Guidelines for consolidated accounting and other quantitative methods to facilitate consolidated supervision

February 25, 2003

DBOD.No. BP.BC. 72 /21.04.018/2001-02

All Scheduled Commercial Banks
(excluding RRBs and LABs)

Dear Sir,

Guidelines for consolidated accounting and other quantitative methods to facilitate consolidated supervision

In view of the increased focus on empowering supervisors to undertake consolidated supervision of Bank Groups and since the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision (BCBS) have underscored this requirement as an independent principle, the RBI set up a multi-disciplinary Working Group in November 2000 under the Chairmanship of Shri Vipin Malik, Director on the Central Board of RBI. The Working Group examined the feasibility of introducing consolidated accounting and other quantitative methods to facilitate consolidated supervision and made recommendations accordingly. The Working Group has identified the following three components of consolidated supervision :

(a) consolidated financial statements (CFS),

(b) consolidated prudential reports (CPR), and

(c) application of prudential regulations like capital adequacy and large exposures/ risk concentration on group basis.

2. The draft guidelines on consolidated accounting and other quantitative methods to facilitate consolidated supervision were prepared on the basis of the Working Group's recommendations and were issued to banks vide letter DBOD.No. BP.2388 /21.04.018/2001-02 dated June 24, 2002, seeking their comments. On the basis of the feedback received from banks and the deliberations with the officials of banks and FIs the draft guidelines have been revised. It has been decided to implement them with suitable changes, wherever considered necessary. Accordingly, the guidelines to be followed by banks to aid consolidated supervision have been formulated to enable smooth implementation and are furnished in the **{** HYPERLINK \l "anx" **}**.

3. You are advised to place the guidelines before the Board of Directors and ensure strict compliance with the same commencing from the year ending March 31, 2003.

4. Please acknowledge receipt.

Yours faithfully
Sd/-

(**M.R.Srinivasan**)
Chief General Manager-in-Charge
Encls: As above

Annexure

Guidelines for Consolidated Accounting and other quantitative methods to facilitate Consolidated Supervision

Scope

1. Initially, consolidated supervision would be mandated for all groups where the controlling entity is a bank. In due course, banks in mixed conglomerates would be brought under consolidated supervision, where:

i) the parents may be non-financial entities, or
ii) the parents may be financial entities falling under the jurisdiction of other regulators like Insurance Regulatory and Development Authority or Securities and Exchange Board of India, or
iii) the supervised institution may not constitute a substantial or significant part of the group.

Components

2. The components of consolidated supervision as proposed to be implemented by the RBI include:

a) Consolidated Financial Statements **[CFS]**, which are intended for public disclosure.
b) Consolidated Prudential Reports **[CPR]** for supervisory assessment of risks which may be transmitted to banks (or other supervised entities) by other group members.
c) Application of certain prudential regulations like capital adequacy, large exposures / risk concentration etc. on group basis.

3. Banks are required to put in place an appropriate MIS to support their compliance with the consolidated accounting and reporting requirements.

Consolidated Financial Statements (CFS)

4. All banks coming under the purview of consolidated supervision of RBI, whether listed or unlisted should prepare and disclose Consolidated Financial Statements from the financial year commencing from April 1, 2002 in addition to solo financial statements.

5. Consolidated Financial Statements is required to be prepared in terms of Accounting Standard (AS) 21 and other related Accounting Standards prescribed by the Institute of Chartered Accountants of India (ICAI) viz. Accounting Standard 23 and Accounting Standard 27. For the purpose, the terms 'parent', 'subsidiary', ‘associate’, ‘joint venture’, 'control' and 'group' would have the same meaning as ascribed to them in the above Accounting Standards of the Institute of Chartered Accountants of India.

6. A parent presenting Consolidated Financial Statements should consolidate all subsidiaries – domestic as well as foreign, except those specifically permitted to be excluded

under Accounting Standard 21. The reasons for not consolidating a subsidiary should be disclosed in Consolidated Financial Statements. The responsibility of determining whether a particular entity should be included or not for consolidation would be that of the Management of the parent entity and the Statutory Auditors should comment in this regard if they are of the opinion that an entity which ought to have been consolidated had been omitted.

Components of Consolidated Financial Statements

7. Consolidated Financial Statements should normally include consolidated balance sheet, consolidated statement of profit and loss, Principal Accounting Policies, Notes on Accounts, etc.

Format of Consolidated Financial Statements

8. Since Accounting Standard 21 has not prescribed any format for publishing consolidated financial statements, banks should adopt the format furnished in Appendix A for presentation of their consolidated financial statements. The Consolidated Financial Statements are in addition to the bank's solo balance sheet and profit and loss account prepared as per the formats prescribed under Section 29 of Banking Regulation Act, 1949.

Reference date

9. The financial statements used in the consolidation should be drawn up to the same reporting date. If it is not possible, Accounting Standard 21 allows adoption of 6 month old balance sheet of subsidiaries and prescribes that adjustments should be made for the effects of significant transactions or other events that have occurred during the intervening period. In the case that the balance sheet dates of parent and subsidiaries are different, inter-group netting may be done as on the balance sheet date of the parent entity. In the cases where the balance sheet date coincides with that of the bank, the nationalised banks may publish their Consolidated Financial Statements without waiting for Comptroller and Auditor General audit of the accounts of their subsidiaries. However, banks have to ensure completion of statutory audit of the accounts of such subsidiaries before consolidation with the parent's accounts.

Accounting policies

10. Consolidated Financial Statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to do so, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

11. For the purpose of preparing Consolidated Financial Statements using uniform accounting policies banks may rely on a Statement of Adjustments for non-uniform accounting policies, furnished by the Statutory Auditors of the subsidiaries.

12. If different entities in a group are governed by different accounting norms laid down by the concerned regulator for different businesses then, where banking is the dominant activity, accounting norms applicable to a bank should be used for consolidation purposes in respect of like transactions and other events in similar circumstances. In situations where no accounting norms have been prescribed by the regulatory authority and different accounting policies are followed by different entities of the group, balance of business may be used as a deciding factor for application of accounting norms. For dissimilar items and circumstances, different accounting policies would have to be followed.

13. For the purpose of valuation, the investments in associates (other than those specifically excluded under Accounting Standard 23) should be accounted for under the "Equity Method" of accounting in accordance with Accounting Standard 23. Investment in RRBs sponsored by banks would also be treated as investments in associates for the purpose of Consolidated Financial Statements and accounted by "Equity Method" as prescribed under Accounting Standard 23.

14. The valuation of investments in subsidiaries which are not consolidated and associates which are excluded under Accounting Standard 23, should be as per the relevant valuation norm issued by Reserve Bank of India.

15. The valuation of investments in joint ventures should be accounted for under the 'proportionate consolidation' method as per Accounting Standard 27 on "Investments in Joint ventures" issued by Institute of Chartered Accountants of India.

16. As regards disclosures in the 'Notes on Accounts' to the Consolidated Financial Statements, banks may be guided by general clarifications issued by Institute of Chartered Accountants of India from time to time.

17. The Consolidated Financial Statements has to be submitted to Reserve Bank of India within one month from the publication of the bank's annual accounts.

Consolidated Prudential Reports (CPR)

18. In addition to the Consolidated Financial Statements, banks coming under the purview of consolidated supervision of Reserve Bank of India should also prepare Consolidated Prudential Reports. Consolidated Prudential Reports will be initially introduced on half-yearly basis from March 31, 2003 as part of off-site reporting system on the lines of the

existing DSB returns for the solo entities. The frequency of reporting would be subsequently reviewed and may be increased.

19. Consolidated Prudential Reports for half-year ended March has to be submitted by end June. If audited results of entities under the Consolidated Prudential Reports are not available, banks should submit the provisional Consolidated Prudential Reports with unaudited results of such entities, by end June. However, Consolidated Prudential Reports for the half-year ended March with audited results has to be submitted by end September. The Consolidated Prudential Reports for half-year ended September has to be submitted by end of December. Banks should develop software for auto consolidation of Consolidated Prudential Reports at their end.

<u>Scope</u>

20. Reserve Bank of India confines Consolidated Prudential Reports to all groups where the controlling entity is a bank. If the bank is a parent company within a group, the bank should submit Consolidated Prudential Reports for the entities under its control.

21. Consolidated Prudential Reports for a consolidated bank should include information and accounts of related entities viz. subsidiaries, associates and joint ventures of the bank, which carry on activities of banking or financial nature. Banks should justify the exclusion of any entity for the purpose of Consolidated Prudential Reports. All related entities of the bank may be consolidated with the parent on the lines prescribed in the various Accounting Standards issued by the Institute of Chartered Accountants of India viz. subsidiaries will be consolidated on a line by line basis (AS 21), associates will be consolidated by the equity method (AS 23) and joint ventures will be consolidated by the proportionate consolidation method (AS 27).

22. For the purpose of preparation of Consolidated Prudential Reports, the consolidation may exclude group companies which are engaged in (a) insurance business and (b) businesses not pertaining to financial services. The valuation of investment in related entities which are not consolidated should be as per the relevant valuation norm issued by Reserve Bank of India.

23. In respect of related entities which operate under severe long term restrictions which significantly impair their ability to transfer funds to the parent, banks shall disclose separately the book value of the amounts due from such related entities and the net amounts recoverable from them. Banks may also consider making appropriate provisions for the shortfall.

<u>Format</u>

24. The format of reporting for Consolidated Prudential Reports purposes is enclosed in Appendix B. The Consolidated Prudential Reports comprises of Consolidated Balance Sheet, Consolidated Profit & Loss Account, and select data on financial/ risk profile of the consolidated bank. The reporting format for the consolidated balance sheet and the consolidated profit and loss account will be the same as prescribed in Appendix A for Consolidated Financial Statements.

Application of Prudential Norms at group / on consolidated position

25. For the purpose of application of prudential norms on a group wide basis, a 'consolidated bank' is defined as a group of entities which include a licensed bank, which may or may not have subsidiaries. As a part of consolidated supervision the following prudential norms/ limits are prescribed for compliance by the consolidated bank:

a) Capital Adequacy

b) Large Exposures

c) Liquidity Ratios, mismatches, SLR, CRR (where applicable)

Capital adequacy

26. Banks have already been advised to voluntarily build into their own balance sheet, on a notional basis, the risk weighted components of their subsidiaries at par with the risk weights applicable to the bank's own assets vide circular DBOD.No.BP.BC.169/ 21.01.002/ 2000 dated May 3, 2000. Banks were also advised to provide for capital shortfall in the subsidiary in their own books in a phased manner beginning from the year ending March 2001 to rectify the impairment to their net worth on switch over to consolidated accounting.

27. A Consolidated bank should maintain a minimum Capital to Risk-weighted Assets Ratio (CRAR) as applicable to the parent bank on an ongoing basis from the year ending 31 March 2003. While computing capital funds, parent bank may consider the following points:

i) Banks are required to maintain a minimum capital to risk weighted assets ratio of 9%. Non-bank subsidiaries are required to maintain the capital adequacy ratio prescribed by their respective regulators. In case of any shortfall in the capital adequacy ratio of any of the subsidiaries, the parent should maintain capital in addition to its own regulatory requirements to cover the shortfall.

ii) Risks inherent in *deconsolidated* entities (i.e., entities which are not consolidated in the Consolidated Prudential Reports) in the group need to be assessed and any shortfall in the regulatory capital in the deconsolidated entities should be deducted (in equal proportion from Tier 1 and Tier 2 capital) from the consolidated bank’s capital in the proportion of its equity stake in the entity.

Large Exposures

28. As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, in addition to adherence to prudential limits on exposures assumed by banks, consolidated banks should also adhere to the following prudential limits on:

i) Single & Group borrower exposures,

ii) Capital market exposures, and

iii) Exposures by way of unsecured guarantees and unsecured advances.

29. The operational details in this regard are furnished below.

i) Exposure by the consolidated bank to a single borrower/ debtor should not exceed 15% of its capital funds. Exposure by the consolidated bank to a borrower/ debtor group should not exceed 40% of its capital funds. The aggregate exposure on a borrower/ debtor group can exceed the exposure norm of 40% by an additional 10% (i.e. up to 50%) provided the additional exposure is for the purpose of financing infrastructure projects. Computation of capital funds, exposure etc. would be on par with the methodology adopted for banks.

ii) The consolidated bank's aggregate exposure to capital markets should not exceed 2 per cent of its total on-balance-sheet assets (excluding intangible assets and accumulated losses) as on March 31 of the previous year. This ceiling will apply to the consolidated bank's exposure to capital market in all forms, including both fund based and non-fund based, similar to the computation for the parent bank. Within the total limit, investment in shares, convertible bonds and debentures and units of equity-oriented mutual funds should not exceed 10 percent of consolidated bank's net worth.

iii) The norms relating to unsecured guarantees and unsecured funded exposures on the lines of the guidelines issued to banks vide circular DBOD.No.666/C.96/(Z)-67 dated May 3, 1967, as amended from time to time, are also extended to the consolidated bank.

30. <u>Liquidity Ratios</u>:

(i) <u>CRR & SLR requirements</u>:

The existing liquidity requirements applicable to banks on a solo basis are extended to the consolidated bank as well. If the related entities in the consolidated bank are banks, liquidity position i.e., CRR and SLR would be monitored on a consolidated basis after netting out intra-group transactions and exposures. If the related entities in the consolidated bank are heterogeneous comprising non-banking entities, compliance with the CRR / SLR norms would be restricted to the banking entities on a consolidated basis. In respect of non-banking financial entities within bank groups, they should comply with the liquidity requirements prescribed at solo level.

(ii) <u>Asset Liability Management :</u>

Maturity wise distribution/ analysis of assets and liabilities should be disclosed on a consolidated basis in the Consolidated Prudential Reports. Tolerance limits for near-term and short-term deficits/ mismatches in the first two time bands of 1-14 days and 15-28 days would be monitored at the consolidated level. Intra-group transactions and exposures should be excluded from this consolidation.

Review

31. The above instructions would be reviewed after one year from the date of implementation.