B K KHARE & Co
CHARTERED ACCOUNTANTS

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Regulatory

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MCA Updates

Amendments to Schedule III of the Companies Act, 2013

MCA has amended Schedule III of the Companies Act 2013. Schedule III contains the general instructions for preparation of the Balance Sheet and the Statement of Profit and Loss of a company. Broadly, the changes have been made to align Schedule III with recent changes in various laws and to make it more meaningful. Notable disclosures to be made in the Balance Sheet and the Statement of Profit and Loss with effect from April 1, 2021 are as follows. →

MCA broadens scope of reporting by Auditors in Audit report

MCA, vide its Notification dated March 24, 2021, broadens the scope of reporting by inserting clause (e) in Rule 11 of the Companies (Audit and Auditors) Rules, 2014 which defines 'Other Matters to be included in the Audit Report'.

These rules may be called the Companies (Audit and Auditors) Amendment Rules, 2021. As per the amendments, the following additional matters are also required to be included in Audit Report. These amendments shall come into force with effect from April 1, 2021. →

SEBI Updates

SEBI issues clarification on valuation of bonds issued under Basel III framework

The Securities and Exchange Board of India (SEBI), vide para 8 of the Circular No. SEBI/HO/IMD/DF4/CIR/P/2021/032 dated March 10, 2021, had inter alia stated that the maturity of all perpetual bonds shall be treated as 100 years from the date of issuance of the bond for the purposes of valuation. →

RBI Updates

Large Exposures Framework – Deferment of applicability of limits on non-centrally cleared derivatives exposures

Non-centrally cleared derivatives exposures will continue to be outside the purview of exposure limits till September 30, 2021.

IBOR

Non-Banking Finance Companies (NBFCs) in India need to plan for an effective Inter Bank Offered Rate (IBOR) transition, as majority of LIBOR rates are likely to be phased out by the end of 2021.

London Inter Bank Offered Rate (LIBOR) is one of the most common series of benchmark rates referenced by contracts measured in trillions of dollars across global currencies. About $ 350 trillion worth of contracts across the globe are pegged to LIBOR, which is the key interest rate benchmark for several major currencies. Some of the leading banks in India have also embarked on the journey to assess the impact of LIBOR cessation on their Balance Sheets and operations. →

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Amendments to Schedule III of the Companies Act, 2013

Key amendments

S. No.	Particulars	Amendments
1.	Rounding off	Companies have to now round off the figures appearing in the financial statements. Hitherto it was optional. Further, the criteria for rounding off shall be based on “total income” instead of “turnover”.
2.	Promoters’ Shareholding	Company shall disclose shareholding of Promoters.
3.	Current maturities of long-term debt	Current maturities of long-term borrowings shall be disclosed separately.
4.	Ageing	Trade Payables and Trade Receivables ageing schedule to be given.
5.	Immovable Properties	The company shall provide the details of all the immovable properties (other than properties where the Company is the lessee and the lease agreements are duly executed in favour of the lessee) whose title deeds are not held in the name of the company in the given format and where such immovable properties are jointly held with others, details of the extent of the company’s share are required to be given.
6.	Disclosure of Loans granted to Related Parties	Disclosures to be made where Loans or Advances in the nature of loans are granted to promoters, directors, KMPs and other related parties.
7.	Capital Work in Progress	Capital work-in progress ageing schedule shall be given.
8.	Disclosure of Benami Properties	Disclosure to be made of any proceedings initiated or pending against the company for holding any benami properties under the Benami Transactions (Prohibition) Act, 1988.
9.	Disclosure of willful defaulter	Details to be given where a company is a declared willful defaulter by any bank or financial Institution or other lender.

S. No.	Particulars	Amendments
10.	Transaction with Companies whose name has been struck off by Registrar	Disclosure of any transactions with companies whose name has been struck off.
11.	Registrar of Charges	Details and reasons thereof shall be disclosed where any charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period.
12.	Disclosure of Ratios – Ratios with explanation and reason for 25% or more variation to be disclosed	Following Ratios to be disclosed: (a) Current Ratio, (b) Debt-Equity Ratio (c) Debt Service Coverage Ratio (d) Return on Equity Ratio (e) Inventory turnover ratio (f) Trade Receivables turnover ratio (g) Trade payables turnover ratio (h) Net capital turnover ratio (i) Net profit ratio (j) Return on Capital employed (k) Return on investment
13.	Utilisation of funds raised	Disclosure of utilisation of borrowed funds and share premium to be given.
14.	Material discrepancies between quarterly and annual financial statements submitted to bank	Reconciliation and reasons of material discrepancies in quarterly statements submitted to bank and books of account.

S. No.	Particulars	Amendments
15.	Transactions disclosed as income in Income tax	Details of transactions not recorded in the books that have been surrendered or disclosed as income in the tax assessments.
16.	Additional Regulatory Information	• Disclosure with respect to borrowings from banks and financial institutions not used for the specific purpose for which it was taken at the Balance Sheet date. • Disclosure of revaluation, if done, is based on the valuation by a registered valuer as defined under Rule 2 of the Companies (Registered Valuers and Valuation) Rules, 2017. • Intangible assets under development ageing schedule and completion schedule. • Disclosure with respect to non-compliance of the Companies (Restriction on Number of Layers) Rules, 2017. • Disclosure with respect to effect of such Scheme of Arrangements accounted for in the books of account of the Company "in accordance with the Scheme" and "in accordance with accounting standards" and deviation in this regard shall be explained.

MCA broadens scope of reporting by Auditors in Audit report

Key amendments

- New reporting regarding advances, loans and Investments other than those disclosed in notes to the accounts and receiving of funds for further lending or investing other than those disclosed in notes to the accounts (camouflaged loans or investments).

  - Camouflaged lending or investment, where outbound or inbound loans, advances and investments are intended to be routed through a conduit entity, masking the identity of the ultimate beneficiary. The issue under consideration is "camouflaged investments".

  - The term camouflage investments, means those transactions which are undertaken by a company for some identified beneficiary. However, the transaction does not take place between the company and the ultimate beneficiary directly, but is masked by the inclusion of an intermediary acting as a conduit entity (an entity acting on the instructions of the company for channelising the funds to any other entity identified by the company).

  - These transactions mask the identity of the real beneficiary. In a world where financial transactions are regularly used for carrying illicit transactions, money laundering transactions or other suspicious activities, it is important that the trail of financial transactions is transparent. Hence, there is a concern whether the identification of the end beneficiary is consciously being masked. The proposed amendments are a means to address this issue.

    - The MCA, vide the amendment Notification, is aiming to unveil the ultimate beneficiary behind the camouflage financing. Though investment through "conduit entities" is not barred by law, the same needs to be adequately disclosed in the notes to the accounts of the company. Therefore, MCA, vide its amendment Notification, requires the management of the company to give a representation that, except as otherwise disclosed in the notes to the accounts, the Company has neither employed, nor is itself acting as a "conduit entity" for any financial transaction.

    - The Company needs to provide specific representations in respect of the above to the auditor and the auditor needs to report whether representations made contain any material misstatement.

- Dividend declared or paid is in compliance with Section 123 of the Companies Act, 2013.

- Comment on use of accounting software having audit trail. (Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.)

SEBI issues clarification on valuation of bonds issued under Basel III framework

The SEBI Circular sought to regulate investments by Mutual Funds (MFs) in additional tier 1 (AT1) and additional tier 2 (AT2) bonds issued by banks under the Basel 3 framework. This was aimed at reducing the risks faced by MFs and the retail investors in them if any of the banks fail to meet their debt repayment obligation. The regulator has asked MFs to cap their investments in such bonds. According to the limits placed, one MF cannot invest more than 10 per cent of its funds on such instruments issued by a single issuer. In addition, one MF scheme cannot hold more than 10 per cent of its net asset value in such risky instruments. The exposure of one MF scheme to issuances by one financial institution is capped at 5 per cent.

Issued by banks, AT1 bonds are perpetual bonds, i.e., they do not have a maturity date. These are quasi equity instruments that regularly pay yields to the investors. Often these bonds are mis-sold to retail investors with bank representatives promising high returns without explaining the risks to the investors. There are many risks attached to this high yield instrument. Since there is no maturity date, it is entirely up to the bank whether to redeem these bonds or not after a few years. Banks, if they choose to do so, can continue to pay interest on these bonds without redeeming them. Typically, call options are built into the contract to allow banks to redeem these bonds if they wish to do so.

In addition, the fine print of these AT1 issuances allow the banks to skip paying interest to investors or even write down the value of these bonds in case its capital adequacy falls below some prescribed levels. The Reserve Bank of India (RBI) can also ask banks to completely write down these issuances, which means that entire investments in these bonds can be wiped off if the bank is not doing well.

The risks associated with AT1 bonds came to the fore when investors of Yes Bank's AT1 bonds saw their entire investment in these bonds being wiped off. This followed the RBI's decision to write down the entire value of AT1 bonds as part of the rescue package designed for Yes Bank.

The Department of Financial Services noted that the SEBI order on valuation norms can cause volatility in NAVs of debt funds which could cause disruption in the debt markets as MFs sell such bonds in anticipation of redemptions. The new rule could affect capital raising by PSU banks. The finance ministry asked SEBI to withdraw its directive to MF houses to treat additional tier-I (AT-1) bonds as having a maturity of 100 years as it could disrupt the market and impact capital-raising by banks.

Based on the above intervention of Department of Financial Services and finance ministry and representation of the MF Industry to consider a glide path for implementation of the policy and request of other stakeholders, it has been decided vide Circular No. SEBI/HO/IMD/DF4/CIR/P/2021/034 dated March 22, 2021, that the deemed residual maturity for the purpose of valuation of existing as well as new bonds issued under Basel III framework shall be as below.

Key amendments

Time period	**Deemed Residual Maturity of Basel III AT-1 bonds (Years)**	**Deemed Residual Maturity of Basel III Tier-2 bonds (Years)**
Till March 31, 2022	10	10 years or Contractual Maturity whichever is earlier
April 1, 2022 – September 30, 2022	20	Contractual Maturity
October 1, 2022 – March 31, 2023	30	Contractual Maturity
April 1, 2023 onwards	100**	Contractual Maturity

** From the date of issuance of the bond

It has been decided to revise the deemed residual maturity period for Basel III AT-1 and Tier 2 bonds. However, the duration for bonds issued under Basel III framework shall be calculated based on the deemed residual maturity in the above table.

Further, if the issuer does not exercise call option for any ISIN then the valuation and calculation of the Macaulay Duration* shall be done considering maturity of 100 years from the date of issuance for AT-1 Bonds and Contractual Maturity for Tier 2 bonds, for all ISINs of the issuer. In addition to the above, if the non-exercise of call option is due to the financial stress of the issuer or if there is any adverse news, the same shall be reflected in the valuation.

*The Macaulay duration is the weighted average term to maturity of the cash flows from a bond. The weight of each cash flow is determined by dividing the present value of the cash flow by the price. Macaulay duration is frequently used by portfolio managers who use an immunisation strategy.

Association of Mutual Funds in India (AMFI) is advised to issue detailed guidelines with respect to valuation of bonds issued under Basel III framework, which shall be implemented by April 1, 2021.

AT-1 bonds are considered perpetual in nature, similar to equity shares as per the Basel III guidelines. They form part of the tier I capital of banks. SEBI has recently issued regulations that put a limit of 10 per cent for cumulative investments by MFs in Tier I and Tier II bonds.

Restrictions on MFs' exposure to debt instruments with special features will restrict a MF under all its schemes as the MFs will not be permitted to own more than 10 per cent of such instruments issued by a single issuer. Presently, there are no specified investment limits for such instruments. **Maturity of all perpetual bonds would be treated as 100 years from the date of issuance for the purpose of valuation.

It could lead to panic redemption by MFs, impacting overall corporate bond market as fund houses would resort to selling other bonds to raise liquidity in debt schemes. With new limits, the incremental ability of MFs to buy bank bonds would be constrained and this would result in increase in coupon rates. This could lead to higher borrowing cost for corporates at a time when the economic recovery is still nascent. Capital raising by PSU banks from the market will be adversely impacted due to limited appetite from other investors. This could lead to increased reliance on the government for capital raising as AT1 and Tier II bonds would need to be replaced by core capital.

IBOR

Key Challenges

- NBFCs cannot remain detached from this transition as it is equally important for them to inventorise their LIBOR linked borrowings and derivative exposures and develop a proactive roadmap to assess the impact on their financial statements, bottom line and their ability to raise overseas borrowings at a competitive rate.

- This is an opportunity for NBFCs to develop LIBOR transition plans and proactively communicate with regulators, investors, lenders, customers and other counterparties.

- This will invariably enable NBFCs to proactively engage with their corporate clients who will also be impacted by LIBOR migration on account of their sizeable overseas borrowings and derivative exposures.

- NBFCs with exposures to interest rate derivatives and foreign currency borrowings linked to LIBOR need to be mindful of transition to Alternative Reference Rates (ARR), also known as Risk Free Rates (RFR).

- There is an estimated overseas foreign currency borrowing of $ 13 billion and notional derivative exposure covering forward rate agreements, interest rate swaps and cross currency swaps to the tune of $ 18 billion across the top 10 NBFCs.

- It is imperative for NBFCs to understand what it means to link their forex borrowings and derivative transactions to Secured Overnight Financing Rate (SOFR), Sterling Overnight Index Average (SONIA), or other comparable RFR benchmark interest rates. The Sterling Overnight Index Average, abbreviated SONIA, is the effective overnight interest rate paid by banks for unsecured transactions in the British sterling market. It is used for overnight funding for trades that occur in off-hours and represents the depth of overnight business in the marketplace.

- Incidentally, the Mumbai Interbank Forward Offer Rate (MIFOR), widely used by banks in India for setting prices on forward rate agreements and derivatives, has USD LIBOR as its core component.

- This may now be linked with SOFR, the ARR used for US dollar denominated derivatives and loans.

- NBFCs may need to examine their legacy contracts linked to LIBOR and understand hedging and other implications on new contracts that may be linked with SOFR or any other comparable benchmark rates.

- An early impact assessment will help NBFCs understand the problem statement and respond ahead of time, if it means repapering the contracts or aligning its wider treasury and hedging objectives on foreign currency loans hedged with derivatives.