Guidance on specific issues with respect to certain Accounting Standards

1. Accounting Standard 9 – Revenue Recognition

Non-recognition of income by the AIFIs in the case of non-performing advances and non-performing investments, in compliance with the regulatory prescriptions of the RBI, should not attract a qualification by the statutory auditors as this would be in conformity with provisions of the standard, since it recognizes postponement of recognition of revenue where collectability of the revenue is significantly uncertain. With respect to revenue recognition under the standard, an item of income shall not be considered to be material if it does not exceed one percent of the total income of the AIFI if the income is reckoned on a gross basis or one percent of the net profit (before taxes) if the income is reckoned net of costs. If any item of income is not considered to be material as per the above norms, it may be recognized when received.

2. Accounting Standard 23 – Accounting for Investments in Associates in Consolidated Financial Statements

This Accounting Standard sets out principles and procedures for recognizing, in the consolidated financial statements, the effects of the investments in associates on the financial position and operating results of a group. The Standard requires that an investment in an associate shall be accounted for in consolidated financial statements under the equity method subject to certain exceptions. The term 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. Such an influence may be gained by share ownership, statute or agreement. As regards share ownership, 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. Conversely, if the investor holds, directly or indirectly through subsidiaries less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence. The issue is whether conversion of debt into equity in an enterprise by an AIFI by virtue of which the AIFI holds more than 20 percent will result in an investor-associate relationship for the purpose of AS 23.

From the above it is clear that though an AIFI 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 this Accounting Standard. Hence the test shall not be merely the proportion of investment but the intention to acquire the power to exercise significant influence.

3. AS 27 - Financial Reporting of Interests in Joint Ventures

This Standard is applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of ventures and investors, regardless of the structures or forms under which the joint venture activities take place. This Standard identifies three broad types of joint ventures, namely, jointly controlled operations, jointly controlled assets and jointly controlled entities. In case of jointly controlled entities, where AIFIs are required to present consolidated financial statements, the investment in JVs shall be accounted for as per provisions of this standard. In respect of joint ventures in the form of joint controlled operations and jointly controlled assets, this Accounting Standard is applicable for both solo financial statements as well as consolidated financial statements.

4. AS 26 – Intangible assets

This standard prescribes the accounting treatment for intangible assets that are not dealt with specifically in another accounting Standard. With respect to computer software which has been customized for the AIFI’s use and is expected to be in use for some time, the detailed recognition and amortization principle in respect of computer software prescribed in the

Standard adequately addresses these issues and may be followed by the AIFIs.

5. AS 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. It is clarified that the standard shall not apply to investments, inventories and financial assets such as loans and advances and shall generally be applicable in so far as it relates to fixed assets. The Standard shall generally apply to financial lease assets and assets acquired in settlement of claims only when the indications of impairment of the entity are evident.

6. AS 11 - The Effects of Changes in Foreign Exchange Rates[14]

AS 11 is applied in the context of the accounting for transactions in foreign currencies and in translating the financial statements of foreign operations. The issues that arise in this context have been identified and the EXIM Bank may be guided by the following while complying with the provisions of the standard:

(I) Classification of Integral and Non-integral Foreign Operations

Paragraph 17 of AS 11 states that the method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise. For this purpose, foreign operations are classified as either "integral foreign operations" or "non-integral foreign operations". These classifications are for the limited purpose of compliance with the Standard.

(II) Exchange rate for recording foreign currency transactions and translation of financial statements of non-integral foreign operation.

(a) Paragraph 10 of the Standard allows, for practical reasons, the use of a rate that approximates the actual rate at the date of the transaction The Standard also states that if exchange rates fluctuate significantly, the use of average rate for a period is unreliable. Since the enterprises are required to record the transactions at the date of the occurrence thereof, the weekly average closing rate of the preceding week can be used for recording the transactions occurring in the relevant week, if the same approximates the actual rate at the date of

[14] At present, AS 11 is applicable only to the EXIM Bank.

the transaction. In view of the practical difficulties in applying the exchange rates at the dates of the transactions and since the Standard allows the use of a rate that approximates the actual rate at the date of the transaction, AIFIs may use average rates as detailed below:

(b) FEDAI publishes a weekly average closing rate at the end of each week and a quarterly average closing rate at the end of each quarter for various currencies.

(c) Those foreign currency transactions, which are currently not being recorded in Indian Rupees at the date of the transaction or are being recorded using a notional exchange rate may now be recorded at the date of the transaction by using 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.

(d) <u>Quarterly average closing rate</u>, published by FEDAI at the end of each quarter, can be used for translating the income and expense items of non-integral foreign operations during the quarter.

(e) If the weekly average closing rate of the preceding week does not approximate the actual rate at the date of the transaction, the closing rate at the date of the transaction shall be used. For this purpose, the weekly average closing rate of the preceding week would not be considered approximating the actual rate at the date of the transaction if the difference between (1a) the weekly average closing rate of the preceding week and (1b) the exchange rate prevailing at the date of the transaction, is <u>more than three and a half percent</u> of (1b). In respect of non-integral foreign operations, if there are significant exchange fluctuations during the quarter, the income and expense items of non-integral foreign operations shall be translated by using the exchange rate at the date of the transaction instead of the quarterly average closing rate. For this purpose, the exchange rate fluctuation would be considered as significant, if the difference between the two rates is <u>more than seven percent</u> of the exchange rate prevailing at the date of the transaction.

(f) AIFIs are encouraged to equip themselves to record the foreign currency transactions of Indian branches/ offices as well as integral foreign operations and translate the income as well as expense items of non-integral foreign operations at the exchange rate prevailing on the date of the transaction.

(III) Closing rate

Paragraph 7 of the Standard defines 'Closing rate' as the exchange rate at the balance sheet date. In order to ensure uniformity among banks/ AIFIs, closing rate to be applied for the purposes of AS 11 (revised 2003) for the relevant accounting period would be the last closing spot rate of exchange announced by FEDAI for that accounting period.