KPMG

Ind AS: Practical perspectives (NBFCs)

An analysis of published results of NBFC debt and equity listed companies for the year ended 31 March 2019

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Foreword

Non-Banking Financial Companies (NBFCs) including Housing Finance Companies (HFCs) have adopted Ind AS from 1 April 2018. These companies have recently published their financial results for the year ended 31 March 2019. As NBFCs embrace Ind AS, KPMG in India, through its publication, 'Ind AS: Practical perspectives (NBFCs)' aims to capture emerging trends and practices by analysing these financial results.

In this publication, we analyse the results of 60 NBFCs (28 NBFCs that have their debt securities listed on the BSE and 32 equity listed NBFCs on BSE 500). Basis of our analysis is a comparison of the reported financial results for the year ended 31 March 2018 under the erstwhile Indian GAAP with the restated financial results for the same period under Ind AS, that have been published as comparatives for the year ended 31 March 2019.

In the earlier quarters of the financial year 2018-19, the implementation and disclosures relating to the application of Ind AS had been substantially impacted by the financial reporting relaxations provided by the Securities and Exchange Board of India (SEBI) for the first-time adoption of Ind AS. Now for the year end results, both, the equity listed and debt listed NBFCs have disclosed their balance sheets in the revised format along with comparatives as at 31 March 2018, and equity reconciliations as on that date. However, while the equity listed NBFCs have provided consolidated financial results, many of the debt listed companies have reported only separate financial results. This has brought in diversity in results presented by companies.

We found that most of the companies have presented only bare minimum information mandated by SEBI, without sufficient explanations. As a result, the transition related choices made and exemptions availed are not evident in the published results thus far. Due to these reasons, the financial results do not fully showcase the extent of qualitative differences between erstwhile Indian GAAP and Ind AS.

The trend of impact of Ind AS on key financial metrics for the year ended 31 March 2018 is in line with the trend observed in our publications Ind AS: Practical Perspectives (NBFCs) for the half year ended 30 September 2018 and quarter ended 30 June 2018. There is an increase in revenue from operations, finance cost and employee cost under Ind AS in comparison to the erstwhile Indian GAAP while there is a fall in profit after tax. Additionally, we observed that there is an increase in loan loss provision reported by 12.6 per cent by the equity listed NBFCs while debt listed NBFCs showcased a reduction in the loan loss provision by 12.1 per cent.

We hope you will find this publication useful in enhancing your understanding of NBFCs' results under Ind AS and we welcome any suggestions or feedback that you may have.

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Basis of our analysis

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Background to Ind AS adoption for NBFCs

Non-Banking Financial Companies (NBFCs) have adopted Ind AS from 1 April 2018. These companies have recently published their financial results for the year 31 March 2019. As NBFCs embrace Ind AS, KPMG in India, through its publication, 'Ind AS: Practical perspectives (NBFCs)' aims to capture emerging trends and practices by analysing these financial results.

Profile of companies covered

In this edition of Ind AS: Practical perspectives (NBFCs), we have analysed the annual results announced by 60 NBFCs (28 NBFCs that have their debt securities listed on BSE and 32 equity listed NBFCs on BSE 500). This publication analyses the impact of adoption of Ind AS on the profits of these companies and identifies some of the key areas that contribute to the impacts on net interest income, PAT[1] and loan loss provisions (expected credit losses), etc.

Of the 28 debt listed companies analysed in this publication, seven companies are Housing Finance Companies (HFCs) while 21 companies are other NBFCs, and of the 32 equity listed companies analysed, nine are HFCs while the balance 23 are other NBFCs.

Basis of analysis

Analysis in the subsequent sections of this publication is based on the profit reconciliations presented for the year ended 31 March 2018 under erstwhile Indian GAAP with the restated results for the same period under Ind AS that have been published for the year ended 31 March 2019.

For our analysis on loan loss provision we have considered the information available on 31 March 2019.

As necessary explanations/notes to the profit reconciliations have not been provided in a narrative form by all the covered companies, we have determined the nature of adjustments to profit with regard to a particular Ind AS on the basis of the descriptions available in the reconciliations and on the basis of our analysis of those descriptions. It is also pertinent to note that debt listed companies are not required to present additional information by way of investor presentations. Further, certain values and percentages referred to in this publication should be considered as indicative and may change if computed differently and/or on use of different set of assumptions. Additionally, standard-wise/adjustment-wise Ind AS impact analysis on profitability is based on absolute values of adjustments disclosed in the reconciliations.

1. PAT: Profit after Tax

Impact on key metrics of NBFCs

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2.9%
Profit After Tax*

9.7%
Revenue from operations*

9.4%
Finance cost*

8.0%
Employee cost*

(Source: KPMG in India's analysis based on the primary data gathered from BSE 500 companies and debt listed companies on BSE upto 3 June 2019)

*Represents the change as compared to the erstwhile Indian GAAP

Impact on key metrics of debt listed and equity listed NBFCs for the year ended 31 March 2018 under erstwhile Indian GAAP and Ind AS

On an overall basis, for the 60 companies analysed, the profit after taxation has reduced from INR52,917 crore under erstwhile Indian GAAP to INR51,373 crore under Ind AS, a reduction of 2.9 per cent. While the revenue under Ind AS has increased to INR3,62,039 crore from INR3,30,179 crore under erstwhile Indian GAAP (an increase of 9.7 per cent), there has been a concurrent increase in employee costs from INR20,433 crore under erstwhile Indian GAAP to INR22,061 crore under Ind AS (an increase of 8 per cent) and an increase in finance cost from INR1,56,717 crore under erstwhile Indian GAAP to INR1,71,514 under Ind AS (increase of 9.4 per cent).

Equity listed companies

On an aggregation of the results of all the 32 equity listed companies covered in the analysis, the net profit under Ind AS for the year ended 31 March 2018 has decreased from INR48,121 crore to INR46,366 crore, a reduction of 3.65 per cent as compared to that under the erstwhile Indian GAAP. This reduction is primarily driven by the impact of EIR[2], loan loss provision (ECL[3]) and employee benefit costs, partly offset by the increase in reversal of the deferred tax liability on special reserves by certain HFCs.

Debt listed companies

A similar aggregation of the results of the debt listed companies covered in the analysis reveals a different trend from that observed in case of equity listed companies above. The aggregate profits of all the 28 debt listed companies covered in the analysis revealed that the net profit under Ind AS for the year ended 31 March 2018 has increased to INR5,007 crore as compared to that under the erstwhile Indian GAAP of INR4,796 crore, an increase of 4.4 per cent. The key differentiating factor in the results of the equity listed companies and debt listed companies was the amortisation of costs and fees on loan origination, expected credit losses and gains or losses on derecognition of financial assets.[4]

2. EIR: Effective Interest Rate
3. ECL: Expected Credit Losses
4. ESOP: Employee Stock Option Plan

Analysis of impact of key standards

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The following section of this publication highlights some of the key impacts of adoption of Ind AS that have been reported as part of the profit reconciliation for the year ended 31 March 2018.

Recognition of interest income and expense using EIR method

Interest income and expenses are required to be recognised using EIR, accordingly, directly attributable and incremental fees and costs in respect of loans and borrowings are not to be recognised upfront under Ind AS.

On an aggregate of the revenue from operations of all the 28 debt listed companies, the revenue recognised under Ind AS was lower than that under erstwhile Indian GAAP by 0.61 per cent while the finance cost recognised under Ind AS was lower than that recognised under the erstwhile Indian GAAP by 3.73 per cent. Unlike the decrease in revenue observed in case of debt listed companies, in the case of equity listed companies, the revenue under Ind AS for the year ended 31 March 2018 was greater than that under the erstwhile Indian GAAP by 11.8 per cent. For the equity listed companies, the finance cost increased by 12.9 per cent under Ind AS when compared to that under the erstwhile Indian GAAP.

Expected Credit Loss (ECL)

Overall impact on net worth and erstwhile Indian GAAP loan loss provisions

NBFCs

The following table depicts the impact of expected credit losses on previously reported numbers of loan losses for year ended 31 March 2018

Aggregate reported loan loss provisions under erstwhile Indian GAAP (INR crore)	19,089
Aggregate restated loan loss provisions under Ind AS (INR crore)	19,352
Increase in loan losses (INR crore)	263
Percentage increase	1.4

We analysed 44 NBFCs, of which five did not report the ECL numbers under Ind AS separately. Of the balance 39 NBFCs, three reported similar provision numbers under Ind AS vis-à-vis erstwhile Indian GAAP, and 15 reported a higher Ind AS provision as compared to erstwhile Indian GAAP (125.9 per cent increase in provision). Out of these 15 NBFCs, one NBFC had a substantial jump in the loan loss provision number and balance 14 NBFCs reported an aggregate increase of 39.1 per cent in the loan loss provision. Balance 21 NBFCs reported a reduction in aggregate provision, which stood at 36.4 per cent.

HFC

The following table depicts the impact of expected credit losses on previously reported numbers of loan losses for year ended 31 March 2018

Aggregate reported loan loss provisions under erstwhile Indian GAAP (INR crore)	3,110
Aggregate restated loan loss provisions under Ind AS (INR crore)	4,761
Increase in loan losses (INR crore)	1,651
Percentage increase	53.1

Out of the 16 HFCs analysed, two reported similar provision numbers under Ind AS vis-à-vis erstwhile Indian GAAP. Of the balance 14 companies, eight reported a higher Ind AS provision as compared to erstwhile Indian GAAP (172.5 per cent increase in provision). Out of these eight HFCs, one HFC has a substantial jump in the loan loss provision number, and balance seven HFCs reported an aggregate increase of 52.1 per cent in the loan loss provision. The balance six HFCs reported a reduction in aggregate provision, which stood at 18.9 per cent.

Staging analysis

Rebuttal of Days Past Due (DPD) criteria

Ind AS 109 requires staging assessment for retail loans based on DPD criterion. Many companies have used staging criterion in line with the standard (stage 1 – current-30 DPD, stage 2 – 30-90 DPD and stage 3 - > 90 DPD) with an exception of four NBFCs. In case of two NBFCs, where these criteria have been rebutted, stage 3 is considered at > 60 days past due and in two other cases stage 1 is considered up to 60 days past due and stage 2 as 60-90 days past due. These NBFCs have not provided a detailed rationale in their investor presentations for the rebuttal of the 30 days past due and 90 days past due thresholds provided in the standard. We may expect to see this justification in their annual financial statements.

Split of loan outstanding by stages

A total of 15 companies (including seven HFCs) have disclosed information on composition of loan outstanding by stages.

On the basis of our analysis of the results presented for the year ended 31 March 2019, on an overall basis, 2.74 per cent of the loans outstanding is classified as stage 3 category (4.53 per cent in the results presented in 30 September 2018, 18 companies had provided details at that time). For NBFCs other than HFCs, the average percentage loans classified in stage 3 category was 4.71 per cent of the total loan outstanding (ranging from 0.75 – 8.91 per cent) and for HFCs the average was 1.52 per cent of the total loan outstanding (ranging from 0.46 – 4.48 per cent).

Loan loss provision (ECL) coverage

The erstwhile Indian GAAP required standard asset provision to be recognised at a specific rate ranging from 0.25 per cent to 0.40 per cent on performing loans depending on whether the company was an NBFC or a HFC. Under Ind AS 109, loan loss provision is required to be recorded at 12-month expected loss for stage 1 loans (good loans) and lifetime losses for stage 2 and stage 3 loans, i.e. loans which have witnessed significant increase in credit risk since inception. Stage 3 loans have been considered as impaired loans for non-performing assets and provision coverage reporting purposes.

- **NBFCs (other than HFCs)**

  Based on the analysis of disclosures made by eight NBFCs (other than HFCs) for the year ended 31 March 2019, the loss rates under Ind AS ranged from 0.52 – 3.05 per cent of the gross stage 1 and 2 loans together.

  10 NBFCs (other than HFCs) have reported their provision coverage on stage 3 loans which ranges from 19 – 71 per cent, indicating that depending on the loan outstanding, the NBFCs are able to recover approximately 81 to 29 per cent of the exposure at default.

  On an overall basis, loan loss provision (ECL) coverage for stage 1 and stage 2 loans together is 1.64 per cent and for stage 3 is 42.3 per cent for NBFCs (other than HFCs).

- **HFCs**

  Based on the analysis of stagewise provisioning disclosures made by five HFCs for the year ended 31 March 2019, the loss rates under Ind AS ranged from 0.2 – 0.8 per cent of the gross stage 1 and 2 loans together.

  Five HFCs have reported their provision coverage on stage 3 loans which ranges from 21 - 44 per cent, indicating that depending on the loan outstanding, the HFCs are able to recover approximately 79 to 56 per cent of the exposure at default.

  On an overall basis, loan loss provision (ECL) coverage for stage 1 and stage 2 is 0.75 per cent and for stage 3 is 39.06 per cent for HFCs.

Gross/Net non-performing assets

Following is the analysis for NBFCs (other than HFCs)

A total of 14 NBFCs (other than HFCs) have reported their gross and net NPA using Ind AS numbers. Stage 3 loans are classified as NPAs.

The gross NPAs reported by these NBFCs ranged from 0.47 – 8.68 per cent and net NPAs ranged from 0.2 – 5.49 per cent.

Following is the analysis for HFCs

A total of eight HFCs have reported their gross and net NPA using Ind AS numbers. Stage 3 loans are classified as NPAs.

The gross NPAs reported by these NBFCs ranged from 0.44 – 4.48 per cent and net NPAs ranged from 0.35 – 1.95 per cent.

Use of conservative approach for loan loss provisioning under Ind AS by certain HFCs

On the basis of our analysis, few companies (mainly HFCs) have continued to retain loan loss provisions held under erstwhile Indian GAAP over and above the loan loss provision (ECL) requirements under Ind AS, based on their articulation of a 'prudence' driven approach. This fact has been highlighted by such companies.

Derecognition of financial assets

Generally, under Ind AS, securitisation structures that are most commonly used in India would not qualify the derecognition criteria. However, Reserve Bank of India (RBI) compliant assignment transactions are likely to meet Ind AS derecogntion criteria. As a result, companies would need to bring back the securitised assets in their books and record them as collateralised borrowings. On assignment transactions, the excess interest spread retained by the companies would be recorded as gains upfront rather than on a deferred basis as is done currently under erstwhile Indian GAAP.

The impact ranged from 0.03 – 9.5 per cent of the previously reported net worth under erstwhile Indian GAAP at 31 March 2018.

Segment reporting

Ind AS requires segment disclosures to be based on the components of the company that the management monitors while making decisions about operating matters, i.e. it requires looking at the company 'through the eyes of the management'. This approach is different from that followed under erstwhile Indian GAAP and is likely to lead to identification to different operating segments. The trends in segment reporting indicate that for a majority of companies, the operating segments have remained unchanged.

Next steps

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We have observed that NBFCs provided minimal disclosures in the financial results as at 31 March 2019. We expect to see detailed disclosures in the annual financial statements of the NBFCs in relation to the impact of Ind AS on transition as well as detailed description of significant accounting policy choices made by companies. Ind AS requires disclosures that are both qualitative as well as quantitative in nature and therefore, we expect that more insights would be available into the impact of Ind AS on the overall financial statements e.g. details on ECL, fair value measurements, etc. Further, Ind AS 107, *Financial Instruments: Disclosures*, also requires companies to make significant disclosures in relation to concentration to credit risk, credit quality, liquidity risk, market risk and fair value related disclosures.

Moreover, the auditor's report for these entities would also highlight key audit matters that required significant auditor attention arising during the audit of these entities. This is likely to help readers understand the areas in the financial statements that are subject to the highest level of management judgement.

Notes


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