Scheduled commercial banks, insurers/insurance companies and non-banking financial companies will be faced with unique challenges on adopting Ind AS in accordance with the phased road map laid down by the MCA and the RBI.

This thought leadership paper, which contains views of our expert (Khozema Anajwalla), explains.

Transition to Ind AS for scheduled commercial banks, insurance and non-banking financial companies

Why would there be an impact?

- The **current** regulatory guidelines are **rule based and prescriptive** whereas the onset of Ind AS will bring about some degree of **volatility** within profitability and equity;
- **Prudence** is the norm of RBI guidelines and **fair value** presentation is the objective of Ind AS; &
- Transition from a **rule-based and regulator-specified criteria method** ensuring consistency of application to an **ECL framework** is likely to result in **earlier recognition of credit losses**.

Where are the key challenges?

- **Implementation** challenge with regard to EIR;
- **Operational** challenge due to lack of adequate and reliable data necessary for the computation of EIR;
- **Implementation** challenge of the impairment model of Ind AS 109 as the ECL framework is largely subjective and based on management judgement. It requires fairly sophisticated credit modelling skills. It is also a huge challenge not only for banks but also for auditors, regulators and supervisors; &
- **Challenge in migrating** to fair value measurement arising on account of the absence of
    - active markets for corporate bonds and loans;
    - an established body of accredited valuers; &
    - adequate historical experience in the use of fair values by banks.

Here is an overview of the roadmap provided by the regulators and our advisory roadmap for a smooth transition to Ind AS by banks, insurance companies and NBFCs.

Roadmap provided by the regulatory authorities for implementation of Ind AS:

2015	
Sep 08	RBI released the report of the working group on implementation of Ind AS by banks in India.
Sep 29	RBI recommended a road map for implementation of Ind AS from 2018-19 onwards.
2016	
Jan 18	MCA issued a press release on the Ind AS roadmap for scheduled commercial banks, insurers/insurance companies and NBFCs.
Feb 11	RBI issued a circular on the implementation of Ind AS for scheduled commercial banks
Mar 30	MCA notified the companies *(Indian Accounting Standards) (Amendment)* Rules, 2016 which include a road map for implementation of Ind AS by NBFCs.
Jun 23	RBI issued a circular providing directions to ALL scheduled commercial banks to submit their PROFORMA financial statements in accordance with Ind AS for the half year ended September 30, 2016, latest by November 30, 2016.

Roadmap for smooth transition

IND AS NOT APPLICABLE TO REGIONAL RURAL BANKS .

VOLUNTARY ADOPTION OF IND AS UNLESS SPECIFIC CRITERIA BEING MET NOT PERMITTED TO SCHEDULED COMMERCIAL BANKS, INSURANCE COMPANIES AND NBFCs.

Your roadmap for a smooth transition to Ind AS reporting:

Continuous efforts towards learning, training and developing internal controls is essential.

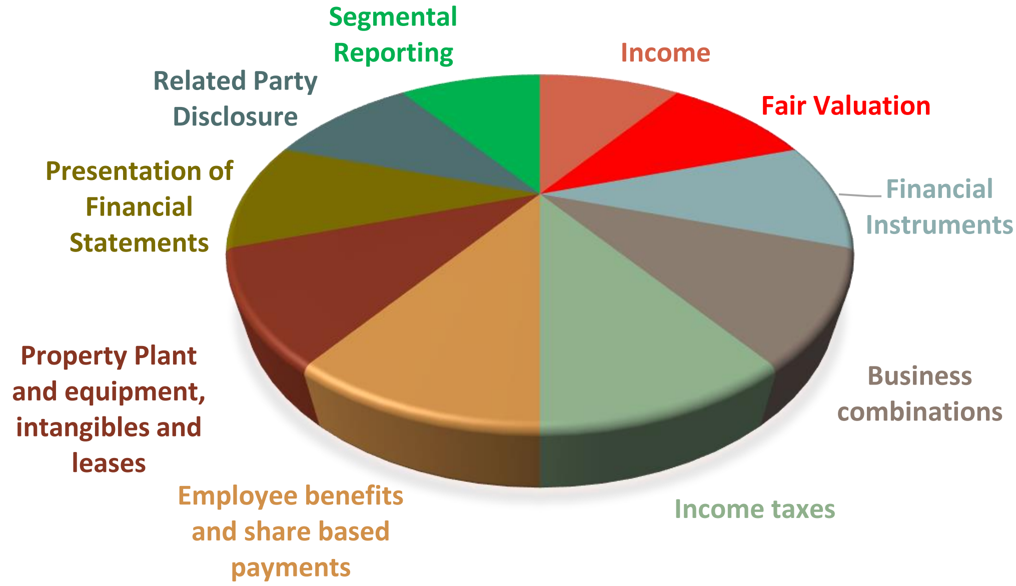
- Gearing the IT, treasury and risk management teams;
- Analyzing the diagnostics of Indian GAAP versus Ind AS;
- Analyzing impact on group policies versus Ind AS;
- Selecting from the choice of alternatives;
- Preparing the opening balance sheet;
- Preparing quartery updates for comparative reporting;
- Developing disclosure templates; &
- Preparing full set of financial statements based on Ind AS.

Applicability of Ind AS:

Applicable to	Applicability of Ind AS - Phase I from April 01, 2018	Applicability of Ind AS - Phase 2 from April 01, 2019
Commercial banks, term lending institutions, refinance institutions and insurance companies	Applicable to all the companies irrespective of their net worth	-
Listed NBFCs	Net worth >= INR 500 Crores	Net worth < INR 500 crores
Unlisted NBFCs	Net worth >= INR 500 Crores	Net worth >= INR 250 but less than INR 500 crores

Ind AS is also applicable to holding companies, subsidiaries, joint ventures or associates of the above mentioned institutions.

KEY IMPACT AREAS FOR TRANSITIONING TO IND AS



Key impacts on financial reporting:

1. A**ccounting for unrealized gains or losses** on investments accounted at FVTPL will present some amount of **volatility** in the profit and loss account. **Accounting for interest income on an effective interest rate** basis will impact net interest income, interest spreads and margins reported by banks.
2. **Impairment** seems to be one of the most significant area of impact on financial reporting. ECL framework shall be applied to all financial instruments such as financial assets, lease and trade receivables, financial guarantee contracts that are subject to impairment accounting. Greater use of fair values sometimes causes volatility in the income statement or equity.
3. **Measuring fair value for portfolios of derivatives** with offsetting risks; the adjustment to reflect 'own' credit risk may potentially cause hedge ineffectiveness in case derivatives are used for hedging purposes.
4. **Accounting for business combinations** would result in:
   - **a. recognition** of assets and liabilities at fair value;
   - **b. recognition** of intangible assets and contingent liabilities hitherto unrecorded on the acquiree's balance sheet to be now recorded at fair value in the acquirer's balance sheet;
   - **c. recognition** in the profit and loss account of the resulting gain or loss on measurement at fair value of the previously held equity interest in the acquiree in case of business combination being achieved in stages and thus increasing volatility;
   - **d. recognition** of net assets and the measurement of previously held equity interests and non-controlling interests thus significantly changing the value of goodwill recorded in financial statements;
   - **e. non-amortization** of goodwill but with the requisition of testing the same on an annual basis for impairment: &
   - **f. prescription of treatment solely** in accordance with Ind AS 103 for schemes filed with the High Court.
5. **Accounting for deferred taxes** in the CFS will be differ significantly from current Indian GAAP especially with respect to non-distributed profits of intra-group transactions, subsidiaries, joint ventures and associates. The principle of 'convincing evidence' per Ind AS in contrast to 'virtual certainty' is less stringent with a higher probability of recognizing deferred tax asset on unabsorbed depreciation and carry forward of losses.
6. **Accounting for ESOPs** will have to be remeasured using the fair value method probably resulting in increased charges for ESOPs for many entities with a significant impact on earnings per share. Various policies currently being followed in India for **accounting for share-based payments** to non-employees and for **accounting for group ESOPs** will now have to be in accordance with Ind AS 102 thereby reflecting the true compensation cost of receiving employee benefits.
7. **Component accounting** under Ind AS 16 will require entities to restructure their fixed asset register and re-compute depreciation. Annual impairment testing as opposed to amortization can create volatility in the profit and loss statement. Service contracts such as ATM contracts under Ind AS may need to be **accounted for as 'leases'** on the use of the specific asset being essential to the operations as well as satisfying certain conditions. This can have a substantial impact due to de-recognition of the asset from the books of the service provider on satisfaction of the finance lease classification.
8. **Presentation of financial statements** under Ind AS 1 would result in classification into current and non-current assets and liabilities on the face of the balance sheet with certain exceptions. **SOCIE** is now **mandatory.**
9. **Reassessment of the list of related parties** for enhanced relationships that can get covered under the scope of definition of related party in accordance with Ind AS 24.
10. **Change in segment reporting approach** as Ind AS 108 requires operating segments to be identified on the basis of internal reports on components of the entity under regular supervision and review by the CODM so as to allocate resources to the segment and also assess its performance. Entities will be required to furnish a disclosure of customer concentration enabling investors to assess the risks faced by a company. This would result in compilation of information of the revenue generated by each customer to furnish the necessary disclosures in accordance with Ind AS 108.

Integration, coordination and alignment of existing main objectives with Ind AS is the key to success.

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Glossary

Glossary of abbreviations:

ATM	Automated teller machine
CFS	Consolidated financial statement
CODM	Chief operating decision maker
ECL	Expected credit loss
EIR	Effective interest rate
ESOP	Employee stock ownership plan
FVTPL	Fair value through profit or loss
GAAP	Generally accepted accounting principles
Ind AS	Indian accounting standards
INR	Indian rupee
IT	Information technology
MCA	Ministry of corporate affairs
NBFC	Non-banking financial company
RBI	Reserve Bank of India
SOCIE	Statement of changes in equity

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