Making the financial sector Ind-AS ready

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Banks need to develop loan risk assessment policy to sync with new accounting standard in two years

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The Ministry of Corporate Affairs last week laid out a road map for implementation of the new Indian Accounting Standards (known as Ind-AS) for scheduled commercial banks, insurance companies and non-banking financial companies (NBFCs). As the banking sector gets its act in place to clean up the non-performing assets from the balance sheets, it would simultaneously have to prepare a loan risk assessment policy within the next two years in keeping with the requirements of the new accounting standards.

According to the roadmap suggested by the ministry – in consultation with the Reserve Bank of India (RBI), Insurance Regulatory and Development Authority of India (Irdai), and the Pension Fund Regulatory and Development Authority — commercial banks, insurance companies and NBFCs with net worth of ₹500 crore or more will have to compulsorily implement the new accounting standards from 2018-19. They also have to prepare comparative information for FY17-18.

Accounting and audit experts say one of the foremost challenges before the financial sector players would come from implementing provisions under Ind-AS 109. These require the recognition of expected credit losses based on forward-looking information, not just incurred losses. Today, there are no accounting norms for the losses incurred by the banks. These are provisioned for according to the existing Reserve Bank of India (RBI) guidelines. "Ind-AS 109 requires an expected credit loss mechanism to determine the provision of losses, or expected losses in future. There is a specific guidance in the accounting standards that banks have to comply with," says Pankaj Chadha, partner in Indian member firm of EY Global.

Further, any loan loss provision will not only take into consideration past credit deterioration or events, but also future likelihood of default, such as risks arising out of non-recoverability, or any delay in contractual payments. "Estimation of expected credit loss will require development of complex model and data points. The beauty of this accounting norm (Ind-AS 109) is that the banks would have to make extensive disclosures as to what mechanisms they are following while doing credit-risk assessments," adds Chadha.

Sai Venkateshwaran, partner and head of accounting advisory services, KPMG in India, says the roadmap applicable for banks and NBFCs in India closely follows the timelines for the global adoption of the new standard on financial instruments (IFRS-9), in particular the new expected loss model for impairment of financial assets (loan loss provisioning), which is slated for 2018. "This will ensure that Indian banks and NBFCs will not be far behind their global counterparts, while having the benefit of learning from the global experience," he says. IFRS-9 is the equivalent of Ind-AS 109 in international financial reporting standards.

The main challenge will be recognition of expected credit losses based on forward-looking information, not just incurred losses

Ashish Gupta, partner, Walker Chandiok & Co LLP, notes that the new accounting requirements for classification, measurement and impairment of financial assets are not only judgmental and complex, but will also require significant investments in processes and IT systems.

Within the next two years, the sector regulators — RBI and Insurance Regulatory and Development Authority of India (Irdai) — will have to adopt these standards and issue guidelines and circulars to avoid confusion among the financial sector players. "How quickly these regulators align these new accounting norms to their own standards, and issue circulars and notifications, would be quite important," points out Chadha.

The roadmap does not permit the entities to implement the new accounting norms before the prescribed time. "If they permit voluntary adoption, it will be difficult to regulate the entities as different banks may use different accounting basis. That would make it difficult for the regulator to monitor those entities," he says.

Experts are of the view that implementing Ind-AS is likely to impact key performance metrics and will require more thoughtful communication with the board of directors, shareholders and other stakeholders. The financial sector players would also have to assess the impact of the new accounting standards on the entity's processes, systems, controls, income taxes and contractual arrangements. "Successful Ind-AS implementation will require a thorough strategic assessment, a robust step-by-step plan, alignment of resources and training, strong project management and, finally smooth integration of various changes into normal business operations," says a recent note prepared by PwC for its clients.