ANALYSIS OF HDFC LIMITED'S TRANSITION TO IND AS

In accordance with the notifications issued by the Ministry of Corporate Affairs and National Housing Bank, HDFC Limited (the Corporation) has adopted the Companies (Indian Accounting Standards) Rules, 2015 (Ind AS) notified under Section 133 of the Companies Act, 2013 with effect from April 1, 2018.

For the quarter ended June 30, 2018, the Corporation has adopted Ind AS for its standalone financials. These financials have been subjected to limited review by the statutory auditors of the Corporation.

The comparative Statement of Profit and Loss for the quarter ended **June 30, 2017** is based on the erstwhile Indian Generally Accepted Accounting Principles (Previous GAAP). This has been restated to meet Ind AS requirements. The difference in the accounting principles adopted by the Corporation on transition to Ind AS has been subjected to limited review by the statutory auditors.

Effective Date

The effective date of transition to Ind AS is **April 1, 2017**. Accordingly, the net worth as at March 31, 2017 will be adjusted through the Transition Reserve and will be reported with the financials as at September 30, 2018. Earnings for the previous year have been restated.

Transition to Ind AS

Key Changes and its Impact on HDFC Limited

1. **Effective Interest Rate on Interest Earning Assets and Borrowings**

    a. **Interest Earning Assets**

Under Ind AS, all income on assets are recorded on**Effective Interest Rate (EIR)[1] basis.**

Key Changes:

Fees on interest earning assets which were earlier booked upfront on a cash basisare included in the calculation of EIR resulting in temporary deferral of revenue;

[1]EIR is defined in Ind AS as 'the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability.'

Similarly ***DSA commission***isalso included in the calculation of EIR.

Interest on Non Performing Assets (NPA): Interest income on NPAs which was not accrued earlier is now recognised as part of Ind AS adjustment, if the security is adequate and the present value of realisation of the security is greater than the outstanding loan dues.

b. Borrowing Costs

Under Ind AS, all expenses on borrowings are recorded on EIR basis.

Thus, redemption premium on zero coupon bonds, discount and issue expenses on rupee denominated bonds issued overseas (which was earlier routed through the Securities Premium Account)and interest on step-up non-convertible debentures have been charged to the Statement of Profit and Loss on an EIR basis.

Impact: For the quarter ended June 30, 2017, the adjustment in net interest income (net of tax) pursuant to the adoption of EIR under Ind AS was ₹ 106crore lower compared to the previous GAAP.

2. Classification of Assets

The Corporation's assets have been classified based on expected performance. Exposure at Default (EAD) is the total amount outstanding including accrued interest as on the reporting date.

Under Ind AS, the Corporation's assets have been classified as follows based on EAD:

- **Stage 1**: Performing Assets
- **Stage 2**: Under Performing Assets
- **Stage 3**: (a) Performing but identified as assets having some degree of stress; (b): Non-Performing Assets

Classification of Assets for Computation of Expected Credit Loss (ECL):

Exposure at Default (EAD) %	Quarter ended June 30, 2018	Quarter ended June 30, 2017	Year ended March30, 2018
Stage 1	94.76%	94.90%	94.17%
Stage2	1.54%	2.50%	1.48%
Stage 3(a): Standard, stressed assets	2.52%	1.49%	3.24%
Stage 3(b): Non Performing Loans	1.18%	1.11%	1.11%
	100.00%	100.00%	100.00%

3. **Expected Credit Loss (ECL)**

Asset classification and provisioning moves from the rule based, incurred losses model to the ECL model of providing for **expected future credit losses**. Thus, loan loss provisions are made on the basis of the Corporation's historical loss experience,future expected credit loss and after factoring in various macro-economic parameters.

Impact: The application of the ECL model(as against provisioning made in accordance with NHB prudential norms) has resulted in an increase of ₹ 51crore (net of tax)for the quarter ended June 30, 2017 under Ind AS compared to the previous GAAP.

Ind AS requires the Corporation to provide for the entire ECL on the legacy portfolio as at April 1, 2017. Accordingly, excess provisions carried by the Corporation are to be adjusted to the opening reserves as on April 1, 2017.

The table below provides the classification of the Corporation's assets based on EAD and the ECL computation under Ind AS

As per IND AS	Qtr Ended June 30,2018	Qtr Ended June 30,2017
	Rs cr	Rs cr
Gross Stage 3*	13,866	8,222
ECL Provision Stage 3**	3,863	2,396
Net Stage 3***	10,003	5,826
Coverage Ratio% Stage 3	28%	29%
Gross Stage 1 & 2	360,738	308,301
ECL Provision Stage 1 & 2	565	586
Net Stage 1 & 2	360,173	307,715
ECL Provision % Stage 1 & 2	0.16%	0.19%

** Gross value of total dues (principal and interest thereon) where some degree of stress is perceived*
*** Total dues (principal and interest thereon) which are unlikely to be received in respect of stressed loans*
**** Total dues (principal and interest thereon) likely to be received in respect of stressed loans*

4. Investments

Under Ind AS, the Corporation has opted to value its equity investments in subsidiary and associate companies **at cost**.Consequently, profits will be booked through the Statement of Profit and Loss if and when any of the investments are sold.

Other equity investments are measured at Fair Value Through Profit or Loss or Fair Value Other Comprehensive Income. Debt instruments are valued at amortised cost.

Impact: Under Ind AS,for the quarter ended June 30, 2017,the increase in fair value of investments through the P/L was ₹ 17 crore.

5. Fair Valuation of Employee Stock Option Schemes (ESOS)

Even though the Corporation has always granted stock options at market price, expense for obligations under ESOS issued during the period has to be fair valued and amortised as part of employee benefit expenses over the period of vesting.

On June 1, 2017, the Corporation granted stock options under ESOS-17. The vesting period was primarily for 1 year with effect from that date and the last vesting date for ESOS-17 is December1, 2020. Accordingly, theexpense for obligations under ESOS-17 has to be fair valued and amortised as part of employee benefit expenses primarily over the period June 1, 2017 to May 31, 2018.

Impact: For the quarter ended June 30, 2017, fair market value of ESOS resulted in an increase in employee benefit expenses to the extent of ₹95 crore under Ind AS.

6. Deferred Tax Liability (DTL) on Special Reserve

Ind AS does not require the creation of DTL on the amount transferred to the Special Reserve. Accordingly, DTL created on special reserve as at March 31, 2017 will be reversed and the charge through the Statement of Profit and Loss Account in earlier years will also be reversed.

Impact: For the quarter ended June 30, 2017, DTL on Special Reserve of ₹105 crore has been reversed.

7. Assignment of Loans to HDFC Bank

The income on the loan assignment transactions with HDFC Bank is being received as a servicing income, which is recognised over the life of the asset.

Impact: There is no impact due to transition to Ind AS on account of the arrangement between the Corporation and HDFC Bank on sourcing and servicing of loans.

Conclusion

All subsidiary and associate companies of the Corporation whose accounts are consolidated with the Corporation are required to restate their accounts except for HDFC Bank Limited, HDFC Life Insurance Company Limited and HDFC ERGO General Insurance Company Limited. This is because Ind AS is applicable for banks from April 1, 2019 and insurance companies from April 1, 2020.

Thus the Corporation will disclose standalone quarterly/year to date financials and not consolidated financials in FY19, except for the quarter/year ended March 31, 2019.

Summary of the reconciliation of the Net Profit as reported under the erstwhile Indian GAAP and Ind AS:

Particulars	Quarter ended June 30, 2017
	Rscr
Net Profit After Tax as per Previous GAAP	1,552.42
Adjustments:	
Adjustment on account of effective interest rate / forex valuation / net interest on credit impaired loans	(106.31)
Adjustment on account of expected credit loss	(50.55)
Adjustment due to fair value of stock options	(95.16)
Fair value change in investments	17.49
Reversal of Deferred tax liability on Section 36(1)(viii) for the quarter	105.21
Other Adjustments	1.37
Total effect of Transition to Ind AS	(127.95)
Net Profit After Tax as per Ind AS	1,424.47
Other Comprehensive Income (net of tax)	(14.56)
Total Comprehensive Income (net of tax) as per Ind AS	1,409.91