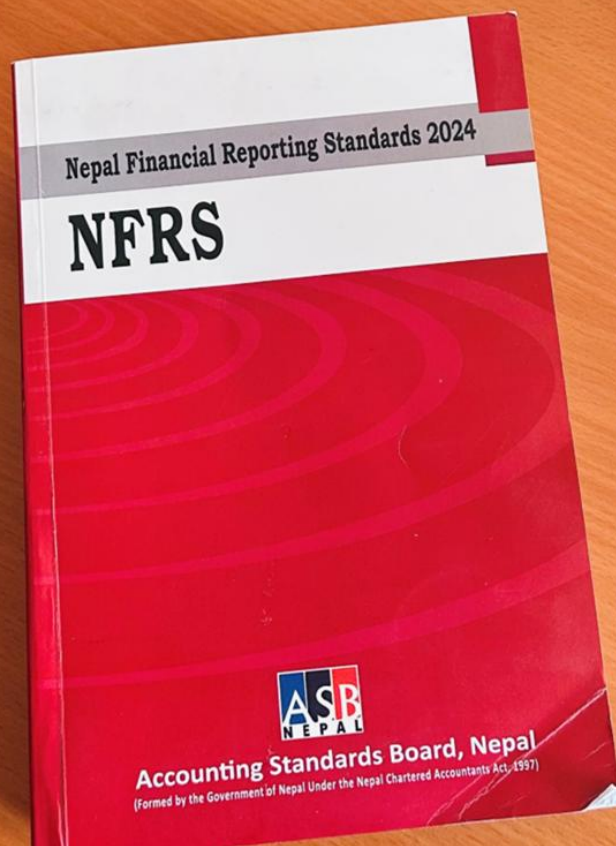




Navigating NRB's Guidance Note on Interest Income Recognition 2025

This presentation provides an in-depth overview of the Nepal Rastra Bank's (NRB) Guidance Note on Interest Income Recognition, focusing on its alignment with NFRS 9: Expected Credit Loss (ECL) requirements.



Introduction to the NRB Guidance Note

Aligning with NFRS 9: Expected Credit Loss

The Nepal Rastra Bank (NRB) has issued Guidance Note on Interest Income Recognition on 27 July 2025. This guidance note aims to help banks align their accounting practices with the NFRS 9: Expected Credit Loss (ECL) requirements, ensuring greater transparency and accuracy in financial reporting.

Purpose

To standardize interest income recognition practices in line with international accounting standards.

Scope

Applicable to all licensed banks and financial institutions operating in Nepal.

Objective

Enhance financial stability and improve the quality of financial disclosures.

Phased Implementation: A Three-Year Transition

The NRB guidance note introduces a structured three-year transition plan to facilitate a smooth adoption of the new interest income recognition standards. This phased approach allows banks ample time to adapt their systems and processes.

Financial Year	Stage 1 & 2 Loans	Stage 3 Loans /POCI
2081/82	Coupon rate × Principal (Accrual basis)	Only recognize interest if cash is received
2082/83	Same as above	Same as above (Cash basis only)
2083/84	Use Effective Interest Rate (EIR) on Gross Carrying Value	Use EIR on Amortized Cost

This phased implementation ensures that banks gradually transition to the full EIR methodology, mitigating potential operational disruptions.

Key Changes in Year 3 (FY 2083/84)

The most significant shifts in interest income recognition come into effect in the third year of the transition period, specifically for the financial year 2083/84.

Stage 1 & 2 Loans

Interest will be calculated using the **Effective Interest Rate (EIR)** on the **Gross Carrying Amount** of the loan. This reflects a more precise income recognition aligned with the expected future cash flows.

Stage 3 & POCI Loans

Interest will be calculated using EIR on the **Amortized Cost**. This means interest is recognized after deducting the Expected Credit Loss (ECL) provision, providing a more conservative and realistic reflection of income from impaired assets.

Old Term Loans (Pre-Ashad end 2083)

For loans originated before Ashad end 2083 (the end of the fiscal year 2083), banks are permitted to use a **Deemed EIR** if the actual EIR cannot be easily calculated. This excludes any fees already booked.

- Amortized cost: Gross Carrying amount of loan less ECL provision upto previous quarter for funded exposure.
- Amortized cost for POCI: Gross carrying amount of loan less ECL provision at origination for funded exposure.

Stage-Based Recognition Logic

Understanding Loan Classification

The recognition of interest income is intrinsically linked to the stage classification of a loan **at the end of the previous quarter**. This stage-based approach ensures that income recognition aligns with the credit risk profile of the loan.



Stage 1/ Normal (Pass)

Loans with no significant increase in credit risk since initial recognition.



Stage 2/ Watchlist / Rescheduled (Performing)

Loans with a significant increase in credit risk but not yet credit impaired.



Stage 3/ Non-Performing (NPL) / Rescheduled (Non- Performing)

Loans that are credit impaired, typically non-performing loans.

Interest Income Recognition for Normal Loans

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Step 1: Identify Loan Stage

Determine the loan's stage at the end of the reporting quarter. For existing loans, reference the immediate previous quarter's stage. For newly disbursed loans, the stage is identified at the date of disbursement. This initial classification sets the basis for income calculation.

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Step 2: Calculate Interest Income

Once the loan stage is identified, proceed to calculate the interest income. This calculation method varies depending on the loan's stage and specific accounting policies. Detailed methodologies for interest income calculation based on loan stages are covered in Slide 3.

Interest Income Recognition: Old Term Loan

For old term loans, recognizing interest income involves two key steps:

Step 1: Identify Previous Quarter's Stage

Determine the loan's stage from the immediate previous quarter.

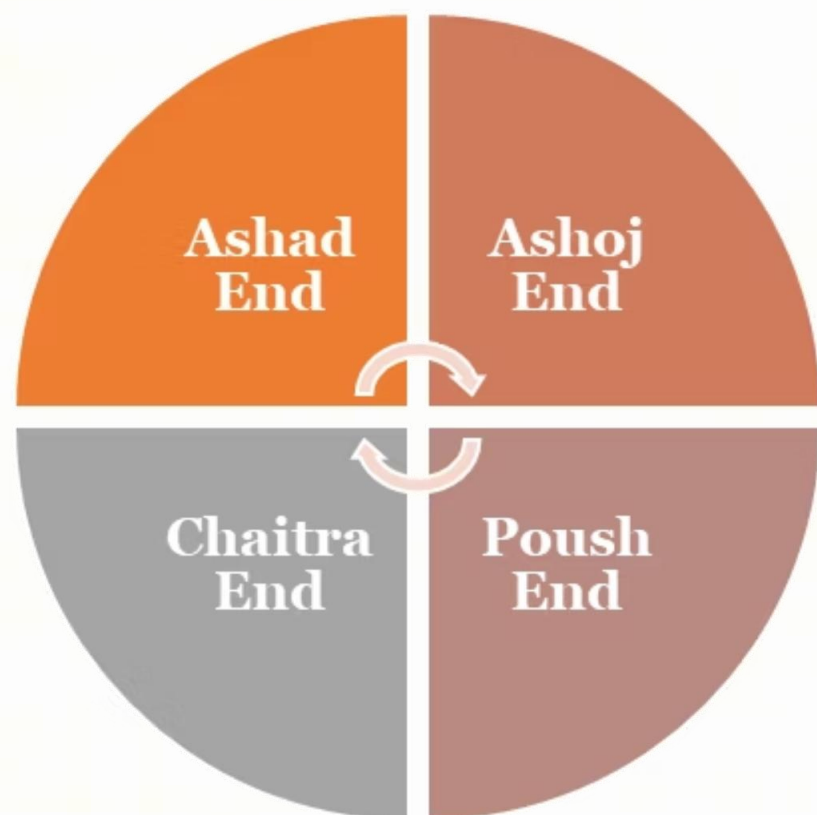
Step 2: Calculate Interest Income

Calculate interest income based on the loan's identified stage.

Formula: Interest Income = Amortized Cost * Deemed EIR (Stage 3 Loan)

Quarterly Interest Income Calculation

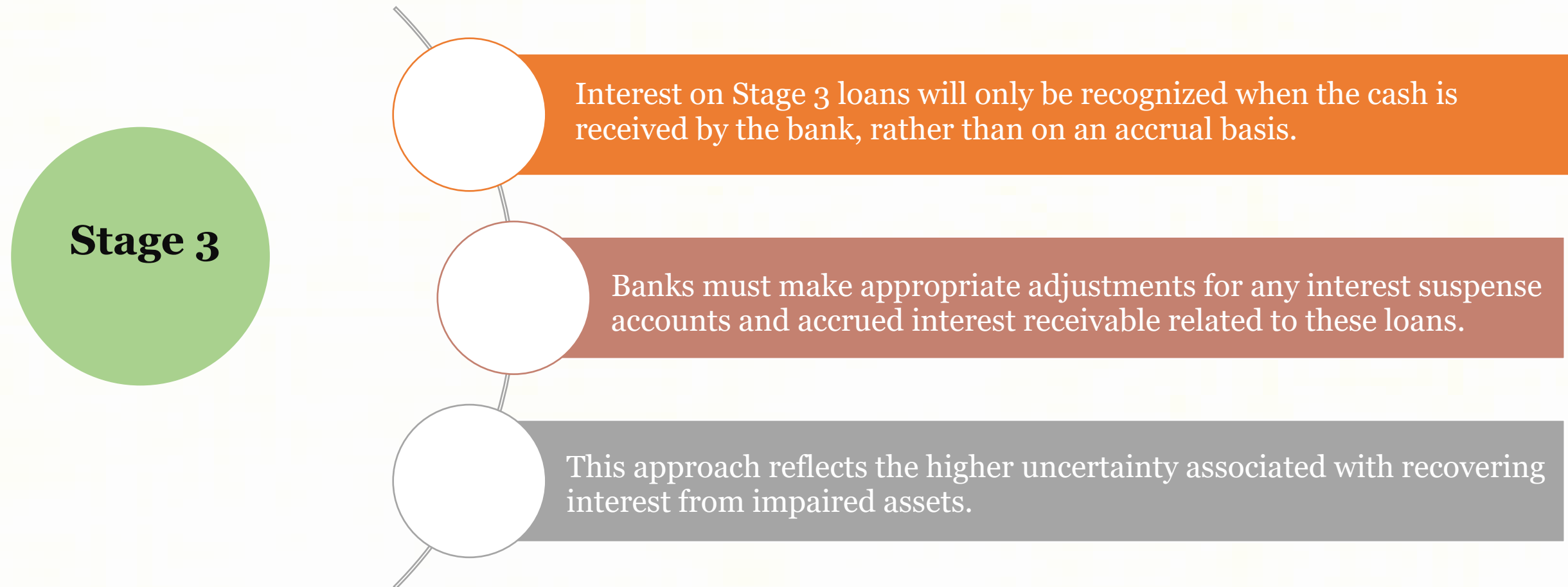
From FY 2081/82 onwards, banks are mandated to record interest income on a quarterly basis. This change aims to provide more granular and timely financial reporting, enhancing the accuracy of income recognition throughout the fiscal year.



- **Frequency:** Interest income must be calculated and recorded every quarter.
- **Per Loan Account:** Each loan account's interest must be tracked individually, based on its stage classification.
- **Annual Summation:** The total annual interest income will be the sum of all four quarterly income figures.
- **Enhanced Monitoring:** This approach facilitates better monitoring of loan performance and accurate income accruals.

Cash Basis for Stage 3 Loans in Early Years

During the initial two years of implementation (FY 2081/82 and FY 2082/83), Cash basis of accounting applies to Stage 3 loans (Non-Performing Loans - NPLs) to ensure a conservative approach to income recognition.



Forward-Looking Expectations

Full EIR Implementation Expected from FY 2083/84

The NRB guidance clearly outlines the expectation for all banks to fully implement the Effective Interest Rate (EIR)-based income recognition method from the financial year 2083/84.

Mandatory EIR

New (performing loans)are expected to use EIR on Gross Carrying Value.
New (Non-performing loans) are expected to use EIR on Amortized cost.

Justification Required

Banks must be prepared to explain and justify their interest income calculations.



Deemed EIR Alternative

For older loans where actual EIR calculation is impractical, Deemed EIR is permissible.

Regulatory Scrutiny

NRB and auditors will closely scrutinize income calculation methodologies.

Key Takeaways and Next Steps

The NRB Guidance Note on Interest Income Recognition marks a significant step towards aligning banking practices with international standards. Proactive adaptation is crucial for compliance and sound financial health.

Phased Adoption

Understand the three-year transition plan and its specific requirements for each fiscal year.

EIR Implementation

Prioritize system upgrades and training for full EIR implementation by FY 2083/84.

Documentation

Maintain meticulous records and justifications for all interest income calculations, especially for Deemed EIR.

Continuous Monitoring

Implement robust internal controls for quarterly, stage-based interest income tracking.

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