

NFRS IN THE COOPERATIVES SECTOR

BACKGROUND AND INTRODUCTION

Section 74 of the Cooperatives Act, 2074 requires Cooperatives to maintain their books of accounts using the double entry system of accounting so as to provide a true and fair view of the affairs of the Cooperative. Books of accounts should be prepared using the financial reporting standards prescribed by Regulatory Authority. The Institute of Chartered Accountants of Nepal (ICAN) is the regulatory authority for pronouncing accounting and financial reporting frameworks in Nepal. ICAN has pronounced the following financial reporting frameworks:

Financial Reporting Framework	Applicable for	Applicable from
Full NFRS	Large Entities	<i>Already applicable*</i>
NFRS for SMEs	Small and Medium sized entities (SMEs)	FY 2081-82 onwards
NAS for MEs	Micro Entities (MEs)	FY 2081-82 onwards
NAS for NPOs	Non-profit organizations.	FY 2081-82 onwards

* Full NFRS was made applicable for large entities on a phase-wise manner and is fully applicable for all large entities as of today.

Cooperatives, like any other entities, will need to prepare their financial statements for FY 2081-82 onwards as per the NFRS/NAS based new financial reporting frameworks. NAS for NPOs has been tailor-made for non-profit organizations whereas the other 3 are meant for entities formed with a profit motive. Accordingly, Cooperatives will have to apply either full NFRS, NFRS for SMEs or NAS for SMEs depending on the category within which they fall. Certain financial and non-financial thresholds have been defined for categorization of profit-oriented entities into the 3 categories which have been summarized below:

Criteria	Large Entities	SMEs	MEs
Borrowings from banks, financial institutions and similar bodies.	50 crores and above	5crores -50 crores	Up to 5 crores
Assets held in a fiduciary capacity (deposits from members in case of cooperatives)	50 crores and above	5crores -50 crores	Up to 5 crores
Annual turnover	100 crores and above	10crores -100 crores	Up to 5 crores
Balance Sheet total	100 crores and above	10crores -100 crores	Up to 5 crores
Number of employees	More than 300		

Entities that are either listed or in the process of getting listed are classified as large entities. However, this criteria is not applicable to cooperatives.

Cooperative Societies should ascertain the category within which they fall and should prepare their financial statements accordingly from FY 2081-82 onwards. Micro entities can choose to apply NFRS for SMEs or full NFRS and SMEs can choose to apply full NFRS voluntarily.

This guidance has been prepared with an objective to shed light on major gaps and challenges that are likely to arise in the adoption of the new financial reporting frameworks in the cooperatives sector. This guidance is expected to help the users to navigate the various challenges upon transition to the new standards.

This guidance is accompanied by model financial statement of Cooperatives based on Full NFRS, NFRS for SMEs and NAS for MEs.

COMPARISON BETWEEN FULL NFRS, NFRS for SMEs and NAS for MEs

The main differences between the 3 financial reporting frameworks have been summarized for quick reference. While there are many other differences from a theoretical standpoint, only those differences that are expected to be relevant to the cooperatives sector in Nepalese context have been presented herewith. The comparison is intended for a quick reference and includes only the broad strokes.

1. Components of Financial Statements

Full NFRS	NFRS for SMEs	NAS for MEs
<p>Components of financial statements include:</p> <ul style="list-style-type: none"> • Statement of financial position • Statement of profit or loss and other comprehensive income. • Statement of cash flows • Statement of changes in equity • Notes comprising summary of significant policies, explanatory notes and other information. <p>An Entity includes a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement or when it reclassifies items in its financial statements. Opening statement of financial position should also be prepared as at the date of transition upon first time adoption of NFRS.</p> <p>Accordingly, upon first time adoption of NFRS, entity should present at least 3 statements of financial position.</p> <p>NFRS 5 requires non-current assets held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of profit or loss.</p>	<p>Same as in case of Full NFRS, except that opening statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement need not be included.</p> <p>While NFRS for SMEs requires entities to present a reconciliation of adjustments upon transition to NFRS for SMEs, presentation of the statement of financial position as at the date of transition is not mandated.</p> <p>Accordingly, upon first time adoption of NFRS for SMEs; entity may prepare only 2 statements of financial position.</p> <p>Under full NFRS, non-current assets held for sale that meet the criteria for classification as such as per NFRS 5 are presented separately in the statement of financial position. There is no corresponding requirement under NFRS for SMEs. However, entities should present the results of discontinued operations separately in the statement of profit or loss. NFRS for SMEs allows an entity to present a statement of income and retained earnings in place of a statement of comprehensive income and a statement of changes in equity if the only changes to its equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy. This exemption will not be applicable in case of cooperatives because they are required to create multiple reserves and funds as per Cooperatives Act and Rules and the a statement of changes in equity will be necessary to present movement in those reserves and funds.</p>	<p>Same as in case of NFRS for SMEs; except that the income statement is referred to as “Statement of Income” and there is no concept of “Other Comprehensive Income” unlike NFRS and NFRS for SMEs.</p> <p>Moreover, there is no concept of “non-current assets held for sales and discontinued operations under NAS for MEs. Accordingly, the results of discontinued operations need not be presented separately unlike in case of full NFRS and NFRS for SMEs</p>

2. Impairment of loans and advances measured at amortized cost

Full NFRS	NFRS for SMEs	NAS for MEs
Entities are required to adopt the “Expected Credit Loss (ECL)” model for impairment of loans and advances from FY 2081-82 onwards; replacing the previous “Incurred Credit Loss (ICL)” model. ECL model is expected to result in a forward looking measurement of impairment that is expected to result in recognition of impairment losses when there is a significant increase in credit risk; unlike the previous ICL model which required recognition of losses only when there is an objective evidence of impairment (effectively when a default event actually occurs).	Impairment of loans effectively follows the “Incurred Credit Loss (ICL)” model in case of NFRS for SMEs. At the end of each reporting period, an entity should assess whether there is objective evidence of impairment of loans and advances measured at amortized cost. If there is objective evidence of impairment, the entity shall recognize an impairment loss in profit or loss immediately. Entities are required to develop various parameters and criteria to determine whether there is objective evidence of impairment.	Requirements are similar as compared to NFRS for SMEs.

3. Employee Benefit Expenses

Full NFRS	NFRS for SMEs	NAS for MEs
Entities are required to measure the provision for defined benefit obligations and other long-term employee benefits using projected unit credit method. Projected unit credit method requires the use of various actuarial assumptions including future salary increases, staff turnover and various other factors. For defined benefit obligations, service cost and interest cost are recognized in profit or loss and actuarial gains/losses on remeasurement are recognized in other comprehensive income. For other long-term employee benefits, all 3 components are recognized in profit or loss.	NFRS for SMEs allows the entities to recognize actuarial gains/losses on remeasurement of defined benefit obligations in either profit or loss or in other comprehensive income; as an accounting policy choice. If an entity is not able, without undue cost or effort, to use the projected unit credit method to measure its obligation and cost under defined benefit plans, the entity is permitted to make simplifications in measuring its defined benefit obligation with respect to current employees by ignoring future salary increases, future service and mortality assumptions.	Measurement requirements are further simplified in case of NAS for MEs. Benefits payable on retirement, such as gratuity, shall be measured and recognized as a liability at the amount that would be payable at the end of the reporting period, if the employees leave on that date. Employees who have not completed the minimum period of service to be entitled to the retirement benefit at the end of the reporting period are not considered in the measurement of the liability.

4. Government Grants

Full NFRS	NFRS for SMEs	NAS for MEs
<p>Grant is recognized when there is a reasonable assurance that the entity will be able to comply with the conditions attached to the grant and that the grant will be received. Government grants are recognized in the statement of comprehensive income over the periods necessary to match them with the related costs that they are intended to compensate for, on a systematic basis.</p> <p>Government grants are classified as either grants related to income or grants related to assets. Grants related to assets are recognized either by deducting the grant from the cost of asset or recognizing the grant as deferred income and amortizing the deferred income over the useful life of the asset on a systematic basis.</p>	<p>An entity recognizes government grants according to the nature of the grant as follows:</p> <ul style="list-style-type: none"> • A grant that does not impose specified future performance conditions on the recipient is recognized in income when the grant proceeds are receivable. • A grant that imposes specified future performance conditions on the recipient is recognized in income only when the performance conditions are met. • Grants received before the income recognition criteria are satisfied are recognized as a liability and released to income when all attached conditions have been complied with. <p>Grants are measured at the fair value of the asset received or receivable.</p>	<p>An entity shall recognize government grants as follows:</p> <p>(a) a grant that does not impose specified future performance conditions on the recipient is recognized as income when the grant proceeds are receivable.</p> <p>(b) A grant that imposes specified future performance conditions on the recipient is recognized as income only when the performance conditions are met.</p> <p>(c) A grant that is provided to incur an expense is recognized as income in the periods in which the expense is recognized in statement of income.</p> <p>(d) A grant that is provided to acquire an asset is recognized in a systematic basis over the useful life of the asset.</p> <p>(e) grants received before the revenue recognition criteria are satisfied are recognized in the statement of financial position as deferred income.</p>

5. Deferred taxes

Full NFRS	NFRS for SMEs	NAS for MEs
<p>Deferred taxes are recognized on temporary differences between carrying amount of assets and liabilities and their respective tax base.</p>	<p>Requirements for recognition of deferred taxes are similar as compared to full NFRS.</p>	<p>Entities need not recognize deferred taxes on temporary differences between carrying amount of assets and liabilities and their respective tax base.</p>

6. Property, plant and equipment

Full NFRS	NFRS for SMEs	NAS for MEs
Entities can choose either the cost model or the revaluation model for subsequent measurement of property, plant and equipment.	Requirements for subsequent measurement of property, plant and equipment are similar compared to full NFRS.	Entities should account for property, plant and equipment at the end of subsequent reporting periods using the cost model. NAS for MEs does not mention about the revaluation model.

7. Lease

Full NFRS	NFRS for SMEs	NAS for MEs
Lessees should recognize a right of use asset and lease liability on commencement of a lease with an exception for short-term leases and leases where the underlying asset is of low value.	<p>Leases should be classified by lessees as either finance lease or operating lease.</p> <p>In case of a finance lease; the underlying assets and liabilities are recognized at fair value or, if lower, at the present value of the minimum lease payments at the inception of the lease. The present value of minimum lease payment is discounted using the interest rate implicit in the lease or incremental borrowing rate.</p> <p>In case of an operating lease, the rental payments is recorded as an expense on a straight- line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit or the payments to the lessor are structured to increase in line with expected inflation to compensate for the lessor's expected cost increases.</p>	Requirements are similar compared to NFRS for SMEs. However, NAS for MEs makes an assumption that leases entered into by micro entities are most likely to be operating leases/

8. Investment Properties

Full NFRS	NFRS for SMEs	NAS for MEs
NAS 40 defines investment properties as properties (being land and/or building”) held for long-term capital appreciation or for earning rentals. They can be measured using cost model (similar to property, plant and equipment) or can be measured using fair value model (measured at fair values annually with differences recognized in profit or loss).	Investment properties are carried at fair value if the fair values can be measured reliably without undue cost or effort. Cost model can be used only as an exception if the fair values cannot be measured reliably without undue cost and efforts.	There is no concept of investment properties.

9. Intangible Assets

Full NFRS	NFRS for SMEs	NAS for MEs
Research costs are expensed as incurred. Development costs are capitalized when specific criteria are met. Intangible assets with indefinite useful lives are not amortized. The assessment of useful life is reviewed at each annual reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment. However, such assets must be tested for impairment at least annually.	All research and development costs are recognized as expenses. All intangible assets are assumed to have finite lives. If the useful life of an intangible asset cannot be established reliably, the life shall be determined based on management’s best estimate but shall not exceed ten years.	NAS for MEs does not provide any specific requirement related to intangible assets.

10. Bearer plants

Full NFRS	NFRS for SMEs	NAS for MEs
Biological assets except bearer plants are within the scope of NAS 41-Agriculture and are measured at fair value less cost to sell with differences recognized in profit or loss.	An entity involved in agricultural activity measures biological assets at fair value less cost to sell where such fair value is readily determinable without undue cost or effort. Where fair value is not used, the entity	NAS for MEs does not provide any specific requirement related to agriculture.

Bearer plants are outside the scope of NAS 41 and are accounted for as per the requirements of NAS 16-Property, plant and equipment.	measures such assets at cost less any accumulated depreciation and any accumulated impairment losses. Unlike full NFRS, section 34 of NFRS for SMEs does not make an exception for bearer plants.	
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11. Borrowing costs

Full NFRS	NFRS for SMEs	NAS for MEs
Borrowing costs are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognized as expenses.	Earlier, entities would have to recognize borrowing costs as expenses. However, as per recently issued carve-out by Accounting Standards Board, entities can now choose to capitalize borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset to the cost of that asset. The carve-out provides an accounting policy choice to entities either to capitalize the borrowing cost under certain circumstances or to recognize the costs as expenses.	Under NAS for MEs, entities should recognize borrowing cost as expenses.

MAJOR CHANGES UPON TRANSITION TO NFRS/NAS FOR COOPERATIVES

The new accounting requirements under the various financial reporting frameworks are expected to be challenging, particularly in the cooperative sector. Various items will have to be measured as per the new accounting requirements whereas some areas will pose major challenges. The major changes and challenges relevant to the cooperatives sector have been discussed herewith:

NON-BANKING ASSETS

Generally, Cooperatives accept land and/or building as collateral against loans disbursed to members, which are realized through auction in case the member defaults on the loan. Sometimes, such properties held as collateral cannot be realized through auction for recovery of loans and the cooperative assumes ownership of the property as per the prevailing laws. Such property should then be realized by the cooperative according to its bylaws and prevailing laws. Under GAAP, such properties generally appeared in the Balance Sheet of the cooperatives as “Non-banking assets” and were measured at cost; cost generally being the amount due from the member.

Under the new financial reporting frameworks, such properties should be treated as follows:

Full NFRS
<p>Such properties should be classified as “Non-current assets held for sale (NCAHFS)” as per the requirements of NFRS 5-Non-current assets held for sale and discontinued operations. NFRS 5 defines NCAHFS as non-current assets whose carrying amounts will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset must be available for immediate sale in its present condition and its sale must be highly probable. Sale is considered highly probable when the following conditions are met:</p> <ul style="list-style-type: none">• The Management must be committed to a plan to sell the asset• An active programme to locate a buyer must have been initiated• The asset must be marketed at a price that is reasonable in relation to its current fair value• It is expected that the sale will be completed within 1 year of classification (NFRS 5 provides certain exceptions to this criteria). <p>In the current scenario, it has been observed that Banks and Financial Institutions (BFIs) generally classify such properties as “Investment Properties (IP)” as per the provisions of NAS 40- Investment Property. NAS 40 defines investment properties as properties (being land and/or building”) held for long-term capital appreciation or for earning rentals. Moreover, properties held for currently undetermined use are also classified as investment properties. NAS 40 allows entities to measure investment properties using either cost model (where assets are subsequently measured at cost less accumulated depreciation and accumulated impairment losses) or the fair value model (where assets are subsequently measured at fair values, with differences recognized in the statement of profit or loss).</p> <p>While it can be argued that non-banking assets would also meet the criteria to be classified as investment properties, classification as NCAHFS would provide better information about the substance of the transaction. It is worth noting that investment properties that meet the aforementioned criteria for classification as NCAHFS should be classified as such. Investment properties that are accounted for using the cost model are within the classification and measurement requirements of NFRS 5. Investment properties that are accounted for using the fair value model are outside the scope of measurement requirements of NFRS 5 but remain within its classification requirements. This is because, under NFRS 5, assets are measured at fair value less cost to sell; which would produce similar measurement as compared to fair value model for investment properties; except for “costs to sell”.</p>

While most Cooperatives hold non-banking assets for disposal, some Cooperatives also use the properties for their own use in administrative offices. In that case, such owner-occupied properties should be classified as “property, plant and equipment” and are within the scope of NAS 16-Property, plant and equipment. There was no provision in the Cooperatives Act, 2074 that mandated cooperatives to dispose of such non-banking assets and as a result, some cooperatives may have brought the assets to own use. However, recent cooperative directives issued by Nepal Rastra Bank for cooperatives require such assets to be disposed off as soon as possible.

Measurement of NCAHFS:

NFRS 5 requires NCAHFS to be measured at lower of carrying amount and fair value less cost to sell.

NFRS for SMEs

NFRS for SMEs does not have an equivalent standard for NFRS 5-Non-current assets held for sale and discontinued operations for dealing with non-current assets held for sale.

As a result, the closest equivalent in case of NFRS for SMEs would be Section 16-Investment Property. Hence, SMEs should classify such properties as investment properties. If such properties are held for own use as administrative offices, such owner-occupied properties should be classified as “property, plant and equipment” and are within the scope of Section 17-Property, plant and equipment.

Measurement of Investment Properties

Investment property whose fair value can be measured reliably without undue cost or effort shall be measured at fair value at each reporting date with changes in fair value recognized in profit or loss. If the fair values can not be so measured, they can be measured at cost less accumulated depreciation and accumulated impairment losses as per Section 17.

NAS for MEs

There is no concept of “Non-current assets held for sale” or “Investment property” in case of NAS for MEs. As a result, such properties would continue being classified as “non-banking assets”. Cooperatives can adopt appropriate accounting policies in this regard for measurement of such properties.

Alternatively, the following approach can be followed:

Introduction to NAS for MEs provides the following guidance:

If an entity applies this Standard, the basis of preparation note and audit report can refer to conformity with the NAS for MEs. If an entity opting to follow this Standard also opts to follow any specific standard(s) of NFRS or NFRS for SMEs in full or any part thereof, the same should be disclosed in the financial statements.

Accordingly, cooperatives can elect accounting policies based on full NFRS or NFRS for SMEs with appropriate disclosure in the notes.

Implementation Issues

Fair value based measurement under NFRS for SMEs poses a unique challenge in case of Cooperatives. Section 68 of the Cooperatives Act, 2074 requires cooperatives to transfer gain on sale of fixed assets to “General

Reserve”. Since non-banking assets are measured at fair values under NFRS for SMEs, fair value gains on such properties should be recognized in profit or loss. However, such unrealized fair value gains should be accumulated under a separate heading within equity; namely “Fair value reserve” or another similar heading. Cumulative unrealized fair value gains will appear under such reserve till disposal and the balance in such reserve should be transferred to “General Reserve” upon realization.

This issue is unlikely to arise in case of full NFRS because the properties are measured at lower of carrying amount and fair value less cost to sell; thereby eliminating any chances of a gain being recognized.

If fair valuation exercise results in a loss, such loss should be treated as any other expense. However, in case of subsequent fair value gains, the net cumulative gain (net of earlier losses) would be transferred to the said reserve. Any fair value gains on first time adoption of NFRS/NFRS for SMEs should be treated accordingly. The following example illustrates this requirement:

Example 1

ABC Cooperative applies NFRS for SMEs and has a non-banking asset as follows:

Amount on initial recognition (equal to amount due from debtor): 500,000

Fair value less cost to sell at the end of reporting period: 700,000

The assets appears in the statement of financial position as an investment property at 700,000 with fair value gain of 200,000 recognized in profit or loss. This gain should be transferred to a separate heading within equity (eg. Fair value reserve).

Under full NFRS, the asset would be measured at 500,000; being the lower of carrying amount (500,000) and fair value less cost to sell (700,000).

GOVERNMENT GRANTS

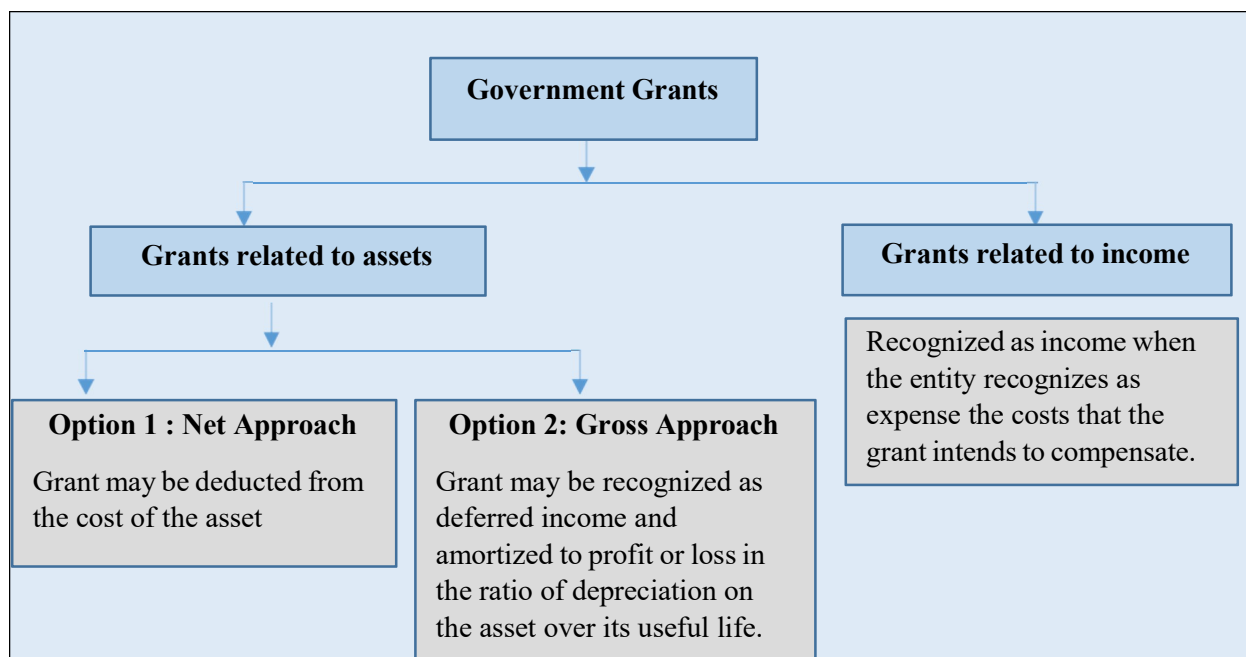
Section 68 of the Cooperatives Act, 2074 requires cooperatives to transfer grants of capital nature to capital reserve. Varying practices have been observed under GAAP for accounting of government grants. Upon transition to NFRS, cooperatives should achieve a harmonious compliance of both the Act and the financial reporting frameworks.

Full NFRS

Accounting for government grants is dealt with by NAS 20- Accounting for government grants and disclosure of government assistance. NAS 20 requires entities recognize grants in profit or loss on a systematic basis over the periods in which the entity recognizes as expenses the related costs for which the grants are intended to compensate. NAS 20 essentially follows “income approach” for accounting of grants. Grants are classified as either “Grants related to assets” or as “Grants related to income”.

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. These grants are generally understood as grants of capital nature as per the Cooperatives Act, 2074.

Grants related to income are government grants other than those related to assets. The accounting requirements for grants are illustrated as follows:



Transition to NFRS poses a challenge from compliance point of view concerning grant related to assets. The net approach results in deduction of grant from the cost of asset, which would result in non-compliance with the Cooperatives Act, 2074 which requires such grants to be transferred to general reserve. Hence, cooperatives should follow the gross approach under which a harmonious compliance of both the legal and accounting requirements can be achieved as illustrated in the following example.

Example 2: ABC Cooperative purchased a server for 10,00,000 on 1 Shrawan 2081 and 40% of the cost was reimbursed by the municipality.

ABC recognizes the server as property, plant and equipment and depreciates over its estimated useful life of 5 years on a straight-line basis. The grant received of Rs. 4,00,000 is recognized as deferred income and is amortized to profit or loss over 5 years on a straight line basis.

For the year ended 31st Ashadh 2082, the cooperative earned a net profit of Rs. 20 lacs which includes income in respect of amortized portion of deferred grant equal to Rs. 80,000 (4,00,000 / 5).

The net profit should be allocated to various reserves and funds as follows:

Net profit	20,00,000
Less: Amortization of deferred income	(80,000)
Balance	19,20,000
Transfer to general reserve (19,20,000 x 25% + 80,000)	5,60,000
Balance remaining after transfer to General reserve (to be allocated to other funds as per the Cooperative Act and Rules)	14,40,000

At the end of the useful life of the asset, total grant of 4,00,000 will have been transferred to General reserve.

This treatment ensures compliance with NAS 20 which requires entities to account for grants using the “income approach” and also with the provisions of Cooperatives Act which requires grants of capital nature to be transferred to general reserve.

Cooperatives may sometimes receive grant in kind; for eg; cooperatives operating in the agriculture sector may receive cold storage facility as grant. Such assets and the related deferred income should be recognized at fair values.

NFRS for SMEs

Accounting for government grants under NFRS for SMEs is fairly simplified and is dealt with by Section 24- Government Grants.

An entity shall recognize government grants as follows:

- (a) a grant that does not impose specified future performance conditions on the recipient is recognized in income when the grant proceeds are receivable;
- (b) a grant that imposes specified future performance conditions on the recipient is recognized in income only when the performance conditions are met; and
- (c) grants received before the revenue recognition criteria are satisfied are recognized as a liability.

NFRS for SMEs effectively classifies government grants as either conditional or unconditional. For grants of capital nature (as per the Cooperatives act), the grants should be recognized as a liability until the conditions (if any) are met. Once the conditions are met, the grant income can be recognized in profit or loss and the allocation of profits to general reserve follows the same pattern as discussed in Example 2 above.

The major recognition difference between full NFRS and NFRS for SMEs in case of conditional grants is that under full NFRS, an entity can recognize a grant if it has a reasonable assurance that the conditions attached to the grant will be fulfilled; an entity applying NFRS for SMEs can only recognize the grant when the conditions attached to the grant are actually fulfilled.

NAS for MEs

Section 17- Government Grants deal with accounting for government grants under NAS for MEs.

An entity shall recognize government grants as follows:

- (a) a grant that does not impose specified future performance conditions on the recipient is recognized as income when the grant proceeds are receivable.
- (b) a grant that imposes specified future performance conditions on the recipient is recognized as income only when the performance conditions are met.
- (c) a grant that is provided to incur an expense is recognized as income in the periods in which the expense is recognized in statement of income.
- (d) a grant that is provided to acquire an asset is recognized in a systematic basis over the useful life of the asset.
- (e) grants received before the revenue recognition criteria are satisfied are recognized in the statement of financial position as deferred income.

Point (d) above deals with grants of capital nature (as per the Cooperatives act). Hence, the accounting requirements would be the same as in case of full NFRS as explained in Example 2 above.

IMPAIRMENT OF LOANS AND ADVANCES

Loans and advances constitute a major portion on the assets side of Balance Sheet for cooperatives engaged in the deposit and lending business. The loans are subject to impairment requirements as per regulatory requirements and as per various financial reporting frameworks.

As per the regulatory requirements, Cooperatives earlier followed the PEARLS model for determination of loan loss provision as detailed below:

Loan Ageing	Loan Loss Provision
Not overdue	1%
Overdue for up to 12 months	35%
Overdue for more than 12 months	100%

However, Nepal Rastra Bank has recently issued the directives for Cooperatives engaged in the savings and credit business; effectively revising the regulatory requirements for FY 2081-82 and onwards. Loans should now be classified as either performing loans (overdue for up to 3 months) or non-performing loans (overdue for more than 3 months).

Loan Ageing	Loan Loss Provision
Good loans (overdue for up to 3 months)	1%
Sub-standard loans (overdue for 3-6 months)	25%
Doubtful loans (overdue for 6-12 months)	50%
Loss loans (overdue for more than 12 months)	100%

Further guidelines on classification are provided in the directives.

The regulatory requirements differ from the impairment requirements as per the financial reporting frameworks. Banks and Financial Institutions (BFIs) have achieved a harmonious compliance of both regulatory and NFRS/NAS requirements by recognizing impairment losses at an amount higher of the two. Cooperatives can adopt the same policy to achieve similar harmonious compliance. The requirements as per NFRS/NAS have been summarized below:

Full NFRS			
Loans and advances where contractual cash flows consist solely payments of principal and interest and which are held within the business model where the objective is to collect contractual cash flows till maturity are measured at amortized cost. Such financial assets are subject to impairment requirements.			
Entities are now required to adopt the “Expected Credit Loss (ECL)” model for impairment of loans and advances from FY 2081-82 onwards; replacing the previous “Incurred Credit Loss (ICL)” model. ECL model is expected to result in a forward looking measurement of impairment that is expected to result in recognition of impairment losses when there is a significant increase in credit risk; unlike the previous ICL model which required recognition of losses only when there is an objective evidence of impairment (effectively when a default event actually occurs). ECL model requires entities to classify the loans and advances into 3 stages as follows:			
Stages of Impairment	Remarks	Impairment loss	Interest income recognition
Stage-1	Loans where there is no significant increase in credit risk.	Recognized based on 12-month ECL	As per the original EIR (effectively accrual basis)

Stage-2	Loans where there is a significant increase in credit risk	Recognized based on lifetime ECL	As per the original EIR (effectively accrual basis)
Stage-3	Loans where default event has occurred.	Recognized based on lifetime ECL	As per the credit-impaired EIR (effectively cash basis)

Cooperatives will now need to frame policies and procedures for classification of loans and calculation of impairment losses. They will have to set parameters and criteria to identify cases where there has been a significant increase in credit risk and where default events have occurred. Impairment calculation generally follows the given formula:

Impairment loss = Exposure at Default (EAD) x Probability of Default (PD) x Loss Given Default (LGD)

Previous regulatory requirements did not require elaborate statistical calculations and accordingly, the historical data requirements were not extensive; simple ageing information was sufficient. However, the new ECL requirements require entities to analyze past historical information and extrapolate the data to arrive at future expectations, factoring macroeconomic data and forecasts into the calculations. This is expected to be challenging for cooperatives considering the lack of past historical data and the lack of sophisticated software to support such calculations.

NFRS for SMEs and NAS for MEs

Loans and advances that yield fixed returns (in the form of interest and principal) are measured at amortized cost and are subject to impairment requirements.

Impairment of loans effectively follows the “Incurred Credit Loss (ICL)” model in case of NFRS for SMEs and NAS for MEs.

At the end of each reporting period, an entity should assess whether there is objective evidence of impairment of loans and advances measured at amortized cost. If there is objective evidence of impairment, the entity shall recognize an impairment loss in profit or loss immediately. Entities are required to develop various parameters and criteria to determine whether there is objective evidence of impairment. Impairment calculation generally follows the given formula:

Impairment loss = Exposure at Default (EAD) x Probability of Default (PD) x Loss Given Default (LGD)

PD and LGD is determined based on statistical analysis of past data.

Cooperatives are expected to face significant challenges due to lack of past data to support such calculations. While calculations are relatively simplified as compared to ECL model for large entities, the data requirements are still expected to be a major challenge for cooperatives.

EQUITY AND LIABILITY

Liability is a present obligation as a result of past events, settlement of which is expected to result in an outflow of resources embodying economic benefits. A liability exists and should be recognized when an entity has no realistic alternative but to settle the obligation. Equity represents residual interest in an entity after deducting all liabilities from assets.

Share capital of Cooperatives; unlike other entities, are refundable if a member chooses to exit the organization. Such instruments are referred to as “puttable instruments” and would meet the definition of a liability. However, certain provisions of NFRS/NAS enable classification of share capital of cooperatives as equity.

Full NFRS

A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all the following features:

- (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation.
- (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments.
- (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features.
- (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity
- (e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss

Simply put, if the puttable feature is to be ignored, the share capital of a cooperative satisfies all criteria for classification as equity. Para 16A and 16B of NAS 32-Financial Instruments: Presentation enable share capital of cooperatives to be classified as equity

NFRS for SMEs

Similar requirements have been given in Section 22- Liabilities and Equity of NFRS for SMEs. Accordingly, the requirements in NFRS for SMEs are consistent with the requirements in full NFRS and hence, Cooperatives applying NFRS for SMEs can classify share capital as equity.

NAS for MEs

The guidelines in NAS for MEs are different. Section 15-Equity states the following:

Members' shares in co-operative entities and similar instruments are equity if:

- (a) the cooperative entity has an unconditional right to refuse redemption of the members' shares; or
- (b) redemption is unconditionally prohibited by local law, regulation or the entity's governing charter.

The criteria would not be met considering the legal provisions in section 64 of Cooperatives Act, 2074 that require an entity to redeem the share capital if a member wants to exit the entity. This would result in the share capital being classified as a liability. This is likely to produce undesired results and could reduce the understandability of financial statements.

Introduction to NAS for MEs provides the following guidance:

If an entity applies this Standard, the basis of preparation note and audit report can refer to conformity with the NAS for MEs. If an entity opting to follow this Standard also opts to follow any specific standard(s) of NFRS or NFRS for SMEs in full or any part thereof, the same should be disclosed in the financial statements.

The Cooperative applying NAS for MEs can adopt classification guidelines for equity and liability prescribed for NFRS for SMEs using the aforementioned facility and can accordingly continue to classify share capital as equity.

Cooperatives in Nepal are required to allocate the net profits for a financial year to various reserves as required by the Cooperatives Act and Rules as follows:

Relevant provision	Name of Fund/ Reserve	Appropriation
Section 68 of the Cooperatives Act, 2074	General Reserve	<ul style="list-style-type: none"> • 25% of current year profit • Grants of capital nature • Gain on sale of fixed assets • Income from other sources
Section 69 of the Cooperatives Act, 2074	Patronage Refund reserve	<ul style="list-style-type: none"> • 25% of current year profits remaining after allocation to General reserve.
Section 70 of the Cooperatives Act, 2074	Cooperative Promotion Fund	<ul style="list-style-type: none"> • 0.5% of current year profits remaining after allocation to general reserve.
Section 27 of Cooperatives Rules, 2075	<ul style="list-style-type: none"> ▪ Cooperative Education Fund ▪ Share Dividend reserve ▪ Employee bonus Fund ▪ Cooperative Development Fund ▪ Loss recovery fund ▪ Social development fund ▪ Stabilization fund ▪ Other risk management fund 	<ul style="list-style-type: none"> • At least 5% of profits remaining after appropriation to general reserve, patronage refund reserve and cooperatives promotion fund to be allocated to each reserve.

This can pose some issues for cooperatives applying NFRS/NAS frameworks. The issues have been discussed herewith:

Employee Bonus
The provisions of the Cooperative Rules, 2075 contradict with the provisions of Bonus Act, 2030. Bonus Act requires entities to allocate 10% of net profits for bonus distribution to employees. Whenever the provisions of rules contract with those of an act, the act should prevail. Accordingly, Cooperatives should recognize bonus expense as per the provisions of Bonus Act. In that case, further allocation to Employee Bonus Fund is not necessary.

Classification as Liability or Equity	
Various funds required to be maintained as per the prevailing laws may either be in the nature of equity or liability as discussed hereunder:	
Particulars	Remarks
General Reserve	This is an indivisible fund as per section 68 of Cooperatives Act, 2074. Cooperatives should classify this reserve as equity.
Patronage Refund Reserve	Amount apportioned to this reserve should be distributed to members as per the methodology set out in section 25 of the Cooperatives Rules, 2075. Section 25 requires any amount remaining undistributed to be transferred to general reserve. Hence, it implies that distribution is discretionary and not mandatory. Hence, this reserve should be classified as equity.
Cooperative promotion fund	Section 70 of the Cooperatives Act, 2074 requires amount allocated to this fund to be deposited in the designated fund maintained by Ministry of Land Management, Cooperatives and Poverty Alleviation. Deposit into the fund is non-discretionary and hence, it should be classified as a liability.
Stabilization Fund	Section 103(2) of the Cooperatives Act, that deals with stabilization fund states that interested cooperatives can make contributions to the fund, which is maintained by NEFSCUN. Section 27 of the Cooperatives Rules, 2075 states that amount can be allocated to stabilization fund as approved at the annual

	<p>general meeting (AGM). The prevailing laws render contributions to the fund as being discretionary.</p> <p>Some cooperatives may adopt bylaws approved by AGM requiring compulsory contributions to stabilization Fund. The fund should be classified as a liability in this case. In other cases, cooperatives should consider whether or not they have an obligation to make deposits into the fund and the amount should be classified as a liability or equity accordingly.</p>
Share Dividend Fund	Dividend distribution is completely discretionary and not mandatory. Hence, this reserve should be classified as equity.
Other Reserves and Funds	The Cooperatives Act and Rules do not provide any further guidance regarding the use of the funds. Cooperatives should consider their practices and bylaws to ascertain whether they have a present obligation to incur expenses out of the fund. Liabilities should be recognized only when the cooperative has a present obligation to settle them.

FIRST TIME ADOPTION

Major entities in Nepal fall under the SMEs and MEs category and this holds true for cooperatives also. The first time adoption requirements under all 3 financial reporting frameworks are mostly the same. While accounting for various items are different under the 3 frameworks, the first time adoption procedures are broadly the same. The following steps are generally followed:

Step 1: Restate the Statement of Financial Position as at the beginning of the earliest prior period presented, that date is referred to as the “date of transition”. For example; For an entity that applies any of the financial reporting frameworks for the first time during FY 2081-82, the date of transition shall be 1 Shrawan 2080. The first step towards adoption of the new framework would be to restate the statement of financial position as of that date; with remeasurement adjustments being recognized directly in equity.

Step 2: Restate the Income Statement for the prior period. Continuing with the above example, the entity would then need to restate the income statement for FY 2080-81.

Step 3: Restate the statement of financial position as at the end of the previous reporting period; being 31st Ashadh 2081 in the example being considered.

Step 4: Prepare financial statements for the current year (FY 2081-82 in our example) in accordance with the applicable financial reporting framework.

An entity needs to present a reconciliation of equity as at the date of transition (1 Shrawan 2080), as at the end of the previous reporting period (31 Ashadh 2081) and a reconciliation of income statement for the previous reporting period (FY 2080-81); with explanatory notes detailing the effects of all remeasurements and reclassifications upon transition to the new reporting standard..

Entities applying full NFRS are required to present at least 3 Statements of Financial Position upon first time adoption of NFRS. While NFRS for SMEs and NAS for MEs do not require presentation of statement of financial position as at the date of transition, a reconciliation of equity as at that date will nevertheless be required to be presented in the notes accompanying financial statements. The model financial statements for NFRS for SMEs and NAS for MEs includes 3 Statements of Financial Position for better understanding, cooperatives can choose not to present the Statement of Financial Position as at the date of transition.

Reduction in equity upon transition to NFRS/NAS

In the Nepalese context, first time adoption of NFRS/NAS is likely to result in reduction of equity. One of the reasons is that most cooperatives have been recognizing long-term employee benefits on payment basis and they will need to recognize the provisions upon first time adoption with corresponding decrease in equity. The issue that arises is that cooperatives do not have any free reserves, commonly referred to as retained earnings. So, how the reduction in equity should be dealt with is a practical issue that cooperatives will face. One of the possible way outs has been illustrated in the following example:

Example 3- ABC Cooperative provides accumulated leave benefits to its employees which it earlier recognized as an expense only upon payment. It adopts NFRS for SMEs from FY 2081-82. It recognized a provision for accumulated leave on transition to NFRS and as a result, the total reduction in equity as at 31st Ashadh 2081 is Rs. 20,00,000.

The reduction is presented as a negative balance within “Retained Earnings” under equity as at 31 Ashadh 2081. The Cooperative earned net profits of Rs. 1,00,00,000 during FY 2081-82. The profits will be allocated as follows:

Net Profit	1,00,00,000
Previous losses upon transition to NFRS	(20,0,000)
Balance	80,00,000
Transfer to General Reserve (25% of current year profit; i.e 25% of 100 lacs)	(25,00,000)
Balance after transfer to general reserve	55,00,000
Transfer to Patronage Refund Reserve (25% of balance after transfer to general reserve)	(13,75,000)
Transfer to Cooperative Promotion Fund (0.5% of balance after transfer to general reserve)	(27,500)
Balance profit to be allocated to remaining reserves as per section 27 of Cooperatives Rules, 2075	40,97,500

The Cooperatives may also adjust the reduction in equity with balance available in loss recovery fund, subject to the bylaws.