PRD/2004/ 187

DBOD No.BP.BC. 82 /21.04.018/2003-04

April 30, 2004

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Guidelines on compliance with Accounting Standards (AS) by banks

Please refer to our circular DBOD No.BP.BC.89/21.04.018/2002-03 dated March 29, 2003 which contained detailed guidelines pertaining to the following Accounting Standards which are already operational.

AS 5, AS 9, AS 15, AS 17, AS 18, AS 22, AS 23, AS 25, and AS 27.

These guidelines were based on the recommendations made by the Working constituted under the Chairmanship of Shri N.D.Gupta, former president of ICAI to recommend steps to eliminate/ reduce gaps in compliance by banks with the Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI).

2. The Working Group had also made recommendations in respect of the following three Accounting Standards.

Accounting Standard	Pertaining to
24	Discontinuing operations
26	Intangible assets
28	Impairment of assets

3. Of the above, AS 26 relating to intangible assets has become operational from the accounting period commencing from April 1, 2003. The remaining standards viz. AS 24 and AS 28 are effective for the accounting period commencing from April 1, 2004.

4. In terms of our guidelines on action to be taken by banks / auditors in connection with AS 25, Interim Financial Reporting contained in paragraph 11.2.4 of the Annexure to our circular DBOD No.BP.BC.89/21.04.018/2002-03 dated March 29, 2003, **all banks** were advised to adopt the format prescribed for public sector banks by the RBI vide circular DBS.ARS.BC.13/ 08.91.001/ 2000-01 date May 17, 2001 with a view to ensure uniformity in disclosure. Since the above proforma for half yearly review has been revised vide our circular DBS.CO.ARS.17/08.91.001/2002-03 dated June 5, 2003, **all banks (listed and unlisted)**, including foreign banks, are advised to adopt the revised proforma.

5. ICAI, which was represented on the Working Group, has also agreed to furnish appropriate clarification on the Accounting Standards in question on the lines of the recommendations of

the Group for the guidance of its members. RBI considers that with the issue of the guidelines as above and adoption of the prescribed procedures, there should normally be no need for any Statutory Auditor for qualifying balance sheet of the bank being audited for non-compliance with Accounting Standards. Hence, it is essential that both banks and the Statutory Central Auditors adopt the guidelines and procedures prescribed. Whenever specific difference in opinion arises among the auditors, the Statutory Central Auditors would take a final view. Persisting difference, if any, could be sorted out in prior consultation with RBI, if necessary. It is advised that any qualifications in the financial statements of banks for non-compliance with any Accounting Standard will be viewed seriously by the Reserve Bank.

6. Banks are advised to place these guidelines before the Board of Directors. Banks are further advised to ensure strict compliance with the standards.

7. Please acknowledge receipt.

Yours faithfully,

Sd/-

(**C.R. Muralidharan**)
Chief General Manager-in-Charge

Annexure

Guidelines on compliance with Accounting Standards by banks

On the basis of the recommendations of the Working Group on Compliance with Accounting Standards by banks, which was constituted by the Reserve Bank of India with Shri N. D. Gupta, the then President of the Institute of Chartered Accountants of India, as Chairman, the following guidelines are issued to banks by RBI with a view to eliminating the gaps in compliance by banks with the Accounting Standard issued by ICAI.

2. These guidelines pertains to the following Accounting Standards (AS):

AS 24, AS 26 and AS 28.

3. Banks should place these guidelines before the Board of Directors and ensure strict compliance with the Standards.

4. Accounting Standard 24 - Discontinuing operations

4.1 Gist of the Accounting Standard

This Statement establishes principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations. This Statement applies to all discontinuing operations of an enterprise. This Statement does not establish any recognition and measurement principles. Rather, it requires that an enterprise follow recognition and measurement principles established in other Accounting Standards, e.g., Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date and Accounting Standard (AS) 28, Impairment of Assets. This Statement requires an enterprise to make certain disclosures relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in the Statement) occurs. The disclosures required by the Statement should continue in financial statements for periods up to and including the period in which the discontinuance is completed.

4.2 Possible reasons for non-compliance

This Accounting Standard becomes effective from accounting period commencing on or after April 1, 2004. While adopting the Accounting Standard, a doubt may arise as to 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 the Standard since banks generally undertake rationalisation of branches more or less on a continuous basis depending on business requirements.

4.3 Action to be taken by banks

4.3.1 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 this Accounting Standard will not be applicable to merger / closure of branches of banks by transferring the assets/ liabilities to the other branches of the same bank.

4.3.2 Disclosures would be required under the Standard only when:

i) discontinuing of the operation has resulted in shedding of liability and realisation of the assets by the bank

or

decision to discontinue an operation which will have the above effect has been finalised by the bank

and

ii) the discontinued operation is substantial in its entirety.

5. AS 26 – Intangible asset

5.1 **Gist of the Accounting Standard** - This Statement prescribes the accounting treatment for intangible assets that are not dealt with specifically in another Accounting Standard. This Statement requires an enterprise to recognise an intangible asset if, and only if, certain criteria are met. The Statement also specifies how to measure the carrying amount of intangible assets and requires certain disclosures about intangible assets. This Statement is applied by all enterprises in accounting for intangible assets, except certain assets specified in the Statement including financial assets. The Statement requires that an intangible asset should be measured initially at cost. The Statement requires that internally generated goodwill should not be recognised as an asset. The Statement also deals with subsequent expenditure on an intangible asset. The Statement requires that after initial recognition, an intangible asset should be carried at its cost less any accumulated amortisation and any accumulated impairment losses. This Statement also deals with amortisation of intangible assets, including amortisation period, amortisation method etc.

5.2 Action to be taken by banks

The issues that arise and require clarification while complying with the Accounting Standard have been identified. Banks may be guided by the following while complying with the Standard.

- This AS will not apply to intangible assets created in the books of banks before the effective date of this AS subject to the transitional provisions as laid down in paragraphs 99 and 100.

- It may be 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. It is observed that the detailed recognition and amortisation principle in respect of computer software prescribed in Appendix A to the Standard adequately addresses these issues and may be followed by banks.

- Intangible assets recognised and carried in the balance sheet of banks in compliance with AS 26 will attract provisions of Section 15(1) of the BR Act 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. The intangible assets which would be created in the books of banks consequent upon the adoption of AS 26 would generally represent payments made by enterprises towards acquisition of assets which may not be tangible like corporate computer software, brand equity etc. and would not be in the nature of deferred revenue expenditure like expenses incurred to raise capital, expenses incurred for launching any new products etc. All these items are intangible assets. Therefore, any expenditure incurred towards these intangible items would attract the provisions of BR Act and for carrying any such item in the books, banks would have to seek exemption from Section 15(1) of the BR Act, from the Government.

6. AS 28 – Impairment of assets

6.1 **Gist of the Accounting Standard -** This Statement prescribes the procedures that an enterprise applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and this Statement requires the enterprise to recognise an impairment loss. This Statement also specifies when an enterprise should reverse an impairment loss and it prescribes certain disclosures for impaired assets. This Statement requires that an enterprise should assess at each balance sheet date whether there is any indication that an asset may be impaired. If any such indication exists, the enterprise should estimate the recoverable amount of the asset. The Statement also describes some minimum indications for this purpose. The Statement deals in detail with the determination of the recoverable amount of an asset. The Statement requires that if the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount. That reduction is an impairment loss. The Statement requires that an impairment loss should be recognised as an expense in the statement of profit and loss immediately, unless the asset is carried at revalued amount in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets, in which case any impairment loss of a revalued asset should be treated as a revaluation decrease under that Accounting Standard.

6.2 **Possible reasons for non-compliance**

This Accounting Standard becomes effective from accounting period commencing on or after March 31, 2004. While adopting the Accounting Standard, there could be doubts regarding how frequently the assets covered by the Standard need to be reviewed to measure impairment or types of assets to which the Standard would not apply.

6.3 **Action to be taken by banks**

6.3.1The Standard would not apply to investments, inventories and financial assets such as loans and advances and may generally be applicable to banks in so far as it relates to fixed assets.

6.3.2 Banks may also take into account the following specific factors while complying with the Standard.

(i) Paragraphs 7 and 8 of the Standard have clearly listed the triggers which may indicate impairment of the value assets. Hence, banks may be guided by these in determining the circumstances when the Standard is applicable to banks and how frequently the assets covered by the Standard need to be reviewed to measure impairment.

(ii) In addition to the assets of banks which are specifically identified at paragraph 6.3.1 above, viz. financial assets, inventories, investment, loans & advances etc to which the Standard does not apply, the Standard would 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.