulations, 2015 was implemented in May 2015, after almost two decades. In this article, we discuss the overview of the regulation and its key issues.

Lastly, under the section 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.

Warm regards,

The SKP Assurance Team

An overview of Ind AS

A majority of the nations across the world have chosen to adopt IFRS for the presentation of their financial information. India has its own set of accounting standards, commonly referred to as I-GAAP, which are quite different compared to IFRS. The government is taking noteworthy steps to ensure that there is uniformity between global and Indian reporting to facilitate doing business in India.

Ind AS are a converged version of IFRS. Their adoption is expected to bring about a paradigm shift in the sphere of corporate Indian financial reporting. The shift to Ind AS is a three phased process beginning with the voluntary adoption of Ind AS for the financial year beginning on or after 1 April 2015. These long awaited accounting reforms are expected to help improve India's global footprint with respect to transparency in financial reporting. Furthermore, the changes in reporting principles will have a pervasive impact on all operational departments of the organisation. In the days to come, organisations will have to impart effective training to their personnel to ensure that the process of adapting to reporting changes does not hamper organisational functioning. It is an opportunity that comes with a few challenges which can be effectively countered and capitalised by accountants and the accounting staff throughout the country.

In this article, we examine:

- The MCA roadmap for Ind AS adoption.
- Key carve-outs/carve-ins from IFRS
- Key differences between Ind AS and I-GAAP
- Ind AS 101–First time adoption of Indian Accounting Standards
- Implementation approach
- Impact across company-wide functions

The MCA roadmap for Ind AS adoption

Mandated timeline for adoption

Date of adoption	Financial year beginning on or after 1 April 2015	Financial year beginning on or after 1 April 2016	Financial year beginning on or after 1 April 2017
Applicable to	Voluntary adoption	Companies (listed and unlisted) whose net worth is INR 5 billion or more. Holding, subsidiary, joint venture or associate companies of above companies	All listed companies or companies in the process of being listed. Unlisted companies having net worth of INR 2.5 billion or more Holding, subsidiary, joint venture or associate companies of above companies
Comparatives and date of transition	Comparative periods – Financial year ending on 31 March 2015 or thereafter Date of transition – 1 April 2014	Comparative periods – Financial year ending on 31 March 2016 or thereafter Date of transition – 1 April 2015	Comparative periods – Financial year ending on 31 March 2017 or thereafter Date of transition – 1 April 2016

Clarifications issued by the MCA

- Companies voluntarily adopting Ind AS cannot switch back to I-GAAP.
- Net worth for applicability shall be determined based on the audited standalone financial statements of the company as on 31 March 2014 and thereafter.
- Net worth means the aggregate value of paid-up share capital and all reserves created out of the profits and securities premium account after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet. However, it won't include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.
- Ind AS will apply to both the consolidated and standalone financial statements of the companies covered above.

Exclusions

Insurance, banking and non-banking financial companies do not need to adopt Ind AS as they are regulated by the IRDA/RBI and till the time the IRDA/RBI does not mandate the same, they cannot adopt Ind AS, even voluntarily.

Overseas subsidiaries, overseas joint ventures, or overseas associate companies are not required to compile standalone financial statements as per Ind AS.

However, if the above are subsidiaries, joint ventures, or associates, they may have to report their results as per Ind AS to its Indian parent company, if the parent company has to prepare its consolidated financial statements as per Ind AS.

Key carve-outs/carve-ins from IFRS

India has come a long way in its convergence with IFRS. However, in the process of converging with IFRS, due weightage has been given to the local needs as well. Such differences in Ind AS from IFRS are termed carve-outs/carve-ins. Below is the list of key carve-outs/carve-ins.

Area	Ind AS carve-outs/carve-ins	As per IFRS
Previous GAAP	Ind AS 101 specifies that previous GAAPs are GAAPs followed by the companies to meet their reporting requirements in India.	Previous GAAP is the basis of accounting that a first time adopter used immediately before adopting IFRS.
Other comprehensive income	Only one statement will be prepared comprising of both profit or loss and other comprehensive income.	An entity has an option to present other comprehensive income as a separate statement.
Classification of expenses	Expenses can be classified only by the nature of transaction.	Expenses can be classified either by nature of transaction or by function.
Gain on business combination/ acquisition of associate	Bargain purchase gains on business combinations or acquisition of associates should be recognised either in capital reserve or other comprehensive income.	Such gain is to be recognised in profit or loss.
Straight lining of lease rentals	In cases where the escalation in rentals is in line with the expected general inflation, the rentals are not required to be expensed on a straight-line basis.	No such exemption is available.
Foreign currency convertible bond	An exception to the definition of financial liability is inserted whereby the equity conversion option embedded in a convertible bond, denominated in foreign currency to acquire a fixed number of the entity's own equity instruments, is an equity instrument, if the exercise price is fixed in any currency.	No such exception is provided in IFRS.
Investment property	Investment property can only be measured using cost model.	Investment property can be measured using either a cost model or a fair value model.
Uniform accounting policies for associates and joint ventures	In cases where it is impracticable, Ind AS provides relaxation of uniform accounting policies principle for associates and joint ventures.	No such relaxation is available in IFRS.
Employee benefits	Ind AS mandates the use of government securities yield as discount rate for calculating actuarial liabilities.	IFRS requires the use of corporate bond yields as discount rate for calculating actuarial liabilities.

Key differences between Ind AS and I-GAAP

As expected, there is a significant gap between the Ind AS and I-GAAP which will be discussed in the coming issues. This article focuses on a few selected areas which are universal in nature and will affect most industries and require significant effort.

Revenue recognition (AS 9, Ind AS 115)

Ind AS 115 introduces a new single five-step revenue model for revenue recognition which is applicable to all types of revenue contracts. The paradigm of revenue recognition shifts from transfer of risks and rewards to transfer of control. Most of the time the difference between control and risk/reward is trivial, however, at times, it is very significant and may require an in-depth understanding of the contracts.

The complexities involved in transitioning to the new revenue model are wide. This brings up an important question - Are industries ready to implement this transition? For this reason, three apex industry bodies viz. CII, FICCI and ASSOCHAM have made representations for deferring the implementation of this standard. The corresponding IFRS-15 has been deferred by the International Accounting Standards Board (IASB) untill 1 January 2018 owing to practical difficulties in implementing it. On similar grounds, the National Advisory Committee on Accounting Standard (NACAS) has also recommended that the MCA defer the standard. It remains to be seen whether MCA follows IASB's foot-steps.

Consolidation (AS 21, 23 & 27, Ind AS 110)

The consolidated financial statements must be prepared based on the definition of 'control' which is significantly different under Ind AS 110. According to it, an investor controls an investee, if:

- The investor has powers over the investee to affect the investee's returns
- The investor is exposed to, or has rights to variable returns from its involvement with the investee
- The investor has the ability to use its power over the investee to affect the amount of the investor's returns

This definition of control is complex and may pose a significant challenge to companies when identifying entities which need to be consolidated. It might result in many entities being consolidated which were earlier not consolidated even though its equity ownership is less than 50% of the voting. It may also result into de-consolidation of companies with more than 50% equity ownership that are not consolidated in cases where minority shareholders have substantive participative rights.

Business combinations (AS 14, Ind AS 103)

Currently, AS 14 – 'Accounting for amalgamation' deals with mergers and acquisitions and the treatment of resultant goodwill or reserve.

Ind AS 103, at first, requires an assessment of whether what is acquired in substance constitutes a business combination or a 'group of assets'. This in turn determines whether the accounting thereof should be in the nature of a business combination or treated as an acquisition of assets.

Once it has been established that it is a business combination and not a mere acquisition of assets, it has to be accounted for by using the 'acquisition method'. This method requires all assets to be recorded at their fair value and any consideration paid in excess of fair value of all the assets put together is recorded as goodwill. Goodwill arising due to such business combinations must be tested annually for impairment. In case the fair value of assets is more than the purchase consideration, gain is to be recorded as capital reserve.

Ind AS 103 brings a solution to almost all disparities found in current accounting practices. With this change, varied practices will no longer be followed by Indian corporates for accounting of assets, goodwill, mergers, etc. However, it may also bring other complexities such as business combinations being governed by High Courts, valuation of intangibles, etc.

Financial instruments (AS 13, Ind AS 32, 107 & 109)

Currently, under I-GAAP, there is no comprehensive guidance/standard on accounting for financial instruments. AS 13, 'Accounting for investments', gives guidance on accounting of investments but still does not cover accounting and reporting of financial liabilities.

The Ind AS, has three standards dealing with financial instruments viz. Ind AS 32, Ind AS 107 and Ind AS 109. As it was the case with Ind AS 115, India will be the first country to adopt the new standard on financial instruments viz. Ind AS 109.

Companies adopting Ind AS will move from form-based accounting to substance-based accounting of financial instruments. It is expected that many instruments, which were earlier classified as equity/ shareholders' funds will now be classified as debt (For e.g. redeemable preference shares). There may be cases where an instrument which was earlier classified as debt will now be classified as equity (For e.g. compulsory convertible debentures convertible into fixed number of shares).

Further, an entity will have to classify all its financial assets either at amortised cost or at fair value on the basis of the entity's business model and the cash flow characteristics of the asset.

In the case of equity investments, all the investments will have to be measured at fair value only. The corresponding impact will either be given in 'other comprehensive income' (in case the investment is not held for trading) or in statement of profit/loss (in other cases).

Measurement of financial liabilities, which were usually recorded at par value in I-GAAP, will now be recognised either at fair value through profit and loss (in case the financial liabilities are held for trading) or at the amortised cost (in other cases unless the fair value option is applied).

Convertible bonds will now be split into the equity and liability portion and presented accordingly.

These standards will not only impact financial institutions. Its impact on other classes of industries will also be substantial.

Other key differences

- Presentation of statement of changes in equity
- Restatement of financial statements for errors in the prior period
- Recognition of dividend as a non-adjusting event
- Option to follow revaluation model for property, plant and equipment
- Capitalisation of borrowing costs in the case of general borrowings
- Measurement of inventories for service providers
- Operating segments to be identified based on the chief operating decision maker's outlook of financial information for the purpose of allocating resources and assessing their performance
- Determination of functional currency
- Standards for specific industries
- Additional disclosures and reconciliations for income taxes

Ind AS 101 – First time adoption of Indian Accounting Standard

After discussing certain key differences, the question that arises is how to initiate the whole process of conversion. This is where 'Ind AS 101- First time adoption of Indian Accounting Standard' (the standard) comes to facilitate the transition.

General requirements

- An opening balance sheet is to be presented at the date of transition to Ind AS. The date of transition is the beginning of the earliest comparative period presented as per Ind AS. For e.g. if the company prepares its first Ind AS compliant financials for FY 2016-17 and provides its comparatives for FY 2015-16, the date of transition will be 1 April 2015.
- First Ind AS compliant financial statements shall include at least three balance sheets (including the opening balance sheet), two statements of profit and loss, two statements of cash flows and two statements of changes in equity.
- The entity has to present reconciliation of equity and profit reported as per I-GAAP and as reported as per Ind AS in its first Ind AS compliant financial statements.
- In cases where the company has followed a different accounting policies as per I-GAAP and as per Ind AS on the date of opening the Ind AS balance sheet, the differences are to be directly adjusted from retained earnings since these adjustments arise from the events and transactions which occurred before the date of transition to Ind AS.
- The estimates made under I-GAAP should not be changed unless those estimates were in error. In case the entity needs to make estimates in accordance with Ind AS at the date of transition that were not required under I-GAAP, those estimates shall be in accordance with the conditions existing as on the date of transition.

Typically, all transition differences and accounting policies need to be applied retrospectively. One of the objectives of this standard is to enable a transition at a cost which does not exceed the benefits. To achieve this objective, Ind AS 101 has provided various mandatory exceptions to the retrospective application of accounting policies and optional exemptions from other Ind AS to its first Ind AS compliant financial statements.

Mandatory exceptions

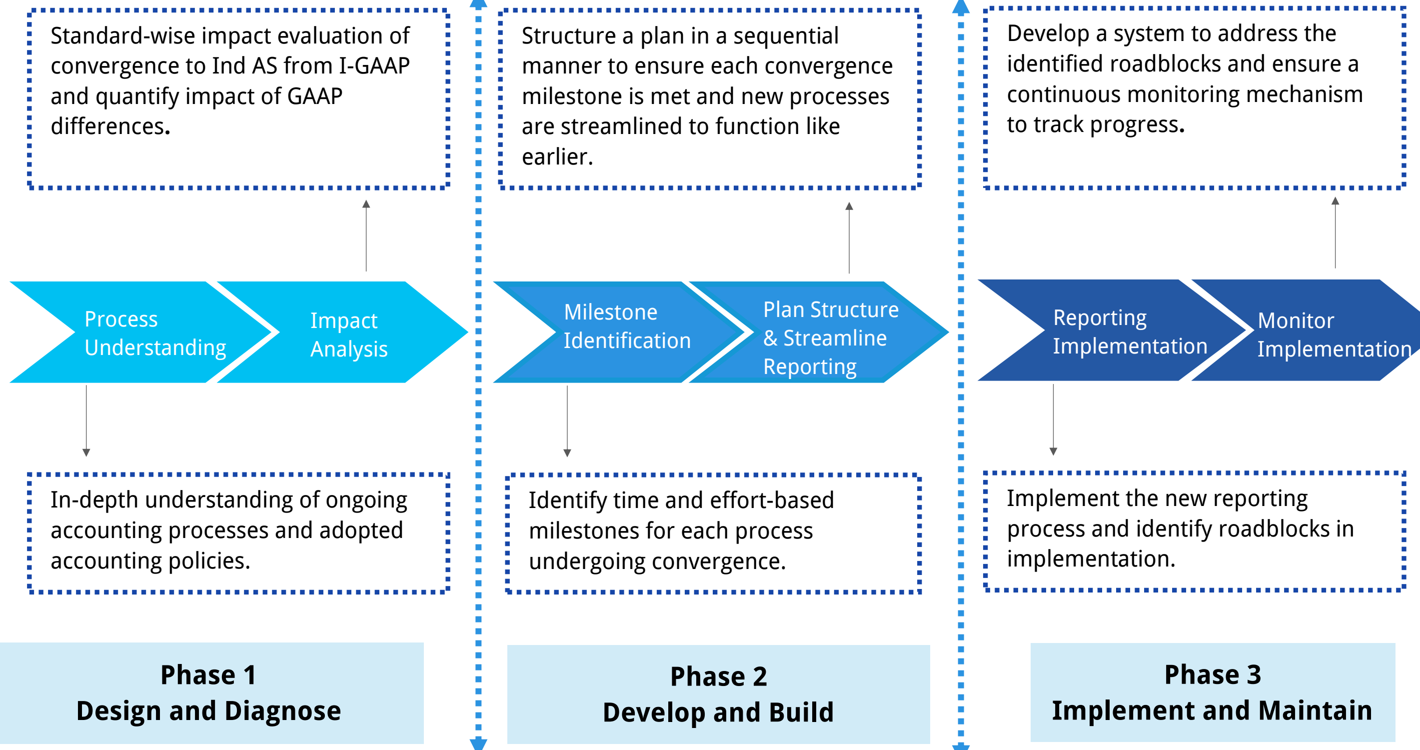
- Derecognition/recognition principles of financial assets and liabilities shall be applied prospectively.
- Reassessment of hedging relationship previously recognised in I-GAAP is mandatory. In case where it does not qualify under Ind AS, existing hedge accounting shall be discontinued.
- Transactions entered into before the date of transition to Ind AS shall not be retrospectively designated as hedges (i.e. not to use any hindsight).
- Assessment for classification and measurement of financial assets shall be made based on the facts and circumstances as on the date of transition.
- Principles of impairment of financial assets as laid down in Ind AS 109 are to be applied retrospectively subject to certain exceptions.
- In cases where government loans are obtained before the date of transition and are below market interest rates, the entity shall not apply principles of recognising the corresponding benefit as laid down in Ind AS 109. The carrying amount as per I-GAAP shall be used in the opening Ind AS balance sheet. An entity shall apply Ind AS 109 principles to such loans after the date of transition to Ind AS.

Optional exemptions

- Option to not restate business combinations which occurred prior to the transition date or any earlier selected date.
- Option to use I-GAAP carrying values or fair value to measure an item of property, plant and equipment, investment property and intangible asset.
- Option to continue the policy adopted under I-GAAP for accounting the exchange differences arising from the translation of long-term foreign currency monetary items recognised in the financial statements for the comparative period.
- Option to measure investment in subsidiaries, joint ventures or associates at I-GAAP carrying amount or at fair value as on the transition date in separate financial statements.
- Option to value non-current assets held for sale and discontinued operations at the transition date instead of initial date of such identification.

Implementation approach

The process of adopting Ind AS shall begin with understanding the existing accounting policies of the organisation and managing this change in reporting pattern in a risk-weighed project-based manner. Sufficient emphasis must be laid on the constant monitoring of implemented changes to ensure unhindered reporting. A graphical depiction of the Ind AS implementation roadmap is given below:



Impact across company-wide functions

The conversion to Ind AS does not restrict its impact simply to the accounting arm of an organisation. The impact will be a pervasive one across all functional departments. We have summarised this graphically as under:

Accounting and Finance

Identify and reconcile differences caused due to:

- Differences in accounting standards, frameworks and disclosure requirements.
- Differences in accounting policies.
- Differences in estimates

Lay the framework for:

- Developing policies and practices to comply with Ind AS requirements.
- Evaluating and revising existing chart of accounts.
- Evaluating and revising existing SOPs to gather information.
- Adopting an outlook conducive to more judgement and approximation based endeavours.

Personnel and Technology

Training and Development

- Orientation on new financial reporting requirements for employees across all areas of accounting operation.
- Set up new timelines, targets and responsibilities to gauge individual performance
- Put in place process oriented teams to execute the convergence.

System restructuring

- Evaluation of data collection and information processes.
- Implementation of changes to controls needed for financial reporting
- Defining authority matrices based on data sensitivity.
- New processes to implement required changes across accounting, taxation and other operational departments.

Business Operations

Gauge the impact of change in accounting policies on:

- Existing contracts
- Pricing practices
- Group company loans
- Preference shares based funding
- Managerial remuneration

Impact analysis and control maintenance

- Ensure communication of impact with various stakeholders viz shareholders, bankers, lenders, etc.
- Assessment of impact on net worth requirements stipulated by governing authority, if any.
- Revisiting performance evaluation criteria of key managers/employees/departments.

In retrospect

The accounting process followed by companies in India will undergo a much warranted evolution as we adopt globally acclaimed practices not just in accounting but also in other operational spheres of business. India today is at a procedural crossroads in globalising the existing business environment. Numerous obstacles may arise in the course of this structural reformation, some of which are summarised as follows:

- Possibility of multiple fair values arrived upon for a single property which may vary from each other significantly.
- Comparison of financial statements of companies from the same industry proving to be a challenge as each company may subjectively adopt options given in Ind AS 101 as per their organisational needs.
- In the absence of an alignment between Income Computation and Disclosure Standards (ICDS) and Ind AS, companies may face several challenges in reconciling the differences.
- The question of the overall preparedness of industry to make this transition remains unanswered.

Meticulously planned efforts in adapting to the best accounting practices accepted worldwide would result in a definitive solution for these obstacles. As India moves towards a new phase of financial reporting and disclosure, Ind AS shall ensure that financial statements prepared by companies in India are in line with global standards.

Component Accounting

Globally, the concept of component accounting has been around for a while. In India, although the concept existed as a recommendation vide 'Accounting Standard 10: Accounting for Fixed Assets', it was not widely applied by companies. Indian accounting has formerly held that the asset as a whole is to be depreciated at a prescribed rate. Schedule II of the Companies Act, 2013(the act) with effect from 1 April 2015 has made component accounting mandatory when relevant and material. Component accounting requires that parts of the fixed asset which bear a cost significant to the whole asset and a useful life different from that of the asset should be accounted for separately as 'a component'. The Application Guide on the provisions of Schedule II to the act issued by the Institute of Chartered Accountants of India discusses the application of component accounting and also suggests material thresholds in identifying components. The implementation of this method will bring about an improvement, making depreciation accounting reflect the economic functioning/behaviour of the asset and facilitate accounting for component replacement. In the course of this refresher we have discussed:

- The need for component accounting by comparing it viz a vis the erstwhile method of fixed asset accounting.
- The method of implementing component accounting.
- The challenges that companies may face while adopting component accounting.
- The accounting treatment while transitioning to the componentisation of fixed assets.

Applicability and adoption

As per the amendment notified by the MCA on 29 August 2014:

Component depreciation is mandatory for all classes of companies. The adoption of this change has been laid out in two phases:

- Voluntary adoption for the financial year commencing on or after 1 April 2014. This should be done for the entire block of assets as at 1 April 2014.
- Mandatory adoption for all the financial statements prepared for financial years commencing on or after 1 April 2015.

Component accounting is not restricted to assets acquired after 1 April 2014 or 1 April, 2015 as the case may be.

The need for componentisation

Specific parts of the principal asset without which the asset cannot function to its full capacity and that may have a different useful life than that of the principal asset would be treated as components for that asset. These components may occupy a significant portion of the cost of the asset. Under the existing method of accounting followed for fixed assets there was no separate accounting treatment for these material components and the principal asset. This had often resulted in carrying value not representing an accurate summary of the asset position. We have drawn up a comparison between the erstwhile method and component method of fixed asset accounting.

Depreciation is charged on the principal asset as a whole, at the prescribed rates due to which components and the principal assets, even if they have different useful lives are depreciated at the same rate.

Demarcating the depreciation apportioned to a specific component of the principal asset was difficult.

The asset is demarcated into components based on their relevance and materiality.

The depreciable amount of the component is allocated over the useful life of the component.

Depreciation gets charged more evenly as per the useful life determined for principal assets and their components.

In case of replacement of components there may exist a balance of written down value for the asset component being replaced, as depreciation is not apportioned over the component's useful life.

The cost incurred on the replacement of the components under the existing method of accounting should to be expensed out in the year of incurrence instead of capitalising it.

Components are depreciated completely as the depreciable amount of the component is apportioned over its useful life.

If the component is replaced, the method prescribes immediate capitalisation of new components and expensing out of the balance of written down value of older components.

Asset componentisation: Procedure

Step 1: Identification

Identifiying significant parts is a matter of judgment and is decided on a case-to-case basis. Identifying separate parts of an asset and determining their useful life is not merely an accounting exercise. It involves technical expertise. Hence, technical experts might need to be involved to determine the significant parts of an asset.

A company needs to identify only material/significant components separately for depreciation. Materiality is a matter of judgement and needs to be decided on the facts of each case. To perform materiality testing, a de minimis limit is normally set, below which assets are excluded from component accounting.

Materiality thresholds are completely subject to management decisions. The company may consider 10% of the asset's original cost as a threshold to determine whether a component is material/significant.

Step 2: Grouping

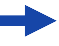
The company shall demarcate the asset into parts based materiality and the useful life of the component. The rationale of depreciation under Schedule II is allocating the depreciable amount of the component over its useful life. This requires that the identified components would be sub-divided into groups. Components would be grouped together if they have:

- the same useful life
- use the same method for charging depreciation.

If the useful life of the component is lower than the useful life of the principal asset as per Schedule II, it should be used for apportioning the depreciable amount of the component over its useful life.

On the other hand, if the useful life of the component is higher than the useful life of the principal asset, the company has a choice of using either the higher useful life or the useful life of the principal asset and accordingly apportioning the depreciable amount over the useful life.

However, higher useful life for a component can be used only when management intends to use the component even after the expiry of the useful life of the principal asset.



Step 3: Residuary Grouping

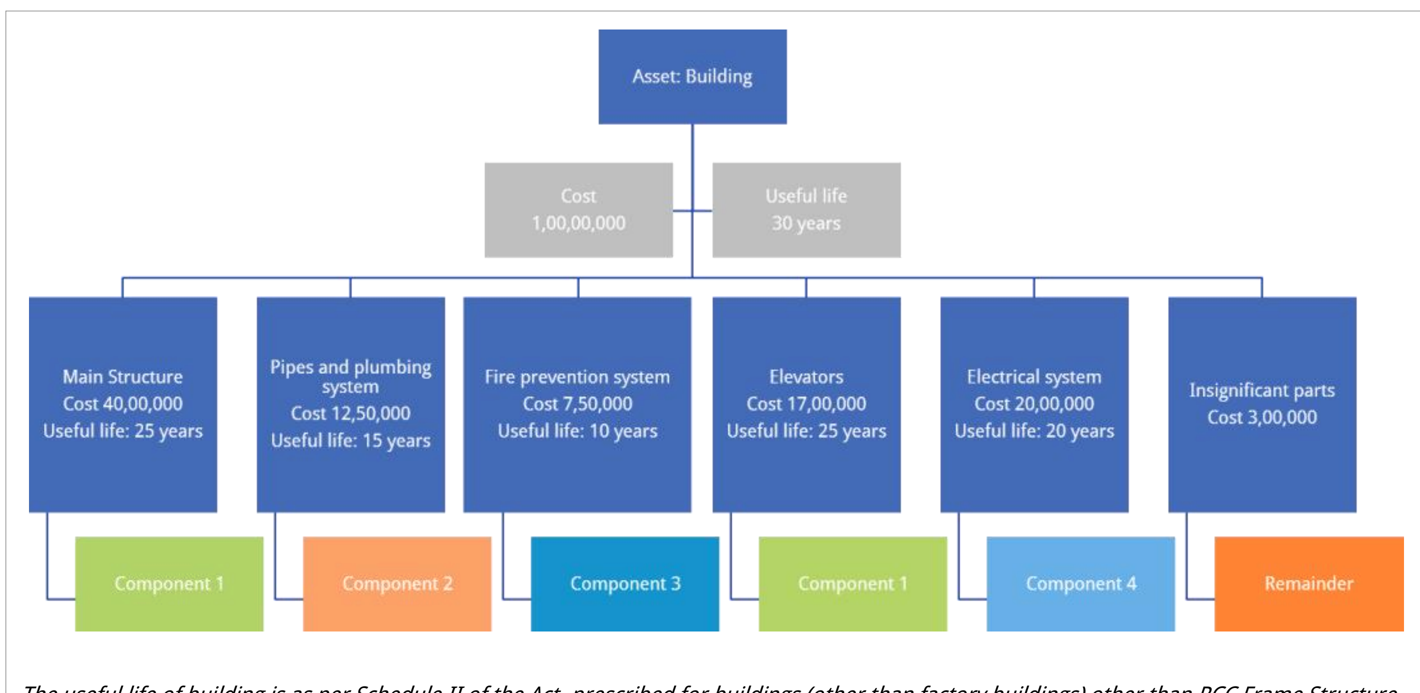
After the second phase, there may still be parts of the principal asset which have not formed part of any component group owing to their insignificant cost compared to the main asset.

These parts shall then be clubbed as a remainder group that is individually insignificant and then be depreciated over the useful life of the principal asset.

If the insignificant parts have the same useful life, when grouped together these insignificant parts may cross the materiality threshold as set by the management. In such a case, the block of insignificant

parts shall be accounted for as a separate component of the principal asset.

Illustration



The useful life of building is as per Schedule II of the Act- prescribed for buildings (other than factory buildings) other than RCC Frame Structure

Transitioning to component accounting

While transitioning from the existing method of asset accounting to component accounting, companies could face two situations:

Situation 1: Remaining useful life of the component is nil.

Component has outlived its useful life as estimated by the management on adoption of component depreciation.

How to address

- Depreciate the balance i.e. written down value of the component net off residual value if any.
- Adjust either:
  - By charging against the opening balance of retained earning net of deferred tax; OR
  - Charge to profit and loss account.

Situation 2: There exists a remaining useful life for the component.

The component has been used for a period less than its useful life as estimated by the management, to adopt component accounting.

How to address

Depreciate the balance i.e. written down value of the component net off residual value over the remaining useful life of the component.

Hurdle-Cross: Addressing the challenges of componentisation

Estimating the life of components

The new Schedule II of the act prescribes a useful life for the whole asset, in the absence of useful life prescriptions for individual components, it is the management's judgement that shall be the modus operandi for the application of this new method of presentation. Situations may arise where companies from the same industry estimate a different useful life for a similar component of assets based on their own judgement. Also in some cases management may seek expert opinion on estimating the life of the asset but may discard the asset before the useful life runs out.

Determination of cost of components

For components to be identified, it is imperative that the cost of each component be determined making cost determination one of the primary necessities of component accounting. As component accounting was not mandatory in India until now, it is possible that the separate cost of each significant component of an asset is not available in the books of accounts. In order to determine the cost of such components the following criteria can be used:

- Cost break up provided by the vendor
- Cost break up given by an internal/external technical expert
- Current replacement cost of the component of the related asset and applying the same basis on the historical cost of asset.

Restructuring and Training

The fixed asset registers maintained by companies as per the erstwhile method will undergo a complete restructuring, making operating procedure for the accounting of assets an area to be redesigned. Accounting staff will need to be trained in order to adopt this mandate without any hiccups.

In retrospect

One of the most widely discussed topics in the Indian accounting world is the convergence with International Financial Reporting Standard by transitioning to Ind AS. This transition to Ind AS enables India to adopt globally acclaimed best practices in accounting and financial reporting. The mandatory adoption of component depreciation takes Indian companies a step closer to Ind AS. Component depreciation is one of the many significant changes that have taken place in Indian accounting. It is with the passage of time that these changes will bring about qualitative improvement in the financial disclosures made by the Indian accounting fraternity.

Increased scrutiny – an overview of the SEBI (Prohibition of Insider Trading) Regulations, 2015

Stock markets across the world have evolved over a period of time. Its history dates back to the thirteenth century when the Venetian's brokers used to carry slates with information for trading in government securities. While the stock market is a strong barometer for the economic growth of any developed country, there are numerous instances of securities frauds and scams across the globe which shatter investor confidence in the market. Securities fraud would include corporate misconduct, dummy corporations, internet fraud, insider trading, accountant fraud, mutual fund frauds, short selling abuses, etc. Insider trading, one of the types of securities fraud, is a malpractice in which a company's securities are traded by people, who by virtue of their association, have access to otherwise non-public information, at a given point in time, to make larger profits. Hence, it is an unfair practice wherein other stock holders are at a disadvantage due to lack of such information.

Stock market regulators across the globe have made several attempts to regulate and curb insider trading transactions by introducing regulations and amending them from time to time. While USA was the first country to enact regulations on insider trading, India's Security and Exchange Board of India (SEBI) enacted regulations in 1992 i.e. SEBI (Prohibition of Insider Trading) Regulations, 1992, to regulate the insider trading related transactions and offences. In January 2015, SEBI attempted to overhaul the old regulations to address the inadequacies of the earlier 1992 regulations.

This article primarily focuses on important features of the SEBI (Prohibition of Insider Trading) Regulations, 2015 which has been made applicable from 15 May 2015. The regulations cover key obligations imposed by legislation along with possible solutions for their implementation by the financial market players or by those to whom it had been mandated by SEBI.

Applicability

The new SEBI (Prohibition of Insider Trading) Regulations, 2015, are applicable to securities listed and proposed to be listed on stock exchanges.

The regulations are applicable to any connected person or 'insider' who is associated with the company in a contractual, fiduciary or employment relationship, having direct or indirect access to unpublished price sensitive information that is not generally available.

Unpublished Price Sensitive Information (UPSI) and responsibility of an insider

UPSI has been defined as information **not generally available** and **which may impact the price**. Generally available information is information that is accessible to the public on a non-discriminatory platform such as stock exchange platforms.

As per the regulations, the insider who is in possession of any UPSI shall not communicate, provide, or allow access to any UPSI, except such information that further legitimate purposes. Such a person can communicate and publish such UPSI if it is in the best interest of the company or to comply with any existing regulations, requiring such public disclosure of information.

The management of any organisation shall have Non-Disclosure Agreements (NDA) or confidentiality agreements signed by such persons, restricting the use and dissemination of such information by them.

Trading by insiders

SEBI regulations debar insiders, while in possession of such UPSI, from trading in company securities directly or indirectly, to restrict them from taking advantage of such material information.

Such insiders are allowed to trade in the company's securities provided he proves his innocence by

demonstrating the circumstances including the following:

- The transaction is off-market and both parties have made an informed decision.
- In the case of non-individual insiders
  - The individuals taking trading decisions were different from the insider persons and were unaware of the unpublished price sensitive information.
  - Appropriate arrangements are made to ensure these regulations are not violated.
  - Trades were pursuant to the trading plan set up in accordance with regulation.

Trading plan

SEBI, through this new regulation, has introduced the 'trading plans' concept to facilitate compliant trading by insiders, whereby the insider is entitled to execute trades pursuant to the trading plan. The insider will formulate a trading plan and present it to the compliance officer for approval and public disclosures.

Such trading plans shall:

- Set out the value of trades to be effected, number of securities to be traded along with the nature of trade and the intervals at, or dates on which such trades will be effected.
- Not overlap any period for which another trading plan is already in existence.
- Have the commencement of trading not earlier than 6 months from public disclosure of the plan.
- Be submitted for a minimum period of 12 months.

The compliance officer within the organisation shall review the trading plan and assess whether the plan has any potential for violation of these regulations. Accordingly, the compliance officer shall approve the plan. Once the trading plans are approved, the compliance officer shall notify the stock exchanges where the securities are listed. The trading plan, once approved, needs to be compulsorily adhered to and shall be irrevocable.

Trading restrictions after disclosure of financial results

The insider is restricted from dealing in securities for a certain period after the information is disclosed to the public. As per the regulations, no trading will be allowed between the twentieth trading day prior to closure of financial period and the second trading day after disclosure of financial results. E.g. for the September 2015 quarter end close, if the management decides to disclose the financial results on 27 October 2015, then an insider will not be allowed to trade between 20 September 2015 and 29 October 2015.

The trading window would be compulsorily closed for the above mentioned period for all insider persons in order to ensure effective dissemination of disclosed financial information amongst the public.

Disclosure of Trading by insiders

Who	What	Whom	When
Initial disclosures			
Promoter, Key Managerial Person, Director	Holding of securities of company on appointment as key managerial personnel or director or upon becoming promoter	To company	Within 7 days of such appointment
Continual disclosures			
Promoter, Employee, Director	Particulars of trade (number of securities acquired, disposed) - Transaction or series of transactions in the calendar quarter in excess of Rs.1 million	To company	Within 2 trading days of transaction
Company	Particulars of trade	To stock exchange	Within 2 trading days of receipt of disclosure

The disclosure to be made by any person shall also include those persons who are immediate relatives to such persons who have made the trade and also includes any other person for whom such person takes trading decisions.

Code of fair disclosure and conduct

Companies need to establish a code of practices and procedures for fair disclosures of UPSI in accordance with the principles set out in Schedule A of the Regulations. Schedule A of the Regulations sets out certain minimum standards such as equality of access to information, publication of policies such as those on dividend, inorganic growth pursuits, calls and meetings with analysts, publication of transcripts of such calls and meetings, etc.

The code of practices and procedures for fair disclosures of UPSI and every amendment thereto shall be promptly intimated to the stock exchanges where the securities are listed.

Every listed company shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons towards achieving compliance in accordance with Schedule B of the regulations.

Every listed company formulating a code of conduct shall identify and designate a compliance officer to administer the code of conduct and other requirements under these Regulations.

Roles and responsibilities of the compliance officer

The compliance officer monitor sand regulates the trading of securities by employees and connected persons and ensures adherence of insider trading regulations. Given below is the summary of activities that the compliance officer is required to perform to ensure compliance under SEBI Insider Trading Regulations.

Policy and Procedures	Internal Operations	Monitoring	Reporting and MIS
▪ Review compliance of internal policies, procedures, maintenance of records and monitoring adherence to the rules ▪ Review of HR policies, procedures and its integration with compliance requirements ▪ Send an intimation to the Stock Exchange ▪ Implement/administer code of conduct ▪ Have Non-Disclosure Agreements (NDA) or confidentiality agreements signed	▪ Review trading plans submitted ▪ Grant approval or reject trading plans ▪ Monitor the execution of trading plans ▪ Seek periodical declarations/disclosures from promoters, employees and directors ▪ Set/follow process for intimating the declaration/disclosures to the Stock Exchange ▪ Determine the closing and reopening trading window dates.	▪ Monitor and approve the trading plan ▪ Review and monitoring the mechanism by compliance officer or his office along with defined roles and responsibility	▪ Create a reporting mechanism to board of director/audit committee/Stock exchange ▪ Assist Board/Audit Committee in reviewing compliance ▪ MIS to management

Penalties

While most of the powers of SEBI are in continuance and some have been amended, there is no separate penalty defined under the new regulations for insider trading. However, a reference is made to the provision under the SEBI Act, 1992 making it is publishable with a penalty of INR 250 million or three times the profit made out of insider trading, whichever is higher. Any person contravening or attempting to contravene or abetting the contravention of the Act may be liable to imprisonment for a term which may extend to ten years or with a fine which may extend to INR 250 million or with both.

Conclusion: Safe market – safe trading

With this new set of regulations governing insider trading, corporates will need to allocate an additional budget for monitoring, compliance and surveillance of insider trading. The mandatory monitory mechanism requires every company to have a code of practices and procedures for fair disclosure of UPSI. They must also have a reporting mechanism on trading by their employees and other connected persons.

Though this amendment came after two decades, the new regulations are considered to be a good attempt to tighten controls, checks and balance around insider trading in the Indian financial market. Undoubtedly, it is a welcome move. However, it still requires clarity on certain issues which will contribute to the effective implementation of insider trading norms.

Setting the appropriate top level objectives and instilling a culture of good governance are key to fostering ethical behaviour and minimising crises brought about by improper or poorly controlled conduct. In our upcoming release of assurance insights, we would cover practical approaches and key challenges faced by companies towards complying with insider trading regulations.

Companies Act, 2013: Key updates

The Companies (Management and Administration) Amendment Rules, 2015

- Rule 23 of the Companies (Management and Administration) Rules, 2014 states the criteria to be followed for giving a "Special Notice" to the company.
- One of the criteria for a "Special Notice" to be given to the company states that, "it shall be signed either individually or collectively by such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not more than five lakh rupees has been paid up on the date of the notice", the words "not more than five lakh rupees" has been substituted with 'not less than five lakh rupees'.
- Revised Form MGT 7 (Form of Annual Return) has been issued.

Source: The Ministry of Corporate Affairs vide notification dated 28 August 2015

The Companies (Accounts) Second Amendment Rules, 2015

- The definition for "Indian Accounting Standards" has been inserted as clause (da) in rule 2 sub rule (1) after clause (d), which states:
- "Indian Accounting Standards" means the Indian Accounting Standards referred to in Rule 3 and Annexure to the Companies (Indian Accounting Standard) Rules, 2015."
  Note: For Rule 3 and Annexure refer Companies (Indian Accounting Standards) Rules, 2015.
- Rule 4A "Forms and items contained in financial statements" has been inserted after Rule 4 "Conditions regarding maintenance and inspection of certain financial information by directors", which states that "the financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards (AS) or Indian Accounting Standards (Ind AS) as applicable, provided that the items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the AS or Ind AS, as the case may be."
- Rule 8 sub rule (3) requires the Board to report on Conservation of energy, Technology absorption and Foreign exchange earning and outgo. In order to exempt some companies from this reporting, a proviso has been inserted which states that the requirement of furnishing information and details under Rule 8 sub rule (3) shall not be applicable to a Government company engaged in the production of defence equipment.
- Rule 12 sub rule (1) states that "Every company shall file the financial statements with Registrar together with Form AOC -4." these words have been substituted with "Every company shall file the financial statements with Registrar together with Form AOC-4 and the consolidated financial statements, if any, with Form AOC-4 CFS".
- Revised Form AOC-4 (Form for filing financial statement and other documents with the Registrar) and Form AOC-4 CFS (Form for filing consolidated financial statement and other documents with the Registrar) have been issued.

Source: The Ministry of Corporate Affairs vide notification dated 4 September 2015

The Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015

The aforesaid rules are in suppression of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011. These Rules are briefly stated below:

- Definition for terms:
  - "Documents and forms" means the documents and forms required to be filed with any authority as specified under the Act or rules or regulations made thereunder.
  - "Extensible Business Reporting Language" (XBRL), means a standardised language for communication in electronic form to express report or file financial information by the companies under the Act.
  - "Taxonomy" means in XBRL, an electronic dictionary for reporting the business data as approved by the Central Government in respect of any documents or forms indicated in these rules.
- E-form "AOC-4 XBRL" (Form for filing XBRL document in respect of financial statement and other documents with the Registrar) has been issued and shall be filed using XBRL taxonomy issued by the MCA for the financial year commencing on or after 1 April 2014.
- Class or classes of companies who are required to file their financial statement and other documents under section 137 (Copy of financial statement to be filed with Registrar) of the Companies Act, 2013 in E-form AOC-4 XBRL are:
  - All companies listed with any Stock Exchange(s) in India and their Indian subsidiaries, or
  - All companies having paid up capital of rupees 5 crore or above
  - All companies having turnover of rupees 100 crore or above, or
  - All companies which were hitherto covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011
  - Banking, Insurance, Power Sector and NBFC's are exempt from XBRL filing.
- As per sub section 6 of section 148 (Central Government to specify audit of items of cost in respect of certain companies) of the Companies Act, 2013, a company shall have to furnish cost audit report and other documents to Central Government using XBRL taxonomy issued by the MCA for the financial years commencing

on or after 1 April, 2014 in e-form CRA-4 (Form for filing cost audit report with the central government).

Source: The Ministry of Corporate Affairs vide notification dated 9 September 2015

Extension of time for filing of cost audit report to the Central Government for FY 2014-15

The MCA vide General Circular No. 08/2015 dated 12 June 2015 had extended the date for filing of Form CRA-4 "Form for filling Cost Audit Report with the Central Government" and waived off any additional fees applicable on filing of Form CRA-4 till 31 August 2015. The aforesaid extension has been further extended upto 30 September 2015.

Source: The Ministry of Corporate Affairs vide General Circular 12/2015 dated 1 September 2015

Alterations to Schedule III

The MCA has made two broad alterations in Schedule III, they are as follows:

- "Trade payables" under the head "Equity and Liabilities" in Part I – Balance Sheet has been bifurcated into two heads namely:
  - Total outstanding dues of micro enterprises and small enterprises, and
  - Total outstanding dues of creditors other than micro enterprises and small enterprises.
- In lines with the above change, paragraph 6 (FA) "Trade Payables" has been inserted after paragraph 6 (F) "Short - term borrowings" under the head "Notes: General Instructions for preparation of Balance Sheet" which requires disclosure in notes, they are as follows:
  - The principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year.
  - The amount of interest paid by the buyer in terms of section 16 of the Micro, Small and Medium Enterprises Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year.
  - The amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006.
  - The amount of interest accrued and remaining unpaid at the end of each accounting year, and;
  - The amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.
  - Explanation: The terms 'appointed day', 'buyer', 'enterprise', 'micro enterprise', 'small enterprise', and 'supplier', shall have the same meaning assigned to those under clauses (b),(d),(e),(h),(m) and (n) respectively of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.

Source: The Ministry of Corporate Affairs vide notification dated 4 September 2015

Certain paragraphs of Schedule III not applicable to Government companies

- The Central Government in public interest has directed that paragraphs 5(ii)(a)(1), 5(ii)(a)(2), 5 (ii)(e), 5(iii), 5(viii)(a), 5(viii)(b), 5 (viii)(c) and 5(viii)(e) relating to "Additional Information of the General Instructions for preparation of Statement of Profit and Loss" in Schedule III, shall not be applicable to government companies producing Defence equipment including the Space research, the aforesaid paragraphs in brief are stated below:
  - In case of manufacturing companies, raw materials and goods purchased under broad head and in case of other companies, gross income derived under broad heads.
  - In case of all concerns having works in progress, works in progress under broad heads.
  - Value of import calculated on C.I.F basis by the company.
  - Expenditure in foreign currency on account of royalty, know-how, interest, etc.
  - Total value of imported and indigenous raw materials, spare parts and components consumed and the percentage of each to the total consumption.
  - Earning in foreign exchange classified under the heads, such as, Export of goods calculated on F.O.B basis, interest and dividend, royalty, know-how, other income and the nature thereof.
- The paragraphs mentioned above shall not be applicable to government companies producing Defence equipment including the Space research, subject to their fulfilment of the following conditions:
  - The Board of Directors of the Company has given consent with regard to non-disclosure of information relating to the aforesaid paragraphs as may be applicable.
  - The company shall disclose in the Notes forming part of the balance sheet and profit and loss account, the fact of grant of exemption under this notification.
  - The company shall comply with the prescribed Accounting Standards.
  - The company shall ensure that its financial statements represent a true and fair state of affairs of its finances, and
  - The company shall maintain and file such information as may be prescribed or called for or required by the government or the RBI or any other regulator.
- This notification shall be applicable in respect of financial statement prepared for the financial years ending on or after the 31 March, 2016.

Source: The Ministry of Corporate Affairs vide notification dated 4 September 2015

Note: All the above mentioned Rules and Notifications shall come into force from the date of their publication in the Official Gazette

About SKP

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