KPMG

IFRS Notes

Banks to submit pro forma Ind AS financial statements

24 June 2016

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Introduction

On 23 June 2016, the Reserve Bank of India (RBI) issued a circular (reference DBR.BP.BC.No.106/ 21.07.001/2015-16) (the RBI circular) providing directions to all scheduled commercial banks (excluding regional rural banks), to submit their pro forma financial statements prepared on the basis of the Indian Accounting Standards (Ind AS) for the half-year ended 30 September 2016, latest by 30 November 2016.

Banks will be guided by the Ind AS notified by the Ministry of Corporate Affairs (MCA) from time to time and should also refer to the report published by RBI's Working Group on 'Implementation of Ind AS by Banks in India' in October 2015.

"RBI's directions represent a step forward in the process for implementation of Ind AS by banks in India, and reiterates their commitment to ensure banks follow a structured process for this transition. Banks should ensure that they have a robust process in place to evaluate and select appropriate accounting policies and then to generate financial information as per the new framework, as the pro forma Ind AS financial statements will be a good indicator of what to expect on final transition. For banks that still haven't started working on this, there's a lot to be done between now and November 2016, when the filing with RBI is due."

Sai Venkateshwaran
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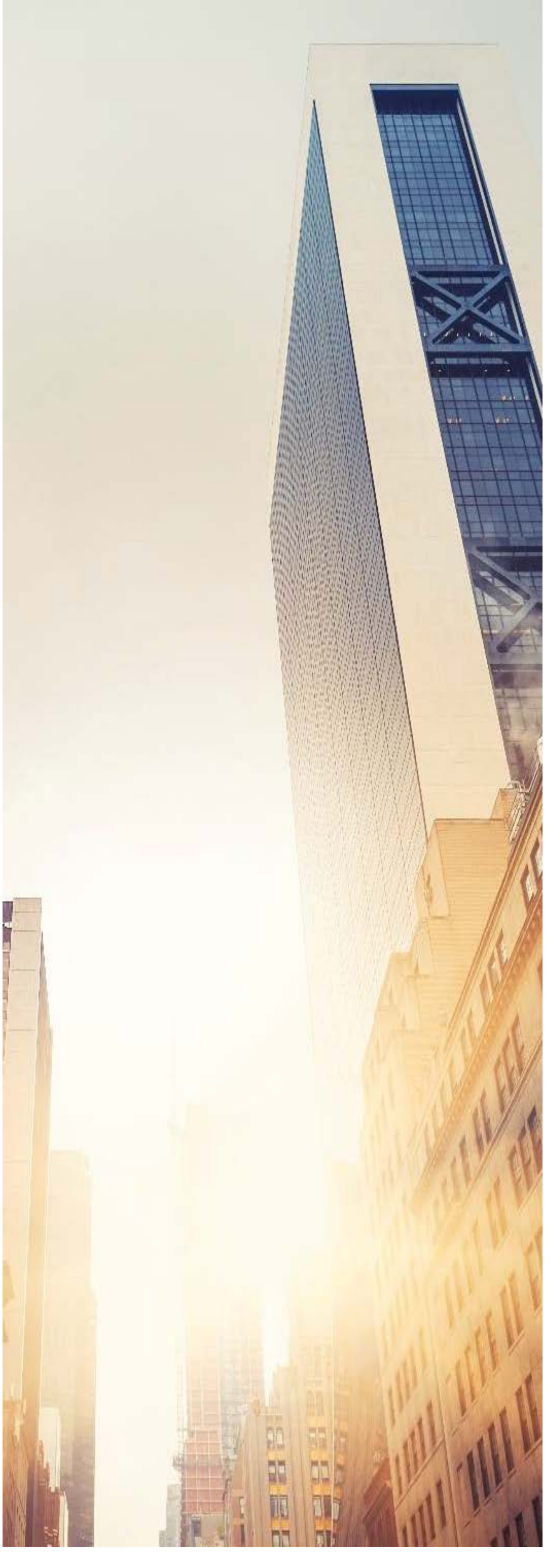

Background

On 11 February 2016, RBI issued a circular (RBI/2015-16/315) requiring scheduled commercial banks to comply with Ind AS for accounting periods beginning from 1 April 2018 onwards, with comparatives for periods ending on or after 31 March 2018. Ind AS would be applicable to both stand-alone as well as consolidated financial statements. This circular had directed banks to be prepared to submit their pro forma Ind AS financial statements to RBI from the half-year ended 30 September 2016 onwards. The RBI circular issued on 23 June 2016 reiterates these directions and provides the formats as well as guidelines for preparation of such pro forma financial statements.

Overview of the RBI circular

Essential aspects

The following are key points from the RBI circular:

1. All scheduled commercial banks (banks) are required to submit their pro forma Ind AS financial statements, for the half-year ended 30 September 2016, latest by 30 November 2016.
2. The pro forma Ind AS financial statements need not be audited, since this information, while being a fair estimate of the impact to opening equity, is likely to change.
3. The pro forma financial statements should consist of the following:
    - Balance sheet, including statement of changes in equity,
    - Statement of profit and loss, and
    - Notes.
4. The RBI circular prescribes formats for the above, which are to be considered only for the preparation and submission of pro forma Ind AS financial statements.
5. The formats for the Ind AS financial statements for the accounting period beginning 1 April 2018 shall be notified separately.
6. A one-time exemption from preparing consolidated pro forma financial statements has been provided to banks which are not in a position to submit both stand-alone and consolidated pro forma Ind AS financial statements for the half-year ended 30 September 2016. Such banks are permitted to submit only stand-alone financial statements for this half-year. However, banks shall submit both stand-alone and consolidated pro forma Ind AS financial statements in the subsequent periods.

Key disclosures in the pro forma Ind AS financial statements

Accounting policies

In addition to the financial information prepared on the basis of the prescribed formats, the RBI circular requires banks to disclose the significant accounting policies applied while preparing the pro forma financial statements. These include policies relating to:

- Financial assets and financial liabilities, including the use of the ‘fair value option’ in designating financial assets or financial liabilities at Fair Value Through Profit or Loss (FVTPL) upon initial recognition.
- Impairment of financial assets, with details relating to the approach, assumptions and estimation techniques used. These include information on methodology for computation of Expected Credit Losses (ECL), level of segmentation in the portfolio used, criteria used for movement from stage 1 to stage 2 and 3 for ECL estimation, the method used to compute lifetime ECL, inclusion of forward looking information in ECL estimates and the impact of moving from the current approach to the ECL approach.
- Derivatives and hedge accounting.
- Derecognition of financial assets and financial liabilities.

- Employee benefits.
- Offsetting financial instruments.
- Income taxes.
- Significant areas of estimation uncertainty, critical judgements and assumptions in applying the accounting policies.
- Approach on exemptions under Ind AS 101, *First Time Adoption of Indian Accounting Standards.*

Date of transition for banks

The notional date for transition to Ind AS for the purposes of preparation of pro forma Ind AS financial statements for the half-year ending 30 September 2016 is 1 April 2016.

However, the date for transition to Ind AS for preparation of Ind AS financial statements for accounting periods beginning on or after 1 April 2018, remains unchanged and shall be as per the provisions of Ind AS 101.

Reconciliations

The RBI has directed banks to provide certain reconciliations which are to be given in sufficient detail so as to understand the material adjustments to the balance sheet as well as the statement of profit and loss. These reconciliations are expected to foster better understanding of how the transition from the existing financial reporting framework to Ind AS affected the reported balance sheet and financial performance. In addition, these reconciliations are expected to enable RBI to understand the significant adjustments to equity that could impact regulatory capital.

Following are the reconciliations which are to be included in the pro forma financial statements:

- Reconciliation of equity reported in accordance with the existing financial reporting requirements as on 1 April 2016 to its equity in accordance with Ind AS as on the same date.
- Reconciliation of equity reported in accordance with the existing financial reporting requirements as on 30 September 2016 to its equity in accordance with Ind AS as on the same date.
- Reconciliation of the total comprehensive income in accordance with Ind AS for the half-year ended 30 September 2016 with the profit or loss under the existing financial reporting requirements.

Next steps

- To submit pro forma Ind AS financial statements for the half-year ending 30 September 2016 onwards, the RBI has directed banks to refer to the broad application guidance in this circular as well as seek specific clarifications or highlight issues to the RBI in this regard.
- The RBI may issue further instructions, guidance or clarifications on relevant aspects as and when required.

Our comments

The RBI in its circular (circular DBR.BP.BC.No.76/21.07.001/2015-16) dated 11 February 2016 directed banks to set up a Steering Committee to plan and initiate the Ind AS implementation process. The strategy for this implementation has to be disclosed in the annual report from the financial year 2016-17 onwards. The Audit Committee is required to oversee the Ind AS implementation process and provide quarterly reports to the bank's Board on this subject.

Implementation of these steps by the banks is expected to assist in timely and effective submission of Ind AS pro forma financial statements for the half-year ended 30 September 2016 onwards and set the pace for smooth transition to Ind AS from 1 April 2018 onwards.

However, there are some critical issues which may be considered:

Accounting policies adopted for preparation of pro forma Ind AS financial statements

In order to prepare pro forma financial statements, banks are required to evaluate, select and develop as well as disclose the appropriate accounting policies for various types of transactions or financial statement items. The RBI recognises that these pro forma financial statements represent only a fair estimate of the impact to opening equity and are subject to change. However, banks should carefully assess the accounting policies adopted, as these are expected to provide a good indication of the likely impact on the banks' financial results when they ultimately transition to Ind AS. In addition, the level of effort and cost involved in estimating the adjustments is likely to be significant; however, it may consequently lead to efficiency in the final transition process due to the work already performed.

Further, this process provides banks with an opportunity to highlight relevant issues and seek clarity from the RBI. The policies adopted and their resultant impact on financial results and equity, may form the basis for further guidance from the RBI. Hence, banks should ensure that the process of selecting the accounting policies is implemented thoroughly, with adequate levels of rigour and analysis as is required.

Impairment methodology

Impairment is expected to be one of the most significant areas of impact for banks on transition to Ind AS. Consequently, the RBI circular seeks detailed information from banks on the methodology, assumptions and techniques used in estimating ECL. This is expected to involve significant time and effort by banks. Further, the RBI has advised banks to maintain a certain degree of flexibility in their approach towards designing systems and processes around impairment assessment, since RBI is expected to finalise its policy based on the inputs from banks coupled with the requirements of Ind AS 109, *Financial Instruments*.

While this circular requires detailed disclosures on impairment accounting policies, there is no detailed format of a note on impairment. Banks are expected to prepare their own disclosures till the time RBI provides additional disclosures in this regard.

This may serve to be a key challenge for banks since they are required to strike a balance between developing a thorough and robust approach to impairment assessment (in order to have a realistic estimate of the impact) and ensuring that enough flexibility is maintained to allow for changes based on RBI's policy as determined in the future.

Impact on group companies

Banks are required to submit consolidated pro forma Ind AS financial statements to the RBI. This means that all subsidiary, associate and joint venture companies of these banks shall also be required to prepare pro forma Ind AS financial information. This may be a key challenge for companies that have not initiated their Ind AS transition efforts and are therefore unable to prepare Ind AS financial information for the half-year ended 30 September 2016. While RBI has provided relief for group companies for the first half-year, we suggest that companies should commence their Ind AS transition process early to be prepared for submission of Ind AS financial information for the year ended 31 March 2017.

Banks get visibility on the impact of Ind AS on the structure of their transactions

Banks can expect to have good visibility of the likely impact on financial results when they prepare pro forma Ind AS financial statements. This provides an opportunity for business functions to understand the impact on or arising from their contracts and transactions and implement changes to the extent possible to avoid undesirable accounting outcomes.

Communication with stakeholders

While the pro forma Ind AS financial results are only for the purposes of submission to the RBI and are not expected to be publicly available, they present an opportunity for banks to understand the likely impact, well in advance of the actual Ind AS transition date. Therefore, banks may be able to better plan their communication with their stakeholders prior to actual transition and accordingly manage stakeholder expectations.

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The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

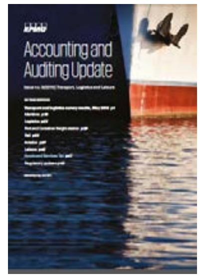
Voices on Reporting

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our recent call, on 22 June 2016, we covered key financial reporting and regulatory matters that are expected to be relevant for stakeholders for the quarter year ending 30 June 2016.

Our call included updates from the Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI), the Institute of Chartered Accountants of India (ICAI etc.

Missed an issue of our Accounting and Auditing Update or First Notes

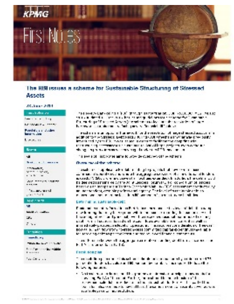


Issue no. 9/2016 – Transport, Logistics and Leisure

This month the Accounting and Auditing Update focusses on the transport, logistics and leisure sector and highlights key matters relating to accounting, financial reporting and regulatory areas relevant to this sector. This sector encompasses various sub-sectors. In this edition, we cast our lens on six sub-sectors: maritime, logistics, ports, rail, aviation and leisure. For the sub-sectors discussed in this publication, the Ind AS guidance relevant to revenue recognition and property, plant and equipment is likely to throw up potential challenges following the adoption of Ind AS and our articles elaborate those implementation challenges. The publication carries the results of a survey that we ran with a number of leading transport and logistics companies on the key regulatory changes that they face. These include Ind AS, the Companies Act, 2013, Income Computation and Disclosure Standards (ICDS) and proposed Goods and Services Tax (GST).

This publication also highlights direct and indirect tax issues, such as the treatment of service tax collected as part of gross income, ports facing ambiguity on claiming tax holiday and certain withholding tax issues, etc. Additionally, the article on GST highlights its expected impact on the supply chain, shipping, and logistics sub-sectors.

Finally, our publication carries a regular synopsis of regulatory updates including the guidance note on CARO 2016 issued by the Institute of Chartered Accountants of India and a summary of the clarifications given by the Ind AS Transition Facilitation Group in its second bulletin.



The RBI issues a scheme for Sustainable Structuring of Stressed Assets

23 June 2016

The Reserve Bank of India (RBI), through its notification, DBR.No.BP.BC.103/21.04.132

/2015-16 dated 13 June 2016, has issued guidelines for a scheme for Sustainable Structuring of Stressed Assets (the scheme) to facilitate the resolution of large borrower accounts that are facing severe financial difficulties.

The scheme is an optional framework for the resolution of large stressed accounts in addition to the Strategic Debt Restructuring (SDR) mechanism that was previously introduced by the RBI. It was issued in order to facilitate the deep financial restructuring necessary for a sustained revival of large projects, even without a change in promoters as was envisaged under the SDR mechanism.

This issue of First Notes aims to provide overview of the scheme.

Previous editions are available to download from: www.kpmg.com/in