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Prudential Guidelines

Differences between SAS 10 and the revised prudential guidelines

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Introduction

The revised CBN prudential guidelines addresses several regulatory requirements of deposit money banks in Nigeria. This presentation focuses on the loan loss provisioning aspects of the guidelines and areas of conflict with Nigerian Statement of Accounting Standards

The current SAS 10 – Accounting for Banks and non-Bank Financial Institutions Part 1 – which deals with income and loss recognition on loans and advances by banks is largely based on the previous version of the prudential guidelines

SAS 10 (para. 51c) only permits the use of regulations issued by regulatory authorities (in this case CBN), <u>where the regulation stipulates shorter periods for recognizing non-performing loans or higher percentages for determining provisions for non-performing loans</u>

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

The differences in loan loss recognition between the revised prudential guidelines and SAS 10 relates mostly to specialised loans which are not recognised by SAS 10. However, there are other areas of differences

The revised prudential guidelines generally prescribes longer periods and lower percentages in recognising and determining provisions respectively for non-performing specialised loans

Other areas of conflict include requirement for general provisions on performing loans, collateral adjustments for loans classified as lost, and treatment of restructured agricultural

The following pages highlights these differences

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

Topic	Per SAS 10	Per revised prudential guidelines
Classes of loans	Loans & advances are categorised primarily into performing and non-performing	Loans are classified based on performance and into specialised and non-specialised with differing loan loss recognition and measurement criteria
Disclosure requirement for specialised loans	No specific requirement for specialised loans	These are: •Total loans outstanding under each specialised loan and provision against the loan; •Non-performing loans by loan type and its percentage to total specialised loans, and movement of specific provision under each category; •The non-performing loans should be classified into: i. Watchlist ii. Substandard iii. Doubtful iv. Very doubtful v. Lost

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

Topic	Per SAS 10	Per revised prudential guidelines
Classification of non-performing loans	Non-performing loans are not classified into bands. However, loan loss criteria are specified for loans on which: • interest is overdue by more than 90 days; and •principal and/or interest is over due by more than 120, 180 and 360 days respectively	Non-performing loans are categorised/classified. •Non-performing, non-speacilised loans are classified into: i. Substandard (overdue>90days); ii. Doubtful (180-360days); and iii. Lost (>360days). •Non-performing specialised loans are classified into i. Watchlist; ii. Substandard; iii. Doubtful; iv. Very doubtful; and v. Lost.

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

Topic	Per SAS 10	Per revised prudential guidelines
Margin facilities	Margin loans are not treated differently from other types of loans. Recognition of credit losses is based on the number of days by which payments are overdue	Margin facilities should be marked to market on a daily basis. The excess of loan balance over the market value should be provisioned and charged to the profit and loss account
Collateral adjustments for loans classified as lost	Collateral adjustments limited to 50% of the estimated net realisable value (NRV) of the security, provided that principal repayment is not overdue by more than 2 years	Haircuts specified for different types of collateral. Haircut adjustment is available for only 1 year However there seem to be some inconsistency within the guidelines as paragraph 12.2b(2) requires 100% provision on non-specialised loans classified as lost irrespective of NRV of security, while paragraph 12.2b(4) allows for collateral adjustment

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

Topic	Per SAS 10	Per revised prudential guidelines
Restructured agricultural loans classified as lost	There is no specific treatment for restructured agricultural loans. However, provisions for non-performing revolving and overdraft loans should continue until it is clear the rescheduling is working	Where natural calamities impair the repayment capacity of agricultural borrowers, agricultural loans to the borrowers can be resheduled and the resheduled loans immediately treated as performing loans
Facilities without approval	There are no specific requirements on provisioning for loans without approval	Loans without approval that are not regularised within 90 days are required to be classified in accordance with the requirements of non-specialised loans
General provisions	Minimum of 1% general provision required for loans and advances not specifically provided for	General provisioning guidelines to be issued by CBN on ad-hoc basis. For financial year that ended in 2010, the CBN issued a circular suspending the requirement for general provision

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

Topic	Number of days payment's overdue	Per SAS 10	Per revised prudential guidelines
Loss recognition criteria for specialised loans	>90 days	Suspend interest when overdue by more than 90 days (or such shorter period specified by regulatory authorities)	Suspend interest
	90 – 180 days	Full provision for principal repayments overdue by more than 120 days (or such shorter period specified by regulatory authorities). No provision required for balance not due. However, old prudential guidelines require 10% for balance not due	25% provision for total outstanding balance required for only SME and Agriculture financing loans where interest/principal is overdue by 90 days to1 year. No provision required for other categories of specialised loans

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

Topic	Number of days payment's overdue	Per SAS 10	Per revised prudential guidelines
Loss recognition criteria for specialised loans	180 - 360 days	When principal repayments are overdue for between 180 - 360 days (or such shorter period specified by regulatory authorities), full provision is made for overdue amount and 50% provision required for principal not due	Provision required for all categories of specialised loans does not exceed 25% of total outstanding balance
	> 360 days	When principal repayments are overdue for over 360 days (or such shorter period specified by regulatory authorities), full provision is made for overdue amount and 100% provision for principal not due	Provision rate ranges between 25% and 100% depending on the type of the specialised loan

Differences in loss recognition requirements between SAS 10 and the revised CBN prudential guidelines

Topic	Number of days payment's overdue	Per SAS 10	Per revised prudential guidelines
Loss recognition criteria for specialised loans	> 2 years	100% provision for outstanding balance irrespective of security held	Required provision ranges between 50% and 100% of total outstanding balance depending on the category of the specialised loan Where collateral adjustment is taken, the adjustment is available for a maximum of 1 year

Way forward for 31 Dec 2011

The revised prudential guidelines is not as stringent as SAS 10 with respect to the following areas:

1. General provisioning for performing loans
2. Loan loss recognition criteria for specialised loans
3. Collateral adjustment for loans classified as lost
4. Restructured agricultural loans

Paragraph 51© of SAS 10 forms the basis for which the old prudential guidelines became an integral part of SAS 10.

As the application of the requirements of the revised prudential guidelines in the 4 aspects mentioned above will result in financial statements that are non-compliant with paragraph 51© of SAS 10, the financial statements cannot be deemed to have complied with Nigerian GAAP.

It is pertinent to note that the Nigerian Accounting Standards Board is the only recognized body in Nigeria responsible for developing and issuing accounting standards.

Way forward for 31 Dec 2011

Open to discussion!

Post Dec 2011 - Impact of IFRS on loan loss provisioning

Little or no similarity exists between the recognition and measurement criteria of loan loss provisions per Nigerian GAAP (SAS and prudential guidelines) and IFRS. Highlights of the differences between IFRS and Nigerian GAAP include:

Topic	***SAS/CBN Prudential guidelines***	***IFRS***
Identifying impaired loans	Specifies a predetermined policy for identifing impaired loans based on number of days outstanding and the nature of the loan	No prescriptive requirement for identifying impaired financial assets (loans). However, an entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. An impairment can only arise as a result of one or more events that occurred after the initial recognition of the asset.

Post Dec 2011 - Impact of IFRS on loan loss provisioning

Topic	***SAS/CBN Prudential guidelines***	***IFRS***
Measurement of loan loss provisions	Specifies the amount of provision required based on the impairment classification of the loan, i.e. 25%, 50%, 75% or 100% of the outstanding amount, with provisions for collateral adjustments	The amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's original effective interest rate. A collective impairment is required for: a) individually insignificant assets where an impairment indicator was identified; and b) all other assets where no indicator was identified (IBNR)
Interest in suspense	Requires that interest be suspended on non-performing loans	No requirement to suspend interest.

Post Dec 2011 - Impact of IFRS on loan loss provisioning

Topic	***SAS/CBN Prudential guidelines***	***IFRS***
Intervention of regulators	CBN can mandate banks to make additional provisions based on CBN's analysis of the bank's portfolio	Provision for impairment loss is based only on objective evidence of impairment and the difference between the carrying amount and the estimated cash flows
Disclosures	Disclosure requirements are similar to that of IFRS in certain respects such as movement in loan loss provisions, however, they are not as extensive	Extensive disclosures on credit risks required such as maximum amount of exposure, description of collateral, credit quality of financial assets that are neither past due nor impaired, and credit quality of financial assets whose terms have been renegotiated

Post Dec 2011 - Impact of IFRS on loan loss provisioning

Section 12.4 of the CBN prudential guideline prescribes the following treatment for the difference between loan loss provisions determined per IFRS and per the CBN prudential guidelines:

a) Where prudential provisions is greater than IFRS provisions; transfer the difference from the general reserve to a non-distributable regulatory reserve

b) Where prudential provisions is less than IFRS provisions; the excess charges resulting should be transferred from the regulatory reserve account to the general reserve to the extent of the non-distributable reserve previously recognized.

This treatment is similar to the practice in other African countries that have adopted IFRS such as Ghana, Uganda, Tanzania, and Zambia.

Post Dec 2011 - Impact of IFRS on loan loss provisioning

Extracts of accounting policies and notes on differences between loan loss provisions under prudential guidelines and under IFRS:

A Commercial Bank in Zambia

Note on general banking reserve:

"The balance in the general banking reserve represents the excess of impairment provisions determined in accordance with the Central Bank Prudential Regulations over the impairment provisions recognised in accordance with International Financial Reporting Standards (IFRS). The reserve is not distributable."

Post Dec 2011 - Impact of IFRS on loan loss provisioning

Extracts of accounting policies and notes:

<u>A Bank in Uganda</u>

Accounting policy on statutory reserve:

"IAS 39 requires the bank to recognise an impairment loss when there is objective evidence that loans and advances are impaired. However, BOU prudential guidelines require the bank to set aside amounts for impairment losses on loans and advances in addition to those losses that have been recognised under IAS 39. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining profit or loss. These amounts are dealt with in the statutory reserve."

Note on statutory reserve:

"The statutory reserve represents an appropriation from retained earnings to comply with Bank of Uganda's prudential guidelines on impairment of loans and advances. It represents the excess of loan provision as computed in accordance with Bank of Uganda prudential guidelines over the impairment of loans and advances arrived at in accordance with IAS 39. The revaluation surplus and statutory reserve are not distributable."

Post Dec 2011 - Impact of IFRS on loan loss provisioning

Extracts of accounting policies and notes:

A Bank in Ghana

Note on regulatory credit risk reserve:

"Regulatory credit risk reserve represents the excess of loan impairment provision determined under the Bank of Ghana guidelines over the provisions for loan impairment."

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