

# **Ind AS and Audit of Banks and NBFC**

**July 7, 2018**

# Broad conceptual differences



Ind AS -principles based as compared to current prescriptive guidance issued by the regulators

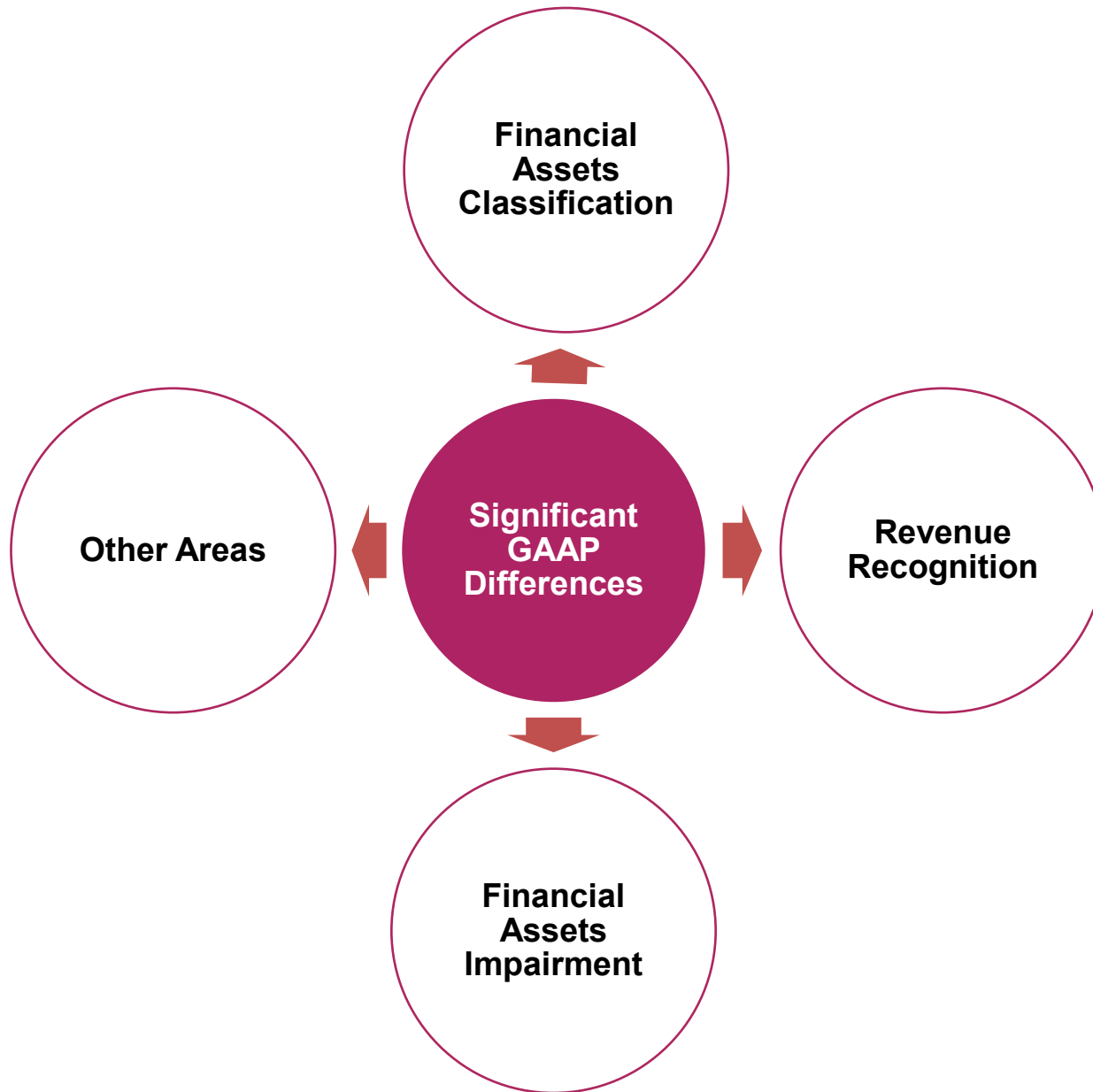
Detailed rules or guidance on implementation is still awaited

Immediate need for credit / business functions of banks to focus on IND AS

# Key areas to focus on audit

- Assessment of Business model
- Amortization of fees
- MTM adj. and amortization of investment (inc. hedges and CVA/DVA)
- Impairment on loans & investments (ECL)
- Reversal of lease accrual on SLM
- Amortization of retail fees (net of DSA cost)
- Fair valuation of ESOP

# Significant GAAP Differences



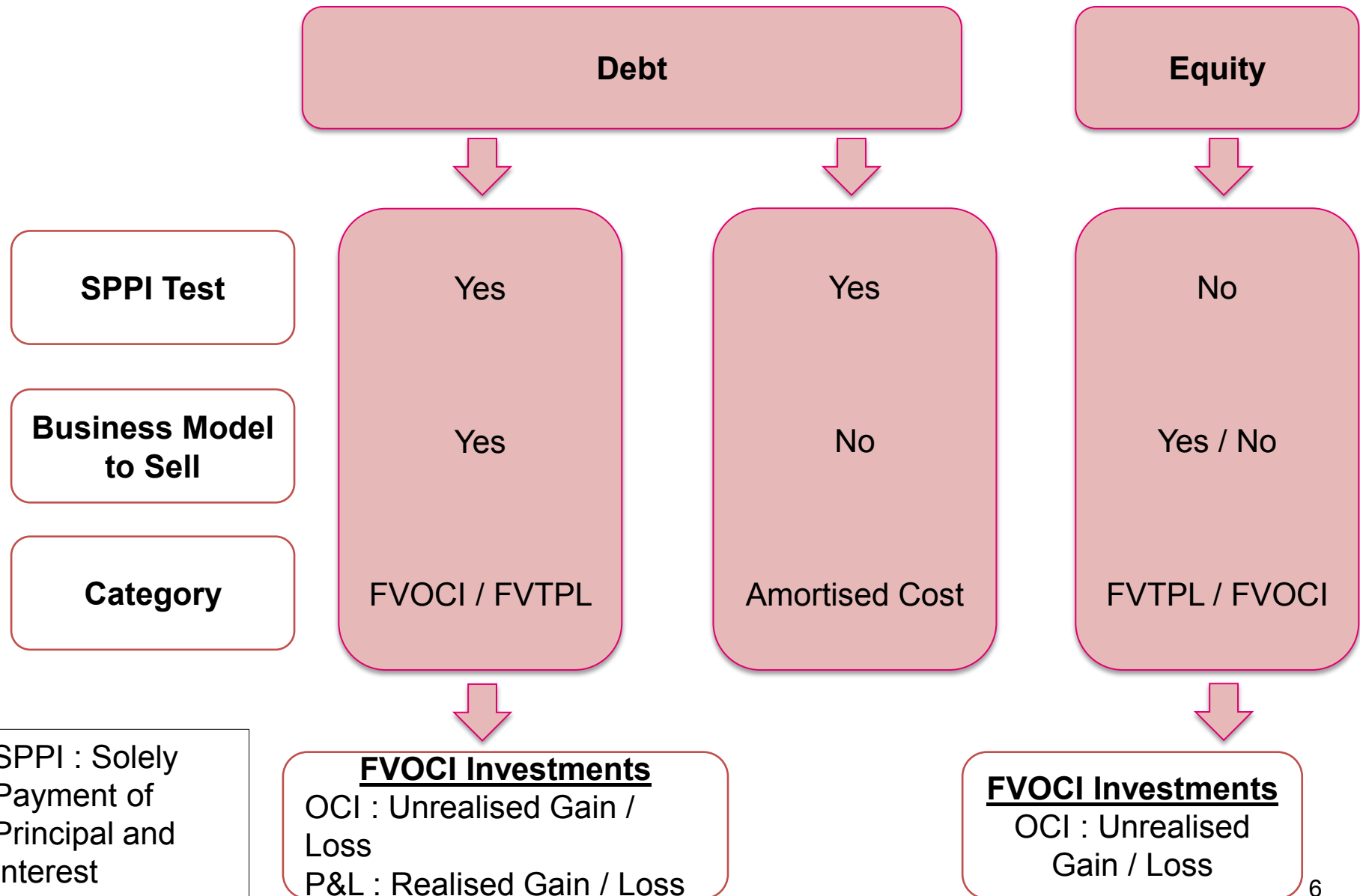
# Financial Assets Classification

Area	Investments Categories	Initial Recognition	Subsequent Measurement	Classification Criteria
<b>IGAAP</b>	<ul style="list-style-type: none"> <li>▪ HTM</li> <li>▪ HFT</li> <li>▪ AFS</li> </ul>	<ul style="list-style-type: none"> <li>▪ At cost  (i.e. transaction price)</li> </ul>	<ul style="list-style-type: none"> <li>▪ HTM - Cost</li> <li>▪ AFS/HFT - Only net depreciation provided</li> </ul>	<ul style="list-style-type: none"> <li>▪ RBI guidelines</li> <li>▪ Intention of sale / holding</li> </ul>
<b>IND AS</b>	<ul style="list-style-type: none"> <li>▪ Amortised cost</li> <li>▪ FVOCI</li> <li>▪ FVTPL</li> </ul>	<ul style="list-style-type: none"> <li>▪ At Fair value</li> </ul>	<ul style="list-style-type: none"> <li>▪ Amortised cost</li> <li>▪ Fair value                             <ul style="list-style-type: none"> <li>- OCI</li> <li>- P&amp;L</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Entity's business model</li> <li>▪ Contractual cash flow</li> </ul>

FVOCI : Fair Value through Other Comprehensive Income  
 FVTPL : Fair Value through Profit & Loss

# Financial Assets Classification Criteria

Classification decision to be made at inception



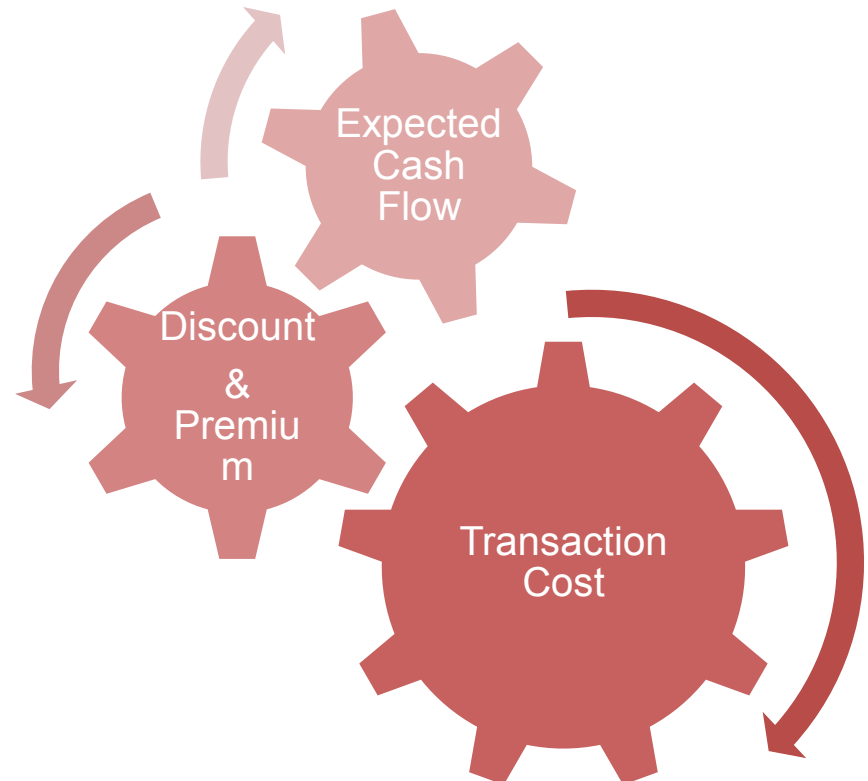
# Revenue Recognition

Area	Loan Origination Fees
IGAAP	<ul style="list-style-type: none"><li>▪ Processing fees recognized upfront</li><li>▪ Sourcing costs recognised as expenses</li></ul>
IND AS	<ul style="list-style-type: none"><li>▪ Loan origination fees net of costs amortised as interest income</li><li>▪ Effective Interest Rate (EIR) method</li></ul>

## Effective Interest Rate

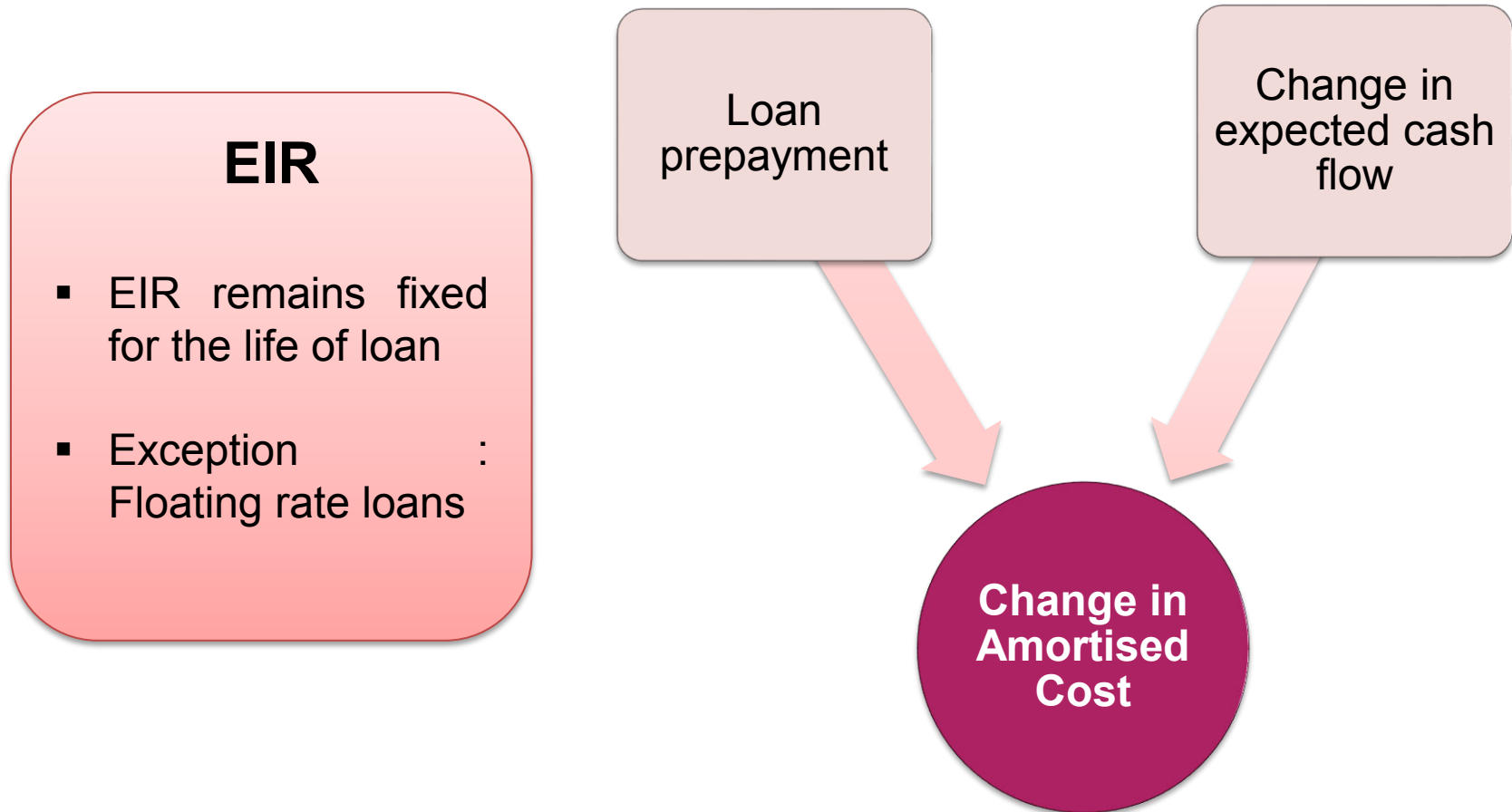
The rate that exactly discounts estimated future cash flows through the expected life of the financial asset to the gross carrying amount

## Elements of EIR



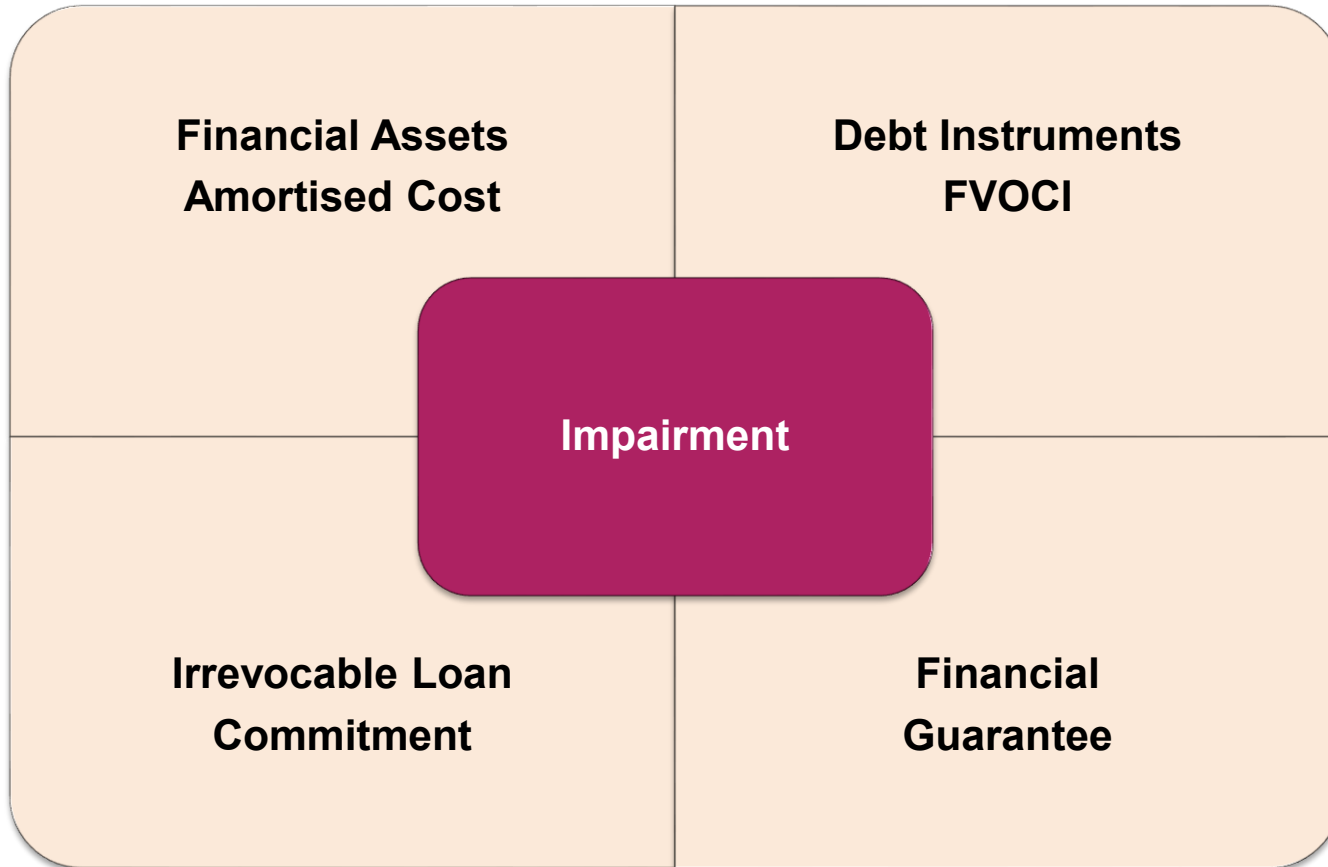
# Factors affecting EIR & amortised cost

## When amortised cost to be changed?



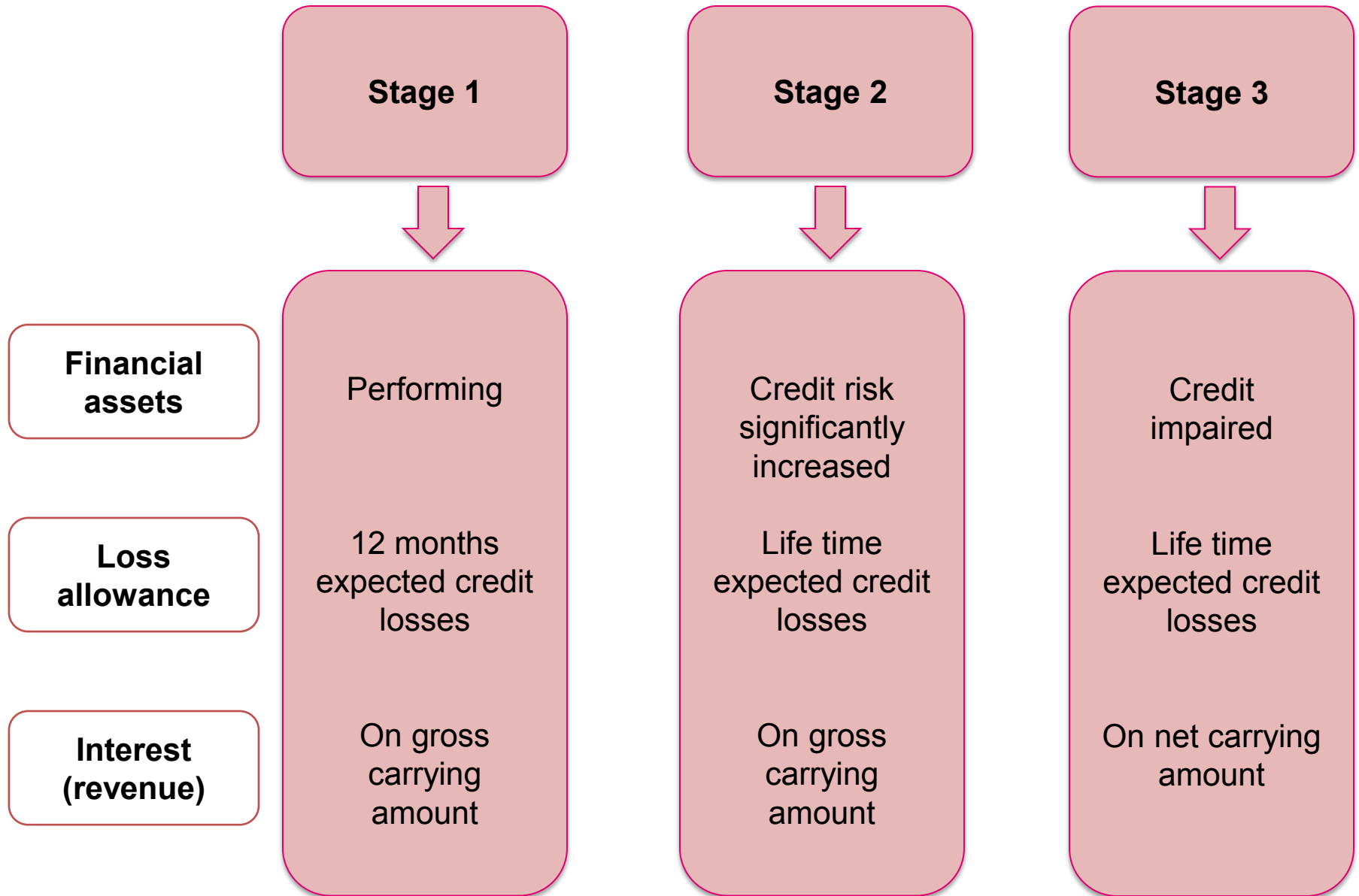


# Impairment Applicability



Impairment provision is also required for Non fund based and undrawn exposures

# Impairment Provisioning



# Impairment provisioning approach

## Individual Assessment

Corporate NPA and other impaired accounts

Provision = O/s amount  
Less PV of estimated cash flow

## Collective Assessment

Other accounts  
(E.g.: Standard loans, Retail NPA, etc.)

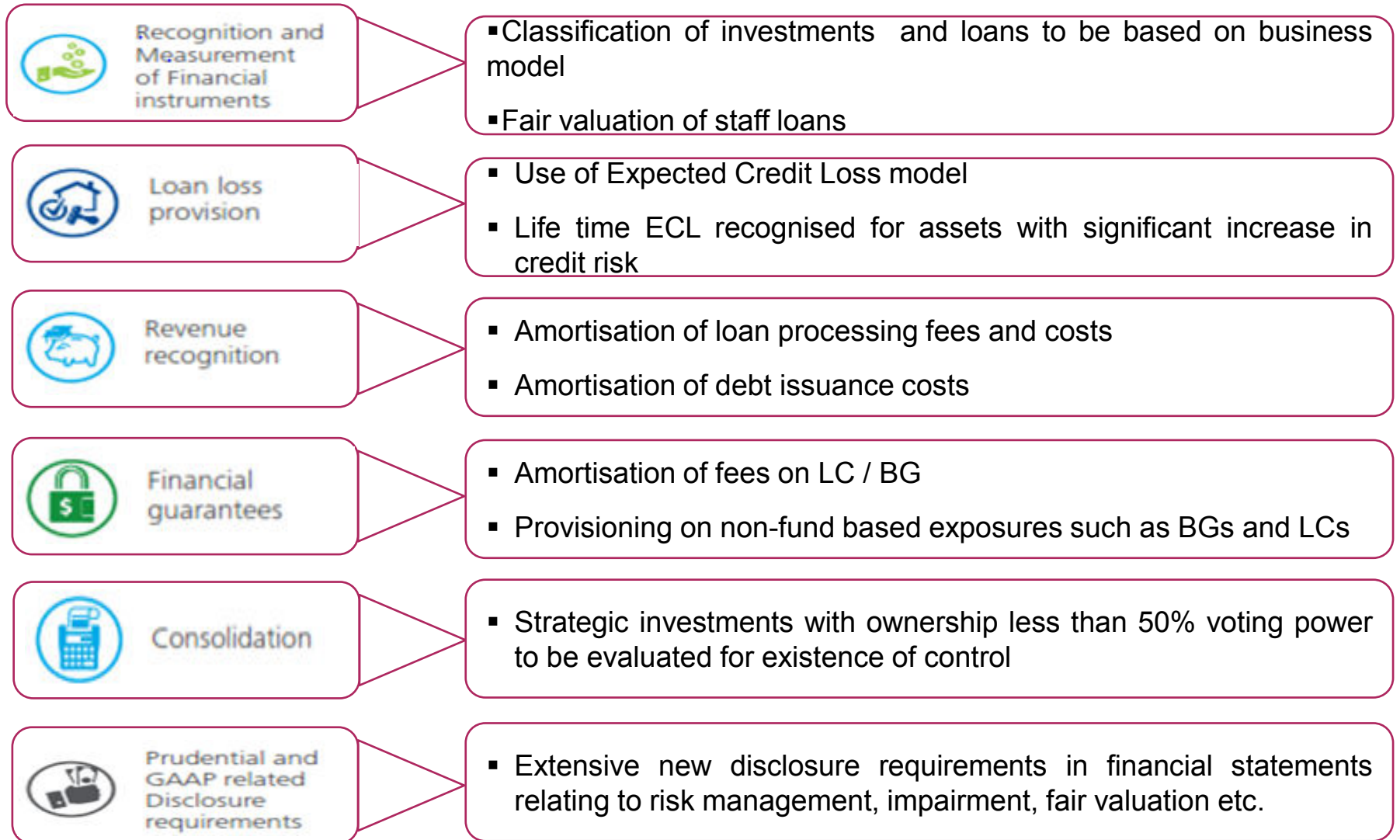
Provision =  
 $EAD * PD * LGD$

EAD : Exposure at default; PD : Probability of default; LGD : Loss given default

# Significant Differences - Other Areas

Area	Consolidation	Debt Issuance Cost	ESOP	Derivatives
<b>IGAAP</b>	<ul style="list-style-type: none"> <li>Ownership of more than 50% voting power or composition of the governing body</li> </ul>	<ul style="list-style-type: none"> <li>Recognize d upfront as expense</li> </ul>	<ul style="list-style-type: none"> <li>Intrinsic value method</li> </ul>	<ul style="list-style-type: none"> <li>Trading derivatives measured at fair value</li> <li>Hedge derivatives accounted for on accrual basis</li> </ul>
<b>IND AS</b>	<ul style="list-style-type: none"> <li>Broader definition of control as existence of power</li> <li>Can exist even with less than 50% ownership of equity</li> </ul>	<ul style="list-style-type: none"> <li>Amortized over the tenure of debt using EIR</li> </ul>	<ul style="list-style-type: none"> <li>Fair value method</li> <li>Amortization of comp. cost in P&amp;L over the vesting period</li> </ul>	<ul style="list-style-type: none"> <li>All derivatives measured at fair value</li> <li>Hedge derivatives : both underlying and derivative to be measured at fair value</li> </ul>

# Impact for banks under Ind AS



# Key disclosures

- Specific quantitative disclosures are required under Ind AS for the following types of risks
- Credit risk disclosure includes:
  - Information about credit quality of assets neither past due nor impaired
  - Analysis of age of financial assets that are either past due or impaired
  - Information about collateral
- Liquidity risk:
  - Maturity analysis for financial liabilities based on remaining contractual maturities
- Market risk
  - Sensitivity analysis showing how profit or loss and equity would have been affected by changes in the relevant risk variable

# Key disclosures

- Fair valuation and fair value related hierarchy disclosures
- Level 1: unadjusted quoted prices in active markets for identical assets or liabilities
- Level 2: Inputs other than the quoted price included in level 1 that are observable either directly or indirectly
- Level 3: Unobservable inputs
- FEDAI/FIMMDA may provide guidance on standard valuation methodologies

Thank you