Seminar on Statutory Audit of Bank Branches

“INCOME RECOGNITION, ASSET CLASSIFICATION & PROVISIONING NORMS (NPA)”

WIRC,12TH MARCH, 2016

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HISTORY OF IRAC NORMS

- In line with the international practices and as per the recommendations made by the Committee on the Financial System (Chairman Shri M. Narasimham), the Reserve Bank of India has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts.
- The recommendations of Shri M. Narsimham Committee regarding income recognition, asset classification and provisioning were sought to be implemented by Reserve Bank of India in a phased manner over a three – year period from the year commencing from the year 1992-93.

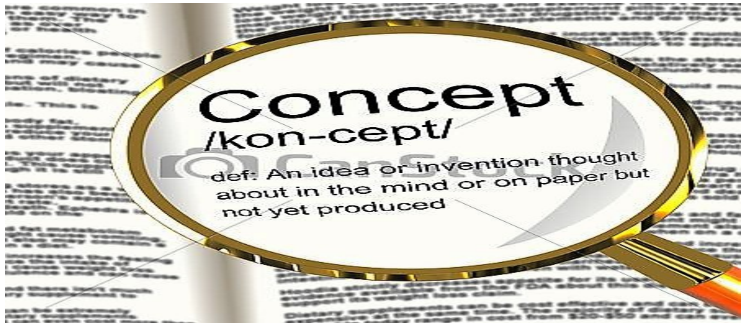
HISTORY OF IRAC NORMS

- The term loan becomes NPA when interest and / or installment remain past due for four quarters during 92-93, three quarter during 93-94. From the year 93-94 the term loan is treated as NPA in interest or installments of principle has remained overdue for any 2 quarters as on the balance sheet date, although the default may not be committed continuously for 2 quarters.
- This period is reduced to 1 quarter with effect from 31st March 2004.

NON

- (NPA)

DEFINITIONS



A non performing asset (NPA) is a loan or an advance where:

a) **Term Loans:** A term loan is treated as a non-performing asset (NPA) if interest and/or instalment of principal remain overdue for a period of more than 90 days.

‘OVERDUE’:

Any amount due to the bank under any credit facility is ‘overdue’ if it is not paid on the due date fixed by the bank.

DEFINITIONS

b) Cash Credits and Overdrafts: A cash credit or overdraft account is treated as NPA if it remains out of order as indicated above.

DEFINITIONS

c) Bills Purchased and Discounted: Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days.

- **(d) Securitisation:** The asset is to be treated as NPA if the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms

DEFINITIONS

- **(e) Agricultural Advances:** A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons and, a loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

DEFINITIONS

- **LONG TERM DURATION CROPS:**
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one

DEFINITIONS

- Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan.

DEFINITIONS

(f) Credit Card Accounts:

As per latest circular on **Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Credit Card Accounts :**

In order to bring in greater credit discipline as also to provide operational flexibility to credit card issuers, it has been decided that 'past due' status of a credit card account for the purpose of asset classification would be reckoned from the payment due date mentioned in the monthly credit card statement.

DEFINITIONS

Consequently, in case of banks, a credit card account will be treated as non-performing asset if the minimum amount due, as mentioned in the statement, is **not paid fully** within 90 days from the payment due date mentioned in the statement.

However, banks shall report a credit card account as ‘past due’ to credit information companies (CICs) or levy penal charges, viz. late payment charges, etc., if any, only when a credit card account remains ‘past due’ for more than three days. The number of ‘days past due’ and late payment charges shall, however, be computed from the payment due date mentioned in the credit card statement.

DEFINITIONS

(g)

In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of a derivative contract, if these remain unpaid for a period of 90 days from the specified due date for payment.

DEFINITIONS

Provisioning requirements for derivative exposures Credit exposures computed as per the current marked to market value of the contract, arising on account of the interest rate & foreign exchange derivative transactions, credit default swaps and gold, shall also attract provisioning requirement as applicable to the loan assets in the 'standard' category, of the concerned counterparties. All conditions applicable for treatment of the provisions for standard assets would also apply to the aforesaid provisions for derivative and gold exposures.

EXCEPTIONS

Advances against Term Deposits, NSCs, KVPs/IVPs, etc.

Advances against Term Deposits, NSCs, KVPs/IVPs, etc. Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs, provided adequate margin is available in the accounts. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

EXCEPTIONS

Loans with moratorium for payment of interest

In the case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence do not become NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

EXCEPTIONS

Loans with moratorium for payment of interest

In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of instalment of principal or payment of interest on the respective due dates.

EXCEPTIONS

Government guaranteed advances

The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income.

State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.

RECOGNITION OF NPA IN CASE OF CONSORTIUM ADVANCES

Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances.

Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

ACCOUNTS WITH TEMPORARY DEFICIENCIES

- The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular. A working capital borrowed account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower's financial position is satisfactory.

ACCOUNTS WITH TEMPORARY DEFICIENCIES

- Regular and ad hoc credit limits need to be reviewed/ regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon.

- In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

ACCOUNTS REGULARISED NEAR ABOUT THE BALANCE SHEET DATE

- The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA.

INCOME RECOGNITION POLICY

The income from non-performing assets (NPA) is not recognised on accrual basis but is booked as income only when it is actually received. Therefore, the banks should not charge and take to income account interest on any NPA. **This will apply to Government guaranteed accounts also .**

INTEREST APPLICATION

On an account turning NPA, banks should reverse the interest already charged and not collected by debiting Profit and Loss account, and stop further application of interest. However, banks may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing Gross Advances, interest recorded in the Memorandum account should not be taken into account.

REVERSAL OF INCOME

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.

INCOME RECOGNITION POLICY

EXCEPTION:

I. Interest on advances against Term Deposits, National Savings Certificates (NSCs), Indira Vikas Patras (IVPs), Kisan Vikas Patras (KVPs) and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.

INCOME RECOGNITION POLICY

- **EXCEPTION:**

II. Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.

APPROPRIATION OF RECOVERY IN NPA'S

Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned .

ASSET CLASSIFICATION

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A. Sub-Standard Assets

A substandard asset would be one, which has remained NPA for a period less than or equal to 12 months.

Such an asset will have well defined credit weaknesses that jeopardies the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.

B. DOUBTFUL ASSETS

With effect from March 31, 2005, an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months.

A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.

B. DOUBTFUL ASSETS

Doubtful Asset -Three Categories

Category	Period
Doubtful - I	up to One Year
Doubtful – II	One to Three Years
Doubtful - III	More than Three Years

C. LOSS ASSTES

A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

PROVISIONING NORMS

STANDARD ASSETS:

(a) Direct advances to agricultural and SME sectors at 0.25 per cent.

(b) Advances to Commercial Real Estate (CRE) Sector at 1.00 per cent.

(c) Advances to Commercial Real Estate – Residential Housing Sector (CRERH) at 0.75 per cent

(d) All other loans and advances not included in (a) and (b) above at 0.40 per cent Housing loan at teaser rate it will be @ 2% On newly restructured advances after 1-6-2013 @ 3.5% for March 2014, 4.25% for March 2015 and @ 5% for March 2016. On old restructured advances @ 2.75%

PROVISIONING NORMS

STANDARD ASSETS:

The provisions on standard assets should not be reckoned for arriving at net NPAs.

(iii) The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions Others' in Schedule 5 of the balance sheet.

PROVISIONING NORMS

SUBSTANDARD ASSETS:

Secured Exposures	15 % on total outstanding should be made without making any allowance for ECGC/DICGC guarantee cover and securities available.
Unsecured Exposures	25%
Unsecured Exposures in respect of Infrastructure loan accounts where certain safeguards such as escrow account are available.	20%

DOUBTFUL ASSETS

I.100 percent of the extent to which the advance is not covered by the realisable value of the security to which the bank has a valid recourse and the realisable value is estimated on a realistic basis.

II. In regard to the secured portion, provision may be made on the following basis, at the rates ranging from 25 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful:

DOUBTFUL ASSETS

Period for which the advance has remained in 'doubtful' category	**Provision requirement**
Up to one year	25 %
One to three years	40%
More than three years	100 %

Income recognition

- For NPA accounts income should be recognised on realisation basis.
- When an account becomes non-performing, unrealised interest of the previous *periods* should be reversed or provided.
- Interest income on additional finance in NPA account should be recognised on cash basis.
- In project loan, funding of interest in respect of NPA if recognised as income, should be fully provided.
- If interest due in respect of NPA is converted into equity or anyother instrument, income recognised should be fully provided.

LOSS ASSETS

- The entire asset should be written off.
- If for any reason, an asset is allowed to remain in books, 100 percent of the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component should be provided for.

VALUATION OF SECURITIES

- In respect of NPAs with the balance of Rs. 5.00 crores & above, bank needs to formulate policy for annual stock audit by external agencies & in respect of immovable properties, valuation to be respect of immovable properties, valuation to be carried out once in 3 years by approved valuer.

TREATMENT OF INTEREST SUSPENSE ACCOUNT

- Amounts held in Interest Suspense Account should not be reckoned as part of provisions. Amounts lying in the Interest Suspense Account should be deducted from the relative advances and thereafter, provisioning as per the norms, should be made on the balances after such deduction.

ADVANCES COVERED BY ECGC GUARANTE

- In the case of advances classified as doubtful and guaranteed by ECGC, provision should be made only for the balance in excess of the amount guaranteed by the Corporation. Further, while arriving at the provision required to be made for doubtful assets, realizable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by the Corporation and then provision made as illustrated hereunder

ADVANCES COVERED BY ECGC GUARANTE

Outstanding Balance	Rs. 4 lakhs
Less: Value of security held	Rs. 1.50 lakhs
Unrealised balance	Rs. 2.50 lakhs Less
Less: ECGC Cover (50% of unrealisable balance) Rs. 1.25 lakhs	Rs. 1.25 lakhs
Net unsecured balance	Rs. 1.25 lakhs
Provision for unsecured portion of advance	Rs. 1.25 lakhs (@ 100 percent of unsecured portion)
Provision for secured portion of advance (as on March 31, 2012)	Rs.0.60 lakhs (@ 40 per cent of the secured portion) Total
Total provision to be made	Rs.1.85 lakhs (as on March 31, 2014)

ADVANCE COVERED BY GUARANTEES OF CREDIT GUARANTEE FUND TRUST FOR MICRO AND SMALL ENTERPRISES (CGTMSE) OR CREDIT RISK GUARANTEE FUND TRUST FOR LOW INCOME HOUSING (CRGFTLIH)

- In case the advance covered by CGTMSE or CRGFTLIH guarantee becomes nonperforming, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing assets. An illustrative example is given below:

ADVANCE COVERED BY GUARANTEES OF CREDIT GUARANTEE FUND TRUST FOR MICRO AND SMALL ENTERPRISES (CGTMSE) OR CREDIT RISK GUARANTEE FUND TRUST FOR LOW INCOME HOUSING (CRGFTLIH)

Outstanding Balance	Rs. 10 lakhs
CGTMSE/CRGFTLIH Cover	75% of the amount outstanding or 75% of the unsecured amount or Rs.37.50 lakh, whichever is the least
Period for which the advance has remained doubtful	More than 2 years remained doubtful (say as on March 31, 2014)
Value of security held	Rs. 1.50 lakhs

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Value of security held	Rs. 1.50 lakhs