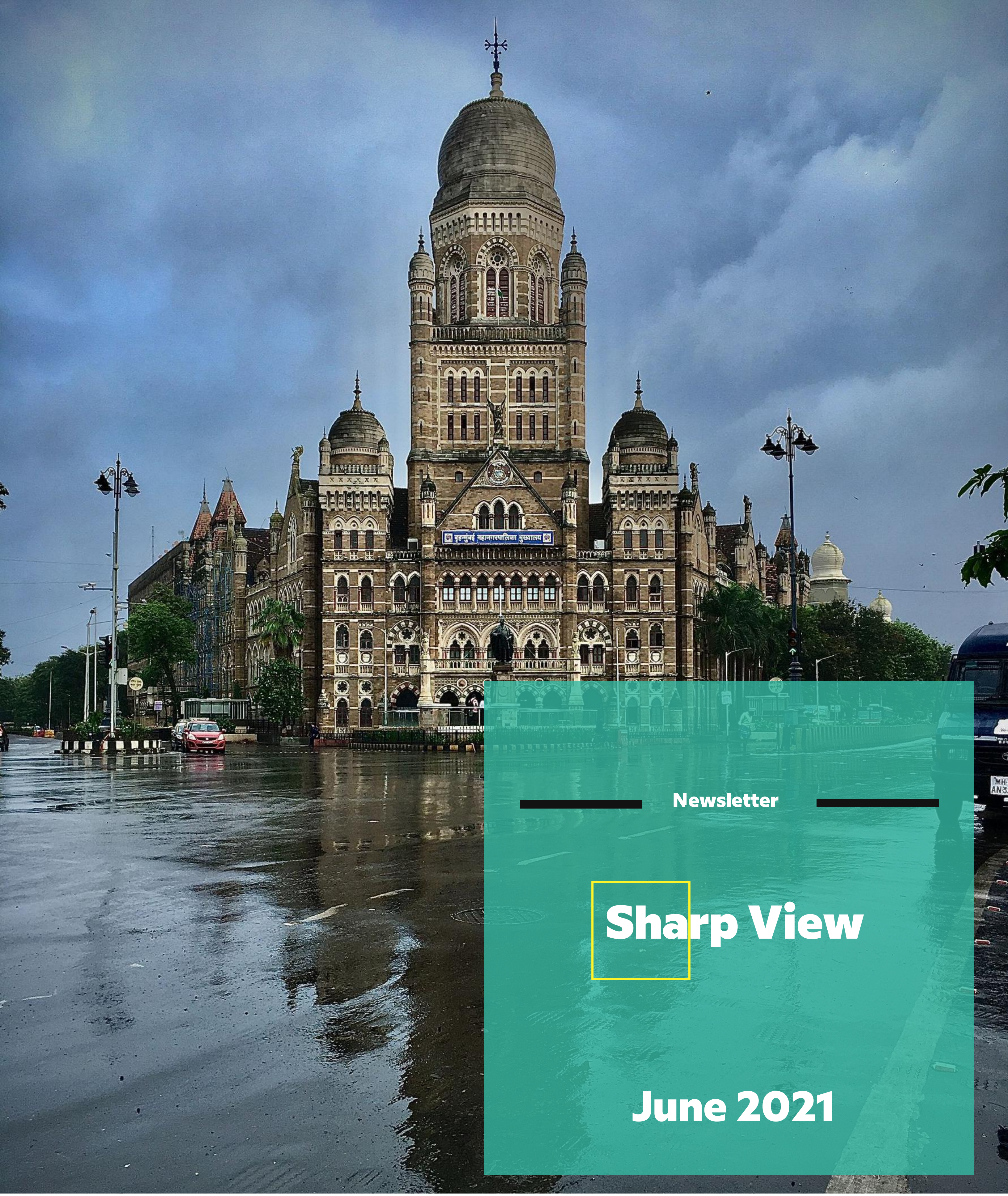


Newsletter

Sharp View

June 2021

SHARP & TANNAN

Assurance | Consulting | GRC | Taxation

Ahmedabad | Bengaluru | Chennai | Coimbatore | Delhi | Goa | Mumbai | Pune | Vadodara

June 21

As India looks to come out of the second wave of Covid-19, here is what June brings to her.

June marks the onset of the south-west monsoon in India. An average monsoon is predicted for the current year (rainfall as between 96% and 104% of a 50-year average of 88 cm) which is expected to boost the $ 2.9 trillion economy.

Nearly 50% of India's farmland does not have irrigation cover and south-west monsoons delivers close to 70% of the rain that India needs to water its farms and recharge reservoirs and aquifers. This is bound to improve the agriculture output and increase the income of every second Indian - who relies on agricultural income for his livelihood.

Income Tax Events to look forward to in June:

15 June 2021 - Payment of first installment of advance tax
30 June 2021 - Statement of Financial Transactions (SFT) for FY 20-21 under Rule 114E
30 June 2021 - Statement of Reportable Account for the calendar year 2020 under Rule 114G
30 June 2021 - Statement of TDS for the last quarter of FY 20-21 under Rule 31A

Assurance

Reserve Bank of India has recently made major amendments with respect to the appointment of statutory auditors in various financial institutions. Ms. Aarti Joshi presents a balanced perspective on the short and long term impact of the key changes made. (see pages 5 and 6)

Governance Risk & Compliance

The current pandamic has brought to the fore, the need of having a robust Enterprise Risk Management Framework. Ms. Poonam Bhatia explores the choices and explains the pros and cons of each of them. (see pages 8 and 9)

ERP's are now backbone of any company, but if not configured correctly can lead to material misstatements. Ms. Anmol Chetwani's article provides useful tips on how to create a robust Bill of Material Hygiene in SAP Environment. (see pages 10 and 11)

Taxation

With effect from 01st July 2021, buyers of goods will be required to deduct TDS on payments made to sellers in excess of INR50 lakh. Ms. Aarti Joshi explains the same by way of FAQ's. (see pages 13 to 15)

Assurance

1. RBI | Appointment of Auditors

Is prevention better than cure? - The RBI bombshell

Is prevention better than cure? - The RBI bombshell

A month ago, RBI has notified new norms on appointment of statutory auditors (from Q3 of FY 2021-22) of banks and financial institutions. The new norms are mandatory for commercial banks, urban co-operative banks and non-banking financial companies (NBFCs) in respect of appointment of their statutory auditors, which include clauses on:

- Joint audit;
- Fixing of minimum and maximum number of auditors / joint auditors;
- Reduction in the audit tenure from 4 years to one term of 3 years (with a cooling off period of 2 terms); and most importantly
- Enhancing the independence of auditors.

These are the 'key' for achieving RBI's goals of strengthening the governance and assurance functions in financial sector. The norms will enhance the quality of audit (due to increased independence of auditors), the quality of financial reporting, safeguarding the interest of stakeholders and making the auditors jointly responsible for their work.

Till date many stakeholders have made various representations to RBI for diluting the norms, deferring them to a couple of years and allowing transitional period for smooth adoption.

We have put in our Sharp Views and hope you find it informative.

Is it too early? : Has RBI hurriedly brought in the new norm, without taking industry consultations, representations? Should they have mandated the norms in a phased manner?

We would say, NO:- The earlier the better. RBI, in its 'Statement on Developmental and Regulatory Policies' issued in December 2020, had specifically announced future policy measures for improving the quality of financial reporting and harmonization of the norms across the financial sector. If representations would have been sought from industry, these norms would have been postponed and would never have been implemented. The norms are announced at the beginning of FY 21-22 so as to render sufficient time for banks / NBFCs to appoint their auditors. For UCBs and NBFCs, these guidelines can be adopted from H2 (second half of the year) to avoid disruption.

- Minimum 2 independent audit firms (joint auditors): For entities with asset size of INR15,000 crore or more, minimum 2 independent audit firms should be appointed as Statutory Central Auditors / Statutory Auditors (SCA/SA). Making two auditors accountable for the same audit will improve the audit performance and wherever required, the auditor can seek the opinion of joint auditor. The maximum cap on joint auditors enhances the accountability, since the responsibility does not get diluted to more than the prescribed number of auditors. In our view, this would make the audit unbiased and more reliable. Also, the term 'independent' firm means that the firms must not have any common partners, neither should they belong to a common network of firms.

- Audit tenure: Till date, the tenure of the auditor was 4 years followed by a 6-year cooling off period. From now onwards, the tenure will be reduced to 3 years, with a cooling off period of 2 terms (6 years.) New and smaller audit firms will stand a chance to get appointed by rotation. This would make the audit process less monotonous and a fresh team of auditors can review the accounts for a block of every 3 years. Also, appointment of a new team will deter the previous auditors and the entity from establishing a comfortable relationship which may compromise strict adherence to audit principles.

- **One year time gap between assignments:** The independence of statutory auditor is diluted when he handles more than one assignment / function for the same entity (say, consultancy or any other non-audit function). It was hitherto possible for an auditor to simultaneously take-up a non-audit assignment of the same entity through another firm, where he had a partnership / substantial interest. The new guidelines clearly deny the appointment of SCA / SA in the entity or its group entities for 1 year both before and after the conduct of the entity's audit. This would break the chain of existing auditor-client relationship and many new firms will now stand a chance to gain non-audit consultancy work.

- **Eligibility of auditors / partners:** The full-time partners of the audit firm (proposed to be appointed) must not have any other engagement / employment, except for the firm which is proposed to be appointed as auditor of the bank / NBFC. This ensures dedicated flow of work and in turn the audit performance as a whole. A single audit firm can audit a maximum of 4 commercial banks, 8 UCBs and 8 NBFCs in a year.

- **Indirect interest - prohibited!** RBI has clearly cut the connections not only between the auditors of the same group, but also of the client (auditees) so as to safeguard the scope of audit and independence of auditors. Any bank / NBFC, to which another entity (having the same auditor) has a wide exposure, should assess the independence of the auditor before his appointment. If such independence is jeopardized, the board of directors ('BOD') of the bank / NBFC should NOT appoint the auditor.

- **Increased responsibilities on BOD / LMC:** The new guidelines make the BOD / Local Management Committee of Banks / NBFCs equally responsible for practically all the compliances like:
  - Deciding the number of auditors (within the minimum and maximum limits specified);
  - Assessing the auditors' independence;
  - Reviewing the performance of SCA / SAs on an annual basis; and
  - Reporting of serious lapses in conduct of audit.

This entrusts the management with 'propriety' function, thereby reducing the possibility of collusion and frauds in financial sector. Making the auditor and auditee jointly responsible for audit, will definitely increase the transparency and reliability of the audit.

Health of the Indian economy and in turn the financial sector, is adversely affected by COVID disruptions in financial year 20-21. Audit of banks for FY 21-22 will assume much significance considering an increasing number and value of NPAs due to inability of many business borrowers to repay their commitments. RBI has taken a right preventive step in this direction and brought the new regulations at the start of the financial year itself, so that players get ample time to be compliant with the new norms. The players may face some initial problems like shortlisting the eligible audit firms, placing additional responsibilities on the BOD and removal of on-going auditors before completion of their term, but this will help in a long way to ensure good governance and assurance to all stakeholders.

The complete circular can be assessed at:
https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI258A67AD30976F44929FA2AB2B41DC805D.PDF

GRC

1. ERM | COSO vs ISO

ERM| COSO 2017 or ISO 31000:2018 – which framework to choose?

2. ERP | BOM - Bill of Materials

Is your product/work order Bill of Materials accurate enough to show correct consumption figures in financial reporting?

ERM| COSO 2017 or ISO 31000:2018 – which framework to choose?

Enterprise risk management (ERM) is the process of identifying and addressing methodically the potential events that represent risks to the achievement of strategic objectives, or to opportunities to gain competitive advantage.

There are many frameworks and guidelines which help in ERM. Two most widely used frameworks are:

I. COSO – Committee of Sponsoring Organizations

COSO Board commissioned and published in 2004 the Enterprise Risk Management—Integrated Framework
The framework was updated in 2017, COSO 2017 ERM –Integrating Strategy and Performance. The first part of the updated publication offers a perspective on current and evolving concepts and applications of enterprise risk management. In the second part, the Framework, is organized into five easy-to-understand components that accommodate different viewpoints and operating structures, and enhance strategies and decision-making.

II. ISO - International Organization for Standardization

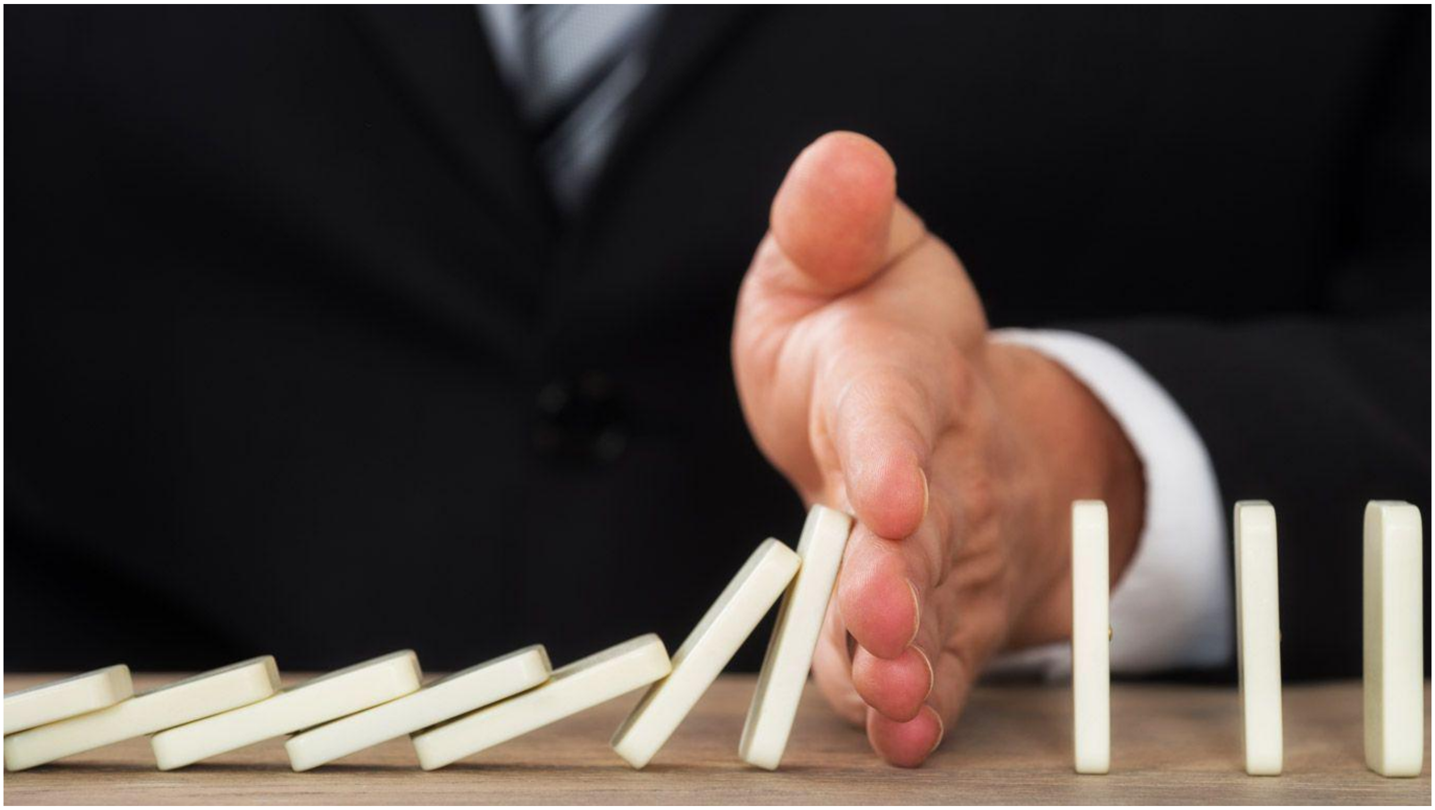
The standard for Risk Management was first published in 2009. The same was updated in 2018, ISO Risk Management Guidelines. it presents a high-level overview of risk management and how a risk management initiative can be implemented across the organization.

The question arises as to which framework can be used to implement the ERM. The following below present some major differences which could be understood on reading of both frameworks.

TOPIC	COSO 2017	ISO 31000:2018
1. ERM	ERM is viewed as integral to strategy setting, mission in COSO	ERM Is inclined towards creating and maintain value but not specifically mentioned to be corelated to Strategy
2. Risk Definition	Risk is the possibility that events will occur and affect the achievement of objectives.	Risk is the effect of uncertainty on objectives.
3. Inherent Risk	Inherent risk is the natural level of risk inherent in a process or activity without doing anything to reduce likelihood or mitigate the severity Inherent risk has mention in COSO EXAMPLE: In case if organization is having data stored/backup in cloud servers, the inherent risks is the unavailability of services in case of glitches	There is no mention of inherent risk in ISO

TOPIC	COSO 2017	ISO 31000:2018
4. Risk Appetite	Risk Appetite is mentioned in detail in COSO EXAMPLE: An organization cannot have a debt ratio more than 1.5. This implies that the organization's is willing to take debt upto 1.5 times of equity and not more than that and the appetite of organization is 1.5 times	Although ISO has a brief mention of Risk Appetite, but it does not provide in depth insight on the same
5. Focus	COSO focuses more on financial controls and hence is more inclined to be used by financial entities and auditors	ISO is apparently more inclined towards overall risk management and hence can be used by anyone including but not limited to financial entitles. Organizations using other ISO's may be more inclined in using ISO.
6. Impact Analysis	Impact is calculated at the event level EXAMPLE: 1. COVID 19 Pandemic: The impact is calculated by loss of business in financial terms	Impact analysis is done for each consequence for every business process even if indirectly connected to the event EXAMPLE: COVID 19 Pandemic In ISO, the said risk would be calculated for: Purchase: RM required will not be available or will be available in staggered manner Sales: Due to RM bottleneck, sales would be impacted HR: People may not be able to attend offices Production: As a result of limited personnel, production may require to be done in multiple shift which may ultimately lead to higher cost
7. Approach	The focus is more on governance aspect as to how the board can view the risk and link the same with strategy and performance	It provides more detail on the actual groundwork of risk management process.
8. Risk Centric Approach	It focuses more on managing and controlling risks; perceiving risk is something which is more of a threat in nature	ISO places more emphasis on managing risks and also exploiting the upside of risks in the form of opportunity and creating value to the organization

Is your product/work order Bill of Materials accurate enough to show correct consumption figures in financial reporting?



The manufacturing world is a complex landscape. One thing that hasn't changed is the importance of the bill of materials (BOM) accuracy. Equally important is to have a system in place that ensures the accuracy of bills of materials. Automated BOM in ERP can definitely help real-time inventory and consumption, complete revision control, and no delay in production.

Accuracy of product definition is key to ensuring accuracy of material consumption reported for production and sale.

The enterprise may prone to have error/gaps in accurate BOM definition and its update for specific products in SAP-based ERP, which may sometimes lead to erroneous consumption reporting and ultimately can impact the accuracy of profitability reporting.

Some possibilities or areas of such errors/Gaps in BOM update are explained in the following pages.

Therefore, checking periodic BOM hygiene and comparing BOM-based standard consumption vs actual consumption would be one of the key starting points.

BOM hygiene

A bill of materials (BOM) is a list of the raw materials & its quantities to manufacture a 1 unit of FG.

Based on the BOM defined, the product costing, valuations & RMC part is taken into consideration.
However, at many times, the BOM is not correctly defined & reviewed at regular intervals leading to variances in BOM consumption viz-a-viz Actual Consumption affecting valuations, Profits & RMC %.

Some of the illustrations of BOM Hygiene are as follows -

1 —
Material defined negative
Eg, Material defined as -10kg instead of 10kg
Due to negative sign, material will be generated instead of consumption

2 +
Scrap defined positive
Eg, Scrap defined as 10% instead of -10%
Due to positive sign, scrap will be consumed instead of generation

3
Incorrect UOM defined
Eg, Material defined as 10g instead of 10kg

4
Quantity missed out
Eg, Quantity missed out instead of 10kg
Due to this, quantity will be 0

BOM vs actual consumption

Snippet of BOM

A bill of materials (BOM) is a list of the materials & its quantity required to manufacture 1 unit of FG.

At the time of booking production order, production BOM is released & SAP will post the material consumption as defined in BOM whereas in certain circumstances actual consumption is higher/lower leading to variances in SAP vs Actual data leading to under higher/lower profitability reporting.

Some of the illustrations of variances are described in the diagram-

Excess / lower material consumed
Eg, As per BOM, 100 kg of "Material A" is to be consumed against a production order, however, 80 kg/120 kg of "Material A" is consumed leading to lower/excess consumption

Alternative material consumed
Eg, As per BOM, 100 kg of "Material A" is to be consumed against a production order, however, 100 kg of "Material B" is consumed having different price

Excess / lower scrap generated
Eg, As per BOM,10% of scrap is to be generated against a production order, however, 8%/12% of scrap is generated leading to lower/excess scrap generation

Scrap not generated
Eg, As per BOM,10% of scrap is to be generated against a production order, however, no scrap generated

Taxation

TDS Provisions | Section 194 Q – Operative from 1 July 2021

FAQ's

There are various payments attracting TDS provisions in income tax law and CBDT keeps on adding / modifying these provisions considering the nature of payments and volumes involved. Last year, TCS provisions under section 206C (1H) was introduced, making the 'seller' responsible to collect tax on payments received from the 'buyer.' Finance Act 2021 has introduced a similar provision of TDS (w.e.f. 1 July 2021) where the buyer is required to deduct tax from payments made to 'seller' at the time of payment / credit whichever is earlier.

One may ask, whether the same transaction attracts TDS and TCS, both at a time? Is there any threshold applicable for these sections? What exactly are the requirements to be complied with? Since 1st July is nearing and we think you should be abreast of these provisions, we have compiled some FAQs which would answer most of your queries.

<u>The Law</u>

Any buyer who is responsible for paying any sum to any resident seller for purchase of any goods of the value or aggregate of such value exceeding INR50 lakh in any previous year, shall, at the time of credit of such sum to the account of the seller or at the time of payment thereof by any mode, whichever is earlier, deduct an amount equal to 0.1 % of such sum exceeding INR50 lakh as income-tax.

Buyer: Buyer means a person whose total sales, gross receipts or turnover from the business carried on by him exceed INR10 crore during the financial year immediately preceding the financial year in which the purchase of goods is carried out.

The provisions of this section shall not apply to a transaction on which:

- Tax is deductible under any of the provisions of this Act; and
- Tax is collectible under the provisions of section 206C other than a transaction to which sub-section (1H) of section 206C applies.

FAQ's

1. Who shall be liable to deduct tax? When?

The buyer is responsible for deducting tax at the time of crediting the amount to seller's account/ payment to seller, whichever is earlier, if:

- There is a purchase of goods from the seller
- The seller is 'resident'
- Buyer's turnover / sales / gross receipts of the immediately preceding PY exceed INR10 crore

TDS is to be made @ 0.1% on the value of purchase / payment in excess of INR50 lakh. In case the seller is unable to produce PAN / AADHAR, then the TDS rate will be 5%.

2. Does the TDS provision apply to import of goods?

Assuming that the seller in a non- resident, these provisions will not apply. However, if the seller is a resident, irrespective of the location and movement of goods, the transaction would get taxed. However, other conditions (as mentioned above) need to be fulfilled in order to attract TDS provisions.

3. What is section 206(1H)?

Section 206(1H) deals with tax collected at source (TCS).

Every person, being a seller, who receives any amount as consideration for sale of any goods of the value or aggregate of such value exceeding INR50 lakh in any previous year, other than the goods being exported out of India or goods covered in sub-section (1) or sub-section (1F) or sub-section (1G) shall, at the time of receipt of such amount, collect from the buyer, a sum equal to 0.1 % of the sale consideration exceeding INR50 lakh as income-tax. The above provision will not apply, if the buyer has deducted and paid TDS.

Except in cases of certain specified goods / specified dealers (e.g. export of goods, sale of motor vehicles, tour operators, forex dealers, sale to government agencies) the seller becomes liable to collect tax from the buyer on the value exceeding INR50 lakh, at the time of receipt. In case the buyer fails to produce PAN / AADHAR, the TCS rate shall be 5%.

4. Do sections 194Q and 206C (1H) apply simultaneously?

No, section 206C (1H) is not applicable where buyer is liable to deduct tax and has deducted it. Only if the buyer fails to deduct TDS u/s 194Q, the seller becomes responsible to collect tax.

> Important to note:
>
> Position from 1 July 2021: TDS u/s 194Q becomes operational from 1 July 2021. So, till that date, the seller is liable to make TCS by default. From 1st July onwards, the primary responsibility of TDS is on the buyer, failing which the seller must collect tax (TCS).

5. Is TDS applicable on transactions of 'securities' and 'commodities'? Also on transmission of electricity?

As per the 'Sale of Goods Act' the above items fall under the definition of 'goods.'

In transactions of sale / purchase of shares, stocks, securities and commodities, there is absence of one-to-one contact between buyers and sellers. Hence there would be practical difficulties in implementing TDS provisions on such transactions. We expect CBDT to issue relaxations on such transactions. Also, transactions in electricity, renewable energy certificates and energy saving certificates traded through registered power exchanges would be made exempt in due course.

Similar relaxations were issued by CBDT in 2020 on TCS provisions.

6. Does purchase of software attract TDS applicability?

Sale / purchase of software is sometimes categorized as goods, sometimes as services. Depending upon the nature of contract between the buyer and the seller, one should draw inference. If the purchase of software is intended to be bought as a 'merchandise' / 'goods' TDS provisions would apply. In determining the applicability, 'substance' of the transaction must prevail over its 'form' while categorizing it as either 'goods' or 'services.'

7. Is TDS applicable on advance payment?

Advance payment made towards future purchase qualifies for TDS. TDS should be made at the time of credit or payment whichever is earlier. TDS is applicable on the amount exceeding INR50 lakh.

Loans / Advances given: Mere advance which is in the nature of loan will not qualify for TDS. However, in future, if such loan is adjusted by the buyer against subsequent purchases, then TDS liability arises, on the adjusted amount in excess of INR50 lakh.

8. Default in making TDS and furnishing TDS returns:

Default in deducting tax, default in paying TDS so made and failure to furnish TDS returns will attract interest under section 201.

9. Illustrative chart showing applicability of section 194Q and 206C(1H)

Particulars	Case I	Case II	Case III
Turnover of seller in the preceding FY	INR15 crore	INR9 crore	INR15 crore
Turnover of buyer in the preceding FY	INR9 crore	INR15 crore	INR15 crore
Purchase value in the current FY	INR1 crore	INR1 crore	INR1 crore
Amount paid towards purchase	INR75 lakh	INR75 lakh	INR75 lakh
Person liable to make TDS / TCS	Seller (Buyer is below the threshold of his turnover)	Buyer (Seller is below the threshold of his turnover)	Buyer (Both are above their respective thresholds, but TCS provision gets attracted only if buyer fails to make TDS.) Hence, w.e.f. 1 July 2021, buyer is primarily responsible.
Tax rate (assuming that PAN / AADHAR is available)	0.1% of the amount received by seller, exceeding INR50 lakh	0.1% of the amount credited / paid exceeding INR50 lakh	0.1% of the amount credited / paid exceeding INR50 lakh
TDS / TCS amount	INR2,500	INR5,000	INR5,000

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