

Ind AS in Focus

The Reserve Bank of India has issued a circular, "Implementation of Indian Accounting Standards (Ind AS)", requiring scheduled commercial banks (excluding RRBs) to prepare and execute the implementation in advance of the applicability date.

This circular is issued pursuant to a press release issued by the Ministry of Corporate Affairs (MCA) on the roadmap for implementation of Ind AS by banks, non-banking finance companies (NBFCs) and insurance companies.

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The Bottom line

- The MCA issued a press release for Scheduled commercial banks (excluding RRBs), All-India Term-lending Refinancing Institutions (i.e. Exim Bank, NABARD, NHB and SIDBI) to prepare Ind AS based stand-alone and consolidated financial statements for FY 2018-19 with comparatives of FY 2017-18. Notwithstanding the roadmap for other corporates, this would apply to the holding, subsidiary, joint venture or associate companies of Scheduled commercial banks.
- Urban Cooperative Banks (UCBs) and Regional Rural Banks (RRBs) shall not be required to apply Ind AS and shall continue to comply with the existing Accounting Standards.
- The Reserve Bank issued a circular under Section 35A of the Banking Regulation Act, 1949, which mandates banks to comply with Ind AS and its implementation Roadmap issued by the MCA, provides implementation guidance and casts responsibility on the Audit Committees of the Boards and the Boards of the banks.
- As part of the monitoring by the Reserve Bank, the circular introduces additional reporting requirements until implementation. Accordingly banks need to submit 'pro forma Ind AS financial statements' to the Reserve Bank from HY ending 30 Sept 2016 onwards and disclose the strategy for Ind AS implementation, including the progress made, in their Annual Reports for FY 2016-17 and FY 2017-18.
- The Reserve Bank itself has undertaken the responsibility to take steps to facilitate the implementation process and issue necessary instructions/guidance/clarifications on relevant aspects as and when required. Further, from April 2016, the Reserve Bank shall hold periodic meetings with banks in this regard.

This edition of Ind AS in Focus outlines the requirements of the Circular issued by the Reserve Bank on Implementation of Ind AS for banks from FY 2018-19.

For more information, please see the following websites:

www.iasplus.com

www.deloitte.com

Responsibility of the bank and those charged with governance

The Reserve Bank acknowledges the fact that Ind AS implementation is likely to have significant impact on the banks' financial reporting, systems and processes. These changes need to be planned, managed, tested and executed in advance of the implementation date, with monitoring by those charged with governance.

- The Board of the bank has been cast with the ultimate responsibility of determining the Ind AS direction and strategy and overseeing the development and execution of the Ind AS implementation plan.
- The Audit Committee of the Board has been cast the responsibility to oversee the progress of the Ind AS implementation process and report to the Board at quarterly intervals.

What are the responsibilities of banks?

The Reserve Bank has mandated the following activities and reporting requirements for banks:

Activities and reporting requirements	Timeline	Whom?
Set up a Steering Committee, headed by an official of the rank of an Executive Director (or equivalent), comprising members from cross-functional areas of the bank to immediately initiate the implementation process. <ul style="list-style-type: none"> • Mandate of the Steering Committee • Rights and responsibility • Reporting obligation 	Immediately	
Send by email to the Reserve Bank – the name and details of the designated official and the team.	Immediately	Reserve Bank
Assess the impact of the Ind AS implementation on their financial position, including the adequacy of capital, taking into account the Basel III capital requirements, and present the quarterly progress reports to their Boards. It is presumed that such reports presented to the board be prepared/ approved by the Steering Committee first.	Quarterly	Board
Submit 'pro forma Ind AS financial statements' to the Reserve Bank from HY ending 30 Sept 2016 onwards until implementation.	Half yearly	Reserve Bank
Disclose the strategy for Ind AS implementation, including the progress made, in their Annual Reports for FY 2016-17 and FY 2017-18.	Annually	Stakeholders

Observation

The Reserve Bank has asked for strict compliance with the Circular. For the successful overall implementation by the banking industry, it has scripted a detailed implementation activities and reporting plan until implementation, identified critical steps and cast responsibility on those responsible for governance at the highest level.

The Reserve Bank has also taken the responsibility on itself to facilitate the implementation process and issue necessary instructions/guidance/clarifications on relevant aspects as and when required. It will be holding periodic meeting with the banks from April 2016 onwards.

What are the implementation challenges?

The transition to Ind AS is far more than a technical challenge of adopting a new accounting standard. It will be one of the most fundamental changes to affect the banking Industry for many years. The change will transform the way the banking institutions and markets judge performance and value, and may require a decisive shift in areas ranging from product design, lending policies and earnings management to information systems, market communications and performance-based pay.

Beyond accounting, Ind AS has extensive disclosures requirements, which leads to extensive data mining. For example, classification and measurement of financial instruments; nature and extent of its exposure to the associated risks (credit risk, market risk and liquidity risks) both in qualitative and quantitative terms – to reflect the way management perceives, measures and manages these risks; areas involving significant estimates and assumptions and related sensitivities.

The Reserve Bank has identified critical issues that need to be factored in within the Ind AS implementation plan, which include the following:

Critical Issues	Detailed activities
Ind AS Technical Requirements	<p>Project activities</p> <ul style="list-style-type: none"> • Diagnostic analysis of differences between the current accounting framework and Ind AS • Significant accounting policy decisions impacting financials • Drafting accounting policies • Preparation of disclosures • Documentation • Preparation of pro forma Ind AS financial statements • Timing the changeover to Ind AS • Dry-run of accounting systems and end-to-end reporting process before the actual conversion
Systems and processes	<p>Evaluate system changes</p> <ul style="list-style-type: none"> • Assessment of processes requiring changes • Identifying issues having significant impact on information systems (including IT systems) • Developing/ strengthening data capture system, where required • Performing data analytics and data mining
Business Impact	<p>Evaluate business impact</p> <ul style="list-style-type: none"> • Profit planning and budgeting • Taxation • Capital planning • Assessing the impact on capital adequacy
People	<p>Evaluation of resources</p> <ul style="list-style-type: none"> • Setting up adequate and fully dedicated internal staff for implementation • Creating comprehensive training strategy and programme

Observation

Effective Ind AS conversion would require significant input from practically every business unit and link in the decision-making and value-generating chain, including IT, HR, finance, marketing and investor relations. Without careful preparation, the volatility of reported results could reach unexpected levels and the level of execution risk may become unsustainable.

Ind AS is likely to increase income volatility, which certainly needs to be managed, or at least carefully explained to the markets, to avoid undermining investor confidence. Also, Management Information Systems may need to be revamped and economic capital and other common value-at-risk measurements reassessed as the current strategies could prove untenable.

For successful implementation, there is large amount of time commitment that banks will have to invest as there are significant process and information challenges associated with the adoption of this standard. So, it is imperative that the implementation is done right, the first time.

Ind AS 109, Financial Instruments – A big leap

The MCA has introduced Ind AS 109, an accounting standard for Financial Instruments. Ind AS 109 introduces concepts, wherein the accounting of financial assets is required to be reflective of a business model – to earn contractual cash flow versus fair value change, financial assets are derecognised on transfer of risks and rewards, loan loss provision is recognised based on Expected Credit Loss (ECL) model etc. Under the ECL model, a bank will make provisions not only based on its portfolio's historical loss experiences but also by factoring in its future expectations and the economic environment it operates in.

Use of fair value is all pervasive – from the initial recognition, i.e. transaction date, to subsequent measurements at each balance sheet dates, either for determining carrying value, impairment testing or disclosures.

Observation

Ind AS 109 is similar to IFRS 9, which is globally going to be implemented from 1st January 2018. Whereas, the Indian banks will be implementing Ind AS 109 from 1st April 2017 ahead of its global peers and would not have any precedents of experience. Intent, business model and substance-over-form will play a big role in accounting. Thus, the banks will take a big leap from rule-based to principles-based provisioning and accounting.

Importance of project management

Adoption of Ind AS also presents an opportunity to banks to recast their financial position and operating results on a globally recognised set of accounting pronouncements. This opportunity calls for a high degree of strategy in developing a framework for individual decisions. This framework should focus on the interplay between opening Ind AS equity and the potential for volatility in future earnings.

Through its circular, the Reserve Bank has emphasized the importance of project management. A project management framework would involve managing the entire process – a holistic approach to planning and execution by ensuring that all linkages are established between systems, people and business, besides effective communication with stakeholders.

Observation

Large, complex projects inherently require a thoroughly considered strategy. Early identification of issues, careful consideration of alternatives and quick resolution are critical to a project's success. The strategy, the process and the project structure must facilitate and reinforce management's resolution of issues. Organising a major Ind AS implementation project is a demanding task. The most successful global banks have devoted significant resources to their GAAP conversion projects – to analyse their major reporting units component by component, to compare the new accounting standards with existing reporting, to determine the appropriate accounting and to systematically obtain the information to meet the identified requirements under Ind AS. Even the first-time adoption policy choices are made with long-term implications as expected for the financial assets.

Applicability and timeline:

Scheduled commercial banks (excluding RRBs), All-India Term-lending Refinancing Institutions (i.e. Exim Bank, NABARD, NHB and SIDBI) are required to prepare Ind AS-based stand-alone and consolidated financial statements for FY 2018-19 with comparatives of FY 2017-18.

The banks shall apply Ind AS only as per the above timelines and are not permitted to adopt Ind AS earlier.

Notwithstanding the roadmap for corporates, this would apply to the holding, subsidiary, joint venture or associate companies of Scheduled commercial banks.

Urban Cooperative Banks (UCBs) and Regional Rural Banks (RRBs) are not required to apply Ind AS and shall continue to comply with the existing Accounting Standards, for the present.

In addition, the banks are required to submit 'pro forma Ind AS financial statements' to the Reserve Bank from HY ending 30 Sept 2016 onwards until implementation.

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