IMPACT OF IFRS ON INDIAN BANKING SECTOR

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Abstracts:

The objective of this study is to examine the impact of the International Financial Reporting Standards (IFRS) on the Indian banking industry after its adoption on April 1, 2011. This study is based on a comprehensive examination of financial statements from the Indian banking industry, including business per employee, capital and reserve, investments and advances, and net nonperforming assets ratios, as well as the impact of applicable IFRS provisions. The paper's restriction is that it exclusively looks at the Indian banking business, leaving out all other Indian industries. This paper outlines the areas on which the Indian banking sector should concentrate before and after the introduction of IFRS, as well as the implications for the bank's financial statements.

Keyword: Convergent of IFRS, Financial Statement, Financial Reporting. IFRS, Banking

1. Introduction

In a world where the majority of countries use International Financial Reporting Standards (IFRS), the best course of action is to implement IFRS right away. The International Financial Reporting Standards (IFRS) have been established as the global financial reporting standards. It has since been accepted by over 113 nations throughout the world. The Ministry of Corporate Affairs (MCA) in India has released an IFRS convergence plan that applies to all businesses excluding banks and insurance firms. Companies must convert their initial balance sheets in line with the IFRS in a stepwise way, according to the roadmap. The first phase will begin on April 1st, 2011. The convergence of International Financial Reporting Standards from Indian Accounting Standards, on the other hand, raised a slew of concerns, including industry ramifications, reporting implications, and changes to numerous legislative legislation, among others. All scheduled commercial banks must convert their opening balance sheets to the International Financial Reporting Standards (IFRS) as of April 1, 2011, according to the finalized roadmap for the convergence of Indian accounting standards with the International Financial Reporting Standards (IFRS) for banking companies. The Reserve Bank of India has advised banks that they must prepare to accept the new criteria. Other nations' experience has shown that transitioning to IFRS might take 18-24 months to completely integrate and execute. As part of the conversion process, a business should consider not just the present IFRS but also any modifications that may occur in the future. The convergence of International Financial Reporting Standards will alter the company's overall organizational structure. It will change the way companies are evaluated, including the earnings management information and control system, reporting procedures, and valuation standards. The finance and accounting department is not solely responsible for convergence. It took a concerted effort from all of the company's departments.

2. The banking system in India

In India, banks and banking have been divided into different groups. Each group has its benefits and limitations in its operations. They have their dedicated target market. Some are concentrated their work in the rural sector while others in both rural as well as urban. Most of them are only catering in cities and major towns.

2.1 STRUCTURE OF BANKING SYSTEM IN INDIA

Banks can generally be classified into various sub-categories as follows:

- ***PUBLIC SECTOR BANKS IN INDIA***
  - The State Bank Group and Nationalized banks: Is a group of 27 banks
  - Has the largest number of branches in metro/ urban/rural areas throughout the country
  - Contributes to about 75% of the total deposits
  - Contributes about 70% of the total advances of all commercial banks in India.
  - Most have a very large branch network spread over all parts of the country
  - Have a Large deposits and assets base
  - Perform all kinds of core and modern banking functions

3. Research questions

- **Is IFRS create an impact on the Banking sector?**

4. Objectives of the study

Followings are the objectives of the study:

1. To assess the impact of the International Financial Reporting Standards (IFRS) on the Indian banking industry once they have been implemented.

5. Methodology and Research Design

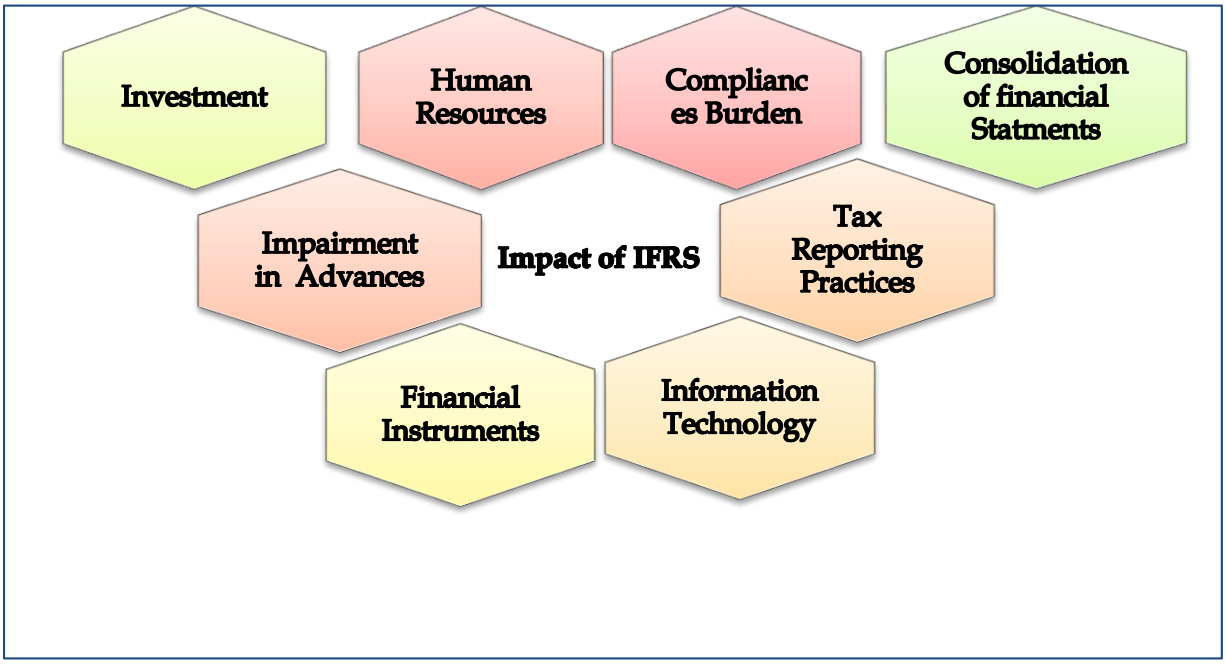
S.No	Particulars	Research Design
1	Research Design	Descriptive research Design
2	Population of the study	All Banks in India
3	Data Collection	From secondary data
4	Source of Data Collection	Journals, Articles, Websites, Newspaper.

6. Status of Indian banking Industry

The implementation of the International Financial Reporting Standards (IFRS) has far-reaching implications for advancements, investments, financial instruments, hedge accounting valuation, regulatory compliance, information technology systems, tax computations, and other sectors. Various authorities control bank accounting in India at the moment. Banks are also responsible for adhering to the Institute of Chartered Accountants of India's Accounting Standards (ICAI). Furthermore, the Reserve Bank of India (RBI) establishes some statutory accounting norms that banks must adhere to. The Reserve Bank of India, for example, has established accounting criteria for investments as well as prudential standards for non-performing loans. The guidelines given by RBI are not in conformity with the IFRS since they are mandated based on prudence rather than the fair presentation purpose of IFRS.

Only seven of the 32 applicable accounting standards in India are IFRS compliant. 12 standards require regulatory adjustments and 10 standards that require conceptual changes. For reporting purposes, the International Financial Reporting Standards encourage the consolidation of financial statements. In India, however, no such preference has been incorporated into any accounting rules. The earlier established Indian accounting standards do not require consolidation of financial accounts, however, IFRS does. As a result, all Indian banks are now forced to consolidate their subsidiaries. The International Financial Reporting Standards place a strong focus on the ratios that demonstrate the organization's financials and performance. It necessitates the publication of those statistics that are important indications of a company's success and profits. It also necessitates the disclosure of managerial salary, as well as any other perks provided to management staff, such as bonuses, ex gratia, commissions, or whatever other term is used. IFRS - 9 is a crucial IFRS that will have a significant influence on the Indian banking sector. The International Financial Reporting Standards (IFRS) - 9 applies to all sorts of financial assets. Investments in government and other securities, as well as loan assets, are among the important elements that are impacted from a bank's standpoint. All financial assets are valued at fair value when they are first identified. The categorization of such assets is used to determine the following measurement. The asset categorization following IFRS – 9 is limited. An instrument must pass the business model and financial characteristics requirements to be categorized at an amortized cost. On the first implementation of the standard, it is doubtful that a company may quickly adjust its business model for a certain portfolio to achieve a specific categorization. To minimize any loss in loan assets owing to the measurement of fair value at the time of the introduction of IFRS, the banking sector has begun to evaluate credit risk management. Credit risk management has begun both inside and outside. Following that, the classification of such assets is used to determine the subsequent measurement. The asset categorization under IFRS – 9 provides for very little flexibility. An instrument must pass the business model and financial characteristics requirements to be categorized at an amortized cost. On the first implementation of the standard, it is doubtful that a company would be able to quickly adjust its business model for a certain portfolio to achieve a specific categorization. To minimize any loss in loan assets owing to the measurement of fair value at the time of the introduction of IFRS, the banking sector has started measuring credit risk management. Internally as well as externally, it has begun credit risk management. Section 78, Section 80, Section 100, Section 205, Section 208, Section 211, Section 394, Section 391, and Schedule VI of the Companies Act, 1956 have all been proposed for revision by the Institute of Chartered Accountants of India. The impact of IFRS convergence on the banking industry is anticipated to be considerable. It will have an impact on net worth, capital sufficiency, the position of advances, the value of derivatives, financial instruments, and other reporting standards. It will also have an impact on the Indian banking industry's financial performance measurement.

7. Impact on Banking Industry



(Source: Secondary Data)

7.1.Investment

According to the existing Indian Accounting Standard – 13 (AS – 13) on Investment Accounting, the organization's investments must be evaluated at a lower cost or fair value. The computation of fair value is straightforward: it is the value, after deducting expenses for the sale of such investments, at which they may be sold in the open market. The measurement of fair value under the IFRS, however, will differ from the current technique. Banks in India must maintain the Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) (CRR). These ratios are maintained by banks investing in government securities. As a result, these securities account for a significant portion of Indian banks' investments. Table - B shows the specifics of the investments held by the various banking organizations. The Indian banks' investments account for around half of the overall advances. As a result, a thorough examination will be required during the convergence process. Investments in equity instruments (other than subsidiaries and joint ventures) are required to be marked to market under RBI regulations. The net losses are recorded, while the net profits are not. Investments in equity instruments are evaluated fairly under IFRS 9. Either the profits or losses are recorded in the income statement or a reserve account. This decision must be taken on an instrument-by-instrument basis at the start of the project and is final. In a proposed standard on loan impairment (not covered by IFRS 9), the IASB is looking at a model that is based on predicted losses rather than experienced losses. To put it another way, the proposed standard mandates that expected credit losses be included in the calculation of the effective interest rate for amortization accounting purposes.

7.2.Human Resources

The International Financial Reporting Standards (IFRS) entail a lot more than just restructuring the chart of accounts. It signifies a shift that extends well beyond the financial department. As a result, human resource difficulties might become a big concern. A conversion project will raise the demands on qualified and professional staff, which may occur at a time when they are not prepared to handle them. It will increase the bank's salary cost as a proportion of overall costs. For example, salaries accounted for 17.03 percent of total costs for State Bank of India and its affiliates in the fiscal year 2009-2010, compared to 15.06 percent and 15.89 percent in fiscal years 2008-2009 and 2007-2008, respectively. This cost will rise much more once the bank hires trained and professional people to apply the IFRS.

7.3.Compliance Burden

Local, national, and international regulatory requirements for banks and capital markets institutions may trip up even the most knowledgeable business. All policies relating to loan and advance value, capital sufficiency, net worth, and so on are measured following Reserve Bank of India guidelines. Compliance with additional legislation, in addition to the Reserve Bank of India's rules and regulations, will have an impact on the Indian banking business. To give you an example, the International Financial Reporting Standards (IFRS) mandates that assets be depreciated throughout their useful lives. The Indian Companies Act of 1956, on the other hand, establishes minimum depreciation rates for several asset classes. Although corporations have the option of charging a greater rate of depreciation, none of them choose to do so. At the moment, all businesses depreciate their assets at the specified rates. The compliance burden will increase the banks' non-operating expenditures. For example, the auditor or consultants must certify numerous types of compliances, such as IFRS compliance, banking rules, Reserve Bank of India recommendations, income tax provisions, and so on.

7.4.Consolidation of Financial Statement

The consolidation of financial accounts is completely based on the ownership and control over another organization, according to Accounting Standard – 23 (AS – 23) on consolidation of financial statements of companies. Consolidation is not required by current accounting standards for all organizations. However, according to IFRS, consolidation is required for all organizations. The IFRS will also modify the measurement and test of ownership. Other than the real stakeholders, it has covered the possible voting rights. All people whose debts or shares must be converted into equity capital of the corporation are included in the possible voting rights. There are no such inclusions in Indian businesses for analyzing the applicability of norms on financial Statement consolidation. The adoption of the International Financial Reporting Standards (IFRS) will influence all of the above. The difficulties that the Indian banking sector has in hedging risk on investments and advances are difficult to quantify. Many requests from the Indian banking industry have been received by the Institute of Chartered Accountants of India and the Ministry of Corporate Affairs requesting a further delay of convergence. Furthermore, convergence would be necessary for Reserve Bank of India prudential rules, as it will be impossible for Indian banks to meet both compliances at the same time for distinct asset classes.

7.5.Impairment in Advances

IFRS recognizes the impairment model for the assets of the organization. However, the banking industry, at present recognizes the provisioning and writes off method for the valuation of its advances as per the prudential norms of the Reserve bank of India. These are the only guidelines that the Indian banking industry is required to comply with. The auditor is required to provide comments on the compliances of these guidelines. The bank is required to examine every investment including advances on a specific basis and shall require valuing them as per the method of present value after adopting the effective rate of interest for discounting. It is tough work for the banking industry. However, the IFRS specify the suitability of the method for measurement of present value for group borrower and individual borrower. It specified the collective method and individual method for measurement of impairment of the assets of the organization. Under IFRS 9, loans and receivable portfolios are accounted for on amortized cost basis, provided these loans do not contain any exotic embedded derivatives. Basic embedded derivatives, such as caps and floor or normal prepayment or extension terms, do not taint amortization accounting. However, amortization accounting is not possible if a loan has a contractual interest rate that is based on a term that exceeds the instrument's remaining life. Similarly, a loan with a convertible option is not eligible for amortization accounting and will have to be accounted for on a fair value basis with changes taken to the income statement. The loan portfolio is accounted for on a fair value basis in cases where banks transfer/securities their loan portfolio. Amortisation accounting is also not allowed for certain non-recourse loans, for example, when a loan to a real estate developer states that the principal and interest on the loan are repayable solely from the sale proceeds of a specific real estate. In such cases, the 'contractual cash flow characteristics are not met and hence, such loans are accounted for on a fair value basis. The advances of the banks for the financial year 2009 – 2010 have been given in Table – A. At the end of the financial year 2009 – 2010 the total advances was Rs. 3497054 Crore. The bank that has more advances shall be required to do more work on the valuation and their appraisal during the conversion of IFRS.

7.6.Tax Reporting Practices

The tax implications of converting to IFRS, like all other parts of conversion, are complicated. Differences in tax accounting are extremely important to banks. However, the consequences of a conversion extend beyond these complicated tax issues to include pre-tax accounting modifications, worldwide planning strategies, and tax information systems. If addressed properly and well in advance of conversion, converting to IFRS has the potential to boost an entity's tax function by allowing for a thorough evaluation of tax concerns and processes. Banks will need to evaluate the following questions if there are changes that affect pre-tax accounting methods: i. Under the Income Tax Act of 1961, is the new financial reporting standard a permitted tax accounting method? Is the new book technique permitted by the Income Tax Act of 1961? Is it required to record changes in accounting procedures after converting to IFRS Will the computation of permanent and temporary differences in Deferred Tax be altered? v. Is the loss caused by fair valuation, which is allowed as an expense under the Income Tax Act of 1961.

7.7.Financial Instruments

In tandem with International Accounting Standards – 39 (IAS – 39) on Financial Instruments, the Institute of Chartered Accountants of India has produced AS 30, AS 31, and AS 32. Financial Instruments: Recognition and Measurement is a common standard for businesses that employ financial instruments in their financial statements, particularly those in the banking industry. It will influence the industry's revenue. To give you an example, the next major standard IFRS 9, Financial Instruments: Categorization and Measurement, mandates two classification alternatives for financial assets, i.e. Fair value or amortized cost Only two requirements must be satisfied for amortized cost classification to be allowed. The asset is first retained inside a business model whose goal is to keep assets to receive contractual cash flow. Second, the financial asset's contractual conditions result in cash flows on certain dates that are purely principal and interest payments on the outstanding principal. When a portfolio kept at amortized cost has more than one rare number of sales, the entire portfolio must be accounted for at fair value. It's important to remember that a single entity can have multiple business models for managing its financial instruments, for example, an entity could have one portfolio of debt securities it manages to collect contractual cash flows and another portfolio of similar debt securities it manages to trade and realize fair value changes. To meet the RBI's statutory liquidity ratio prudential criteria, Indian banks invest in government securities. The bulk of such assets is accounted for at amortized cost under the 'kept to maturity' categorization, according to current RBI guidelines. Unless the bank has a defined strategy, significant portfolio management ability, and a track record of successful business models. It may 'taint' an amortized cost portfolio by requiring the entire portfolio to be measured at fair value, resulting in unwanted volatility in its financial statements.

7.8.Information Technology

The International Financial Reporting Standards (IFRS) are predicted to have a wide range of consequences at many levels of the IT systems architecture. The IT staff will have significant difficulty in realigning the banking's information systems (along with the rest of the organization). From the upstream or source of data to the farthest end of the reporting tools, virtually all applications and interfaces in the system architecture might be affected. External considerations such as local and international rules, financial consolidation of subsidiaries, stock markets, and external auditors will have to be considered by the bank's information technology department. This corporate change will not be completed in a single phase. Updating information technology and information systems will necessitate a significant financial expenditure. For meeting out these investments, Indian banks have made no such provisions. These investments will have a significant influence on bank liquidity.

8. Discussion of Impact and Reducing the loss

The Indian banking industry has begun assessing the organization's loans and advances following the International Financial Reporting Standards (IFRS), although not to complete compliance. Currently, they assess the amount of impairment in loans and advances by calculating present value using the appropriate discounting rates. These current values will be calculated using the group borrowing facility basis in cases where the borrowing is enjoyed on a class or group basis, as well as the collective basis in cases where the borrower enjoys the borrowing for a shorter duration. Credit cards are an example of brief duration for a communal foundation. Credit risk management has begun to be measured in the banking industry. Credit risk management has begun both inside and outside. Every bank has set and allocated certain points for assessing the risk of specific loans. These factors include the borrower's age, the degree of risk involved, the type of the business or profession, expertise in the industry, income coverage for the loans, and so on. Although, before granting loans and advances, the bank's internal department assesses and assigns risk to all applicants. It has also begun the practice of obtaining risk assessments from external firms like CRISIL, CARE, and others for any businesses with a borrowing facility of 10 crores or more, whether as a group borrower or an individual borrower. Before approving a loan, banks check the borrower's credit history with CIBIL. The bank handles this procedure internally, and the information is kept private. This strategy will decrease advance impairment losses while also improving the banking industry's net worth and profitability. The banking sector has begun to implement procedures for appropriate loss provisions for derivatives and financial instruments. It will bring Indian GAAPs up to IFRS standards. The Indian banking industry will benefit from this technique. The majority of banks hired skilled and competent employees. Credit risk management, fair valuation of loans and advances, loss projection, if any, and effective budgeting of revenue and expenditures are all performed by this team. It will improve the banking sector's financial reporting as well as the accurate valuation of investments, loans, and advances. The

Security Exchange Board of India (SEBI), which is in charge of the Indian stock exchange, is also in the process of finalizing revisions to previous standards. The Indian banking industry must adopt and execute any changes suggested by the Securities Exchange Board of India (SEBI).

9. conclusions

The foregoing explanation demonstrates that the adoption of IFRS will have a significant influence on advancements, financial instruments, investments, and, among other things, a hefty investment in information technology system upkeep. However, the sector still requires a full study and appraisal of existing advances and all other instruments following the International Financial Reporting Standards (IFRS). The tax authorities have yet to clarify whether a loss resulting from the devaluation of such advances and instruments is allowable. The Reserve Bank of India has also not addressed the SLR compliances and the maintenance of other reserves through investments in government securities and their value in contravention of IFRS. All of the aforementioned will have a substantial influence on the banking industry's financial statements. It is not a procedure that can be accomplished in a year, and it will take time. The banking industry is now implementing the pension program, which has resulted in a loss of Rs. 12000 crore. It has requested that the Institute of Chartered Accountants of India (ICAI), the accounting and auditing regulating body, and the Reserve Bank of India make provision over five years rather than in the current financial year. In the future, the same treatment may be requested and granted for any loss resulting from the fair assessment of advances, financial instruments, and investments.

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