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Assurance EYe

Reporting Insights

April 2025



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1

Ind AS 117: Overview of key implications on accounting for guarantee contracts

The application of Ind AS 117, *Insurance Contracts*, notified by the Ministry of Corporate Affairs (MCA) on 12 August 2024 has been deferred for parent, investor or venturer entity having investment in insurers/ insurance companies and they may continue using insurance company's group reporting package prepared as per Ind AS 104 to prepare their own Ind AS consolidated financial statements. However, other non-insurance companies, while preparing their Ind AS financial statements for the year ended 31 March 2025, need to apply Ind AS 117 to contracts meeting definition of the term 'Insurance Contract' as per the standard and covered under its scope. The [October 2024 edition of Assurance EYe](#) explains the definition of the term 'insurance contract' in detail and various types of contracts entered into by non-insurance companies which may potentially get covered under Ind AS 117. In this article, we provide a broad overview of accounting for insurance contracts and its potential implications on accounting for financial guarantee and performance guarantee contracts, which are likely to be substantially impacted by the issuance of Ind AS 117 and other related developments.

How we see it

- Ind AS 117 deals with accounting for 'insurance contracts,' irrespective of whether issued by insurance or non-insurance companies.
- Ind AS 117 contains relatively wide definition of the term 'insurance contract.' In practice, many contracts issued by non-insurance companies can also meet the definition.
- Unlike Ind AS 104, Ind AS 117 does not provide an option to apply Ind AS 37. Thus, although definition of the term 'insurance contract' in Ind AS 117 is similar to that in Ind AS 104, the accounting consequences of contracts meeting the definition will undergo a change.
- The application of Ind AS 117 to non-insurance companies has not been deferred. They need to apply it while preparing financial statements for the year ended 31 March 2025.

Accounting for insurance contracts

While the definition of the term 'insurance contract' under Ind AS 117 is similar to that under Ind AS 104, the accounting applicable to 'insurance contracts' covered under Ind AS 117 is significantly different. Under Ind AS 104, entities were allowed to 'grandfather' their existing accounting practices and continue the same, subject to certain criteria being met. This effectively meant that there was a diversity in practice, and many non-insurance entities were applying Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*, to insurance contracts. However, this is no longer possible since Ind AS 117 contains specific accounting requirements for contracts covered under its scope.

Accounting for insurance contracts under Ind AS 117 is complex and, in many cases, there may be a need to involve an actuary to measure obligation under the insurance contract. Ind AS 117 prescribes three approaches for measurement of Insurance Contracts -

- (i) General Model,
- (ii) Premium Allocation Approach, and
- (iii) Variable Fee Approach (applied to insurance contracts with direct participation features).

Given below are the salient features of measurement applied in the General Model:

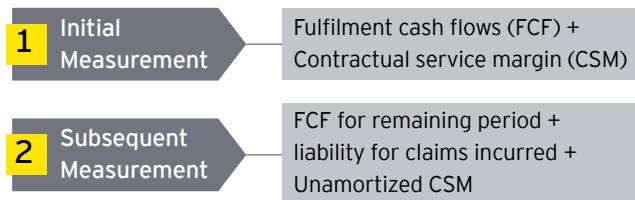
- Estimates and assumptions of the future cash flows consider both inflows and outflows and should reflect the most recent estimates,
- Measurement reflects the time value of money,
- To the extent possible, estimates make maximum use of the observable inputs which are consistent with the market information,
- There is a current and explicit measurement of risk,
- Expected profit is deferred and aggregated in groups of insurance contracts at initial recognition, and
- Expected profit is recognized over the coverage period after adjustments arising from changes in the cash flows assumptions.

On initial recognition, an entity measures a group of insurance contracts at the total amount comprising fulfilment cash flows (FCF) and the contractual service margin (CSM). FCF comprises (a) the estimate of future cash flows, and (b) adjustments to reflect (i) time value of money, (ii) financial risks associated with the future cash flows, and (iii) a risk adjustment for non-financial risk.

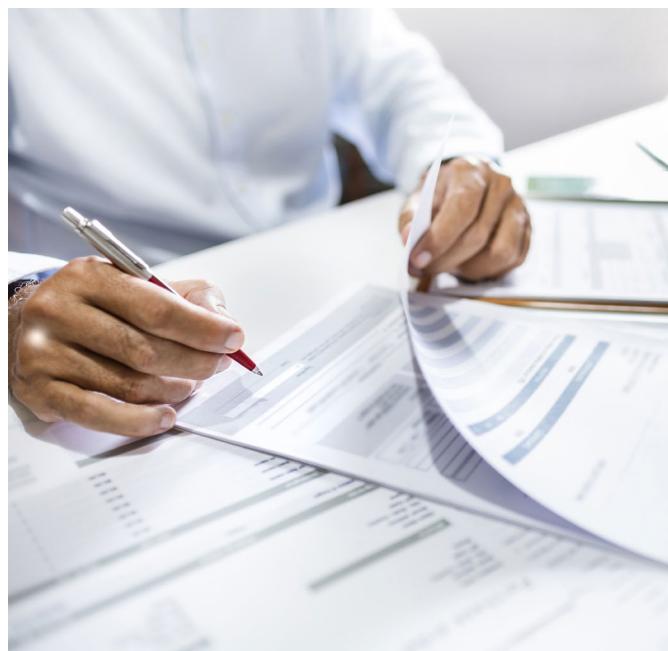
The CSM represents unearned profit to be recognized in future as the entity will render insurance services. This is measured on initial recognition of a group of insurance contracts at an amount that results in recognition of no income or expenses on day one. The CSM cannot be negative, as this would indicate the contract is onerous and any loss need to be recognized immediately.

At the end of each subsequent reporting period, the carrying amount of a group of insurance contracts is remeasured to be the sum of the liability for remaining coverage plus the liability for incurred claims, both determined as at that date. The liability for remaining coverage comprises FCF relating to future services, plus a measure of the CSM, which is yet to be earned. The liability to handle and pay already incurred claims arises from past coverage service. It includes also a liability for claims incurred but not yet reported.

Measurement of insurance contracts - How we see it



A simple example explaining accounting as per Ind AS 117 is given later in this article.



Financial guarantee contracts (FG contracts)

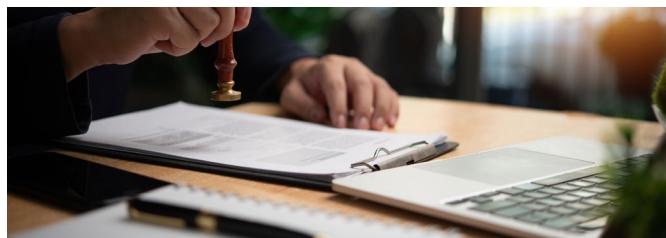
Financial guarantees can take various legal forms, such as guarantees related to financing arrangements, letters of credit, and credit default contracts. In accordance with Ind AS 109 *Financial Instruments*, FG contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. FG contracts also meet the definition of an insurance contract under Ind AS 117. They are, however, generally outside the scope of Ind AS 117 and need to be accounted for in accordance with Ind AS 109. However, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used the accounting guidance applicable to insurance contracts, then only the issuer has an option whereby it can choose to apply accounting as per either Ind AS 109 or Ind AS 117 to such contracts. In such cases, the election is available on a contract-by-contract basis but is irrevocable. We believe that considering the wordings used, an entity that has previously applied Ind AS 104 to FG contracts can choose to apply either Ind AS 109 or Ind AS 117 to such contracts going forward; however, vice versa change is not possible.

Based on past accounting, given below are various possibilities with regard to accounting for FG contracts:

Accounting prior to Ind AS 117	Accounting post Ind AS 117
FG contracts previously accounted for under Ind AS 109	Continue to apply Ind AS 109 accounting (No change)
FG contracts previously accounted for as insurance contracts	Choose to apply Ind AS 109 or Ind AS 117 on contract-by-contract basis
Not issued FG contracts in past	Ind AS 109 accounting is required.

It may be noted that with the issuance of Ind AS 117, there is no change in financial guarantee accounting prescribed under Ind AS 109. Hence, entities, that were accounting for FG contracts under Ind AS 109, will continue to apply the same accounting going forward also. However, considering the change as explained below with regard to meaning of debt instrument, they may need to evaluate higher number of contracts for applying FG contract accounting. Also, the amount and timing of applying FG contract accounting may change.

An example explaining accounting for FG contracts as per Ind AS 109 and Ind AS 117 is given later in this article. It may be noted that Ind AS 117 does not change/ impact accounting by the holder of financial guarantees, as it is only applicable to insurer and not to the holder of insurance.



Meaning of 'debt instrument' - Current vs. future debt

The term 'debt instrument' is used in definition of the term FG contract; however, it is not defined in financial instrument or insurance contract standards. Till recently, there was an understanding that an FG contract requires an existing debt for a guarantee contract to be accounted for as FG contract. The IFRS Interpretations Committee (IFRS IC) received a request in 2024 about how an entity accounts for guarantees that it issues. The IFRS IC did not issue any formal interpretations or clarification on this matter. However, considering IFRS IC discussions and other related developments, it has become clearer that IFRS 9 (and, consequently, Ind AS 109) does not explicitly require the debt instrument to exist when the guarantee is issued. If the guarantee covers losses incurred due to failure to make specified payments by a specified debtor for amounts that are due and payable at the point of the guarantee being called, the guarantee is over a debt instrument. As such, these types of guarantees would be financial guarantees if all other criteria for financial guarantees are met. In other words, guarantees over future debt are also covered under definition of financial guarantee.

How we see it

A guarantee over a future debt instrument, such as an undrawn loan commitment, will still qualify as a financial guarantee contract under Ind AS 109. This is despite the fact that the debt instrument does not exist at the time the guarantee is issued. This will require entities to evaluate higher number of contracts for applying FG contract accounting. Also, the amount and timing of applying FG contract accounting may change.

Example 1 - Guarantee provided by a parent to a subsidiary's banks

A group consists of H Co. (the parent) and S Co. (its wholly owned subsidiary). H Co. has a stronger credit rating than S Co., and S Co. is entering into a loan agreement which will allow S Co. to borrow INR10 billion from a bank over a period of next two years. The loan is repayable in bullet payments after 10 years from the date of sanction. S Co. plans to utilize INR2 billion loan upfront and balance in instalments over the next two years. The bank will charge interest at the rate of 8% per annum to S Co. However, it is willing to reduce the rate to 7.5% p.a. if H Co. guarantees S Co.'s debt. H Co. provides guarantee against full INR10 billion loan of S Co. As per the guarantee arrangement, H Co. will make payments to reimburse the bank for any loss it incurs if S Co. fails to make a payment when due in accordance with the terms of loan arrangement.

In H Co.'s separate financial statements, the guarantee for the entire INR10 billion loan is treated as financial guarantee from day 1 irrespective of the fact that S Co. has utilized only a portion of the loan amount or even if the entire loan amount is unutilized on day 1. Even before the loan is disbursed, the guarantee over an undrawn loan commitment will be treated as a financial guarantee contract and accounted for accordingly. As explained above, H Co. will generally account for such FG contract as per Ind AS 109. However, it will have an option of choosing to apply Ind AS 117 accounting instead of Ind AS 109, only if H Co. has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts.

Financial guarantee/ insurance contracts issued by a parent

A parent company may issue a financial guarantee or other insurance contract that needs to be accounted for under Ind AS 117 or the parent company elects to account for under Ind AS 117 (after meeting prescribed criteria). In most cases, the parent enters into such contracts without receiving any consideration or may receive consideration which is lower than fair value. Since the arrangement provides benefit to the subsidiary, the contract is considered to be in-substance capital contribution/ additional investment in subsidiary. The parent can choose to measure capital contribution using one of below approaches:

Approach 1: Measure the contract at the fair value. This approach reflects fair value of additional benefit provided to the subsidiary and initial measurement aligns with how a

financial guarantee is initially measured under Ind AS 109.

Approach 2: Measure the contract at the fulfilment cash flows (excluding any margin). This approach reflects liability taken on initial recognition by the entity and CSM (which is residual number) is considered zero. When measuring fulfilment cash flows, the parent should include risk adjustment.¹

Under both the approaches, subsequent changes in obligation are recognized in the Statement of Profit and Loss, as per Ind AS 117.

The following example explains accounting for FG contract under Ind AS 109 and two approaches of Ind AS 117.

Example

- Parent P issues financial guarantee to bank against loan taken by its various subsidiaries.
- Fair value of financial guarantee on the date of issuance (1 April 2022): INR600 million.
- Loan term is three years with amount repayable in bullet payment.
- Guarantee term is also three years, i.e., from 1 April 2022 till 31 March 2025.
- P will reimburse bank for default in repayment of loan during FY 2023-2025.
- Expected defaults: INR450 million in third year. It is assumed that the same amount reflects FCF.
- Effects of discounting, risk adjustment and administration expenses are ignored.
- Actual defaults are in line with the expected defaults on day 1, i.e., there is no change in estimates.
- It is assumed that in its separate financial statements, parent measures investment in subsidiaries at cost, less impairment.
- Tax and related aspects are ignored.

Response

Accounting as per Ind AS 117 (assuming criteria for Ind AS 117 application are met and the parent has elected to use such option)

Approach 1: Fair value accounting

On the date of issuing guarantee, parent will recognize fair value (FV) of guarantee as an obligation and an additional investment in subsidiary. The investment will continue to be reflected as such unless there is an impairment.

1. It may be noted that Approach 2 may be applied only if contract is accounted for under Ind AS 117. Under Approach 1 (where measurement is aligned with financial guarantee accounting under Ind AS 109), fair value accounting is mandatory.

The obligation results in FCF of INR450 million and CSM of INR 150 million. CSM will be recognized as income/ revenue over the three years period as insurance services are rendered. The FCF will be recognized as revenue when related obligation arises, i.e., in the third year.

Extracts from the balance sheet for the year ended:

Assets	March 2023	March 2024	March 2025
Investment in subsidiary (INR million)	600	600	600

Extracts from the Statement of Profit and Loss for the year ended (in INR million):

Particulars	March 2023	March 2024	March 2025
Revenue:			
Insurance revenue	50	50	500
Expenses:			
Insurance service expenses	0	0	450
Profit for the year (before tax)	50	50	50

Approach 2: FCF value accounting

On the date of issuing guarantee, parent will recognize estimated FCF amount as an obligation and an additional investment in subsidiary. The investment will continue to be reflected as such unless there is an impairment.

The obligation results in FCF of INR 450 and CSM of INR nil. CSM will be recognized as income/ revenue over the three years period as insurance services are rendered. The FCF will be recognized as revenue when related obligation arises, i.e., in the third year.

Extracts from the balance sheet for the year ended (in INR million):

Assets	March 2023	March 2024	March 2025
Investment in subsidiary	450	450	450



Extracts from the Statement of Profit and Loss for the year ended (in INR million):

Particulars	March 2023	March 2024	March 2025
Revenue:			
Insurance Revenue	0	0	450
Expenses:			
Insurance service expenses	0	0	450
Profit for the year (before tax)	0	0	0

Financial Guarantee contracts: Accounting under Ind AS 109

On the date of issuing guarantee, the parent will recognize FV of guarantee as an obligation and an additional investment in subsidiary. The investment will continue to be reflected as such unless there is an impairment.

The FG obligation is recognized as revenue over the guarantee period. After initial recognition, the parent also continues to recognize FG obligation measured as per Ind AS 109 at the higher of (i) the amount of the loss allowance determined in accordance with Expected Credit Loss (ECL) requirements of Ind AS 109, and (ii) the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principles of Ind AS 115 *Revenue from Contracts with Customers*. Any change in obligation amount is recognized as expense. See table below for computation of obligation amount.

Extracts from the balance sheet for the year ended (in INR million):

Assets	March 2023	March 2024	March 2025
Investment in subsidiary	600	600	600

Extracts from the Statement of Profit and Loss for the year ended (in INR million):

Particulars	March 2023	March 2024	March 2025
Revenue:			
FG revenue	200	200	200
Expenses:			
Impairment loss allowance	50	200	200
Profit for the year (before tax)	150	0	0

Subsequent measurement of financial guarantee obligation as per Ind AS 109

Year ended (amount in INR million)	March 2023	March 2024	March 2025
Representing the higher of:	450	450	450
Amount initially recognized less cumulative amount of income recognized under Ind AS 115	400	200	0
Loss allowance	450	450	450

Performance Guarantee contracts

Performance guarantees (PG) come in many forms and can arise because of the legal form of an arrangement or economic substance. Pre-Ind AS 117, PG contracts not meeting the definition of FG contract and not covered under any other Ind AS were generally accounted for under Ind AS 37, which typically resulted in contingent liability disclosure (unless outflow of economic resources was probable or remote). However, pursuant to Ind AS 117 becoming applicable, such PG contracts may be treated as an insurance contract.

Depending on specific facts and circumstances, different Ind AS may apply to accounting for such guarantee contracts from the issuer perspective:

- Performance guarantees issued in connection with the sale of goods whereby the seller of goods issues the guarantee are accounted for by the issuer under Ind AS 115.
- Accounting for performance guarantee contracts not accounted for under Ind AS 115 will depend on whether they transfer significant insurance risk.
- If PG contracts meet definition of both the term 'insurance contract' and the term 'FG contract', then such contracts will generally be accounted for applying Ind AS 109 accounting. However, if the entity meets criteria as stated above for Ind AS 117 application and it elects to apply Ind AS 117, the entity will apply Ind AS 117 accounting.
- If contracts transfer significant insurance risk and thereby meeting definition of the term 'insurance contract', but they do not meet definition of the FG contract, such PG contracts are accounted for as an insurance contract applying Ind AS 117.
- If contracts do not transfer significant insurance risk, they are generally accounted for as a financial instrument applying Ind AS 109.

The following example explains accounting for various PG contracts.

Example 2: Performance guarantee contracts: Scenarios and considerations

ABC Limited enters into a contract with XYZ to construct a building, and its parent (P) agrees to compensate XYZ if ABC fails to perform, i.e., complete construction within the prescribed period. The key issue is whether P should account for PG contract under Ind AS 117 or Ind AS 109 in its separate financial statements (SFS).

Scenario 1

- If ABC fails to complete the construction within three years, P will complete construction in next 6 months and compensate XYZ for losses incurred.
- P has no right to recover losses from ABC.

In this scenario, P will account for PG as an insurance contract under Ind AS 117 for the following reasons:

- P will compensate XYZ (customer) through completion of construction and for losses incurred, if ABC fails to meet delivery timelines.
- The insurance risk is significant for P, as failure to meet delivery times would trigger a payout.
- The contract is not a financial guarantee, as P does not reimburse XYZ for non-payment on a debt instrument.
- In P's consolidated financial statements (CFS), payments under the guarantee are likely to be treated as penalty or liquidated damages covered under Ind AS 115.

Scenario 2

- If ABC fails to complete the construction on time, XYZ can claim a fixed penalty from ABC under their sales contract.
- XYZ can claim the penalty from P only if ABC fails to pay XYZ.
- P has the right to recover the penalty from ABC if it pays XYZ, due to an indemnity agreement.
- If P fails to pay, XYZ can still claim the penalty from ABC.

In this scenario, P must assess whether PG qualifies as **FG contract** or an **insurance contract**:

- **Financial Guarantee Contract:** The penalty amount does not exist as debt in ABC's financial statements on the date of issuance of guarantee, but Ind AS 109 requires guarantees over future debt to be treated as FG contract if the guarantee covers losses due to non-payment at the time the guarantee is called. Hence, it is considered as a financial guarantee.
- **Insurance Contract:** If P compensates XYZ, it can recover the amount from ABC. P must assess if it has accepted significant insurance risk, and if so, the performance guarantee qualifies as an insurance contract.
- In this case, PG contract meets definition both of FG contract as well as insurance contract. Hence, P will account for the arrangement under Ind AS 109 as FG contract. P will have a choice to apply Ind AS 117 (only if it meets criteria for applying insurance contract accounting, refer discussion above).
- In P's CFS, payments under the guarantee are likely to be treated as penalty or liquidated damages covered under Ind AS 115.

Scenario 3

- If ABC fails to complete the construction, XYZ can claim a fixed penalty from ABC.
- P will pay the penalty to XYZ on behalf of ABC and seek repayment from ABC under pre-agreed terms, regardless of ABC's payment failure.
- If P fails to pay, XYZ can still claim the penalty from ABC.

In this case, P accounts for PG contract as a loan commitment under Ind AS 109 for below reasons:

- The contract does not meet definition of FG contract, as P's payment is not dependent on ABC's failure to pay.
- The arrangement does not have insurance risk but has financial risk. In effect, ABC has offered its customer the right to be paid by its parent P instead of itself.
- From ABC's perspective, this is akin to a letter of credit which does not meet the definition of an insurance contract because failure to make payment by a specified debtor is not a precondition for P's payment to XYZ.
- From P's SFS perspective, it has entered into a loan commitment in which P agrees to make an advance to XYZ with repayment from ABC.
- Even under this scenario, in P's CFS, payments under the guarantee are likely to be treated as penalty or liquidated damages covered under Ind AS 115.

How we see it

The accounting treatment of PG contracts can vary significantly based on specific facts and terms of the contract. A slight change in terms of contract, such as indemnity clauses, payment terms, or nature of guarantee, can determine whether the contract falls under Ind AS 109 (FG contracts) or Ind AS 117 (Insurance Contracts), leading to significantly different accounting outcomes. Therefore, it is important for entities to conduct a thorough analysis of the contract terms beforehand to ensure that appropriate accounting treatment is applied.



Final thought

Ind AS 117 is applicable while preparing financial statements of non-insurance companies for the year ended 31 March 2025. Thus, it is imperative that entities having contracts whose accounting is likely to be impacted by Ind AS 117, particularly Financial Guarantee or Performance Guarantee contracts, conduct a detailed analysis of all such contracts to ensure that they reach an appropriate and well-supported conclusion. If it is determined that a guarantee contract falls under the scope of Ind AS 117 or the entity elects to apply Ind AS 117 to FG contract (after meeting prescribed criteria), it is possible that the entity may need to involve a professional with specialized knowledge, such as an actuary, to properly assess the associated risk, obligation, and financial impact. Actuaries will help in estimating future cash flows, determining appropriate discount rates, and assessing the probability of claims, all of which are crucial in correctly applying the principles of Ind AS 117.

2

Upcoming changes to the timing of recognition and derecognition of financial instruments: Are you ready?

While IFRS 9 or Ind AS 109 *Financial Instruments* deals with recognition and derecognition of financial assets and financial liabilities, one may argue that except for regular way purchases or sales of financial assets, the standards as currently drafted do not explicitly specify the date on which financial asset or financial liabilities should be recognized or derecognized.

In September 2021, the IFRS Interpretations Committee (IFRS IC) was asked when a financial asset settled by a cash payment received via an electronic transfer system is derecognized. The discussion was extended to the derecognition of a financial liability settled by a payment made through an electronic transfer system.

The feedback to the IFRS IC identified diversity in practice for the timing of derecognition of financial assets and financial liabilities, not just those settled via an electronic transfer system, but also using other methods. This includes settlement by cheque, debit card and credit card. The IFRS IC noted that the issue is sufficiently material to require a change to IFRS 9 rather than an interpretation of existing IFRS 9 by the IFRS IC, so it was brought into the scope of the IFRS 9 post-implementation review (PIR).

To address the above issue, the International Accounting Standards Board (IASB) issued amendments to IFRS 9, which are effective for annual reporting periods beginning on or after 1 January 2026, with earlier application permitted.

Date of initial recognition or derecognition of financial assets and liabilities: General principles

The amendments clarify that:

- 1. Recognition:** Financial assets and liabilities are recognized when the entity becomes party to the contractual provisions of the instrument. In case of regular way purchases or sales of financial assets, IFRS 9 contained an exception allowing entities to recognize/derecognize the asset using either trade date or settlement date accounting. The said exception continues to apply and is not impacted by these amendments.
- 2. Derecognition:**
 - Financial Assets:** Financial assets are derecognized when contractual rights to cash flows expire or are transferred. The Basis for Conclusions to the Amendments clarify that, in the absence of having access to the cash, a confirmation from a debtor that a payment instruction has been initiated does not lead to the expiry of the right to receive cash. It is only when the cash is received that such a right expires.

■ **Financial Liabilities:** Financial liabilities are derecognized when the obligations specified in the contract are discharged, cancelled or expires, or the liability otherwise qualifies for derecognition, which is the settlement date. However, an entity may be permitted to derecognize financial liabilities settled by an electronic payment system earlier than their settlement date, subject to certain criteria being met (refer below).

The impact of the Amendments is that, when they become effective, entities will be unable to derecognize a financial asset or financial liability, for which a payment has been received or made outside electronic payment systems, until the amount has cleared in the receiving entity's bank account. This includes payments by cheque, debit card or credit card.

Financial Liabilities: Derecognition exception for electronic payments

The Amendments introduce an accounting policy choice to derecognize financial liabilities before the settlement date if certain conditions are met. An entity can derecognize a financial liability (or part of a financial liability) settled using an electronic payment system before the settlement date only if the following conditions (specified conditions) are met:

- The entity has no practical ability to withdraw, stop or cancel the payment instruction,
- The entity has no practical ability to access the cash to be used for settlement as a result of the payment instruction, and
- The settlement risk associated with the electronic payment system is insignificant. For this to be the case, the payment system must have both of the following characteristics:
 - Completion of the instruction follows a standard administrative process, and
 - There is only a short time between the entity: i) ceasing to have the practical ability to withdraw, stop or cancel the instruction and to access the cash, and ii) when the cash is delivered to the counterparty. However, settlement risk would not be insignificant if completion of the payment instruction were subject to the entity's ability to deliver cash on the settlement date.

Entities that make the accounting policy choice to derecognize the financial liability before settlement date must apply this treatment to all financial liabilities settled using the same electronic payment system. This part of the amendment does not apply and there is no accounting policy choice to

derecognize financial liability settled by other means, such as, payments by cheque, debit card or credit card. A similar accounting policy election is not available for financial assets, whether settled through electronic payment system or otherwise.

An entity is permitted to make an accounting policy choice to derecognize a financial liability before the settlement date, if the entity uses an electronic payment system to settle the liability and certain conditions are met.



How we see it

Many entities receive payment for sale of goods or services through credit or debit cards which are typically not settled as cash until a later date. The entities must carefully consider classification of amounts received in their financial statements. It is expected that the judgment will be required to determine if these amounts qualify as **trade receivables, cash and cash equivalents, or other financial asset**. The amount can be classified as trade receivable only if the entity has a contractual right to receive cash flows from its customer. Similarly, the amount can be classified as cash equivalent if it meets the definition under Ind AS 7 *Statement of Cash Flows*, i.e., it meets the criteria of being highly liquid, readily convertible to cash, and subject to insignificant risk of change in value. If these criteria are not met, the amount should be classified as other financial asset.

We believe that the above criteria will require entities to evaluate each payment arrangement with each counter party individually, assess associated risks, and make appropriate determination. The entities may also evaluate whether they need to disclose accounting policies and/ or judgement applied.

How we see it

The Amendments clarify the recognition and derecognition requirements for financial assets and financial liabilities. Given that the IASB had to amend IFRS 9 to clarify the requirements in this area, in our view, an entity is not required to change its accounting policy on the timing of recognition or derecognition of a financial asset or financial liability to conform with the Amendments until they are adopted.

In preparation for adopting the Amendments, an entity needs to determine what derecognition date it currently applies to each of its financial assets and financial liabilities, and to what extent this conforms to the Amendments. The assessment should include all settlement methods such as cheques, debit cards and credit cards, as well as electronic transfer systems. This assessment requires a thorough understanding of the various cash settlement mechanisms, including when a receivable or payable is settled via each mechanism and when the cash balance is affected.

The Amendments make it clear that adjustments to an entity's reported cash balance at the reporting date for payments and receipts that are in-transit should not be made. This may be a change for most of the companies, especially for those with a long-established practice of such adjustments.

Position under Ind AS

At the time of writing this article, an [Exposure Draft](#) to a similar amendment to Ind AS 109 has been issued but not yet notified. However, in line with the practices followed in past, we expect that a change in similar lines will be finalized and notified in due course. We also expect that the change under Ind AS to be effective for financial year beginning on or after 1 April 2026.

Way forward

The Amendments provide much-needed clarity on recognition and derecognition of financial assets and financial liabilities and will help addressing divergent practices on the matter.

Entities should evaluate their current practices, payment mechanisms, and legal frameworks to ensure compliance. This will involve operational and legal assessments, especially for electronic payment systems and intercompany balances. Additionally, organizations using traditional payment methods, such as cheques, may face significant changes in their accounting practices.

Key implications

■ **Cheques payments** - Once the amendment becomes effective, entities using cheques or other similar payment system will not be able to derecognize financial assets or liabilities until the cheque has been cleared and amount has been credited to debited from the bank account. This will require change in the long-standing practice of derecognizing financial assets or liabilities based on cheques received or issued, pending clearance.

■ **Evaluation of electronic payment systems** - In today's environment, various electronic payments systems (NEFT, RTGS, IMPS, cards network) are prevalent. To avail derecognition exception for derecognition of financial liabilities, payment system should meet the specified criteria. For example, if the payer can cancel the payment instructions, such payments will not result in the derecognition of the associate financial liability and cash.

This will require entities to analyze contractual and legal requirements for each electronic settlement system in each jurisdiction, which may be complex, especially for entities operating in multiple jurisdictions or using multiple electronic payment systems. Different cut-off times may apply to different types of transactions or payment systems. Since the amendment requires the entity using this exception to apply the accounting policy consistently, an entity electing to apply the exception will need to analyze all transactions and payment systems in more comprehensive manner.

■ **Inter-company balances** - If an entity or group elects to apply the exception, it may lead to inconsistencies in intercompany balances since derecognition exception applies to only financial liabilities and not financial assets. This will require additional adjustments to be made to eliminate intra-group balances in consolidated financial statements.



3

Assurance Updates

National Financial Reporting Authority (NFRA) updates

Auditor - Audit Committee Interaction Series

As part of NFRA's enforcement, review and monitoring activities, the auditor's communication with Those Charged With Governance (TCWG) (including the Audit Committees) has been highlighted in various ways. As part of these activities, NFRA felt there was a need for reinforcing the ways and means of communication between the Statutory Auditors and the Audit Committees, in particular drawing upon the requirements in the Companies Act 2013, the two relevant Standards on Auditing (SA), viz., SA 260 (R), *Communication with Those Charged with Governance* and SA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, with other related SAs and the Standard on Quality Control (SQC).

Realizing the need to improve overall audit quality and promote awareness and to promote public and investor's interest, the NFRA has commenced publishing a series of matters for Auditor - Audit Committee Interactions.² As part of this initiative, till the date of finalization of this publication, the NFRA has published the below Series (hereinafter each part is referred to as the 'series').

- a) Series 1: Audit of Accounting Estimates and Judgements
 - Part 1 - Expected Credit Loss (ECL) - Ind AS 109 *Financial Instruments*
- b) Series 1: Audit of Accounting Estimates And Judgements - Part 2 - Income Taxes - Ind AS 12 *Income Taxes*
- c) Series 2: Audit Strategy and Audit Plan - SA 300 *Planning an Audit of Financial Statements*
- d) Series 3: Audit of Related Parties - Ind AS 24 *Related Party Disclosures*, AS 18 *Related Party Disclosures* & SA 550 *Related Parties*

The series highlights that the preparation and presentation of financial statements (including disclosures) requires the management to make estimates and judgements in the recognition and measurement of assets, liabilities, income and expenses. Such areas could include impairment of non-financial assets, ECL for financial assets, provision for liabilities and recognition of deferred tax assets/ liabilities. Keeping in view requirements of the applicable Ind AS, the series draws attention of the auditors to the potential questions the Audit Committee and/ or the Board of Directors (BoD) may ask them in respect of accounting estimates and judgements.

2. The communication is prepared by NFRA staff for promotion of awareness of auditing and accounting standards and audit quality as part of NFRA's education, training, seminar and advocacy initiatives. It is not a policy/standard/recommendation/statement of Executive Body of NFRA, the Authority of the Government and is not a substitute of obligations of Auditors, management, TCWG including Audit Committee.



Expected Credit Loss (ECL)

The first part in the series 1 relates to audit of accounting estimates and judgements pertaining to Expected Credit Loss (ECL) methodology under Ind AS 109.

Ind AS 109 prescribes recognition and measurement of ECL to all types of financial assets such as loans and advances, investments including less-complex items like trade receivables, lease rental receivables, unbilled revenue (also known as contract assets or work-in-progress), security deposits and bank balances. Also, loan commitments and financial guarantee contracts are subject to these ECL requirements. Related disclosure requirements including overall credit risk related disclosures are addressed by Ind AS 107, *Financial Instruments: Disclosures*. ECL computations under Ind AS 109 are not just based on historical credit loss experience but also take into account time value of money, i.e., credit loss is measured based on present value of future cash flows and future forecast economic conditions. In case of financial institutions such as Non-Banking Finance Companies (NBFCs) in India, ECL being an accounting estimate involving significant expert judgment often requires the use of subject matter experts or professionals. These could be either in-house experts of auditors or management experts used by the entity preparing the financial statements.

This series provides a list of illustrative potential questions which the auditors may expect from the audit committee in relation to the ECL. Some of these are as follows:

- Has the auditor considered the changes and trends thereof, in the opening and closing balances, and reversals and charges to P&L on account of ECL? Are there any unusual movements which need to be highlighted to the Audit Committee?
- Has the auditor verified the appropriateness of ECL recognition and measurement **approach adopted by the management for different classes of financial assets and applied tests to specific to each class?** For example,

whether the application of 'Simplified Approach (Provision Matrix based on Past Due bucket') for trade receivables and lease receivables is acceptable? Are there any trade or lease receivables that contain significant financing component which do not qualify for the simplified approach?

- Has the auditor observed any **unusual features in the loans, advances or receivables** granted by the company which may need to be considered while evaluating the appropriateness of ECL?
- Has the auditor observed any **loans, advances or receivables from the Related Parties** (including promoters or promoters related entities)? If yes:
 - Whether auditor has verified the business rationale of such transactions and other audit procedures?
 - Are there any changes in business terms that had or could have a significant impact on such ECL provisioning?
 - How has the auditor verified the accuracy of those balances? Has the auditor checked the genuineness of the receipt of funds as repayment of these receivables to detect any management bias to falsely report lower balances of loans and receivables, which could result in under recording of ECL?
 - Has the auditor assessed the recoverability of such outstanding balances and the adequacy of ECL (impairment loss) allowance for these balances?
 - Has the auditor considered the appropriateness of the stratification or disaggregation/ aggregation of the data for determining ECL?
 - If recoverability is based on management expert's valuation reports or certificates, has the auditor verified the professional competence, objectivity and independence of that expert, and also the data used by the expert to form his opinion? Has the auditor any such concerns on the management expert (including the one appointed by the audit committee u/s 177 of CA 2013)?
- In case the company has material amount of loans and advances or investments, has the auditor **applied adequate procedures to verify the existence of robust internal control systems including credit risk management system** so that management estimates of ECL and related judgments are based on concepts and reliable data that meets the requirements of Ind AS 109?
- Does the entity's **approach for ECL recognition and measurement meet the fundamental principles of the Ind AS 109** i.e., unbiased probability-weighted outcome, time value of money, supportable information/data based on historical events, current conditions as well as forecast of future economic conditions?

- In case the company follows (or is expected to follow, say NBFC or bank) the '3 Three Stage' classification approach, how did the auditor **test the design and operating effectiveness of control mechanism over recognition and measurement of ECL** allowance for significant class of financial assets viz. customer loans, investments?
- Has the auditor checked whether the entity has adequate subject matter experts such as credit risk experts/ recovery specialists, data and IT systems commensurate with the complexity of the credit risk profile of its financial assets and other items subject to ECL requirements?

In addition, this series also provides a reference to the guidance note published by the Basel Committee on Banking Supervision (BCBS) for external auditors and audit committee of banks in relation to the sophisticated ECL models adopted by the financial institutions. This publication lays down ten expectations of the supervisors from the external auditor of the banks and provides potential questions the audit committee may ask the auditors.

Income Taxes

The part 2 of the series includes aspects pertaining to the audit of Income Taxes , in particular, Deferred Tax Assets (DTA) and Deferred Tax Liabilities (DTL) as required by Ind AS 12. Ind AS 12 prescribes recognition, measurement and related disclosure requirements of Current Taxes, DTA, DTL and Uncertain Tax Treatments (UTTs).

Key considerations for the Audit Committee: This part of the series requires the Audit Committee to be informed regarding the following:

- The methodology used to determine recoverability of DTA, impact of any changes in business operations, tax laws, or economic conditions on the recoverability of DTA and the management's process for reviewing and updating valuation of DTA.
- The measurement of DTL is generally less complex than DTAs. However, the Audit Committee should be informed about the consistency of the methodology used in calculating DTL.
- About the existence and effectiveness of controls over the identification, measurement, and disclosure of DTA, DTL and UTTs.

In addition, it suggests that Audit Committees review the adequacy of disclosures related to DTAs, DTLs and UTTs in the financial statements

Some of the illustrative questions which auditors may expect from the Audit Committee in this regard include:



- Has the auditor properly identified the relevant income tax laws enacted or substantively enacted at the reporting date? What were the criteria adopted for determining 'substantially enacted' laws? Has this been done by members of the engagement team with adequate knowledge and experience in tax laws or have other specialists been involved?
- Have there been any significant changes in tax laws, relevant interpretations,/ decisions or regulations that could impact the valuation of DTA and DTL? How have these changes been considered?
- What was the tax rate adopted for the measurement of current taxes and deferred taxes? Was this rate based on the rate expected at the time of reversal of temporary differences?
- What are the key reconciling items reflected in the effective tax rate reconciliation prepared by the Company ? Has the auditor reviewed these and is the auditor satisfied that these are appropriate and reasonable in context of the applicable tax regulation and computation of current tax provision prepared by the Company ?
- Is the computation of current tax provision prepared by the Company in order?
- Has the auditor evaluated effectiveness of internal controls over computation of current tax and deferred tax? What was the process followed by the company to calculate and measure DTA and DTL?
- Has the auditor noticed any revalued non-depreciable assets carried at fair value? If so, what were the special considerations applied?
- How does the auditor ensure the completeness of identified temporary differences?
- How has the auditor assessed the probability of future taxable profits against which the DTA can be utilized?



- Has the auditor noticed any change in previous estimations regarding the recoverability of DTA? If so, how robust were the underlying assumptions used by the Company?
- If the recoverability of DTA is based on management expert's valuation reports or certificates, has the auditor verified the professional competence, objectivity and independence of that expert as well as the data used by the expert to form his opinion?
- What are the key areas relating to the computation of the current tax provision for which there is uncertainty over whether the relevant taxation authority will accept the tax treatment under tax law?
- If the auditor flagged certain uncertainties regarding Company's basis of Going Concern, how do such uncertainties impact future profitability to recover DTA?
- What are the key areas relating to the computation of the current tax provision for which there is uncertainty over whether the relevant taxation authority will accept the tax treatment under tax law?
- For such uncertain tax treatments, how has the Company determined the probability of the taxation authority accepting the tax treatment? Has the Company involved an expert to assist with the determination of such probability? If yes, was the auditor satisfied with the competence of the expert and also, does the auditor agree with the conclusions drawn by the expert?
- Which method has the Company used to reflect the effect of the uncertain tax treatments - most likely amount method or the expected value method?
- Has the Company made consistent judgements and estimates for both current tax and deferred tax (where applicable)?
- Contingent liabilities and contingent assets may arise due to unresolved disputes with taxation authorities. Has the auditor evaluated the adequacy and appropriateness of disclosure of tax-related contingencies in the light of requirements of Ind AS 37?
- Has the auditor considered the tax disputes shown under "Contingent Liabilities" and determined that the treatment of such matters is consistent with the positions taken in recording DTA and DTL?

Planning an audit of financial statements

In this series, the NFRA has stated that development of an effective Audit Strategy and Audit Plan is the critical starting phase of an audit of financial statements. Its timely preparation, communication with TCWG/ Audit Committee and its appropriate revisions during the course of audit will have several advantages leading to effective and efficient audit of financial statements. Audit Strategy is intended to set the overall scope, timing and direction of the audit to guide the preparation of detailed audit plan including completion of the auditor's risk assessment procedures and design of audit procedures responsive to assessed risks.

Some of the illustrative questions which auditors may expect from the Audit Committee in this regard include:

- What is the Auditor's Plan for communication with Audit Committee/ TCWG such as its timing, frequency, mode and contents of the communication?
- In case of Group Auditor (or Principal Auditor):
 - Has the Auditor identified and determined coverage of the components and locations? Has the Auditor understood his/ her role and responsibility and that of component auditor (other auditor), if any, and communicated the same to the component auditor(s)?
 - Has the Principal Auditor advised the other auditor of the use that is to be made of the other auditor's work and report and has made sufficient arrangements for co-ordination of their efforts at the planning stage of the audit?
- In case of initial audit engagement, how is the Auditor planning to obtain sufficient appropriate audit evidence for opening balances? Has the Auditor reviewed the work papers of predecessor Auditor?
- Has the Auditor performed preliminary evaluation of the nature and extent of resources including experts required? Are there areas requiring specialized skill or knowledge needed in any audit area? Which are those areas where the Auditor intends to employ experts such Valuation Professionals, Credit Risk Experts, Forensic Accountants and Information Technology Specialists?
- What are the areas where the Auditor intends to use information technology tools (computer-assisted audit techniques)?
- Is there a plan to use analytics? How will you satisfy yourself that the databases used are reliable? Will the exercise cover all transactions throughout the accounting period?



- Has the Auditor determined whether the entity uses any service organization and whether he/she has planned procedures to obtain assurance over design and/or operating effectiveness of internal controls at the user entity including those that are applied to the transactions processed by the service organization? Does the Auditor's plan include obtaining Type 1 or Type 2 report in case the entity uses a service organization?
- Has the Auditor evaluated the information technology systems and processes? Are there any material or significant risks there?
- What are the Auditor's preliminary views about areas requiring significant attention of the Auditor and potential key audit matters?
- Is there any proposed accounting, auditing or reporting rule that could materially affect the Company's financial statements?
- Are there any unresolved questions from the prior year's audit? Based on previous years' experience, are there accounting policies and methods that can be improved, even in non-material areas?
- What support would the auditor require from the Audit Committee to enable the auditor to discharge his role and responsibilities efficiently and effectively?

Related Party Disclosures and Related Parties

The Auditor-Audit Committee Interactions Series 3 focuses on challenges associated with related party relationships, transactions and disclosures. It states that related party relationships and transactions have been a source of major frauds in the corporate history and some of the modus operandi continues to be seen in recent corporate frauds as well. Further, in some cases, transactions with unrelated parties have the purpose and effect of benefiting related parties.

It is further stated that disclosures of related party relationship and disclosure in the financial statements requires management to *inter alia* (a) identify related party relationships and transactions, (b) identify outstanding balances, including commitments, between an entity and its related parties, (c) identify the circumstances in which disclosure of the items in (a) and (b) is required, and (d) determine the disclosures to be made about those items. Some of these could be challenging, requiring special attention by the Preparers, Audit Committee and the Auditors.

The series provides an overview of requirements under the Companies Act 2013 (as amended), the SEBI LODR, Ind AS 24 and SA 550, related to related party definitions, related party transactions (RPTs), approvals required, disclosures in the financial statements and audit procedures to be performed.

Some of the illustrative questions³ which auditors may expect from the Audit Committee in this regard include:

Illustrative questions related to identification and completeness

- Whether management's understanding of the meaning of related parties is consistent with the definitions given in CA 2013, Ind AS 24, SA 550 and the SEBI LODR?
- Has the auditor inquired the management about: (a) The identity of the entity's related parties, including changes from the prior period, (b) The nature of the relationships between the entity and these related parties, and (c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions?
- Which risk assessment procedures did the auditor perform to understand the management controls established to: (a) Identify, account for, and disclose related party relationships and transactions, (b) Authorize and approve significant transactions and arrangements with related parties, and (c) Authorize and approve significant transactions and arrangements outside the normal course of business?

3. This edition of the Assurance Eye lists only certain illustrative questions which auditors may expect from the Audit Committee on matters covered in each series. Please refer to the Series published by the NFRA for complete list of questions.

- Which audit procedures were performed to identify related party relationships and transactions? Did the auditor consider legal structure of the entire group? Did the auditor consider investment of holding company/ultimate holding company/ subsidiaries/ associates/joint ventures, and other entities of the promoter group?
- How did the auditor determine whether an entity or an individual has control over the company, or vice versa? Has the management reviewed all shareholders' agreements and relevant contracts to identify entities that it has control on and those that control the entity?
- Has the management obtained confirmations from the promoters at the beginning of each financial year to identify their related entities?
- Have the promoters notified to companies whenever there is a change in interest in the related parties? Do the promoters' declarations include direct and indirect holdings (indirect holdings include holdings through layers of subsidiaries) of the promoters?
- Did the management establish procedures to independently validate the information declared by directors or promoters? Did the management establish a procedure to determine and monitor shareholding of investors with a prescribed shareholding?
- Has the management identified individuals or entities that would be classified as 'connected parties' for the purpose of identifying transactions the purpose and effect of which is to benefit a related party (indirect transaction)? Has the list of connected parties been updated on a regular basis and included in the 'related parties' (digital) database maintained by the company?
- Does the company maintain the database of related parties on a technology enabled platform and integrated with other databases of the company? (For example, the vendor master, customer master, etc.)
- Whether the finance, legal and secretarial team perform a post-facto compliance of all transactions entered into during the year? Has the management taken steps to rectify the errors that were identified while performing the post-facto compliance check?
- Has the company obtained periodic confirmations from the directors, promoter group, large shareholders and other related parties that there are no transactions that have been undertaken indirectly with the listed company or its subsidiaries or its related parties?
- Has the management established procedure to identify indirect transactions (transactions where the purpose and effect of which is to benefit related parties)?



- While entering into schemes of arrangement (such as mergers, acquisitions, strategic investments, strategic partnerships, etc.) have the investor and investee companies exchanged a list of their related parties and identified RPTs?
- Did the auditor identify related party relationships and/or transactions which the management had not identified? If yes: (a) Did the auditor inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions? (b) Whether the auditor requested the management to identify all transactions with the newly identified related parties for the auditor's further evaluation? (c) How did the auditor evaluate the risk of material misstatements due to fraud in respect of newly detected related parties/transactions?

Illustrative questions related to evaluation

- How did the auditor determine significant risk in related party relationships and transactions? Did the auditor identify fraud risk factors in connection with related parties? If yes, details thereof along with audit procedures performed to mitigate such risks?
- How did the auditor evaluate business rationale of significant RPTs?
- Did the auditor identify significant RPTs outside the normal course of business? If yes: (a) Whether the business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets? How did the auditor evaluate this matter? (b) Whether the terms of the transactions are consistent with management's explanations? (c) Whether the transactions have been appropriately authorized and approved? (d) Whether the transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework?
- How did the auditor evaluate that an RPT was conducted on terms equivalent to those prevailing in an arm's length transaction?
- How did the auditor obtain assurance that related party disclosure is complete and compliant with the CA 2013, SEBI Regulations 2015 and Ind AS 24?

Illustrative questions related to approvals

- Did the management have any technology enabled database relevant systems, so as to generate an alert for Audit Committee's approvals for all RPTs and shareholders' approvals when the transaction with a related party crosses a particular threshold?
- How did the auditor verify that all companies which are a part of the listed holding company's group, including foreign subsidiaries, comply with the RPT rules as prescribed in the SEBI Regulations 2015 and CA 2013?
- Has the management put in place appropriate controls, such that a particular defined department (say the legal/ secretarial/finance department) monitors changes in contracts, and evaluates: whether the change is a material modification (as defined by the Audit Committee) of an existing contract; and whether appropriate approvals of the Audit Committee and/ or the shareholders have been obtained for a material modification of a contract?
- Did the management engage any internal or external agency to evaluate the entire gamut of related parties like identification, transactions, approvals, disclosures and compliance with laws and regulations? If yes, did the auditor review the report of such an agency?
- Have you evaluated any significant variation between the value of proposed RPT approved by the Audit Committee and the actual value of RPT executed?



How we see it

Through the series, the NFRA has not prescribed any new requirement or amended any of the existing requirements. Rather, it has highlighted the requirements of the relevant existing accounting and auditing standards and need for higher professional skepticism and robust evaluation by various stakeholders involved in the financial reporting chain.

The management including Those Charged With Governance (TCWG) are responsible for the preparation and presentation of financial statements that give a true and fair view of the financial position, financial performance and cash flows of the company in accordance with Ind AS. Such responsibility, among other matters, includes selection and application of appropriate accounting policies, making judgments and estimates which are reasonable and prudent; and the design, implementation and maintenance of adequate internal financial controls. Hence, the management including TCWG will have first responsibility for ensuring due compliance with the applicable requirements, including establishing internal financial controls to meet these requirements and maintain robust documentation which will help the auditors to perform appropriate audit procedures and respond to Audit Committee queries, if any.

While the NFRA has issued two parts of Series 1 (Audit of Accounting Estimates and Judgements) covering ECL on financial assets and income taxes, it has been mentioned in part 1 of the series that there are other areas of financial statements as well requiring exercise of significant judgment and these other areas include impairment of non-financial assets and provisions for liabilities. It may be possible that the NFRA issues similar papers on these two areas as well as any other area of financial statements requiring significant judgment in due course. The NFRA Auditor-Audit Committee Interaction Series may set an expectation and act as a guiding principle for the questions that Audit Committee may consider asking the auditor for other areas involving significant judgment and estimate or otherwise having impact on audit of financial statements.

Securities and Exchange Board of India (SEBI) updates

Industry Standards Forum (ISF) and key Industry Standards formulated

The SEBI issues regulatory directions (by way of regulations, circulars or otherwise) for regulated entities such as listed entities, Market Infrastructure Institutions (MIIs), Intermediaries and Mutual Funds. For effective implementation of these directions and to facilitate ease of compliance, the SEBI realized that there was a need to set standards for implementation of the regulatory directions through the Industry Standards Forum (ISF) (comprising representatives from three industry associations, viz., ASSOCHAM, CII and FICCI). Accordingly, vide an advisory dated 12 February 2025, the SEBI formally recognized ISF by issuing Industry Standards Recognition Manual to formulate standards for implementation of various regulatory directions, in consultation with the SEBI. It is clarified that the regulations and circulars shall take effect as per the dates notified by the SEBI. The Implementation Standards are meant to facilitate uniformity and ease of compliance and shall not be a necessary pre-condition for regulatory directions to become effective.

The SEBI has also clarified that where Implementation Standards are in operation for any regulatory directive, it will be mandatory for the industry participants/ regulated entities concerned to comply with such standards. Any particular regulatory directive, for whose compliance there are industry standards in force, will ordinarily stand complied with if the industry standards are followed. However, compliance with a regulatory directive does not preclude the SEBI from taking cognizance of suspected fraudulent conduct and examining the same which may lead to consequent enforcement actions.

In line with its objective, the ISF has formulated the Industry Standards on following topics in consultation with the SEBI:

- Minimum information to be provided for review of the audit committee and shareholders for approval of a related party transaction
- Regulation 30 of LODR Regulations
- Key Performance Indicators (KPIs) Disclosures in the draft Offer Document and Offer Document

In this edition of Assurance EYe, we are covering *Industry Standards on minimum information to be provided for review of the audit committee and shareholders for approval of a related party transaction*.



Industry Standards on minimum information to be provided for review of the audit committee and shareholders for approval of a related party transaction

The identification of related parties, related party transactions (RPTs) and their approval has been a focus area of regulators for quite some time. The Companies Act 2013 (as amended) as well as the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 (as amended) (hereinafter referred to as the 'SEBI LODR' or the 'LODR') prescribe requirements in this regard. These requirements have been subject to various changes from time to time to ensure that appropriate framework exists for identification and approval of various RPTs so that interest of non-related parties/ minority shareholders/ public shareholders can be protected. In general, the requirements of SEBI LODR with regard to identification and approval of RPTs are more comprehensive.

In accordance with the requirements of the SEBI LODR, all RPTs that a listed entity or its subsidiary proposes to enter as well as any subsequent modification thereto require prior approval of the Audit Committee where only independent directors can vote. In addition, material RPTs and any material modification to past RPT need to be approved by the shareholders and no related party can vote to approve such transactions.⁴ For this purpose:

- a) Transaction(s) to be entered into individually or taken together with previous transactions during a financial year is considered material if it exceeds lower of INR1,000 crore or 10% of the annual consolidated turnover of the listed entity as per its last audited financial statements.
- b) A transaction involving payments for brand usage or royalty is considered material if the transaction(s) to be entered into individually or taken together with previous

4. On 7 February 2025, the SEBI has issued a 'Consultation Paper on Aspects Relating to Secretarial Compliance Report, Appointment of Auditors and Related Party Transactions of a Listed Entity,' for public comments. This consultation paper seeks views / comments / suggestions from public on proposals, among other matters, relating to facilitating ease of implementation with respect to approval of Related Party Transactions (RPTs) undertaken by subsidiaries of a listed entity. Pending finalization, changes proposed in the Consultation Paper have not been considered in this article.

transactions during a financial year, exceeds 5% of the annual consolidated turnover of the listed entity as per its last audited financial statements.

- c) The Audit Committee of a listed entity will define 'material modifications' and disclose it as part of the policy on materiality of RPTs and on dealing with RPTs.

The purpose of the above requirements is to ensure that all RPTs are conducted transparently, fairly and in the best interests of the listed entity and its public shareholders. To facilitate informed decision-making, the SEBI Master Circular dated 11 November 2024 mandates listed entities to provide detailed information on RPTs for review and approval by the Audit Committee and shareholders, wherever required. This requirement ensures that the Audit Committee and the shareholders have relevant data to assess the transaction's nature, terms, and potential impact on the listed entity. To facilitate uniform approach and help listed entities in complying with this requirement, the SEBI has issued industry standards vide its circular dated 14 February 2025 which prescribes minimum information to be provided for review of the Audit Committee and shareholders for approval of RPTs. The Standards issued are in conformity with the provisions of the LODR regulations and/or applicable SEBI circulars. However, if a particular Standard or any part thereof becomes inconsistent with subsequent changes in the LODR regulations and/or SEBI circular, the provisions of the LODR regulations and/or the SEBI circular shall prevail.

Information to be provided to the Audit Committee

Given below is an overview of information required to be disclosed to the Audit Committee:

- a) The responsibility for disclosing information is on management of the Company.
- b) Information needs to be accompanied by certificates from the CEO or CFO or any other KMP of the listed entity and from every director of the entity who is also promoter (promoter director) to the effect that (i) the RPTs to be entered into are not prejudicial to the interest of public shareholders, and (ii) the terms and conditions of the RPT are not unfavorable to the listed entity, compared to the terms and conditions, had similar transaction been entered into with an unrelated party.
- c) In the case of the payment of royalty, the listed entity will strive to compare the royalty payment with a minimum of three industry peers, where feasible. In selecting peers, preference will be given to the Indian listed industry peers. If Indian listed industry peers are not available, a comparison may be made with listed global industry peers, if available.

d) The format prescribed for information has a column for Audit Committee comments. The Audit Committee needs to give comments, if it has any comments on information provided with regard to applicable items.

e) The format contains a long list of information to be provided, running up to 88 points (with many sub-points). It covers general information such as basic details of the related party, its ownership and relationship with the listed entity, financial performance of the related party for past three years, details of previous transactions with the related party and amount of proposed transaction including % of turnover and similar information. In addition, the format requires specific information depending on nature of transaction proposed to be entered into with the related party and, in this part, the applicable information depending on nature of transaction need to be provided. Given below are key highlights of information to be disclosed:

- (i) Clear justification for entering into the RPT, demonstrating how the proposed RPT serves the best interests of the listed entity and its public shareholders - Applicable for all transactions

Transactions relating to sale, purchase or supply of goods or services or other similar transaction

- (ii) Number of bidders/ suppliers from whom bids were received with details of process followed to obtain bids - Specific comment from Audit Committee required if less than three bids are received
- (iii) Best bid/ quotation received and additional cost/ potential loss to the entity in transacting with the related party compared to the best bid - Audit Committee needs to justify additional cost
- (iv) If bids are not invited/ not available, then basis of recommending transaction to Audit Committee

Transactions relating to loans, inter-corporate deposits or advances given

- (v) Comparison of interest rate with rates charged to other parties, interest rates applicable on loans taken by listed entity and by related party
- (vi) The purpose for which the funds will be utilized by the ultimate beneficiary of such funds
- (vii) Latest credit rating of the related party - If credit rating of the related party is not available, Audit Committee to comment on credit worthiness of the related party
- (viii) Default in relation to borrowings, if any, made during the last three financial years, by the related party from the listed entity or any other person

The information provided is required to be incorporated into the agenda of the Audit Committee meeting. The comments of the Audit Committee, where applicable, are required to be recorded in the minutes of the meeting.

Minimum information to be provided to the shareholders

Given below is an overview of information to be disclosed to the shareholders for seeking approval of RPTs:

1. Information to be disclosed should enable the shareholders to take a view whether the terms and conditions of the RPT are favorable to the listed entity.
2. The following information will be provided to the shareholders:
 - a) Information as placed before the Audit Committee for seeking approval of RPTs and broadly explained above.
 - b) The Audit Committee can approve redaction of commercial secrets and other information which will affect competitive position of listed entity from disclosures to shareholders. In such a case, the Audit Committee will certify that, in its assessment, the redacted disclosures still provide all the necessary information to the public shareholders for informed decision-making.
 - c) Justification as to why the proposed transaction is in the interest of the listed entity.
 - d) Statement of assessment by the Audit Committee that relevant disclosures for decision-making were placed before them, and they have determined that the promoter(s) will not benefit from the RPT at the expense of public shareholders.
 - e) Copy of the valuation report or other reports of external party, if any, considered by Audit Committee while approving the RPT.
 - f) In case of sale, purchase, or supply of goods or services or other such transaction, whether the Audit Committee has reviewed the terms and conditions of bids from unrelated parties. If bids were not invited, the fact will be disclosed along with the justification thereof and the basis of recommending that the terms of the RPT are beneficial to the shareholders.
 - g) Comments of the Board/ Audit Committee of the listed entity, if any.
 - h) Any other information that may be relevant

Framework for disclosure of information to the Audit Committee/ shareholders

In accordance with the standards, the level of information to be disclosed pursuant to the above requirement depends on counterparty and amount involved. Given below is the table explaining level of details to be disclosed:

Counterparty	Materiality	Approvals	Disclosure requirement
Any	Material as per SEBI LODR	AC+SH	Comprehensive, i.e., all applicable disclosures
Promoter/ promoter group or person/ entity in which promoter or promoter group is interested	Not material as per SEBI LODR	AC	Comprehensive, i.e., all applicable disclosures#
Any other related party	Amount exceeding INR1 crore and not material as per SEBI LODR	AC	Limited
Any other related party	Amount below INR1 crore	AC	Minimum - Covers only basic information

AC: Audit Committee

SH: Shareholders

#For promoter/ promoter group transactions, limited disclosures will be required if all following conditions are met:

- Transaction is not material as per SEBI LODR
- Transaction relates to P&L items such as purchase/ sale of goods or services, royalty payments
- Transaction with a related party, where the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceed lower of the following:
 - 2% of consolidated turnover
 - 2% of consolidated net worth
 - 5% of average absolute value of consolidated PAT for last three years

When limited disclosures are applicable on meeting the above requirements or as per table above, certain disclosures related to bid information or peer comparison for royalty need not be given.

Applicability date

In accordance with the original SEBI circular, the Standard should have become effective from 1 April 2025. However, it was not clear whether the Standard was applicable for transaction entered into or transactions approved on or after 1 April 2025. To address this matter, the ISF has issued **Frequently Asked Questions (FAQs) on Applicability of the Industry Standards on "Minimum information to be provided for Review of the Audit Committee and Shareholders for Approval of Related Party Transaction (RPT)"** on 15 March 2025. In accordance with the FAQs, approval/ratification of RPTs granted/to be granted before 1 April 2025, the Industry Standards will not be applicable. These standards will apply to any approval/ratification of RPT granted/to be granted on or after 1 April 2025. The standards will also apply while seeking approval of any material modification to previous approved RPT.

The SEBI has since received feedback from various stakeholders requesting extension of timeline for applicability of the Standard. Accordingly, the SEBI has issued another circular extending the effective date of the earlier circular and the Standard to 1 July 2025. The SEBI has also clarified in the new circular that the ISF will take into consideration the feedback received for simplification of the Standard and release the simplifications in a time-bound manner to meet the revised timelines.

How we see it

We believe that the Industry Standards are aimed at providing standardized minimum information to the Audit Committee and the shareholders while approving RPT so that they are able to evaluate various aspects of the transaction including impact on the listed entity and public shareholders before approving any RPT. Hence, the Standard will help in improved transparency and decision making.

In many cases, the Standards may require the listed entities and their management to perform additional procedures before seeking approval of RPT. For example, in many cases, the listed entities may not have invited comparable bids before seeking approval of RPTs related to purchase or sale of goods or services. Considering specific disclosure requirements, it is possible that the Audit Committee of listed entities insists on inviting bids through robust system before seeking its approval of the transaction. Also, listed entities will need to devise appropriate mechanism for compiling and providing appropriate information to the Audit Committee and shareholders for seeking their approval. They may consider using Information Technology (IT) solutions for compilation and provision of such data.

Considering specific requirements of the Standard, it is expected that the Audit Committee of a listed entity, including its Independent Directors, will have more onerous responsibility of evaluating and approving RPTs. First, they will be expected to evaluate all the information thoroughly and frame an independent view whether the proposed transaction is in best interests of the listed entity and its public shareholders and therefore, whether it should be approved. Second, the format requires specific comments of the Audit Committee on specific judgmental aspects of the information provided. Third, it needs to give a specific statement to the shareholders that the promoter(s) will not benefit from the RPT at the expense of public shareholders. We expect that these and other requirements of the Standard will result in significant increase in responsibility of the Audit Committee with regard to evaluation and approval of RPTs, requiring higher involvement of the independent directors in the process.

Consultation paper on draft circular for Management Statement and Auditor's/ Independent Practitioner's Report on digital assurance based on information obtained from external data repositories

The SEBI vide its draft circular dated 03 February 2025 had issued a consultation paper on management statement and auditor's/ independent practitioner's report on digital assurance of financial statements, based on the information obtained from the external data repositories.

The draft circular envisages that the management will prepare a statement giving information such as external regulatory information source, amount as per the external regulatory information source, amount as per books of account, reconciling items between two amounts and management explanation on the reconciling items. For example, GSTN portal allows the client to view and download Electronic Cash Ledger, Electronic Liability Ledger and Electronic Credit Ledger which contains details of input tax accrued, output tax liability, refund received, cash deposited and amount utilized from cash ledger/ credit ledger. These data from the GSTN portal can be reconciled to various information contained in the books of account such as revenue, purchases, balance with the GST authorities, refund claimed and outstanding and ITC claimed and reversed. Some more examples of external digital information which can be reconciled with the information in financial statements include:

1. Tax deducted at source and advance taxes paid can be reconciled with traces portal and Annual Information Statement (AIS) data
2. Total contribution to provident fund by employer and employee can be reconciled with Employees' Provident Fund Organisation portal
3. E-way bills can be used to perform sales cut-off procedure
4. Traffic data submitted to NHAI can be reconciled with toll revenue.



The draft circular also states that the auditor/ independent practitioner will be required to separately report on the said statement by conducting examination in accordance with the "Technical Guide on Digital Assurance" issued by the Institute of the Chartered Accountant of India (ICAI). This report is required to be prepared by an auditor (Statutory Auditor or independent practitioner) who has subjected himself /herself to the peer review process of ICAI and holds a valid certificate issued by the Peer Review Board of the ICAI.

The ICAI had issued the above technical guide in January 2023. The guide primarily focuses on sources of external audit evidence available and their use by the members of ICAI in performing audit procedures. The guide also highlights the importance of reliability and relevance of the source from which the information is being obtained. It provides various illustrations of available sources of external audit evidence and how they can be used. The Technical Guide, however, does not require any separate reporting by auditors on these aspects. Further, no responsibility is cast on the management of listed entity to provide this information obtained from external data repositories to auditors or provide access to such information to auditors.

In accordance with the draft circular, it will be the responsibility of the management, among other matters, to create and maintain all the accounting and other records supporting the contents of the statement. The management of the listed entities will also be responsible for providing access of external data repositories to the auditors, ensuring complete and accurate information. The management will also be responsible for maintenance of the accounting and other records in relation to this and to consider the reconciling items reported basis the comparison of 'amounts reported as per books of account' and 'amounts as per External Regulatory Information source' while preparing financial statements for the financial year ended. The auditor/ independent practitioner will be responsible for verifying accuracy of information contained in the statement prepared by the management and issuing report thereon.

The draft circular proposes to make these requirements mandatory for top 100 listed entities, by market capitalization, from FY 2024-25 onwards, i.e., for the period ending on or after 31 March 2025. Such reports will be required to be submitted to stock exchanges by 31 July, i.e., by 31 July 2025 for FY 2024-25 and thereafter by 31 July for the relevant financial year.

The last date for providing comments/ suggestions was 24 February 2025.

How we see it

The reliability of information contained in financial statements and audit evidence increases when it is reconciled to an external information. These aspects are recognized in various Standards on Auditing (SA) including SA 500 *Audit Evidence*. The statutory auditor while auditing financial statements as per the applicable standards on auditing strives to obtain external audit evidence to support true and fair view of financial information contained in the financial statements. If there are differences that cannot be appropriately explained/ reconciled, the auditor will evaluate the consequential impact while finalizing its opinion on True and Fair view of financial statements. In fact, the above Technical Guide also does not require separate preparation of the statement and reporting by statutory auditor/ independent practitioners thereon. Rather, it requires auditor to evaluate such data at the time of finalizing its opinion on the financial statements.

It is important that the users of the statement understand and appreciate that there may be differences between amounts contained in the books of account and financial statements and external sources, for valid reasons. Also, in certain cases, amounts given in external sources may not be fully reliable due to reasons such as apparent errors, delay in processing information and/ or differences in the purpose of information. Hence, differences between financial statement information and external source data does not mean that financial statement information is incorrect. Listed entities while preparing the statement will need to ensure sufficient information is provided on reconciling items to give such comfort to the users.

It is imperative that listed entities evaluate proposed requirement in detail and raise any concerns on the same immediately to the SEBI. Further, the top 100 listed entities based on market capitalization should gear up for collating and providing the information available at various external regulatory portals (for example, Good and Services Tax portal, TRACES portal, Income-tax e-portal) and their reconciliation with the books of account, for reporting by auditors. This may require significant efforts for companies as well as from the auditors before issuing a separate report on digital assurance as proposed in the draft circular. The listed entities and the auditors may wish to complete this exercise together with audit of the financial statements to avoid a potential scenario where the auditor issues an unmodified opinion on True and Fair view of the financial statements and, subsequently, unreconciled differences are noted between information contained in books of account and external information source.





Acknowledgement

- Vishal Bansal
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- Navneet Mehta
- Deepa Agrawal
- Manan Lakhani
- Amrish M Darji
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EYIN2504-016

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