Sub-group on addressing IFRS convergence implementation issues and formulation of operational guidelines relating to banks - Financial Instruments

Sr. No.	Topic	Issues faced by the banks	Accounting as prescribed by IFRS	Accounting practices adopted presently	Relevant RBI guidelines	Impact of any statute / legislation	Suggestions of the SubGroup
A	**IAS 32 Financial Instruments: Presentation, IAS 39 Financial Instruments: Recognition & Measurement and IFRS 7 Financial Instruments: Disclosures**						
A.1	Fair Value - Gross / Net	Whether MTM should be booked on a net basis. (Ref : FEDAI's Circular dated May 29, 2003 on foreign currency options)	No specifications on whether the positive and negative MTMs on the instruments under the same category should be booked on gross or net basis.	Currently, the same has been booked on Gross basis, per deal / transaction			The positive and negative MTM on multiple contracts with same counter-party, which are settled simultaneously on a particular date, can be booked on net basis,only provided the prerequisites for netting contained in IAS 32 are complied with.Most MTMs will have to be booked gross as offsetting rules under IAS 32 will normally not be met.
A.2	Criteria for impairment of assets	The extant guidelines of RBI laid down objective criteria for assessment of impairment	IAS 39 lays down broad subjective principles for the purpose.	Impairment strictly as per RBI NPA Norms	Master Circular on Advances and other relevant circulars		Standard Assets fixed 0.40% of the provisioning required may have to be withdrawn. There will be a change as a fixed percentage general provisioning is not allowed; however there still needs to be a collective assessment of impairment requirements and IAS 39 will only ensure that there is more backup for conclusion and not just that it is a fixed percentage. For example a bank with less risky assets will have lower provisions than one with more risky ones. RBI needs to suitably amend Master Circular- Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
		There is regulatory concern in regard to inconsistency and incomparability that may arise if full subjective discretion were given to banks for assessment of impairment.	The main criteria is on the collateral value, no provision for impairment is needed				To the extent of the collaterals of the assets (Secured Portion) has the value, the impairment provisioning should not be made for the secured portion; irrespective of the Categorization of the assets (Substandard, Doubtful I, II, III)
		On the Secured Portion also, the provision for impairment needs to be done as per RBI Guidelines					RBI may review its guidelines to banks for assessment of impairment to supplement the subjective principles of IAS 39 and also to align the extant guidelines with IAS 39.

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A.3	Investment under AFS and HFT category is to be valued at fair value.	Currently detailed guidelines by RBI on Valuation of Investments	Fair Valuation based on the available market information is to be done	RBI Circulars are being followed. For unquoted, where the Networth can not be computaed, the Investment is valued at Rs. 1	Master Circular on Investments		Current RBI norms are more stringent, except that IAS 39.66, talks about such impairment loss, if any, can not be reversed.
		Norms for determination of fair value for certain instruments specifically in cases where quotation is not available or market is not sufficiently liquid :			Various Circulars for Securitization Receipts / CDR, etc		
		§ Unquoted equity (whether at cost as per Standard?)					This needs to be addressed appropriately by RBI
		§ SRs (whether to rely on NAV provided by the issuer?)					
A.4	Securitisation transactions	There is possibility of conflict between the accounting prescribed by RBI circular and IAS 39 in relation to de-recognition of assets securitised, recognition of gain on securitisation	IAS39.17 An entity should de-recognise a financial asset when and only when (a) the contractual rights to the cash flows from the financial asset expire or (b)it transfers the financial asset as set out in paragraphs 18 & 19 and the transfer for de-recognition in accordance with paragraph 20. Prescriptions of Paragraph 20 are very critical and those are (a) if the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity should de-recognise the financial asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer. (b) if the entity retains substantially all the risks and rewards of ownership of the financial asset the entity should continue to recognise the financial asset (c) if the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset the entity should determine whether it has retained	The assets are derecognised if the true sale criteria as mentioned in the RBI circular are met. The gain on derecognition would be amortised during the life of the securities even if the assets are not existing in the books	As per RBI Circular (DBOD.NO.BP.BC.60 / 21.04.048/2005 06)		RBI Needs to revise its Guidelines on Securitisation.

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A.5	Acceptances and bills payable	Bank's liability under Acceptances, endorsements of customer bills will have to be recorded as liabilities on balance sheet with a corresponding receivable shown as assets. This will have two implications :	Record the transaction as "Off Balance sheet" item and changes in the Fair Value needs to be accounted for				Not an accounting issue, but the Banking issue from CRR / SLR point of view.
		a) Require the change in balance sheet format under Third Schedule and					
		b) Impact on CRR / SLR					
A.6	Treatment of unrealized gains and losses on AFS Portfolio		As per the Standard, unrealised gain/loss on AFS portfolio shall be shown as part of the equity account.	As per current practice, any depreciation in the value of AFS portfolio is provided for and debited to the P&L and any appreciation is ignored.			The Present RBI Guidelines needs to be revised
							Impact on CRR / SLR and capital adequacy needs to be looked into
A.7	Repo Accounting	There is possibility of conflict between the accounting prescribed by RBI circular (IDMC 3810/11.08.10/2002-03 dated 24/03/2003) and IAS 39. It appears that RBI circular is based on legal form of the transaction i.e. the transaction is an outright sale and purchase. Whereas IAS 39 requires that the transaction be accounted based on 'substance' over form and based on transfer of risk/reward of ownership. Para 37 wordings create some doubts in the minds of readers as to whether certain Repo transactions e.g. where the transferee has the right to sell or re-pledge the collateral meet the criteria for de-recognition. However, transferor can de-recognise the collateral only if he has defaulted under the terms of the contract (Para 37(c). In other cases, the paragraphs 37(a) & (b) do not require de-recognition of the asset by the transferor but only require reclassification into another class of asset.	Paragraph 17 and 18 of IAS 39: an entity should de-recognise a financial asset only when the contractual rights to the cash flows from the financial asset expire or if it transfers the financial asset as set out in paragraphs 18 & 19 and transaction qualifies for de-recognition in accordance with paragraph 20. In accordance with paragraph, the entity can de-recognise the asset only if it transfers substantially all the risks and rewards of ownership of the financial asset. Further as per paragraph 29, if a transfer does not result in de-recognition, entity should continue to recognise transferred asset and recognise a financial liability for the consideration received. Paragraph AG.51 of Application Guide provides examples when an entity has retained substantially all the risks and rewards of ownership which includes, interalia, a sale and repurchase transaction (e.g. REPO transactions) where the repurchase price is a fixed price or the sale price plus a	Repos & Reverse Repos are to be treated as outright sale or purchase in India as per RBI guidelines; accordingly they have to be accounted for. In case of Repo, liability account, should be netted off against Investments for all local reporting as per RBI Guidelines. b) In case of Reverse Repo, asset balances should be included as Investments for all local reporting as per RBI Guidelines	As per the Uniform Accounting Procedure, securities sold/ purchased under Repo/ Reverse Repo are treated as sale /purchase and accounted for in the Repo/ Reverse Repo a/c and entries are reversed on date of maturity	CRR/SLR treatment of REPO & Reverse REPO transactions	RBI circular may be suitably amended to incorporate IAS 39 accounting principles. As the Repo transactions will have to be accounted as collaterised borrowings, this increases the borrowings or inter bank borrowings on the liability side and the investments on asset side of the bank. Accordingly, it will have implications on CRR and SLR requirements of the bank and hence, the related RBI circulars may be reconsidered.

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A.8	Liability revaluation and the impact on computation of NDTL						Not an accounting issue, but the impact on CRR / SLR and Captial Adequacy needs to be considered by the Banks
A.9	Para 93 of the Application Guidelines - which deals with Interest Recognition on impaired assets	Currently, interest recognition has to be stopped in the financial statements, once the asset is classified / reckoned as "NPA"	Once a FA or Group of FA has been written down as a result of an impairment loss, interest income thereafter, is to be recognized using rate of interest used to discount future cash flows for the purpose of measuring the impairment loss	Non recogniztion of Interest eventhough, the same is levied on Assets and parked in Suspense/Memorandum Accounts			RBI Guidelines need to be changed to be in line with IAS 39
A.10	Hedge Accounting	Currently, booking of net negative MTM on Product-wise, category wise basis	Separate Accouning treatment prescribed in IFRS				RBI Circulars on Investment and Hedges needs to be relooked
A.11	Advances restructured as Investments		Needs to be continued to be treated and accounted as advances	Advance restructured into Debentures are treated as Advances whereas Advances restructured into Preference Shares are treated as Investments			RBI to modify guidelines for Advances restructured to Preference Shares
A.12	Categorization of Investments	Capping on HTM Investments	No such capping prescribed by IFRS	No Accounting issue			No Accounting issue. But the RBI Guidelines on Investments under HTM category wrt 25% of the NDTL needs to be relooked
							The reclassification needs to be permitted only as per the rigours of IAS 39 and RBI guidelines revised accordingly
A.13	Short Sale Permitted by RBI	Presently, short sale are required to be covered through repo transaction and short sale and repo is netted in the B/S.	As per the Standard, liability on account of short sale will be measured at MTM basis and difference between receivable and payable will be recognised as profit or loss in P&L.				RBI Guidelines on Short Sale and its covering through REPO deals need to be amended

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A.14	Redeemable preference shares		Redeemable Preference Shares to be treated as liability Dividend and Dividend Distribution Tax on the Redeemable Preference Shares to be treated as Interest	(a) Redeemable Preference Shares reflected as Capital (b) Dividend on Preference considered as Appropriation of Profit for Companies Act, 1956 purpose. RBI circular DBCD No. BP BC 42/21.01.002 suggests accounting of Preference Share Dividend as interest			RBI and Companies Act to be modified.
A.15	Mandatory Borrowing / Lendings at Consessional rates		These are to be fair valued at Market Rates	These are Accounted at the Sanctioned concessional Rates			Even Government / Regulator driven directed / mandatory concessional borrowings / lendings may need to be fair valued