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Keeping up with India's dynamic regulatory scenario

The regulatory environment in India has been in constant flux for some time now, impacting various sectors of the economy. This paper talks about how changes in the accounting or auditing regulations have impacted or are expected to impact companies.

a. NFRA comes into power

The Ministry of Corporate Affairs (MCA) has notified the constitution of the National Financial Reporting Authority (NFRA). It has been given considerable powers over the accounting and auditing profession, which, among others, include:

- Formulating and laying down accounting and auditing policies and standards for adoption by companies or class of companies or their auditors, as the case may be.
- Monitoring and enforcing compliance with the standards mentioned above in such manner as may be prescribed.
- Initiating and conducting investigations into professional or other misconduct committed by any member or firm of Chartered Accountants and imposing monetary penalties/ debarring members or firms from practising as members of the ICAI for a period ranging from 6 months to 10 years at the discretion of the NFRA.

The constitution of NFRA brings about a shift from the self-regulated organisation model, giving the country an independent audit oversight body and enabling India Inc. to align itself with the international best practices.

This has also been expressed in a report by the Committee of Experts (constituted by the MCA), notified in November 2018. In their opinion, the NFRA creates no inconsistency between the provisions of the 2013 Act and the Chartered Accountants Act, 1949. The report has also recommended further reforms like empowering the NFRA to publish audit inspection results, allowing audit firms to advertise their service, forming multi-disciplinary partnerships and requiring the submission of an Annual Transparency Report to the NFRA.

b. Revenue accounting: The new normal

The MCA, in its continuing efforts to converge with IFRS, issued Ind AS 115, Revenue from Contracts with Customers, effective from 1 April 2018. This is a welcome step towards aligning the new standard under Ind AS to the global adoption of new revenue recognition standards under IFRS.

It has already been two quarters since this change came about and more detailed disclosures are expected in the year-end financial results, giving an idea of the impact Ind AS 115 had on India Inc.

Ind AS 115 prescribes a single model for revenue recognition. Some of the industries that have been majorly impacted by the revenue recognition changes include:

- Telecom and Information Technology: Multiple deliverables are commonplace in the industry and the erstwhile practice of revenue recognition was mixed. Cellphone businesses, which accounted for a 'free' handset as a marketing cost, are now required to allocate revenue based on relative standalone selling prices.
- Real Estate: Recognising revenue for real estate contracts (such as apartment sales) has been an issue, and the new model shifts the boundary between percentage of completion and on-completion revenue recognition.
- Engineering, procurement and construction (EPC) contracts: While the sale of materials and installation have been accounted for separately until now, the new standard may require such contracts to be combined to determine the percentage of completion.
- Asset management, legal and professional services and other sectors where performance-based or contingent fees are commonplace: The new model requires such variable payments to be accounted for on a best estimate basis, subject to a constraint.
- Retail: Accounting for rights of return, customer loyalty schemes and warranties are among the most prone arrangements that are affected by Ind AS 115.

The implementation of Ind AS 115 impacts businesses at multiple levels, with changes to systems and processes. The impact may not be limited to the accounting function alone and may affect other aspects such as sales and operations, IT, investor relations and employee performance measurements, to name a few.

c. The transformed auditor's report: Future of audit

The standards on auditing in India are largely consistent with the international standards. The Institute of Chartered Accountants of India (ICAI) has made corresponding changes and issued the new and revised standards on the same lines

as the International Auditing and Assurance Standards Board (IAASB). The new reporting standards are applicable for audits of financial statements for periods beginning on or after 1 April 2018 for listed companies.

The new reporting is a shift from the boilerplate reporting and is therefore tailor-made. The new and revised auditor's reporting standards are expected to:

- Enhance transparency to facilitate users of financial statements in understanding significant judgements made by the auditor in forming an opinion on the financial statements, since they are directly related to the areas of significant management judgement in preparing the financial statements.
- Increase robust communication between those charged with governance, management and the auditor, especially on the Key Audit Matters (KAMs), which are now required to be included in the audit report.
- Increase attention of the management and those charged with governance to the disclosures in the financial statements referred to in the auditor's report.
- Increase professional skepticism of the auditor in areas where KAMs are identified.

From an ongoing perspective, there may not be a drastic change in the reporting from one year to the next, unless there are significant events, transactions or circumstances which affect the entity. This leads to the apprehension that even these reports may eventually end up being boilerplate. However, the standard intends to make the reporting specific to the entity, to the year and to the issues of that particular year. Ultimately, the idea is that the auditor's report should not be just a tick-in-the-box exercise; rather, it should provide an insight into the audit process and the conclusions drawn.

d. Progressive amendments to the Companies Act, 2013

With the objective of improving the ease of doing business in India, the MCA had constituted the Company Law Committee (CLC) to consider the difficulties and challenges faced by various stakeholders arising from the 2013 Act. Thereby, the Companies (Amendment) Act, 2017 was notified earlier this year, which brought about significant changes, including the following:

- Exclusion of instruments regulated by RBI from the definition of 'debentures' — for example, commercial papers not governed by the 2013 Act.
- Simplifying the administrative processes by permitting an officer or an employee to be authorised by the board to authenticate documents on behalf of the board, allowing unlisted companies to hold AGMs in any place in India and threshold limits for small companies being enhanced.
- Removal of Central Government approval in case of excess managerial remuneration subject to approvals by the shareholders in the general meeting.
- Further, Honourable President's assent has been given to Companies Amendment (Ordinance), 2018, which promotes ease of doing business in India, along with better corporate compliance, and inter alia include the following:
  - Rationalisation of fines and penalties under the 2013 Act
  - Declogging NCLT by increasing Central Government's powers to approve routine matters and enhancing the Regional Director's pecuniary jurisdiction
  - Recommendations relating to public deposits, commencement of business declarations, filing of charges and holding of directorships beyond permissible limits.

In view of this Ordinance, MCA has sought public comments on the proposed amendments, which also include opening a special account by a company in a scheduled bank for the amounts remaining unspent on CSR activities.

e. SEBI

SEBI has continued to ease out business practices and taken measures to enhance governance through varied amendments in the recent quarters. The following are some of the changes effected or proposed:

- Constantly regulating the mutual fund industry with respect to maintenance of the total expense ratio (TER).
- Reducing the time period of listing of shares.
- Removal of maintenance of security deposit of 1% with stock exchanges for public issue of debt securities.
- Framework for Enhanced Market Borrowings by Large Corporates, wherein, large corporates shall raise 25% of their incremental borrowings through the bond market.
- Amendment of SEBI (ICDR), which now requires only consolidated financial statements to form part of the offer document, among other changes.

Conclusion

India Inc. is moving towards greater transparency and increased levels of governance through the measures taken by the various regulators. In the process, it continues to embark on the journey of growth.

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