



From Left to Right: Parveen Kumar, National Head Assurance, ASA & Associates LLP; Jaspreet Singh Bedi, Assurance and Transaction Advisory, Partner, Nangia & Co LLP; Sandip Khetan, financial accounting advisory services leader, EY India

ICAI issues guidance to auditors on funding disclosure norms

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NEW DELHI

Auditors must ensure that audited financial statements of companies comply with the government's new investment reporting requirements both in letter and spirit, the Institute of Chartered Accountants of India (ICAI) said on Tuesday. The reporting requirements prescribed in the Companies (Audit and Auditors) Amendment Rules, 2021, are applicable for audits, starting 2021-22. According to the rules, both the management and auditors must submit additional disclosures in notes to accounts to infuse greater transparency in flow of funds between entities and the purpose of the funds.

Companies have to disclose details of transactions on loan, advances or investments made in an intermediary for further



The rules are applicable for audits starting 2021-22. ISTOCK

lending, or investing directly or indirectly.

According to the guidance note, the disclosures should include the date and amount advanced, loaned or invested in intermediaries with details of each intermediary. Besides, the investing-lending company must also declare that provisions of the Foreign Exchange Management Act (FEMA) and

Companies Act have been complied with for the deals and do not breach the Prevention of Money Laundering Act (PMLA).

"These rules have cast onerous responsibility on auditors as scope of reporting under FEMA and PMLA rules is very wide. The management as well as the board of directors will have to carefully evaluate all transactions, including lending or investing in another entity or person to determine the nature and purpose of such funding, which should be very clearly evidenced and documented while approving such funding,"

said Jaspreet Singh Bedi, partner, Nangia & Co. LLP, a consultancy. These amendments require significant additional disclosures in the statutory financial statements of firms and enhance reporting responsibilities of the auditors, as well as the management and board of directors of the firm, said Bedi.

Reporting norms put onus on auditors

SHRUTI CHOUDHARY
New Delhi, 26 April

Auditors should seek direct confirmation on 'borrowed funds' from all entities involved in transactions, including the ultimate beneficiary, to ensure compliance with anti-money laundering laws and foreign exchange rules under new reporting requirements for firms.

In case these entities do not confirm, the auditor may seek external confirmation where the third party provides

evidence for the particular matter or amount, according to the new rulebook by the Institute of Chartered Accountants of India (ICAI).

Even a high level of professional scepticism may be considered as alternative audit procedures, by examining the end-use certificate obtained by the management for amounts funded to determine any such funding for onward lending or investing on behalf of the company, said the country's largest professional accounting body.

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NEW RULE BOOK



▶ Auditors to certify that transactions are not violative of PMLA/FEMA rules, according to ICAI guidelines

▶ Auditors can examine the end-use certificate by companies to see whether borrowed funds are for onward lending or investing

▶ They can exercise alternative audit procedures in case of no confirmation

Reporting norms puts onus on auditors

ICAI released comprehensive guidelines for auditors this week as they prepare a financial statement and audit report for the financial year (2021-22) ended March 31.

The guidelines are in line with new reporting norms notified by the Ministry of Corporate Affairs in 2021, mandating significant additional disclosures in the statutory financial statements of companies.

Under new reporting norms, the company has to disclose compliance with requirements of the Foreign Exchange Management Act (FEMA), 1999, and the Companies Act, 2013, for transactions, and report that the transactions are not violative of the Prevention of Money Laundering Act (PMLA), 2002.

The move is intended to curb growing instances of



borrowing funds/loans being misused and laundered.

Besides, the guidelines clarified that when pass-through transactions are in writing, the reporting in respect of such transactions may be straightforward.

"It is important for the auditor to understand the purpose of funding the other party if the end-use is not specified in the agreement for such funding. This would enable the auditor to understand if the funding to the other party is on a pass-through basis to fund another party," it noted.

The rules, according to auditors, have placed the onerous responsibility on auditors, given the scope of reporting under FEMA and PMLA rules are very wide.

"The management, as well as the board of directors, will have to carefully evaluate transactions of lending or investing in another entity or person to determine the nature and purpose of such funding, which should be very clearly evidenced and documented while approving such funding," said Jaspreet Singh Bedi, partner (assurance and transaction advisory), Nangia & Co LLP.

These guidelines are for providing appropriate guidance to members, so that the requirements of these rules (new reporting requirement) can be fulfilled in letter and spirit. They further specify various scenarios for better

understanding of members and enable them to deal with the practical situations which may be faced by them while reporting under the new regime," said ICAI President Debashis Mitra, in the latest guide.

While Schedule III changes will require wide-ranging disclosures, the amendments to audit report rules and accounts require new disclosures: 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; compliance with respect to payment of dividend.

Further, disclosure requirements are also prescribed for companies that receive funds in the capacity of intermediaries.

