Master Direction on presentation and disclosures in financial statements

A consolidation exercise by RBI

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Introduction

The Reserve Bank of India ('RBI') has, on August 30, 2021, issued RBI (Financial Statements - Presentation and Disclosures) Directions, 2021 ("Master Direction") which deals with presentation and disclosures in Financial Statements of all banking companies.

Applicability

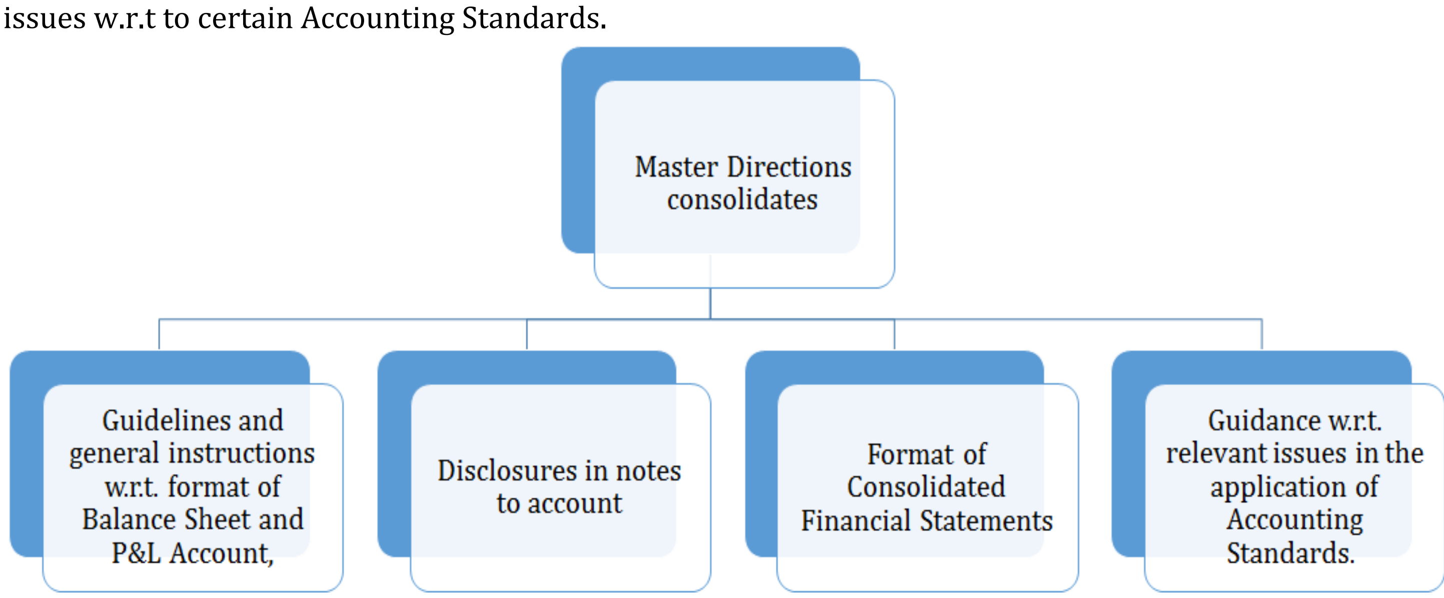
(i) All banking companies (including Foreign Banks, Local Area Banks (LABs), Small Finance Banks, Payment Banks), corresponding new banks, RRBs and SBI as defined in Section 5 of the Banking Regulation Act, 1949 (BR Act).

(ii) Primary co-operative banks ('Urban Co-operative Banks' or 'UCBs') as defined in Section 56 of the BR Act.

This Master Direction consolidates multiple RBI circulars / guidelines relating to disclosures in financial statements of banks in one place, its object being:

> "*A Master Direction incorporating, updating and where required, harmonizing across the banking sector the extant guidelines/instructions/directives on the subject has been prepared to enable banks to have all current instructions on presentation and disclosure in financial statements at one place for reference.*"

While the Master Direction does not provide for new disclosures, it is important to understand the guidance given by RBI on specific issues w.r.t to certain Accounting Standards.



In this article, we have tried to present the issues faced by banks in complying with certain Accounting Standards and guidance given by RBI on such issues. A table setting out the same is as below:

Objective	Issue	Guidance
Accounting Standard 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies		
It requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities. Further, Paragraph 4.3 of Preface to the Statements on Accounting Standards issued by the ICAI states that Accounting Standards are intended to apply only to items which are material.	1. The format of the P&L accounts of banks prescribed in Form B under Third Schedule to the Banking Regulation Act, 1949 does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss. 2. Materiality is not objectively defined in the case of banks. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with AS by Banks dated March 29, 2003	1. Disclosure of the impact of prior period items on the current year's profit and loss, wherever warranted, may be made in the 'Notes on Accounts' to the balance sheet of banks. 2. Any item of prior period income or prior period expenditure shall be considered as material for banks if it exceeds: a) 1% of the total income / total expenditure of the bank if the income / expenditure is reckoned on a gross basis; or b) 1% of the net profit before taxes or net losses as the case may be if the income is reckoned net of costs.
Accounting Standard 9 – Revenue Recognition		
This Standard deals with the bases for recognition of revenue in the P&L statement of an enterprise. It is concerned with the recognition of revenue arising in the course of the ordinary activities of the enterprise from the sale of goods, the rendering of services, and the use by others of enterprise resources yielding interest, royalties and dividends.	Auditors of a few banks had qualified the accounts for non-compliance with AS-9 because the banks had not followed the accrual basis of recognising income in respect of certain items of income which, wherever necessary, are required to be split over two or more accounting periods due to the nature of the transaction. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with AS by Banks dated March 29, 2003	Non-recognition of income by the banks in case of non-performing advances and non-performing investments, in compliance with the regulatory prescriptions of RBI, shall not attract a qualification by the statutory auditors as this would be in conformity with provisions of AS-9, as it recognizes postponement of recognition of revenue where collectability of the revenue is significantly uncertain.

<table>
<tr><th>Objective</th><th>Issue</th><th>Guidance</th></tr>
<tr><td colspan="3">Accounting Standard 11 - The Effects of Changes in Foreign Exchange Rates</td></tr>
<tr><td>AS-11 is applied in the context of the accounting for transactions in foreign currencies and in translating the financial statements of foreign operations.</td>
<td>1. Classification of Integral and Non-integral Foreign Operations
The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operated and is classified as either ‘integral foreign operations’ or ‘non integral foreign operations'. How will the representative offices set up in foreign countries, foreign branches and off-shore banking units set up in India be classified.

2. Exchange rate for recording foreign currency transactions and translation of financial statements of non-integral foreign operation
Banks face difficulty in applying the exchange rate prevailing at the date of the transaction w.r.t. the items which are not being recorded in Indian Rupees or are currently being recorded using a notional exchange rate, due to their extensive branch network and volume of transactions.

3. Closing rate
A standard closing rate is required to maintain uniformity.

4. Foreign Currency Translation Reserve
Will repatriation of accumulated profits from overseas branches be considered as disposal or of interest in non-integral foreign operations?

Previous RBI Circulars which stand repealed:

1. AS - 11 (Revised) Accounting for the Effects of Changes in Foreign Exchange Rates dated 2 March, 2002</td>
<td>1. Foreign branches of Indian banks, IFSC Banking Units (IBUs) and Offshore Banking Units (OBUs) set up in India by banks shall be classified as ‘non-integral foreign operations’. Representative offices of banks set up abroad shall be classified as ‘integral foreign operations’.

2. Banks may use a rate that approximates the actual rate at the date of the transaction:

Weekly average closing rate and a quarterly average closing rate published by FEDAI for various currencies.

Indian branches and integral foreign operations may use the weekly average closing rate of the preceding week, published by FEDAI, if the same approximates the actual rate at the date of the transaction.

Banks may use the quarterly average closing rate, published by FEDAI, for translating the income and expense items of non-integral foreign operations during the quarter.

If the difference between (A) weekly average closing rate of the preceding week and (B) the actual rate at the date of the transaction, is more than 3.5% of (B), the closing rate at the date of the transaction shall be used.

In respect of non-integral foreign operations, if there are significant exchange fluctuations during the quarter, use the exchange rate at the</td></tr>
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Objective	Issue	Guidance
	2. AS-11 (Revised) 'The effects of changes in foreign exchange rates' dated 8 April 2003 3. AS-11 'The effects of changes in foreign exchange rates' dated March 31, 2004 4. Guidelines on compliance with AS 11 (revised 2003) 'The Effects of Changes in Foreign Exchange Rates' dated March 15, 2005 5. Guidelines on compliance with AS 11 (revised 2003) - 'The Effects of Changes in Foreign Exchange Rates' dated April 5, 2006 6. Guidelines on compliance with AS 11 [The Effects of Changes in Foreign Exchange Rates] by banks dated April 18, 2017	date of the transaction instead of the quarterly average closing rate. *(Significant exchange fluctuations means the difference between the prevailing exchange rate at the date of transaction and quarterly average closing rate is more than 7% of prevailing exchange rate.)* 3. In order to ensure uniformity among banks, the closing rate for the purposes of AS-11 would be the last closing spot rate of exchange announced by FEDAI for that period. 4. Repatriation of accumulated profits shall not be considered as disposal or partial disposal of interest in non-integral foreign operations. Accordingly, banks shall not recognise in the P&L account, the proportionate exchange gains or losses held in the foreign currency translation reserve on repatriation of profits from overseas operations.
Accounting Standard 17 – Segment Reporting		
The Standard establishes principles for reporting financial information, about the different types of products and services an enterprise produces and the different geographical areas in which it operates. As per the Standard, for reporting the financial information, business and geographical segments are required to be identified.	Lack of clarity for identifying the business segments and geographical segments as also the absence of uniform disclosure formats as relevant to banks. **Previous RBI Circulars which stand repealed:** 1. Applicability of AS 17,18,21 and 22 dated May 29, 2002 2. Guidelines on compliance with AS by Banks dated March 29, 2003 3. Guidelines - AS 17 (Segment Reporting) dated April 18, 2007	The Master Direction provide for an indicative format for disclosure under AS-17. The business segments are divided into Treasury, Corporate / Wholesale Banking, Retail Banking and Other Banking Business.

Objective	Issue	Guidance
Accounting Standard 18 – Related Party Disclosures		
This Standard is applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. This Standard requires that the name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.	1. Absence of a disclosure format relevant to banks. 2. Banks were not sure who their related parties were, including KMPs. 3. Compliance with AS-18 would infringe upon the bank's obligation to maintain confidentiality of their customers' accounts. **Previous RBI Circulars which stand repealed:** 1. Applicability of AS 17,18,21 and 22 dated May 29, 2002 2. Guidelines on compliance with AS by Banks dated March 29, 2003	1. The Master Direction prescribe an illustrative format for disclosure by banks. 2. Related parties for a bank include its parent, subsidiary(ies), associates/ JV, KMP and their relatives as per section 45 S of the RBI Act, 1934. KMP are the whole-time directors for an Indian bank and the CEO for a foreign bank having branches in India. 3. The disclosures may be limited to aggregate for each of the above related party categories and would pertain to the year-end position as also the maximum position during the year. In terms of AS-18, the disclosure requirements do not apply in circumstances when providing such disclosures would conflict with the reporting enterprise's duties of confidentiality as specifically required in terms of statute, by regulator or similar competent authority. In view of the above, where there is only one entity in any category of related party, banks need not disclose any details pertaining to that related party. However, the relationship with that related party shall be disclosed. *Our comment:* *The confidentiality and secrecy provisions shall come into picture when such related party is also a customer of the bank.*

Objective	Issue	Guidance
Accounting Standard 23 – Accounting for Investments in Associates in CFS		
AS-23 sets out principles and procedures for recognizing, in the CFS, effects of the investments in associates on the financial position and operating results of a group. It requires that an investment in an associate shall be accounted for in CFS under the equity method subject to certain exceptions. ***Associate*** *is defined as an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.* ***Significant influence*** *is the power to participate in the financial and/ or operating policy decisions of the investee but not control over those policies.* *If an investor holds, directly or indirectly through subsidiaries,* ***20% or more of the voting power of the investee, it is presumed that the investor has significant influence****, unless it can be clearly demonstrated that this is not the case.*	Whether conversion of debt into equity in an enterprise by a bank by virtue of which the bank holds more than 20% will result in an investor-associate relationship for the purpose of AS-23. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with AS by Banks dated March 29, 2003	Though a bank may acquire more than 20% of voting power in the borrower entity in satisfaction of its advances it may be able to demonstrate that it does not have the power to exercise significant influence since the rights exercised by it are protective in nature and not participative. In such a circumstance, such investment may not be treated as investment in associate under AS-23. Hence the test shall not be merely the proportion of investment but the intention to acquire the power to exercise significant influence.
Accounting Standard 24 - Discontinuing operations		
This Standard establishes principles for reporting information about discontinuing operations.	Whether rationalisation of branches either in India or overseas without discontinuing any distinctly identifiable line of business of the bank should attract the applicability of AS-24 since banks generally undertake rationalisation of branches more or less on a continuous basis depending on business requirements. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with Accounting Standards (AS) by banks dated April 30, 2004.	Merger/ closure of branches of banks by transferring the assets/ liabilities to the other branches of the same bank may not be deemed as a discontinuing operation and hence AS-24 will not be applicable to merger/ closure of branches of banks by transferring the assets/ liabilities to the other branches of the same bank. **Applicability of AS-24:** 1. Discontinuing of operation has resulted in shedding of liability and realisation of assets by the bank; or 2. decision to discontinue an operation which will have the above effect has been finalised by the bank; and 3. Discontinued operation is substantial in its entirety.

Objective	Issue	Guidance
Accounting Standard 25 – Interim Financial Reporting		
This Standard prescribes the minimum content of an interim financial report and the principles for recognition and measurement in a complete or condensed financial statement for an interim period.	Applicability of AS-25 and recognition and measurement principles laid therein in case of interim financial reporting by banks. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with AS by Banks dated March 29, 2003	The disclosures required to be made by listed banks in terms of the listing agreements would not tantamount to interim reporting as envisaged under AS-25. Hence, AS-25 is not mandatory for the quarterly reporting prescribed for listed banks. The recognition and measurement principles laid down under AS-25 shall, however, be complied with in respect of such quarterly reports. Further, half-yearly review of accounts shall be applicable for all commercial banks irrespective of whether such banks are listed or not as per formats prescribed by RBI (or NABARD for RRBs).
Accounting Standard 26 – Intangible asset		
This Standard prescribes the accounting treatment for intangible assets that are not dealt with specifically in another accounting standard.	It is difficult to estimate the useful life of computer software which has been customised for the bank's use and is expected to be in use for some time. Intangible assets recognized and carried in the balance sheet of banks in compliance with AS-26 shall attract provisions of section 15(1) of the Banking Regulation Act 1949, in terms of which banks are prohibited from declaring any dividend until any expenditure not represented by tangible assets is carried in the balance sheet. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with Accounting Standards (AS) by banks dated April 30, 2004.	The detailed recognition and amortization principle in AS-26 adequately addresses the issues w.r.t. computer software which has been customized for the bank's use and is expected to be in use for some time and may be followed by banks. Banks desirous of paying dividend while carrying any intangible assets in its books must seek exemption from section 15(1) of the Banking Regulation Act, 1949 from the Central Government.

Objective	Issue	Guidance
Accounting Standard 27 - Financial Reporting of Interests in Joint Ventures		
This Standard is applied in accounting for interests in joint ventures (JV) and the reporting of JV assets, liabilities, income and expenses in the financial statements of ventures and investors, regardless of the structures or forms under which the JV activities take place AS-27 identifies three broad types of JV, namely: 1. Jointly controlled operations; 2. Jointly controlled assets; and 3. Jointly controlled entities.	Applicability of AS-27 for banks in case of interests in JV. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with AS by Banks dated March 29, 2003	In case of jointly controlled entities, where banks are required to present CFS, the investment in JV shall be accounted for as per AS-27. Banks shall follow RBI guidelines for reflecting investment in jointly controlled entities in solo financial statements since AS-13 does not apply to banks. In case of jointly controlled operations and jointly controlled assets, AS-27 is applicable for both solo financial statements as well as CFS. RRBs sponsored by banks shall be treated as associates and will be accounted for in CFS as per AS-23. AS-27 shall not apply for investment in RRBs.
Accounting Standard 28 – Impairment of assets		
This standard prescribes the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount.	Applicability of AS-28 on financial lease assets and non-banking assets. **Previous RBI Circulars which stand repealed:** Guidelines on compliance with Accounting Standards (AS) by banks dated April 30, 2004.	AS-28 shall not apply to inventories, investments and other financial assets such as loans and advances and shall generally be applicable to banks in so far as it relates to fixed assets. It shall generally apply to financial lease assets and non-banking assets acquired in settlement of claims only when the indications of impairment of the entity are evident.

Conclusion

Although the Master Direction does not provide any new guidance w.r.t. compliance of Accounting Standards by banks, consolidation of all previous circulars and guidance given by RBI on this matter into this Master Direction will provide an ease of reference for all banks and ensure that no RBI guidance is overlooked while preparation of financial statements.