

## ADVANCES INCLUDING NPA REQUIREMENTS & PROVISIONING FOR CO-OPERATIVE BANKS & CO-OPERATIVE CREDIT SOCIETIES

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### Various Laws Applicable to Co-op. Banks & Co-op. Credit Societies

- 1) **Major changes have taken place in the The Maharashtra Co-op. Societies Act, 1960 (MCS Act)** – subject to final approval of these changes, the MCS Act having 167 sections effective from 26/1/1962 and The Maharashtra Co-op. Societies Rules, 1961 - having 110 rules effective from 23/12/1963 (applicable to any co-operative society registered in Maharashtra and having no branches outside Maharashtra).

or

The Co-operative Societies Act and Rules of the respective state in which the society is registered (Bihar-1935, Orissa-1935, Assam-1950, Karnataka-1959, Madhya Pradesh-1961, Tamil Nadu-1961, Gujarat-1962, Andhra Pradesh-1964, Rajasthan-1965, Kerala-1969, Himachal Pradesh-1971, Delhi-1972, West Bengal-1973).

or

The Co-operative Societies Act, 1912 and Rules (applicable to any state, which does not have its own co-operative law).

or

The Multi-State Co-op. Societies Act, 2002 and Rules (applicable to all societies whose objects are not confined to one state).
- 2) **Bk - The Banking Regulation Act, 1949** as modified by Banking Laws (Application to Co-operative Societies) Act, 1965 effective from 1st March 1966 for the purpose of regulating the banking business of certain co-operative societies and the Banking Regulation (Co-op. Societies) Rules, 1966 effective from 3rd December, 1966
- 3) **Bk - The Reserve Bank of India Act**
  - ◆ Sec.5A of B.R. Act - The provisions of the Banking Regulation Act override the ones in any other Act or the Rules or Byelaws including the Companies Act, 1956.
  - ◆ Sec. 14-A of B. R. Act - A Bank cannot create a floating charge on its assets.
- 4) **Bk - The Foreign Exchange Management Act, 1999**
- 5) The Income Tax Act, 1961 and Rules (the income is taxable, but certain deductions are available u/s 80P)
- 6) The Service Tax Act and Rules
- 7) The Bombay Stamp Act

or

The Stamp Act applicable to the respective State

or

The Indian Stamp Act

- 1\* For purpose of stamping of documents, Branch to follow law of the place where document is executed and not where registered office of bank is situated. Eg., for stamping of documents executed by a branch of Bank of India in Gujarat, The Bombay Stamp Act (as applicable to the State of Gujarat) to be followed and not the Bombay Stamp Act (as applicable to the State of Maharashtra), which is applicable to its registered office in Mumbai.
- 2\* If certain provisions not available in State's Stamp Act, provisions of the Indian Stamp Act, which is a central act, to be followed. eg. provision for revenue stamp
- 8) The Indian Contract Act 1872, Transfer of Property Act 1882 & Sale of Goods Act 1930
- 9) Law of Limitation
- ◆ The law of limitation does not apply to the loan documents executed by a borrower, as long as he continues to be a member of the co-operative sector.
- 10) Circulars issued by Reserve Bank of India from time to time (**Check RBI site – <http://www.rbi.org.in> - for various circulars**) and Circulars, Notifications and directives issued from time to time by the respective departments of co-operation. **RBI has issued 17 Master Circulars on 2<sup>nd</sup> July, 2012**
- 11) Byelaws of the Society
- 12) Accounting Standards - Policies & Guidelines

### Audit of Advances

#### **RBI has issued a number of Master Circulars in this regard**

- ◆ **Exposure Norms & Statutory / Other Restrictions on Loans & Advances**  
(RBI/2012-13/61 UBD.BPD.(PCB) MC No.1/13.05.000/2012-13 dt. July 2, 2012)
- ◆ **Guarantees, Co-Acceptances & Letters of Credit**  
(RBI/2012-13/63 UBD.BPD.(PCB) MC No.4 /09.27.000/2012-13 dt. July 2, 2012)
- ◆ **Finance for Housing Schemes**  
(RBI/2012-13/66 UBD.BPD.(PCB) MC No. 2 /09.22.010/2012-13 dt. July 2, 2012)
- ◆ **Management of Advances**  
(RBI/2011-12/103 UBD.BPD.(PCB) MC No. 5 /13.05.000/2011-12 dt. July 1, 2011)
- ◆ **Priority Sector Lending**  
(RBI/2012-13/57 UBD.BPD.(PCB).MC.No.7/09.09.001/2012-13 dt. July 2, 2012)

1\* Under Exposure norms, RBI has prescribed maximum amount that can be advanced to one borrower - Prudential norms state that total exposure not to exceed 15% of bank's Capital Fund (Tier I+Tier II Cap) for single borrower & 40% for group of borrowers. The said circular has also prescribed maximum individual as well as aggregate limit of unsecured advances.

2\* Sec.20 of B.R. Act - Loans were allowed to be given to directors, committee members and their relatives. However, w.e.f. 1<sup>st</sup> October, 2003, fresh advances to these persons prohibited by RBI, while old advances to be recovered when due and not to be renewed (Circulars dt. Apr. 29, 2003 and June 24, 2003). Further, they are not allowed to stand as surety / guarantors (UBD.PCB.Cir.10/13.05.00/04-05 dt. Aug. 7, 2004). This however does not apply to employee related loans given (RBI/2005-06/175 – UBD.PCB.Cir.No.14/13.05.000/05-06 dt. Oct. 6, 2005). Also see Master Circular on Board of Directors (RBI/2012-13/58 UBD.CO. BPD. MC.No.8 /12.05.001/2012-13 dt. July 2, 2012)

3\* Sec.44 - Loan against own shares not allowed. [Also Sec. 20(1)(a) of B. R. Act].

4\* Sec.44 - Credit Society cannot give loans to or accept guarantees of persons other than its members. However, it can lend to non-members against their deposits.

5\* Rule 41 - Only specified portion of working capital can be used for lending.

6\* Rule 42 - Various regulations in respect of loans granted by society

7\* Rule 43 - A member applying for loan has to hold requisite number of shares. However, wef 15/11/2010, share linking relaxed in case of banks having CRAR of 12% or above.

8\* Rule 45 - Restrictions on members to borrow from more than one credit society.

9\* **Bk** - As per RBI, co-op. banks not allowed to finance a borrower already enjoying credit facilities with another bank without obtaining NOC from such bank.

10\*Rule 45A - Loan against pledge of FDR not to exceed 90% of the deposit amount and period of loan not to exceed beyond maturity date of the deposit. If the borrower does not repay the loan, principal and interest due can be adjusted against the deposit. RBI has given freedom to co-op. banks to make their own rules regarding margin – refer Master Circular on Interest Rates (RBI/2012-13/54 UBD.BPD (PCB) MC. No. 11 /13.01.000/2012-13. July 2, 2012)

11\* Unsecured loans upto Rs.5 lacs can be given subject to 10% of DTL of bank.

12\*Wef 22/9/2010, bullet repayment of gold loans permitted.

## FOR CO-OP. BANKS

## **Income Recognition, Asset Classification, Provisioning & Other Related Matters - Non-Performing Assets (NPA) Norms**

- ◆ Norms prescribed by RBI since 1992 for NPAs by Banks - RBI's Master Circular dt. July 2, 2012 updated upto 30/6/2012 (RBI/2012-13/64 UBD.BPD.(PCB) MC No.3 /09.14.000/2012-13)

**The paragraph numbers mentioned hereinafter refer to this Master Circular**

- ◆ Banks have to classify all advances into standard, sub-standard, doubtful and loss assets, based on age of **principal amount and / or interest overdue** and the value of securities available there against.
- ◆ Tier I banks – is defined as Unit banks i.e. banks having a single branch / Head Office and banks with deposits below Rs.100 crore, whose branches are located in a single district or Banks with deposits below Rs.100 crore having branches in more than one district, provided the branches are in contiguous districts and deposits and advances of branches in one district *separately* constitute at least 95% of the total deposits and advances respectively of the bank. **All other banks are defined as Tier II banks.** (RBI/2007-2008/259 UBD (PCB).Cir.No.35 /09.20.001/07-08 dt. March 7, 2008). For definition, also see Master Circular on CRR and SLR (RBI/2012-13/52 UBD.BPD.(PCB). MC.No:15 /12.03.000/2012-13 dt. July 2, 2012)

**A separate set of NPA norms were prescribed for Tier I banks.** Tier I banks were granted certain relaxation with regard to provision for NPA. This relaxation was in force upto March 31, 2009. Hence, **with effect from April 1, 2009 (FY 2009-10), Tier I banks have to follow the norms applicable to Tier II banks** [Para 2.1.3]

### **Income Recognition Norms for Tier II Banks [Para 4]**

- ◆ Policy of income recognition is based on the record of recovery. Thus,
  - ▣ Account considered as NPA, if interest charged during any quarter is not serviced fully within 90 days from end of quarter.
  - ▣ On account becoming NPA, all accrued interest, fees, commission, etc., which has been credited to income account, but has not been realised, has to be reversed; and
  - ▣ Thereafter, all interest, etc. to be accounted on receipt basis and not accrual basis.
- ◆ The above norms are also applicable to all government guaranteed accounts [Para 4.1.4]
- ◆ Interest on advances against Term deposit receipts, National Saving Certificates, Indira Vikas Patra, Kisan Vikas Patra and Life Insurance policies may be taken to income account, provided adequate margin is available. However, advances against gold ornaments, government and other securities are not covered by this exemption [Para 4.1.2]

- ♦ Fees and commission earned as a result of renegotiation / rescheduling of outstanding debts can be taken on accrual basis during the period covered by the renegotiation / rescheduled extension of credit [*Para 4.1.3*]
- ♦ In case of advances, where moratorium has been granted for payment of interest, interest becomes “due” only after the moratorium period is over.
- ♦ In case of housing or other loans granted to staff, where interest is payable after recovery of principal, interest becomes “due” only on the predetermined “due date”. [*Para 2.2.4*]

### **Definition of Non Performing Asset (NPA)**

An asset, including a leased asset, becomes NPA when it ceases to generate income for Bank. Specifically, various assets can be termed as NPA as follows: [*Para 2.1.2*]

- ♦ Term Loan – interest and / or instalment remains “overdue” for more than 90 days
- ♦ Overdraft & Cash Credit – the account remains “out of order” i.e.
  - ▣ outstanding balance remains continuously in excess of the sanctioned limit / drawing power; **OR**
  - ▣ outstanding balance is less than the sanctioned limit / drawing power limit, but there have been no credits continuously for 90 days / the credits are not enough to cover the interest debited during the same period.
- ♦ Bill Purchased / Discounted – the bill remains “overdue” (i.e. not paid on the due date) for more than 90 days
- ♦ Long Duration Crop Loan (crop season > 1 year) – principal or interest thereon remains “overdue” for 1 crop season. [*Para 2.1.5*]
- ♦ Short Duration Crop Loan – principal or interest thereon remains “overdue” for 2 crop seasons [*Para 2.1.5*]
- ♦ Others – amount becomes NPA, if it remains “overdue” for more than 90 days.

### **Classification of NPAs [*Para 3.1*]**

- ♦ Substandard Asset – an asset which has remained NPA for a period of less than or equal to 12 months.
- ♦ Doubtful Asset – an asset which has remained NPA for more than 12 months
- ♦ Loss Asset – an asset which has been identified as such, but has remained to be provided for / written off.

### **Provisions to be made [*Para 5*]**

Provision has to be made for all the assets, whether it is a standard asset or a NPA. The norms for provisioning are as follows:

- ♦ Standard Asset – based on the type of advance, provision ranging from 0.25% (for a direct agricultural & SME loans) to 0.40% for all other loans should be made. Additionally, w.e.f. December 8, 2009, all banks are mandated to make 1% provision in respect of advances to Commercial Real Estate Sector. Provision not to be netted from gross advances, but should be shown separately as “Contingent Provision against Standard Assets” under “Other Funds & Reserves” as item 2 (viii) of Capital & Liabilities in Balance Sheet [5.1.2 (iv)]
- ♦ Substandard Asset – a general provision of 10% on total outstanding advances should be made (without considering any DICGC, ECGC cover or securities available) [Para 5.1.2 (iii)]
- ♦ Doubtful Asset – a provision of 100% to be made for unsecured portion of advances, while a provision of 20/30/100% to be made on secured portion, which has remained doubtful for upto 1 year / 1 – 3 years / more than 3 years respectively. [Para 5.1.2 (ii)]
- ♦ Loss Asset – a provision of 100% of outstanding amount has to be made. [Para 5.1.2 (i)]

### Summarized Position of Asset Classification & Provision for Tier II Banks [Para 3 & 5]

	Asset Classification	Provision Required
**	Performing (Standard) Asset (Overdue upto 90 days w.e.f. 31 <sup>st</sup> March, 2005)	0.25%-0.40% 1% on Commercial Real Estate Sector loans (w.e.f. Dec. 8, 2009) [Para 5.1.2 (iv)]
**	Non-Performing Asset (NPA) (Overdue > 90 days)	
-	Sub-Standard (NPA upto 12 months w.e.f. 31/3/2005)	10%
-	Doubtful (Sub-standard / NPA for > 12 months / erosion in security > 50%)	20 / 30 / 100% for secured doubtful O/s upto 1 year/ 1-3 years / > 3 years resp. 100% for unsecured doubtful advances
-	Loss (No chance of recovery/erosion in security>90% )	100%

#### Certain Exemptions from Provision

- ♦ Advances against Term deposit receipts, National Saving Certificates, Indira Vikas Patra, Kisan Vikas Patra & Life Insurance policies need not be treated as NPA, provided adequate margin is available. However, advances against gold ornaments, government and other securities are not covered by this exemption, yet gold loans for agricultural purposed are to be considered. [Paras 2.2.8 & 5.4 (iii) & (iv)]
- ♦ If government guaranteed advance becomes NPA, then for the purpose of income recognition, interest on such advance has not to be taken to income unless interest is realised. However, for purpose of asset classification, credit facility backed by Central Govt. guarantee, though overdue, can be treated as NPA only when the Govt. repudiates its guarantee, when invoked; this exception is not applicable for State Govt. guaranteed advances, where advance is to be considered NPA if it

remains overdue for more than **90 days w.e.f. year ended 31<sup>st</sup> March, 2006.** [Para 2.2.5 & 5.4 (i)]

- ◆ Special concessions have been given agricultural loans given to persons affected by natural calamities [Para 2.2.3]
  - ◆ Advances covered by BIFR / ECGC / DICGC Guarantees – separate guidelines have been given for provision to be made in case of accounts covered under the above. [Paras 5.4 (ii) & 5.4 (v)].

### Other Important Aspects of NPAs

- ◆ **Income recognition and asset classification is based on record of recovery and hence availability of security or net worth of borrower / guarantor is not considered for the purpose of treating an account as NPA or otherwise** [Para 2.2.1]
- ◆ The above norms are the minimum prescribed. Additional provision can be made by the bank [Para 5.1.2 (v)]
- ◆ While determining the total advances recoverable from a borrower, debits arising out of devolvement of LCs or invoked guarantees and not cleared also to be added [Ann. 5, Qt.8]
- ◆ NPA accounts are considered borrowerwise and not facilitywise [Para 2.2.2]
- ◆ However, in consortium advance, record of recovery at the Bank being audited only has to be considered. [Para 2.2.2 (ii) & Ann. 5, Qt.5]
- ◆ In working capital borrowal account, drawing power calculated from stock statement older than 3 months has to be considered as “irregular” (overdue). If such “irregular” account continues for 90 days, account has to be classified as NPA, **even though the account is otherwise operated regularly** [Ann. 5, Qt.1]
- ◆ Similarly, accounts where regular / adhoc limits are not reviewed within 180 days from the due date / date of adhoc sanction have to be considered as NPA [Ann. 5, Qt.2]
- ◆ Accounts regularised with a few credits around the Balance Sheet date need to be carefully looked into (source of the credit, genuine entries, additional facilities granted in some other account etc.) [Para 2.2.1 (ii) & Ann. 5, Qt.3]
- ◆ In case of accounts where there is erosion in value of security or fraud has been committed by borrower, the same should straightaway be classified as doubtful or loss [Para 3.3.1]
  - Specifically -
    - ▣ where value of security has eroded by more than 50%, account should be classified as ‘doubtful’ [Ann. 5, Qt.4] and

- ▣ where realisable value of security is less than 10% of outstanding amount, the existence of security should be ignored and account should be classified as 'loss' [Ann. 5, Qt.9]
- ◆ Project loans have also been brought under the NPA norms, with a separate set of guidelines for classification. [Para 2.2.6 & Annex 9]
- ◆ For all NPA accounts, with balance of Rs.10 lacs and above, classified as 'Doubtful', it is very essential to determine **a)** the existence of primary and collateral securities properly charged to the Bank, **b)** its present value through approved valuer (once in 3 years) and **c)** inspection (periodical); in larger advances (limit to be fixed by Board), stock audit at annual intervals by external agency mandatory [Ann. 5, Qt.10]
- ◆ Suit filed accounts should generally be classified as doubtful, unless there is a strong justification to show it is sub-standard.
- ◆ Make specific note and report of accounts which appear to be sticky but are not yet classified as sub-standard / doubtful.
- ◆ Separate set of guidelines for Restructuring of Advances [Para 2.2.7 & Annex 6]
- ◆ **Accounting treatment for accrued interest** [Paras 4.5.3 & 4.5.4 & Annex.3]
  - ▣ accrued interest on Performing Assets can be debited to borrowal a/c & credited to Interest a/c and taken to Income;
  - ▣ accrued interest on NPA a/c **should not be** debited to borrowal a/c, but debited to "Interest Receivable Account" on Asset side of Balance Sheet and credited to "Overdue Interest Reserve Account" on Liability side of the Balance Sheet.

### Upgradation of Accounts

- ◆ Reschedulement of recovery cannot give the advance a better classification than the previous one
- ◆ NPA accounts can be upgraded to Performing Accounts, provided all overdues are adjusted or atleast reduced to a period of less than 90 days
- ◆ However, restructured / rescheduled accounts under CDR or SME schemes or Rehabilitation packages cannot be upgraded until 1 year of satisfactory performance of the account [Paras 3.2.2 (ii) & 3.3.2]
- ◆ Upgradation within the NPA category not permitted (Eg. a Doubtful account cannot be made Sub-standard even if the overdues are reduced to less than 15 months)

## FOR CO-OP. CREDIT SOCIETIES

### Income Recognition & Asset Classification



- ◆ Norms prescribed by department of co-operation for Income Recognition and Asset Classification i.e. Non-Performing Assets (NPA) – Applicable from 31<sup>st</sup> March, 2005 - Circular dt. 10<sup>th</sup> November, 2004 – subsequently made applicable from 31<sup>st</sup> March, 2006 and modified from time to time. The present norms are as follows:

### **Latest Income Recognition wef F.Y. 2010-11 (as per Circular dt. 21.07.2008)**

Initially, it was proposed that NPA norms be modified from FY 10-11 to state that if the instalments are overdue for more than 1 quarter (3 months), the account would become NPA. However, subsequently, the department has stated that the present norms (overdue for more than 2 quarters - 6 months) would continue, till further notice. Hence, the present norms applicable are as follows:

- ◆ Account considered as NPA, if interest due for 2 quarters (6 months) is not actually received.
- ◆ Reversal of accrued interest on account becoming NPA.
- ◆ Thereafter, all interest to be accounted on receipt basis and not accrual basis.

### **Latest Asset Classification & Provision for F.Y. 2010-11**

	<b>Asset Classification</b>	<b>Provision Required</b>
**	<b>Performing (Standard) Asset (Overdue upto 2 quarter [6 months])</b>	Nil
**	<b>Non-Performing Asset (NPA) (Overdue &gt; 6 mths)</b>	
-	<b>Sub-Standard (NPA upto 12 months)</b>	5%
-	<b>Doubtful (NPA &gt; 12 months)</b>	10 / 15 / 20% for secured doubtful O/s upto 2 years/ 2-3 years / > 3 years resp. 50% for unsecured doubtful advances
-	<b>Loss (No chance of recovery)</b>	100%

**Note: NPA provision for small loans upto Rs.10,000/- per borrower need not be made.**

### **Other Important Aspects of NPAs**

- ◆ NPA accounts considered borrowerwise and not facilitywise.
- ◆ Advances against Term deposit receipts, National Saving Certificates, Indira Vikas Patra and Kisan Vikas Patra exempted from norms for Asset Classification, provided adequate margin available (*It implies that advances agst. gold ornaments, insurance policies, govt. & other securities not exempted*)

- ◆ Above norms are minimum prescribed. Additional provision can be made on case by case basis.
- ◆ In consortium advance, record of recovery at Society being audited only to be considered.
- ◆ Accounts regularised with a few credits around the Balance Sheet date need to be carefully looked into (source of the credit, genuine entries, additional facilities granted in some other account etc.)
- ◆ For all accounts classified as 'Doubtful', it is very essential to determine the existence and the present value of the primary and collateral securities through valuation - property valuation (once in 2 years), inspection (periodical), monthly stock statements for stocks hypothecated and depreciation @ 10-15% on plant and machinery.
- ◆ Suit filed accounts to be classified as doubtful, unless there is a strong justification to show it is Sub-standard.
- ◆ Make specific note and report of accounts which appear to be sticky but are not yet classified as sub-standard / doubtful.

### **Upgradation of Accounts**

- ◆ Reschedule of recovery cannot give the advance a better classification than the previous one
- ◆ NPA accounts can be upgraded to Performing Accounts, provided all overdues adjusted
- ◆ Upgradation within the NPA category not permitted (Eg. a Doubtful account cannot be made Sub-standard even if the overdues are reduced to less than 15 months)

### **Write-Off of Bad Debts**

- ◆ Rule 49 - Any asset that has to be written off - 4 stages for write-off.

- i) Recommended by Board.
- ii) Certified by Auditor.
- iii) Sanction by general body
- iv) Approval by Registrar.

However, in case of societies classified as A or B at the time of last audit, Registrar's approval is not required, if the bad debts are written off against Bad Debt fund.

Under Sec. 20A of B.R. Act, prior approval of RBI is required to remit any debt due from past or present directors, or their firms /companies