केन्द्रीय कार्यालय
बालुवाटार, काठमाडौं
फोन नं. : ०१-५७१९६४१/४२/४३/४४
Website : www.nrb.org.np
पोष्ट बक्स : ७३

नेपाल राष्ट्र बैंक

बैंक तथा वित्तीय संस्था नियमन विभाग

पत्र संख्या : बै.वि.नि.वि./नीति/सूचना/१/०८२/८३

मितिः २०८२/०४/११

सूचना

इजाजतपत्रप्राप्त बैंक तथा वित्तीय संस्थाहरु र पूर्वाधार विकास बैंक,

यस बैंकबाट इजाजतपत्रप्राप्त "क", "ख", "ग", र "घ" वर्गका बैंक तथा वित्तीय संस्थाहरु र पूर्वाधार विकास बैंकका लागि आ.व. २०८१/८२ देखि लागू हुने गरी ब्याज आम्दानी लेखांकन सम्बन्धी Guidance Note on Interest Income Recognition, 2025 यसैसाथ संलग्न गरी जारी गरिएको हुँदा सोही बमोजिम गर्नु गराउनु हुन नेपाल राष्ट्र बैंक ऐन, २०५८ को दफा ७९ ले दिएको अधिकार प्रयोग गरी यो सूचना जारी गरिएको छ ।

भवदीय,

कार्यकारी निर्देशक

Guidance Note on Interest Income Recognition, 2025

NEPAL RASTRA BANK

Banks and Financial Institutions Regulation Department

Baluwatar, Kathmandu

July, 2025

Table of Contents

1. Introduction

Considering the technical challenges related to implementation of expected credit loss in initial years including that of effective interest rate, this guidance note has been issued in order to streamline interest income recognition practices across the banking industry.

This guidance note has been prepared for interest income recognition of financial assets measured at amortised cost within the context of NFRS 9 Expected Credit Loss Related Guidelines, 2024 (ECL Guidelines). Pursuant to section 11 of NFRS-9 Expected Credit Loss Related Guidelines, 2024, the guidance note has been issued as a supplementary document with the expectation to serve as pathway towards full implementation of provisions of NFRS 9.

2. Key definitions

2.1. **Amortised cost** refers to the amount as defined as per NFRS 9.

2.2. **Coupon interest rate** refers to the actual interest rate that is charged or applied on loan outstanding to the borrower.

2.3. **Current quarter end** means end of the quarter for which data is being reported.

2.4. **Current quarter** refers to the quarter (3 months period) for which data is being reported.

2.5. **Deemed Effective interest rate** refers to the 'effective interest rate' as defined in NFRS 9 without considering integral fees obtained but considering all other discounts, premiums and other integral costs.

2.6. **ECL Provision** refers to the expected credit loss calculated as per ECL guidelines issued by Nepal Rastra Bank to the banks and financial institutions.

2.7. **Effective interest rate** refers to the **'**effective interest rate' as defined in NFRS 9. It also refers to the credit adjusted effective interest rate in case of purchased or originated credit impaired assets as defined in NFRS 9.

2.8. **Gross Carrying Amount** refers to the amortised cost of a financial asset, before adjusting for any loss allowance.

2.9. **Interest suspense** means amount of interest that has been accrued but interest income has not been recognized in financial statements. This term implies income not recognized for each loan or other financial asset account from the perspective of financial statement and does not necessarily mean interest suspense defined in Core Banking System (CBS) of respective banks and financial institutions.

2.10. **Previous quarter end** means end of the quarter immediately preceding current quarter for which data is being reported.

2.11. **Principal outstanding** refers to the remaining principal amount of the original loan excluding interest receivable.

2.12. **Purchased or originated credit impaired (POCI)** refers to the financial assets that are purchased or originated credit impaired as defined in NFRS 9, recognized during the relevant quarter and also refers to the new loans disbursed during the quarter for accounts that were classified under Stage 3 or Non performing Loan (NPL) at previous quarter end.

2.13. **Regulatory provision** refers to the loan loss provision calculated as per Unified Directives issued by Nepal Rastra Bank.

2.14. **Stage 1** refers to the relevant financial assets classified as 'Stage 1' as per ECL guidelines issued by Nepal Rastra Bank. For those financial institutions that have not developed policy or stages for classification of assets as per ECL guidelines, this refers to the assets classified as 'pass' category as per Unified Directives.

2.15. **Stage 2** refers to the relevant financial assets classified as 'Stage 2' as per ECL guidelines issued by Nepal Rastra Bank. For those financial institutions that have not developed policy or stages for classification of assets as per ECL guidelines, this refers to the assets classified as 'watchlist' category and 'restructured/rescheduled but performing' category as per Unified Directives.

2.16. **Stage 3** refers to the relevant financial assets classified as 'Stage 3' as per ECL guidelines issued by Nepal Rastra Bank. For those financial institutions that have not developed policy or stages for classification of assets as per ECL guidelines, this refers to the assets classified as 'non performing' category and 'restructured/rescheduled but non-performing' category as per Unified Directives.

3. Transitional Arrangement Plan

To advance towards the full implementation of NFRS 9 provisions, the interest income recognition practice will be transitioned as follows:

<table>
<tr><th>Interest income on</th><th>Year 1 (FY 2081/82)</th><th>Year 2 (FY 2082/83)</th><th>Year 3 (FY 2083/84)</th></tr>
<tr><td>Stage 1 Financial Assets</td><td rowspan="2">Based on coupon interest rate on principal outstanding for all financial assets (accrual basis)</td><td rowspan="2">Based on coupon interest rate applied on principal outstanding for all financial assets (accrual basis)</td><td rowspan="2">• Based on effective interest rate applied on gross carrying amount for all financial assets except for old term loans (see below)
• Based on deemed effective interest rate applied for old term loans only (where integral fees have already been recognized as income in previous years)</td></tr>
<tr><td>Stage 2 Financial Assets</td></tr>
<tr><td>Stage 3 or Purchased or Originated Credit</td><td>• Based on cash basis approach (incremental)</td><td>• Based on cash basis approach (incremental)</td><td>• Based on amortised cost as per NFRS 9</td></tr>
</table>

Impaired Financial Assets	• Coupon interest rate applied on principal outstanding	• Coupon interest rate applied on principal outstanding	• Deemed Effective interest rate for old term loans is calculated without taking into account integral fees already booked and is applied on amortised cost • Effective interest rate of all financial assets other than old term loans is to be calculated based on integral fees obtained and also considering discounts, premiums and other integral costs and is applied on amortised cost.

Note: Old term loans refer to the term loans booked up to 2083 Asadh end. Furthermore, banks and financial institutions that can fully implement effective interest rate as per NFRS 9 need not apply deemed effective interest rate or coupon rate for loans in various stages.

4. Basis of interest income recognition

4.1. Paragraph 5.4.1 of NFRS 9 requires an entity to apply the effective interest rate to the amortised cost of a credit-impaired financial asset in subsequent reporting periods. Paragraph BC5.74 of IFRS 9- 'Basis for Conclusions' explains that if a financial asset is credit-impaired at the reporting date, an entity should change the interest revenue calculation at the beginning of the following reporting period.

4.2. Similarly, Paragraph 5.4.2 of NFRS 9 requires an entity to calculate interest revenue, in subsequent reporting periods, by applying effective interest method to gross carrying amount if the credit risk on the financial instrument improves so that the financial asset is no longer credit-impaired.

4.3. Hence, interest income recognition for each quarter shall be based on stage of financial assets as on previous quarter end. (not on current quarter end)

5. Need to maintain quarterly record of interest income

5.1. Banks and financial institutions are expected to maintain quarterly record of interest income starting from beginning of fiscal year 2081/82. This requires staging of financial assets and measurement of expected credit losses starting from Asadh end 2081.

5.2. Therefore, yearly interest income = Q1 interest income + Q2 interest income +Q3 interest income + Q4 interest income.

5.3. From the beginning of fiscal year 2083/84, banks and financial institutions need to maintain quarterly record of interest income booked based on stage of financial assets at each quarter end.

5.4. This quarterly interest income (stage wise) needs to be added cumulatively to arrive at total annual interest income to be reflected in annual financial statements.

5.5. Since the way in which interest income is booked will differ from quarter to quarter based on change in stage of each loan account or other financial assets, the banks and financial institutions need to maintain interest income and other relevant details for each loan account or other financial assets on quarterly basis, from beginning of fiscal year 2083/84.

5.6. Banks and financial institutions are expected to be able to demonstrate how interest income has been booked for each loan account or other financial assets if required by supervisors and auditors.

6. Steps to be followed for quarterly interest income recognition

a) Identify the stage of financial assets based on previous quarter end and if new financial assets are added during the quarter, based on stage at initial recognition.

b) Segregate the stage of each financial assets at account level (1,2 or 3)

c) Determine the interest income for the quarter for each financial assets based on stage identified above, in accordance with the transitional arrangement plan shown above.

7. Determination of Interest income

7.1. Year 1 and Year 2 (FY 2081/82 & FY 2082/83)- Cash Basis (Incremental) Approach for Stage 3

Under this approach, for stage 3 financial assets, interest income recognized on accrual basis (coupon rate or effective rate) shall be adjusted against the movement in accrued interest receivable during the current quarter and interest suspense at beginning of quarter and only cash based interest income during the current quarter shall be recognized. Similarly, for Stage 1 and 2 financial assets, interest income is recognized on accrual basis (coupon rate or effective rate) and any interest suspense at the beginning of quarter is also recognized as interest income.

7.1.1. Points to consider for cash basis (Incremental) approach:

a) Interest suspense cannot be more than Accrued Interest Receivable (AIR) at the same reporting date.

b) Generally, interest suspense cannot be negative unless excess interest income has been booked out of accrued interest receivable.

c) In order for cash basis (incremental) approach to be implemented, banks and financial institutions are expected to reconcile or track the total interest income, AIR, interest actually received and interest suspense booked in general ledger for each quarter to the same details with respect to each customer loan account.

7.2. Year 3 (FY 2083/84) Based on effective or deemed effective interest rate

7.2.1. For All financial assets other than old term loans

Under this approach, interest income is recognized by applying effective interest rate on gross carrying amount applicable for the current quarter for stage 1 and 2 financial assets whereas interest income for stage 3 financial assets at previous quarter end and POCI assets added during the quarter is recognized by applying effective interest rate on amortised cost.

Therefore, following steps are required under this approach.

7.2.1.1. For Stage 3 and POCI :

Interest income = Effective interest rate * Amortised Cost(#)

Amortised Cost for Stage 3= (Gross Carrying Value applicable - ECL Provision as on Previous quarter end for relevant funded exposure)

Amortised Cost for POCI added during the quarter= (Gross Carrying Value applicable - ECL provision at origination for relevant funded exposure)

7.2.1.2. For Stage 1 and 2 Financial Assets:

Interest income = Effective interest rate * Gross Carrying Value applicable

7.2.2. For old term loans

Under this approach, interest income is recognized by applying deemed effective interest rate on gross carrying amount applicable for the current quarter for stage 1 and 2 financial assets whereas interest income for stage 3 financial assets is recognized by applying effective interest rate on amortised cost.

Therefore, following steps are required under this approach.

7.2.2.1. For Stage 3 :

Interest income = Deemed Effective interest rate * Amortised Cost(#)

Amortised Cost for Stage 3= (Gross Carrying Value applicable - ECL Provision as on Previous quarter end for relevant funded exposure)

7.2.2.2. For Stage 1 and 2 Financial Assets:

Interest income = Deemed Effective interest rate * Gross Carrying Value applicable

8. Illustrative example for quarterly interest income

Assumptions:

a) No principal repayments and penal interest have been considered.

b) Stage classification and regulatory classification has been assumed for simplicity purposes. (without considering minimum probation period)

c) Coupon rate is assumed to be 10% and Effective interest rate as per NFRS 9 and deemed effective interest rate both are assumed to be 8%.

d) All other assumptions may not completely reflect reality.

e) Interest due and repayment is assumed at the end of quarter.

At beginning of quarter					During Q1			At end of quarter		
Stage	**Name of Borrower**	**Loan Outstanding**	**Accrued Interest Receivable (AIR)**	**Past due period**	**Interest rate**	**Interest Repayment during Q1**	**Additional Accrual of interest (10%* Principal*90 /365)**	**Closing AIR**	**Category**	**Stage**
3	A	100,000.00	1,500.00	95 days- Substandard	10%	1,000	2,465.75	2,965.75	Doubtful	3
3	B	100,000.00	1,500.00	95 days- Substandard	10%	2,000	2,465.75	1,965.75	Watchlist	2
3	C	200,000.00	2,000.00	185 days- Doubtful	10%	500	4,931.51	6,431.51	Bad	3
3	D	250,000.00	2,500.00	366 days- Bad	10%	500	6,164.38	8,164.38	Bad	3
1	E	300,000.00	3,000.00	30 days- Pass	10%	500	7,397.26	9,897.26	Substandard	3
3	F	300,000.00	3,000.00	95 days- Substandard	10%	10,397.26	7,397.26	-	Pass (settled)	1
3	G	300,000.00	3,000.00	366 days- Bad	10%	10,397.26	7,397.26	-	Pass (settled)	1
1	H	400,000.00	4,000.00	0 days- Pass	10%	5,000	9,863.01	8,863.01	Watchlist	2
Total		**1,950,000.00**	**20,500.00**			**30,294.52**	**48,082.19**	**38,287.67**		

8.1. Interest income using effective or deemed effective interest rate in Year 3

Interest income using effective or deemed effective interest rate approach is determined in Year 3 for Illustrative example as follows:

Stage at beginning of Q1	Name of Borrower	Gross Carrying value for Q1* (1)	ECL provision at beginning of Q1 (2)	Amortised Cost applicable for Q1 (3) = (1) -(2)	Gross interest using effective rate during the quarter (4) =8%*(1)*90/365	Interest income to be booked for Q1	Remarks	ECL provision at end of Q1 (5)	Amortised Cost applicable for next quarter (6) =(1) +(4) - (5) - Interest repayment
3	A	100,000.00	25,375.00	74,625.00	1,972.60	1,472.05	Effective rate applied for quarter * (3)	50,750.00	50,222.60
3	B	100,000.00	25,375.00	74,625.00	1,972.60	1,472.05		50,750.00	49,222.60
3	C	200,000.00	50,500.00	149,500.00	3,945.21	2,949.04		101,000.00	102,445.21
3	D	250,000.00	63,125.00	186,875.00	4,931.51	3,686.30		126,250.00	128,181.51
1	E	300,000.00	7,575.00	292,425.00	5,917.81	5,917.81	Effective rate applied for quarter * (1)	15,150.00	290,267.81
3	F	300,000.00	75,750.00	224,250.00	5,917.81	4,423.56	Effective rate applied for quarter * (3)	7,575.00	287,945.55
3	G	300,000.00	75,750.00	224,250.00	5,917.81	4,423.56		7,575.00	287,945.55
1	H	400,000.00	10,100.00	389,900.00	7,890.41	7,890.41	Effective rate applied for quarter * (1)	20,200.00	382,690.41
Total		**1,950,000.00**	**333,550.00**	**1,616,450.00**	**38,465.75**	**32,234.79**		**379,250.00**	**1,578,921.23**

* Gross Carrying value for q1 is assumed to be same as principal outstanding for simplicity purposes. In reality, the gross carrying value and principal outstanding can be different.

8.2. Net Changes or accounting entries during the quarter

Account	Dr	Cr	Remarks
Gross Carrying Value of Loan (BS)		30,294.52	Interest actually received
Cash or Customer's A/c (BS)	30,294.52		Interest actually received
Gross Carrying Value of Loan (BS)	38,465.75		Gross Interest during the quarter using effective interest rate applied on gross carrying value
Interest income (PL)		32,234.79	As calculated above
Accumulated ECL provision (BS)		6,230.96	Difference in Gross interest accrued and Interest income booked in Stage 3 assets also known as unwinding of discount of ECL (please refer https://www.ifrs.org/content/dam/ifrs/project/curing-of-a-credit-impaired-financial-asset/curing-of-a-credit-impaired-financial-asset-slides.pdf)
Impairment charges (PL)	39,469.04		Change in ECL provision during the quarter after taking into account unwinding of discount of ECL (see above)
Accumulated ECL provision (BS)		39,469.04	
Total	**108,229.31**	**108,229.31**	