

MASTER CIRCULAR

On
Income Recognition, Asset Classification,
Provisioning & Other Related Matters.

(Updated up to June 30, 2006)

(The Master Circular is also available at RBI web-site www.rbi.org.in)



RESERVE BANK OF INDIA

Urban Banks Department,
Central Office
Mumbai

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August 8, 2006

Chief Executive Officers of
All Primary (Urban) Co-operative Banks

Dear Sir/Madam,

**Master Circular on Income Recognition, Asset
Classification, Provisioning & Other Related Matters - UCBs**

Please refer to our Master Circular UBD.BSD.IP.No.15/12.05.05/2004-05 dated December 2, 2004 on the captioned subject. The enclosed Master Circular consolidates and updates all the instructions/guidelines issued on the subject up to June 30, 2006.

Yours faithfully,

(N.S. Vishwanathan)
Chief General Manager-in-charge

Encl: As above.

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Contents

1.	GENERAL	5
2.	NON-PERFORMANCE ASSETS (NPA)	5
2.1	Classification of assets as Non-Performing	5
2.2	Treatment of Accounts as NPAs	10
2.2.1	Record of Recovery	10
2.2.2	Treatment of NPAs – Borrower – wise and not Facility-wise	10
2.2.3	Agricultural Advances	10
2.2.4	Housing Loans to staff	11
2.2.5	Credit Facilities backed by Guarantees by Government of India/ State Governments	11
2.2.6	Project Financing	11
2.2.7	Concept of Commencement of Commercial Production ..	12
2.2.8	Debt Restructuring Mechanism for small and medium enterprises (SMEs)	14
2.2.9	Other Advances	15
2.2.10	Recognition of Income on Investment treated as NPA	15
2.2.11	NPA Reporting to Reserve Bank	15
3.	ASSET CLASSIFICATION	15
3.1	Classification	16
3.2	Definitions.. .. .	16

	3.2.1	Standard Assets	..	..	..	..	..	..	..	16
	3.2.2	Sub-standard Assets	..	..	..	..	..	..	..	16
	3.2.3	Doubtful Assets	..	..	..	..	..	..	..	16
	3.2.4	Loss Assets	..	..	..	..	..	..	..	17
3.3		Guidelines for Classification of Assets	..	..	..	..	..	..	..	17
	3.3.1	Basic Considerations	..	..	..	..	..	..	..	17
	3.3.2	Advances Granted under Rehabilitation Packages Approved by BIFR/Term Lending Institutions	..	..	..	..	..	..	..	17
	3.3.3	Internal System for Classification of Assets as NPAs	..	..	..	..	..	..	..	18
4.		INCOME RECOGNITION	..	..	..	..	..	..	..	18
	4.1	Income Recognition – Policy	..	..	..	..	..	..	..	18
	4.2	Reversal of Income on Accounts Becoming NPAs	..	..	..	..	..	..	..	19
	4.3	Booking of Income on Investments in Shares & Bonds	..	..	..	..	..	..	..	19
	4.4	Partial Recovery of NPAs	..	..	..	..	..	..	..	20
	4.5	Interest Application	..	..	..	..	..	..	..	20
5.		PROVISIONING NORMS	..	..	..	..	..	..	..	21
	5.1	Norms for provisioning on Loans & Advances	..	..	..	..	..	..	..	21
	5.2	Provisioning for retirement benefits	..	..	..	..	..	..	..	25
	5.3	Provisioning norms for sale of assets to SC/ RC	..	..	..	..	..	..	..	25
	5.4	Guidelines for provisions in specific cases	..	..	..	..	..	..	..	26
6.		Divergence in asset classification & provisioning due to non compliance with RBI guidelines	..	..	..	..	..	..	..	27
7.		CLARIFICATION ON CERTAIN FREQUENTLY ASKED QUESTION	..	..	..	..	..	..	..	28
8.		Annex I	..	..	..	..	..	..	..	33

9.	Annex 2	..	..	..	..	..	..	..	..	..	35
10.	Annex 3	..	..	..	..	..	..	..	..	..	38
11.	Annex 4	..	..	..	..	..	..	..	..	..	40
12.	Annex 5	..		..	..	..	..	..	..	..	46
13.	Appendix										

Master Circular

On Income Recognition, Asset Classification, Provisioning & Other Related Matters

1. GENERAL

- 1.1 In order to reflect a bank's actual financial health in its balance sheet and as per the recommendations made by the Committee on Financial System (Chairman Shri M. Narasimham), the Reserve Bank has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the primary (urban) co-operative banks.
- 1.2 Broadly, the policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Likewise, the classification of assets of banks has to be done on the basis of objective criteria, which would ensure a uniform and consistent application of the norms. Availability of security or net worth of the borrower/ guarantor should not be taken into account for the purpose of treating an advance as non-performing asset or otherwise. The provisioning should be made on the basis of the classification of assets into different categories.
- 1.3 The requirements of the State Co-operative Societies Acts and / or rules made thereunder or other statutory enactments may continue to be followed, if they are more stringent than those prescribed hereby.
- 1.4 With the introduction of prudential norms, the Health Code based system for classification of advances has ceased to be a subject of supervisory interest. As such, all related reporting requirements, etc. also ceased to be a supervisory requirement, but could be continued in the banks entirely at their discretion and the management policy, if felt necessary.

2. NON-PERFORMING ASSETS (NPA)

2.1 Classification of Assets as Non-Performing

- 2.1.1 An asset becomes non-performing when it ceases to generate income for the bank. Earlier an asset was considered as non-performing asset (NPA) based on the concept of '**Past Due**'. A 'non performing asset' (NPA) was defined as credit in respect of which interest and/ or installment of principal has remained 'past due' for

a specific period of time. The specific period was reduced in a phased manner as under:

Year ended March, 31 -----	Specific period -----
1993	4 quarters
1994	3 quarters
1995	2 quarters

An amount is considered as past due, when it remains outstanding for 30 days beyond the due date. However, with effect from March 31, 2001 the 'past due' concept has been dispensed with and the period is reckoned from the due date of payment.

2.1.2 With a view to moving towards international best practices and to ensure greater transparency, '90 days' **overdue*** norms for identification of NPAs have been made applicable from the year ended March 31, 2004. As such, save and except certain relaxations mentioned at para 2.1.3 and 2.1.4 below, with effect from March 31, 2004, a non-performing asset shall be a loan or an advance where:

- (i) Interest and/or installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan.
- (ii) The account remains '**Out of order**'[@] for a period of more than 90 days, in respect of an Overdraft/ Cash Credit (OD/CC).
- (iii) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- (iv) In the case of direct agricultural advances as listed in Annex 1, the overdue norm specified at para 2.1.5 would be applicable. In respect of agricultural loans, other than those specified in Annex 1, identification of NPAs would be done on the same basis as non-agricultural advances.
- (v) Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

** Any amount due to the bank under any credit facility, if not paid by the due date fixed by the bank becomes **overdue**.*

@ “An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'”.

2.1.3 Unit banks i.e. banks having a single branch/ HO with deposits upto Rs. 100 crore and banks having multiple branches within a single district with deposits upto Rs. 100 crore have been permitted to classify loan accounts as NPAs based on 180 days delinquency norm instead of the extant 90 days norm. This relaxation will be in force for three financial years i.e. financial years ended/ ending March 31, 2005, 2006 and 2007. The details of the changes and the consequent impact on the existing instructions with regard to asset classification and income recognition in respect of these banks are given in the Annex 5. The deposit base of Rs. 100 crore for the above will be determined on the basis of average of the fortnightly Net Demand and Time Liabilities in the financial year concerned. For the above category of banks, an account would be classified as Non Performing Asset if the :

- (i) Interest and/or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan.
- (ii) The account remains 'Out of order' for a period of more than 180 days, in respect of an Overdraft/Cash Credit (OD/CC).
- (iii) The bill remains overdue for a period of more than 180 days, in the case of bills purchased and discounted.
- (iv) Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

The relaxations are given for the explicit purpose of enabling the UCBs concerned to transit to the 90 day NPA norm in the year 2007-2008 by building up adequate provisions and strengthening their appraisal, disbursement and post disbursement procedures.

2.1.4 All UCBs other than those referred to at para 2.1.3 shall classify their loan accounts as NPA as per 90 day norm as hitherto. However, Gold loans and small loans up to Rs. 1 lakh will be governed by the 90-day norm with effect from the year ending March 31, 2007. Till then, they will be governed by the 180-day norm as hitherto.

2.1.5 Agricultural Advance:

- (i) With effect from September 30, 2004 the following revised norms are applicable to all direct agricultural advances (as listed in the Annex 1):
 - a) A loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons.
 - b) A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.
- (ii) For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.
- (iii) The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each state.
- (iv) Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed of by him. In respect of agricultural loans, other than those specified in the Annex 1 and term loans given to non-agriculturists, identification of NPAs would be done on the same basis as non-agricultural advances which, at present, is the 90 days delinquency norm.
- (v) Banks should ensure that while granting loans and advances, realistic repayment schedules are fixed on the basis of cash flows / fluidity with the borrowers.

2.1.6 Identification of assets as NPAs should be done on an ongoing basis

The system should ensure that identification of NPAs is done on an on-going basis and doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per prescribed norms. Banks should also make provisions for NPAs as at the end of each calendar quarter i.e as at the end of March/ June/ September/ December, so that the income and expenditure account for the respective quarters as well as the P&L account and balance sheet for the year end reflects the provision made for NPAs.

2.1.7 Charging of interest at monthly rests

- (i) Banks should charge interest at monthly rests in the context of adoption of 90 days norm for recognition of loan impairment w.e.f. from the year ended March 31, 2004 and consequential need for close monitoring of borrowers' accounts. However, the date of classification of an advance as NPA as stated in preceding paras, should not be changed on account of charging of interest at monthly basis.
- (ii) The existing practice of charging/compounding of interest on agricultural advances would be linked to crop seasons and the instructions regarding charging of interest on monthly rests shall not be applicable to agricultural advances.
- (iii) While compounding interest at monthly rests effective from April 1, 2003 banks should ensure that in respect of advances where administered interest rates are applicable, they should re-align the rates suitably keeping in view the minimum lending rate charged by the bank (in view of the freedom given to them for fixing lending rates) so that they comply with the same. In all other cases also, banks should ensure that the effective rate does not go up merely on account of the switchover to the system of charging interest on monthly rests.
- (iv) Banks should take into consideration due date/s fixed on the basis of fluidity with borrowers and harvesting/ marketing season while charging interest and compound the same if the loan/ installment becomes overdue in respect of short duration crops and allied agricultural activities.

2.2 Treatment of Accounts as NPAs

2.2.1 Record of Recovery

- (i) The treatment of an asset as NPA should be based on the record of recovery. Banks should not treat an advance as NPA merely due to existence of some deficiencies which are of temporary in nature such as non-availability of adequate drawing power, balance outstanding exceeding the limit, non-submission of stock statements and the non-renewal of the limits on the due date, etc. Where there is a threat of loss, or the recoverability of the advances is in doubt, the asset should be treated as NPA.
- (ii) A credit facility should be treated as NPA as per norms given in paragraph 2.1 above. However, where the accounts of the borrowers have been regularised by repayment of overdue amounts through genuine sources (not by sanction of additional facilities or transfer of funds between accounts), the accounts need not be treated as NPAs. In such cases, it should, however, be ensured that the accounts remain in order subsequently and a solitary credit entry made in an account on or before the balance sheet date which extinguishes the overdue amount of interest or installment of principal is not reckoned as the sole criteria for treatment the account as a standard asset.

2.2.2 Treatment of NPAs – Borrower-wise and not Facility-wise

- (i) In respect of a borrower having more than one facility with a bank, all the facilities granted by the bank will have to be treated as NPA and not the particular facility or part thereof which has become irregular.
- (ii) However, in respect of consortium advances or financing under multiple banking arrangements, each bank may classify the borrowal accounts according to its own record of recovery and other aspects having a bearing on the recoverability of the advances.

2.2.3 Agricultural Advances – Default in repayment due to natural calamities

- (i) Where natural calamities impair the repaying capacity of agricultural borrowers, primary (urban) co-operative banks, as a relief measure may decide on their own to:

- (a) convert the short-term production loan into a term loan or re-schedule the repayment period, and
 - (b) sanction fresh short-term loans
- (ii) In such cases of conversion or re-schedulement, the term loan as well as fresh short-term loan may be treated as current dues and need not be classified as non performing asset (NPA). The asset classification of these loans would, therefore, be governed by the revised terms and conditions and these would be treated as NPA under the extant norms applicable for classifying agricultural advances as NPAs.

2.2.4 Housing Loan to Staff

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.

2.2.5 Credit facilities Guaranteed by Central /State Government

- (i) The credit facilities backed by guarantee of the Central Government though overdue should not be treated as NPA
- (ii) This exemption from classification of government guaranteed advances as NPA is not for the purpose of recognition of income.
- (iii) From the year ended March 31, 2006, State Government guaranteed advance and investment 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 irrespective of the fact whether the guarantee have been invoked or not.

2.2.6 Project Financing

In the case of bank finance given for industrial projects 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 NPA, with reference to the date of debit of interest. They

become overdue after due date for payment of interest, if uncollected.

2.2.7 Concept of Commencement of Commercial Production and Restructuring of Loan Accounts

- (i) Where a unit commences commercial production, but the level and volume of production reached immediately after the date of completion of the project is not adequate to generate the required cash flow to service the loan, it may be necessary to re-fix the repayment schedule. In such cases, the Board of Directors of the bank may lay down broad parameters for guidance of the staff for taking a view whether the unit has stabilised commercial production and there is a need for rescheduling of the loan to treat such advance as NPA or not. In framing these parameters, the following points may be kept in view:
 - (a) In order to arrive at a decision as to whether the unit/project has achieved regular commercial production, the main guiding factor would be whether the unit has achieved cash break-even in order to service the loan.
 - (b) If in the opinion of the bank, the bottleneck in achieving regular commercial production is of a temporary nature not indicative of any long-term impairment of the unit's economic viability and it is likely to achieve cash break even if some time is allowed, the bank may reschedule the loan and treat the asset as standard.
 - (c) However, the lead time would normally not exceed one year from the schedule of commencement of commercial production as indicated in the terms of sanction.
- (ii) In respect of credit facilities sanctioned under consortium arrangements, the decision as to whether the borrowing unit has achieved regular commercial production and there is a need for rescheduling may be taken by the lead institution or lead bank and other participating institutions/banks may follow the same.

- (iii) (a) Treatment of restructured accounts
 - (i) Restructuring/rescheduling/re negotiation of the terms of loan agreement in respect of standard and sub-standard accounts can take place at three stages, viz. (a) before commencement of commercial production, (b) after commencement of commercial production but before the asset has been classified as sub-standard, and (c) after commencement of commercial production and the asset has been classified as sub-standard.
 - (ii) In each of the foregoing three stages, the rescheduling, etc. of principal and/or of interest could take place with or without sacrifice.
- (b) Treatment of restructured standard accounts
 - (i) A rescheduling of the instalments of principal alone, at any of the stages at (a) and (b) above would not cause a standard asset to be classified in the sub-standard category provided the loan/credit facility is fully secured.
 - (ii) A rescheduling of **interest element** at any of the aforesaid two stages would not cause an asset to be down-graded to sub-standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, is either written off or provision is made to the extent of the sacrifice involved.
- (c) Treatment of restructured sub-standard accounts
 - (i) A rescheduling of the instalment of principal alone would render a sub-standard asset eligible to be continued in the sub-standard category for the specified period, provided the loan/credit facility is fully secured.
 - (ii) A rescheduling of interest element would render a sub-standard asset eligible to be continued to be classified in sub-standard category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, is either written off or provision is made to the extent of the sacrifice involved.

- (iii) The substandard accounts which have been subjected to restructuring, etc. whether in respect of principal instalment or interest amount, would be eligible to be upgraded to the standard category only after the specified period, i.e. one year after the date when the first payment of interest or principal, whichever is earlier, falls due, subject to satisfactory performance during the period.
 - (iv) In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.
- (d) Applicability
- (i) The foregoing norms for restructuring, etc. would be applicable to standard and sub-standard assets only. All other prudential guidelines relating to income recognition, asset classification and provisioning would remain unaltered.
 - (ii) The aforesaid instructions would be applicable to all types of credit facilities, including working capital limit extended to industrial units, provided they are fully covered by tangible securities.
 - (iii) These guidelines **are not applicable** to credit facilities extended to traders.
 - (iv) While assessing the extent of security available to the credit facilities, collateral security would also be reckoned, provided such collateral is a tangible security properly charged to the bank and is not in the intangible form like guarantee, etc.
- (e) General
- All standard and sub-standard accounts subjected to restructuring, etc. would be eligible for fresh financing of funding requirements, as per normal policy parameters and eligibility criteria.

2.2.8 Debt restructuring mechanism for Small and Medium Enterprises (SMEs)-

As part of announcement made by the Government of India for improving flow of credit to small and medium enterprises, certain

guidelines have been issued to UCBs for restructuring of debt of all eligible small and medium enterprises (SMEs). Details are furnished in Annex 4.

2.2.9 Other Advances

- (i) Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and Life policies need not be treated as NPAs although interest thereon may not have been paid for more than 90 days provided adequate margin is available in the accounts.
- (ii) Primary (urban) co-operative banks should fix monthly/quarterly instalments for repayment of gold loans for non-agricultural purposes taking into account the pattern of income generation and repayment capacity of the borrowers and such gold loan accounts may be treated as NPAs if instalments of principal and/ or interest thereon are overdue for more than 90 days.
- (iii) As regards gold loans granted for agricultural purposes, interest is required to be charged as per Supreme Court judgement at yearly intervals and payment should coincide with the harvesting of crops. Accordingly, such advances will be treated as NPA only if instalments of principal and/or interest become overdue after due date.

2.2.10 Recognition of Income on Investment Treated as NPAs

The investments are also subject to the prudential norms on income recognition. Banks should not book income on accrual basis in respect of any security irrespective of the category in which it is included, where the interest/principal is in arrears for more than 90 days .

2.2.11 NPA Reporting to Reserve Bank

The primary (urban) co-operative banks should report the figures of NPAs to the Regional Office of the Reserve Bank at the end of each year within two months from the close of the year in the prescribed proforma given in the Annex 2.

3 ASSET CLASSIFICATION

3.1 Classification

- 3.1.1 The primary (urban) co-operative banks should classify their assets into the following broad groups, viz.

- (i) Standard Assets
- (ii) Sub-standard Assets
- (iii) Doubtful Assets
- (iv) Loss Assets

3.2 Definitions

3.2.1 Standard Assets

Standard Asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset should not be an NPA.

3.2.2 Sub-standard Assets

- (i) With effect from March 31, 2005 an asset would be classified as sub-standard if it remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrowers/ guarantors or the current market value of the security charged is not enough to ensure recovery of the dues to the banks in full. In other words, such assets will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.
- (ii) An asset where the terms of the loan agreement regarding interest and principal have been re-negotiated or rescheduled after commencement of production, should be classified as sub-standard and should remain in such category for at least 12 months of satisfactory performance under the re-negotiated or rescheduled terms. In other words, the classification of an asset should not be upgraded merely as a result of rescheduling, unless there is satisfactory compliance of this condition.

3.2.3 Doubtful Assets

With effect from March 31, 2005, an asset is required to be classified as doubtful, if it has remained NPA for more than 12 months. As in the case of sub-standard assets, rescheduling does not entitle the bank to upgrade the quality of an advance automatically. A loan classified as doubtful has all the weaknesses inherent as that classified as sub-standard, 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.

Note: *Consequent to change in asset classification norms w.e.f. March 31, 2005 banks are permitted to phase the consequent additional provisioning over a five year period commencing from the year ended March 31, 2005, with a minimum of 10 % of the required provision in each of the first two years and the balance in equal instalments over the subsequent three years.*

3.2.4 Loss Assets

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

3.3 Guidelines for Classification of Assets

3.3.1 Basic Considerations

- (i) Broadly speaking, classification of assets into above categories should be done taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation of dues.
- (ii) In respect of accounts where there are potential threats to recovery on account of erosion in the value of security and existence of other factors such as, frauds committed by borrowers, it will not be prudent for the banks to classify them first as sub-standard and then as doubtful after expiry of 12 months from the date the account has become NPA. Such accounts should be straight away classified as doubtful asset or loss asset, as appropriate, irrespective of the period for which it has remained as NPA.

3.3.2 Advances Granted under Rehabilitation Packages Approved by BIFR/Term Lending Institutions

- (i) Banks are not permitted to upgrade the classification of any advance in respect of which the terms have been re-negotiated unless the package of re-negotiated terms has worked satisfactorily for a period of one year. While the existing credit facilities sanctioned to a unit under rehabilitation packages

approved by BIFR/term lending institutions will continue to be classified as sub-standard or doubtful as the case may be in respect of additional facilities sanctioned under the rehabilitation packages the income recognition and asset classification norms will become applicable after a period of one year from the date of disbursement.

- (ii) A similar relaxation be made in respect of SSI units which are identified as sick by banks themselves and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements.

3.3.3 Internal System for Classification of Assets as NPA

- (i) Banks should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value accounts. The banks may fix a minimum cut-off point to decide what would constitute a high value account depending upon their respective business levels. The cut-off point should be valid for the entire accounting year.
- (ii) Responsibility and validation levels for ensuring proper asset classification may be fixed by the bank.
- (iii) The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines.
- (iv) RBI would continue to identify the divergences arising due to non-compliance, for fixing accountability. Where there is wilful non-compliance by the official responsible for classification and is well documented, RBI would initiate deterrent action including imposition of monetary penalties.

4. INCOME RECOGNITION

4.1 Income Recognition - Policy

- 4.1.1 The policy of income recognition has to be objective and based on the record of recovery. Income from non-performing assets (NPA) is not recognised on accrual basis but is booked as income only when it is actually received. Therefore, banks should not take to income account interest on non-performing assets on accrual basis.

- 4.1.2 However, interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
- 4.1.3 Fees and commissions earned by the banks as a result of re-negotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the re-negotiated or rescheduled extension of credit.
- 4.1.4 If Government guaranteed advances become 'overdue' and thereby NPA, the interest on such advances should not be taken to income account unless the interest has been realised.

4.2 Reversal of Income on Accounts Becoming NPAs

- 4.2.1 If any advance including bills purchased and discounted becomes NPA as at the close of any year, interest accrued and credited to income account in the corresponding previous year, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.
- 4.2.2 If interest income from assets in respect of a borrower becomes subject to non-accrual, fees, commission and similar income with respect to same borrower that have been accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.
- 4.2.3 Banks undertaking equipment leasing should follow prudential accounting standards. Lease rentals comprises two elements – a finance charge (i.e interest charge) and a charge towards recovery of the cost of the asset. The interest component alone should be taken to income account. Such income taken to income account, before the asset became NPA, and remained unrealised should be reversed or provided for in the current accounting period.

4.3 Booking of Income on Investments in Shares & Bonds

- 4.3.1 As a prudent practice and in order to bring about uniform accounting practice among banks for booking of income on

units of UTI and equity of All India Financial Institutions, such income should be booked on cash basis and not on accrual basis.

4.3.2 However, in respect of income from Government securities/bonds of public sector undertakings and All India Financial Institutions, where interest rates on the instruments are predetermined, income may be booked on accrual basis, provided interest is serviced regularly and is not in arrears.

4.4 Partial Recovery of NPAs

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.

4.5 Interest Application

4.5.1 In case of NPAs where interest has not been received for 90 days or more, as a prudential norm, there is no use in debiting the said account by interest accrued in subsequent quarters and taking this accrued interest amount as income of the bank as the said interest is not being received. It is simultaneously desirable to show such accrued interest separately or park in a separate account so that interest receivable on such NPA account is computed and shown as such, though not accounted as income of the bank for the period.

4.5.2 The interest accrued in respect of performing assets may be taken to income account as the interest is reasonably expected to be received. However, if interest is not actually received for any reason in these cases and the account is to be treated as an NPA at the close of the subsequent year as per the guidelines, then the amount of interest so taken to income in the corresponding previous year should be reversed or should be provided for in full.

4.5.3 With a view to ensuring uniformity in accounting the accrued interest in respect of both the performing and non-performing assets, the following guidelines may be adopted notwithstanding the existing provisions in the respective State Co-operative Societies Act:

- (i) Interest accrued in respect of non-performing advances should not be debited to borrowal accounts but shown separately under 'Interest Receivable Account' on the 'Property and Assets' side of the balance sheet and corresponding amount shown under 'Overdue Interest Reserve Account' on the 'Capital and Liabilities' side of the balance sheet.
- (ii) In respect of borrowal accounts, which are treated as performing assets, accrued interest can alternatively be debited to the borrowal account and credited to Interest account and taken to income account. In case the accrued interest in respect of the borrowal account is not actually realised and the account has become NPA as at the close of subsequent year, interest accrued and credited to income account in the corresponding previous year, should be reversed or provided for.
- (iii) The illustrative accounting entries to be passed in respect of accrued interest on both the performing and non-performing advances are indicated in the Annex 3.

4.5.4 In the above context, it may be clarified that overdue interest reserve is not created out of the real or earned income received by the bank and as such, the amounts held in the Overdue Interest Reserve Account can not be regarded as 'reserve' or a part of the owned funds of the banks. It will also be observed that the Balance Sheet format prescribed under the Third Schedule to the Banking Regulation Act, 1949 (As Applicable to Co-operative Societies) specifically requires the banks to show 'Overdue Interest Reserve' as a distinct item on the 'Capital and Liabilities' side vide item 8 thereof.

5. PROVISIONING NORMS

5.1 Norms for Provisioning on Loans & Advances

5.1.1 In conformity with the prudential norms, provisions should be made on the non-performing assets on the basis of classification of assets into prescribed categories as detailed in paragraph 3 above.

5.1.2 Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the bank, the banks should make provision against loss assets, doubtful assets and sub-standard assets as below:

(i) **Loss Assets**

- (a) The entire assets should be written off after obtaining necessary approval from the competent authority and as per the provisions of the Co-operative Societies Act/Rules. If the assets are permitted to remain in the books for any reason, 100 per cent of the outstanding should be provided for.
- (b) In respect of an asset identified as a loss asset, full provision at 100 per cent should be made if the expected salvage value of the security is negligible.

(ii) **Doubtful Assets**

- (a) 100 per cent 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 should be made and the realisable value is estimated on a realistic basis.
- (b) In regard to the **secured portion**, provision may be made on the following basis, at the rates ranging from 20 per cent to 100 per cent of the secured portion depending upon the period for which the asset has remained doubtful:

Period for which the advance has remained in 'doubtful' category	Provision requirement
Up to one year	20 per cent
One to three years	30 per cent

More than three years	- 50 per cent as on March 31, 2006
(i) outstanding stock of NPAs as on March 31, 2006	- 60 per cent with effect from March 31, 2007
	- 75 per cent with effect from March 31, 2008
	- 100 per cent with effect from March 31, 2009
(ii) advances classified as 'doubtful for more than three years' on or after April 1, 2006	- 100 percent

Two illustrations are furnished below for clarity in this regard.

Illustration 1. Existing stock of advances classified as 'doubtful more than 3 years' as on March 31, 2006

The outstanding amount as on March 31, 2006: Rs 25,000

Realisable value of security: Rs 20,000

Period for which the advance has remained in 'doubtful' category as on March 31, 2006: 4 years (i.e. Doubtful more than 3 years)

Provisioning requirement:

As on ...	Provisions on secured portion		Provisions on unsecured portion		Total (Rs)
	%	Amount	%	Amount	
March 31, 2006	50	10000	100	5000	15000
March 31, 2007	60	12000	100	5000	17000
March 31, 2008	75	15000	100	5000	20000
March 31, 2009	100	20000	100	5000	25000

Illustration 2: Advances classified as 'doubtful more than three years' on or after April 1, 2006

The outstanding amount as on March 31, 2006: Rs 10,000/-

Realisable value of security: Rs 8,000/-

Period for which the advance has remained in 'doubtful' category as on March 31, 2006: 2.5 years

Provisioning requirement:

As on	Asset classification	Provisions on secured portion		Provisions on unsecured portion		Total (Rs)
		%	Amt	%	Amt	
March 31, 2006	Doubtful 1 to 3 years	30	2400	100	2000	4400
March 31, 2007	Doubtful more than 3 years	100	8000	100	2000	10000

(iii) **Sub-standard Assets**

A general provision of 10 per cent on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available.

(iv) **Provision on Standard Assets**

(a) From the year ended March 31, 2000, the banks should make a general provision of a minimum of 0.25 per cent on standard assets.

(b) However, unit banks and banks having multiple branches within a single district with deposit of Rs 100 crore and above and all other UCBs operating in more than one district will be subjected to higher provisioning norms on standard asset as under:

i. The general provisioning requirement for 'standard advances' shall be 0.40 per cent from the present level of 0.25 percent. However, direct advances to agricultural and SME sectors which are standard assets, would attract a uniform provisioning requirement of 0.25 per cent of the funded outstanding on a portfolio basis, as hitherto

ii. For personal loans, loans and advances qualifying as capital market exposures and commercial real estate loans provisioning requirement would be 1.0 %.

(c) The provisions towards "standard assets" need not be netted from gross advances but shown separately as "Contingent Provision against Standard Assets" under "Other Funds and

Reserves" {item.2 (viii) of Capital and Liabilities} in the Balance Sheet.

- (d) In case banks are already maintaining excess provision than what is required/prescribed by Statutory Auditor/RBI Inspection for impaired credits under Bad and Doubtful Debt Reserve, additional provision required for Standard Assets may be segregated from Bad and Doubtful Debt Reserve and the same may be parked under the head "Contingent Provisions against Standard Assets" with the approval of their Board of Directors. Shortfall if any, on this account may be made good in the normal course.
- (e) The above contingent provision will be eligible for inclusion in Tier II capital.

(v) Higher provisions

There is no objection if the banks create bad and doubtful debts reserve beyond the specified limits on their own or if provided in the respective State Co-operative Societies Acts.

5.2 Provisioning for Retirement Benefits

Primary (urban) co-operative banks may have retirement benefit schemes for their staff, viz. Provident Fund, Gratuity and Pension. It is necessary that such liabilities are estimated on actuarial basis and full provision should be made every year for the purpose in their Profit and Loss Account.

5.3 Provisioning Norms for sale of financial assets to Securitisation Companies(SC)/ Reconstruction Companies(RC)

- (a) If the sale to SC/RC is at a price below the net book value(NBV) (i.e. book value less the provision held), the short fall should be written off / debited to P&L A/c of that year, subject to the provisions of the co-operative societies acts/rules/administrative guidelines in regard to write-off of debts.
- (b) If the sale is for a value higher than the NBV, the excess provision will not be reserved but will be utilised to meet the shortfall/ loss on account of sale of other assets to SC/RC.

5.4 Guidelines for Provisions in Specific Cases

(i) State Government guaranteed advances

From the year ended March 31, 2006, State Government guaranteed advance and investment in State Government guaranteed securities would attract extant provisioning norms, if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days irrespective of the fact whether the guarantee have been invoked or not.

(ii) Advances granted under rehabilitation packages approved by BIFR/term lending institutions

(a) The existing credit facilities sanctioned to a unit under rehabilitation package approved by BIFR/term lending institutions, should continue to be classified as sub-standard or doubtful asset as the case may be.

(b) However, the additional facilities sanctioned as per package finalised by BIFR and/or term lending institutions, the income recognition and asset classification norms will become applicable after a period of one year from the date of disbursement.

(c) In respect of additional credit facilities granted to SSI units which are identified as sick and where rehabilitation packages/nursing programmes have been drawn by the banks themselves or under consortium arrangements, no provision need be made for a period of one year.

(iii) Advances against fixed/term deposit, NSCs eligible for surrender, IVPs, KVPs, and life policies are exempted from provisioning requirements.

(iv) Advances against gold ornaments, government securities and all other kinds of securities are not exempted from provisioning requirements.

(v) Advances covered by ECGC/DICGC guarantee

(a) In the case of advances guaranteed by DICGC/ECGC, provision should be made only for the balance in excess of

the amount guaranteed by these Corporations. Further, while arriving at the provision required to be made for Doubtful Assets, realisable value of the securities should first be deducted from the outstanding balance in respect of the amount guaranteed by these Corporations and then provision made as illustrated hereunder:

Example

Outstanding Balance	Rs. 4 lakhs
DICGC Cover	50 per cent
Period for which the advance has remained doubtful	More than 3 years
Value of security held (excludes worth of borrower/guarantor)	Rs.1.50 lakhs

Provision required to be made

Outstanding balance	Rs.4.00 lakhs
Less: Value of security held	Rs.1.50 lakhs
Unrealised balance	Rs.2.50 lakhs
Less: DICGC Cover (50% of unrealisable balance)	Rs.1.25 lakhs
Net unsecured balance	Rs.1.25 lakhs
Provision for unsecured portion of advance	Rs.1.25 lakhs (@ 100 per cent of unsecured portion)
Provision for secured portion of advance (as on March 31 2005)	Rs.0.90 lakhs (@ 60 per cent of secured portion of Rs.1.50 lakh).
Total provision required to be made	Rs.2.15 lakhs (as on March 31,2005).

- (b) In case the banks are following more stringent method of provisioning in respect of advances covered by the guarantees of DICGC/ ECGC, as compared to the method given above, they may have the option to continue to follow the same procedure.

6. DIVERSION IN ASSET CLASSIFICATION AND PROVISIONING

- (i) Banks should ensure scrupulous compliance with the instructions for recognition of credit impairment and view aberrations by dealing officials seriously.

- (ii) Banks should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value accounts. Banks should fix a minimum cut off point to decide what would constitute a high value account depending upon their respective levels. The cut off point should be valid for the entire year.
- (iii) The responsibility and validation levels for ensuring proper asset classification may be fixed by the banks.
- (iv) Where there is wilful non-compliance by the officials responsible for classification and is well documented, RBI would initiate deterrent action including imposition of monetary penalties.

7. CLARIFICATION ON CERTAIN FREQUENTLY ASKED QUESTIONS

7.1 Temporary irregularities

7.1.1 Whether a working capital account will become an NPA if the stock statements are not submitted regularly? What should be the period for which the stock statements can be in arrears before the account is treated as an NPA?

Banks should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Considering the practical difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. 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 borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days (with effect from March 31, 2004).

7.1.2 Whether an account will become an NPA if the review/renewal of regular/ad-hoc credit limits are not done when due? What should be periodicity of review/renewal to decide the present status of an account?

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 or have not been renewed within 180 days from the due date/date of ad-hoc sanction will be treated as NPA, which period will be reduced to 90 days with effect from March 31, 2004.

7.1.3 Regularisation of the account around the date of balance sheet

Whether it will be in order to treat a borrowal account as 'standard', if it has been irregular for a major part of the year, but has been regularised near 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. In other genuine cases, the banks must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.

7.1.4 Classification of NPAs where there is a threat to recovery

How should the instructions on classification of NPAs straightaway as doubtful or a loss asset be interpreted and what can be termed as a 'significant credit impairment'?

An NPA need not go through the various stages of classification in case of serious credit impairment and such assets should be straightway classified as a doubtful/loss asset as appropriate. Erosion in the value of security can be reckoned as significant when the realizable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified

under doubtful category and provisioning should be made as applicable to doubtful assets.

7.1.5 Classification of credit facilities under consortium

In certain cases of consortium accounts, though the record of recovery in the account with a member bank may suggest that the account is a NPA, the banks submit that, at times, the borrower has deposited adequate funds with the consortium leader/member of the consortium and the bank's share is due for receipt. In such cases, will it be in order for the member bank to classify the account as 'standard' in its books?

Asset classification of accounts under consortium should be based on the record of recovery of the 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 will be treated as not serviced in the books of the other member banks, and therefore, be treated as NPA. The banks participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead bank or get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

7.1.6 Appropriation of recoveries

What is the practice to be adopted by banks regarding appropriation of recoveries in NPA accounts?

In the absence of a clear agreement between the bank and the borrower for the purpose, banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

7.1.7 Activities allied to agriculture

Our existing guidelines stipulate that advances granted for agricultural purposes may be treated as NPA if interest and/or instalments towards repayment of principal remains unpaid for two harvest seasons but for a period not exceeding two half years. Whether the same norm can be extended to floriculture

and allied agriculture activities like poultry, animal husbandry, etc.?

As indicated in para 2.1.3, the norms for classifying direct agricultural advances (listed in Annex 1), as NPAs have since been revised w.e.f. September 30, 2004.

7.1.8 Overdues in other credit facilities

There are instances where banks park the dues from a borrower in respect of devolved letters of credit and invoked guarantees in a separate account, irrespective of whether the borrower's credit facilities are regular or not. How to determine when the account in which such dues are parked has become an NPA?

A number of banks adopt the practice of parking the dues of the borrower in respect of devolved letters of credit and invoked guarantees in a separate account which is not a regular sanctioned facility. As a result these are not reflected in the principal operating account of the borrower. This renders application of the prudential norms for identification of NPAs difficult. It is, therefore, advised that if the debts arising out of devolvement of letters of credit or invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower's principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

7.1.9 Treatment of loss assets

An NPA account will be classified as a loss asset only when there is no security in the account or where there is considerable erosion in the realisable value of the security in the account. What can be termed as a 'considerable' erosion for the account to be classified as a loss asset?

If the realisable value of the security, as assessed by the bank/ approved valuers / RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off after obtaining necessary permission from the competent authority as per the Co-operative Societies Act/Rules, or fully provided for by the bank.

7.1.10 Valuation of Security

A major source of divergence in provisioning requirement was the realisable value of the primary and collateral security. Can uniform guidelines be prescribed for adoption in this area, at least for large value accounts?

With a view to bringing down divergence arising out of difference in assessment of the value of security it has been decided that in cases of NPAs with balance of Rs.10 lakh and above:

- (a) The current assets and their valuation are looked into at the time of Statutory Audit/Concurrent audit. However, in order to enhance the reliability on stock valuations, stock audit at annual intervals by external agencies could be considered in case of larger advances. The cut off limit and the names of the external agencies may be finalised by the Board.
- (b) Collaterals such as immovable properties charged in favour of the bank should be got valued once in three years by valuers appointed as per the guidelines approved by the Board of Directors.

Master Circular
on
Income Recognition, Asset Classification,
Provisioning & Other Related Matters

Annex 1

(vide para 2.1.2(iv))

1.1 Direct Finance to Farmers for Agricultural Purposes

1.1.1 Short-term loans for raising crops i.e. for crop loans. In addition, advances upto Rs.5 lakh to farmers against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, where the farmers were given crop loans for raising the produce, provided the borrowers draw credit from one bank.

1.1.2 Medium and long-term loans (Provided directly to farmers for financing production and development needs).

(i) Purchase of agricultural implements and machinery

- (a) Purchase of agricultural implements - Iron ploughs, harrows, hose, land-levellers, bundformers, hand tools, sprayers, dusters, hay-press, sugarcane crushers, thresher machines, etc.
- (b) Purchase of farm machinery - Tractors, trailers, power tillers, tractor accessories viz., disc ploughs, etc.
- (c) Purchase of trucks, mini-trucks, jeeps, pick-up vans, bullock carts and other transport equipment, etc. to assist the transport of agricultural inputs and farm products.
- (d) Transport of agricultural inputs and farm products.
- (e) Purchase of plough animals.

(ii) Development of irrigation potential through

- (a) Construction of shallow and deep tube wells, tanks, and hire-purchase of drilling units.
- (b) Constructing, deepening clearing of surface wells, boring of wells, electrification of wells, purchase of oil engines and installation of electric motor and pumps.
- (c) Purchase and installation of turbine pumps, construction of field channels (open as well as underground), etc.
- (d) Construction of lift irrigation project.

- (e) Installation of sprinkler irrigation system.
- (f) Purchase of generator sets for energisation of pumpsets used for agricultural purposes.

(iii) **Reclamation and Land Development Schemes**

Bunding of farm lands, levelling of land, terracing, conversion of dry paddy lands into wet irrigable paddy lands, wasteland development, development of farm drainage, reclamation of soil lands and prevention of salinisation, reclamation of ravine lands, purchase of bulldozers, etc.

(iv) **Construction of farm buildings and structures, etc.**

Bullock sheds, implement sheds, tractor and truck sheds, farm stores, etc.

(v) **Construction and running of storage facilities**

Construction and running of warehouses, godowns, silos and loans granted to farmer for establishing cold storages used for storing own produce.

(vi) **Production and processing of hybrid seeds for crops.**

(vii) **Payment of irrigation charges, etc.**

Charges for hired water from wells and tube wells, canal water charges, maintenance and upkeep of oil engines and electric motors, payment of labour charges, electricity charges, marketing charges, service charges to Customs Service Units, payment of development cess, etc.

(viii) **Other types of direct finance to farmers**

(a) Short-term loans

- (1) To traditional /non-traditional plantations and horticulture.

(b) Medium and long term loans

- 1. Development loans to all plantations, horticulture, forestry and wasteland.
- 2. Financing of small and marginal farmers for purchase of land for agricultural purposes.

Annex 2

Master Circular

On

**Income Recognition, Asset Classification,
Provisioning & Other Related Matters**

(vide para 2.2.11)

PROFORMA

Name of the Bank:

Classification of Assets and Provisioning made against
Non-Performing Assets as on March 31, -----

(Rs.in lakh)

Classification of Assets	No. of A/Cs	Amount Outstanding	Percent age of Col.3 to total loan outstanding	Provision required to be made		Existing provision at the beginning of the year	Provisioning made during the year under report	Total provisions as at the end of the year	Remarks
				%	Amount				
1.	2.	3.	4.	5.	6.	7.	8.	9.	10.
Total loans and advances									
Of which									
A. Standard Assets				0.25					
B. Non-Performing Assets									
1. Sub-standard				10					
2. Doubtful									
i) Upto 1 year									
a) Secured				20					
b) Unsecured				100					
ii) Above 1 year & upto 3 years									
a) Secured				30					
b) Unsecured				100					

iii) Above 3 years Secured									
a) Outstanding stock of NPAs as on March 31, 2006				a) – 50% as on March 31, 2006					
				-60% w.e.f March 31, 2007					
				-75% w.e.f. March 31, 2008					
				-100% w.e.f. March 31, 2009					
b)Advances classified as 'doubtful more than 3 years' on or after April 1, 2006				b) 100% w.e.f. March 31, 2006					
b) Unsecured				100					
Total doubtful assets (i+ii+iii)									
a)Secured									
b) Unsecured									
3.Loss Assets				100					
Gross NPAs (B1+B2+B3)									

Note: Please indicate the manner in which the provision (item 8) has been made/proposed to be made out of the profit of the current year.

Position of Net Advances/Net NPAs

(Rs. in lakh)

Sr. No	Particulars	Current Year	Previous Year
1.	Gross Advances		
2.	Gross NPAs		
3.	Gross NPAs as percentage to Gross Advances		
4.	Deductions		
	- Balance in interest suspense account/OIR*		
	- DICGC/ECGC claims received and held pending adjustment		
	- Part payment of NPA accounts received and kept in suspense account		
	Total Deductions		
5.	Total NPA provisions held (BDDR, Special BDDR Balance after appropriation)		
6.	Net Advances (1-4-5)		
7.	Net NPAs (2-4-5)		
8.	Net NPAs as percentage of Net Advances		

* i.e. accrued interest on NPA accounts if included (capitalised) in loans and advances

CERTIFIED that the non-performing assets have been worked out as per RBI instructions and provisions made accordingly.

Chief Executive Officer

Statutory Auditors

Annex 3

Master Circular on Income Recognition, Asset Classification, Provisioning & Other Related Matters

Vide para 4.5.3(iii)

Illustrative Accounting Entries to be passed in respect of Accrued Interest on both the Performing and Non-performing Advances

I. Accrued Interest on Performing Advances

- (i) It has been clarified in paragraph 4.5.2 and 4.5.3 (ii) of the Master Circular that accrued interest in respect of performing advances may be charged to borrowal accounts and taken to income account. Illustratively, if the accrued interest is Rs.10,000/- in respect of performing advances of a borrower 'X' (cash credit, overdraft, loan account, etc.) the following entries can be passed in the Books of Account.

(Dr) Borrower's account (CC, OD loan) Rs.10,000.00

(Cr) Interest account Rs.10,000.00

- (iii) In case the accrued interest of Rs.10,000/- in respect of the borrowal account is not actually realised and the account has become NPA as at the close of subsequent year, interest accrued and credited to income account in the corresponding previous year, should be reversed or provided for if the same is not realised by passing the following entries:

(Dr) (P&L a/c) Rs. 10,000.00

(Cr) Overdue Interest Reserve Account Rs. 10,000.00

- (iii) In case accrued interest is realised subsequently, the following entries may be passed:

(Dr) Cash/Bank account Rs. 10,000.00

(Cr) Borrower's Account (CC, OD, Loan) Rs 10,000.00

(Dr) Overdue Interest Reserve Account Rs. 10,000.00

(Cr) Interest account Rs. 10,000.00

II. Accrued Interest on Non-Performing Advances

(i) Accrued interest in respect of non-performing advances may be debited to 'Interest Receivable Account' and corresponding amount credited to 'Overdue Interest Reserve Account'. For example, if the interest accrued in respect of Cash Credit/OD/Loan etc. account of a borrower 'Y' is Rs.20,000/- the accounting entries may be passed as under:

(Dr) Interest Receivable Account	Rs.20,000.00
(Cr) Overdue Interest Reserve Account	Rs.20,000.00

(ii) Subsequently, if interest is actually realised, the following accounting entries may be passed:

(Dr) Cash/Bank Account	Rs.20,000.00
(Cr) Interest account	Rs.20,000.00

(Dr) Overdue Interest Reserve Account	Rs.20,000.00
(Cr) Interest Receivable Account	Rs.20,000.00

III. Accounting of Overdue Interest in Loan Ledgers & Balance Sheet

(i) With a view to facilitating the banks to work out the amount of interest receivable in respect of each non-performing borrowal account, banks can consider opening a separate column in the individual ledger accounts of such borrowers and interest receivable shown therein. This would enable the banks to determine at a particular point of time, the amount of interest actually to be recovered from the borrowers. Total of the amounts shown under the separate columns in the loan ledgers would be interest receivable in respect of non-performing advances and it would get reflected as such on the 'assets' side of balance sheet with a corresponding item on the liabilities side of the balance sheet as 'Overdue Interest Reserve'.

(ii) Similarly, a separate column should be provided in the loan ledger in respect of performing advances for showing accrued interest taken to income account on 31 March every year so that a watch can be kept on them. If the accrued interest is not realised and the account becomes NPA in the subsequent year, the amount has to be reversed or provided for

**Guidelines on debt restructuring mechanism
for Small and Medium Enterprises (SMEs)**

(Vide para 2.2.8)

As part of announcement made by the Hon'ble Finance Minister for improving flow of credit to small and medium enterprises, the following guidelines are issued for restructuring of debt of all eligible small and medium enterprises (SMEs).

2. Definition of SMEs-

SMEs are as defined below:

“ At present, a small scale industrial unit is an undertaking in which investment in plant and machinery does not exceed Rs.1 crore, except in respect of certain specified items under hosiery, hand tools, drugs and pharmaceuticals, stationery items and sports goods, where this investment limit has been enhanced to Rs. 5 crore. Units with investment in plant and machinery in excess of SSI limit and up to Rs. 10 crore may be treated as Medium Enterprises (ME). “

3. Eligibility criteria

(i) These guidelines would be applicable to the following entities, which are viable or potentially viable :

- a) All non-corporate SMEs irrespective of the level of dues to banks.
- b) All corporate SMEs, which are enjoying banking facilities from a single bank, irrespective of the level of dues to the bank.
- c) All corporate SMEs, which have funded and non-funded outstanding up to Rs.10 crore under multiple/ consortium banking arrangement.

- (ii) Accounts involving willful default, fraud and malfeasance will not be eligible for restructuring under these guidelines.
- (iii) Accounts classified by banks as “Loss Assets” will not be eligible for restructuring.
- (iv) In respect of BIFR cases banks should ensure completion of all formalities in seeking approval from BIFR before implementing the package.

4. Viability criteria

Banks may decide on the acceptable viability benchmark, consistent with the unit becoming viable in 7 years and the repayment period for restructured debt not exceeding 10 years.

5. Prudential norms for restructured accounts

i) Treatment of ‘standard’ accounts subjected to restructuring

a) A rescheduling of the instalments of principal alone, would not cause a standard asset to be classified in the sub-standard category, provided the borrower’s outstanding is fully covered by tangible security.

b) A rescheduling of interest element would not cause an asset to be downgraded to sub-standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.

ii) Treatment of ‘sub-standard’ / ‘doubtful’ accounts subjected to restructuring

a) A rescheduling of the instalments of principal alone, would render a ‘sub-standard’ / ‘doubtful’ asset eligible to continue in the ‘sub-

standard' / 'doubtful' category for the specified period (as defined in paragraph 7 below), provided the borrower's outstanding is fully covered by tangible security.

b) A rescheduling of interest element would render a sub-standard / 'doubtful' asset eligible to be continued to be classified in sub-standard / 'doubtful' category for the specified period subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved.

c) Even in cases where the sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as sub-standard / 'doubtful'.

iii) Treatment of Provision

a) Provision made towards interest sacrifice should be created by debit to Profit & Loss account and held in a distinct account. For this purpose, the future interest due as per the current BPLR in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate term premium and credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

b) Sacrifice may be re-computed on each balance sheet date till satisfactory completion of all repayment obligations and full repayment of the outstanding in the account, so as to capture the changes in the fair value on account of changes in BPLR, term premium and the credit category of the borrower. Consequently, banks may provide for the

shortfall in provision or reverse the amount of excess provision held in the distinct account.

c) The amount of provision made for NPA, may be reversed when the account is re-classified as a 'standard asset'.

6. Additional finance

Additional finance, if any, may be treated as 'standard asset' in all accounts viz; standard, sub-standard, and doubtful accounts, up to a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the approved restructuring package. If the restructured asset does not qualify for upgradation at the end of the above period, additional finance shall be placed in the same asset classification category as the restructured debt.

7. Upgradation of restructured accounts

The sub-standard / doubtful accounts at para 5 (ii) (a) & (b) above, which have been subjected to restructuring, whether in respect of principal instalment or interest, by whatever modality, would be eligible to be upgraded to the standard category after the specified period, i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period.

8. Asset classification status

During the specified one-year period, the asset classification status of rescheduled accounts will not deteriorate if satisfactory performance of the account is demonstrated during the period. In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment

schedule. The asset classification would be bank-specific based on record of recovery of each bank, as per the existing prudential norms applicable to banks.

9. Repeated restructuring

The special dispensation for asset classification as available in terms of paragraphs 5, 6 and 7 above, shall be available only when the account is restructured for the first time.

10. Procedure

(i) Based on these guidelines, banks registered under the State Acts may formulate, with the approval of the concerned Registrar of the Co-operative Societies, a debt restructuring scheme for SMEs. However, in the case of Multi State Co-operative banks, the above guidelines may be formulated with the approval of the Board of Directors.

(ii) The restructuring would follow a receipt of a request to that effect from the borrowing units.

(iii) In case of eligible SMEs which are under consortium/multiple banking arrangements, the bank with the maximum outstanding may work out the restructuring package, along with the bank having the second largest share.

11. Time frame

Banks should work out the restructuring package and implement the same within a maximum period of 60 days from date of receipt of requests.

12. Review

Banks may review the progress in rehabilitation and restructuring of SME accounts on a quarterly basis and keep the Board and the concerned RCS informed.

13. Disclosure:

It may be ensured that the scheme formulated in this regard as enumerated in para 10 above is brought to the notice of all beneficiaries. The bank may place the scheme on its website and give adequate publicity through other means. A copy may also be forwarded to SIDBI and the concerned Regional Offices of Reserve Bank of India

Banks should also disclose in their published annual Balance Sheets, under "Notes on Accounts", the following information in respect of restructuring undertaken during the year for SME accounts:

(a) Total amount of assets of SMEs subjected to restructuring.

[(a) = (b)+(c)+(d)].

(b) The amount of standard assets of SMEs subjected to restructuring.

(c) The amount of sub-standard assets of SMEs subjected to restructuring.

(d) The amount of doubtful assets of SMEs subjected to restructuring.

**Relaxed Prudential Norms on income recognition, asset classification and provisioning
for Unit banks i.e. banks having a single branch / HO with deposits upto Rs. 100 crore and banks
having multiple branches within a single district with deposits upto Rs. 100 crore**

(vide para 2.1.3)

Sl.No.	Circulars referred to:	Existing Norms	New Norms
1	<p>Asset Classification norm:</p> <p>(i) UBD.No.BSD.1.PCB.12/12.05.05/2001-2002 dated October 5, 2001</p>	<p>(i) W.e.f. March 31, 2004 the norm for classification of an asset as non performing has been reduced to 90 days from 180 days.</p>	<p>(i) These banks will be required to identify NPAs on the basis of 180 day delinquency norm for three more years commencing March 31 2005, i.e. upto March 31, 2007. However, these banks should build up adequate provisions in the BDDR over the next three years such that they would be able to transit to 90 day NPA norm by March 31, 2008. Since the 90 day norm for asset classification came into force w.e.f. March 31, 2004, revised asset classification norm should not result in any write back of provisions. Moreover, accounts classified as NPA as on March 31, 2004 or earlier should not be reclassified as standard</p>

	<p>(ii) UBD.PCB.Cir 17/13.04.00/2004-05 dated September 4, 2004.</p> <p>(iii) UBD.No.BSD.I.15 /12.05.05/2002-03 dated September 11, 2002.</p>	<p>(ii) Gold loans and small loans up to Rs 1 lakh will be governed by the 90 days norm with effect from the year ending March 31, 2007.</p> <p>(iii) W.e.f March 31, 2005 an asset would be classified as doubtful if it remained in the sub-standard category for 12 months.</p>	<p>merely on the basis of 180 days norm, but should be upgraded through the normal process of upgradation.</p> <p>(ii) In view of (i) above, gold loans and small loan upto Rs 1 lakh will also be governed by 180 days norm upto March 31, 2007 (iii) A Sub standard account will continue to be classified as doubtful after 18 months instead of 12 months upto March 31, 2007.</p>
2	<p>Provisioning Norms:</p> <p>(i) UBD.PCB.Cir21/ 12.05.05/2004-05 dated September 29, 2004</p> <p>(ii) UBD.BSD.IP.MC.No.15/ 12.05.05/2004-05 dated December 2, 2004</p>	<p>(i) Sub standard- 10% (ii) Doubtful (up to one year):100% of unsecured portion plus 20% of secured portion (iii) Doubtful (one to three years) : 100% of unsecured portion plus 30% of secured portion (iv) Doubtful for more than 3 years: 100% of unsecured portion. For secured portion the provision are as under: Outstanding stock of NPAs as</p>	<p>The provisioning norms will be as under from year ended March 31, 2005 upto year ending March 31, 2007:</p> <p>(i) Sub standard- 10% (ii) Doubtful (up to one year):100% of unsecured portion plus 20% of secured portion (iii) Doubtful (one to three years) : 100% of unsecured portion plus 30% of secured portion (iv) Doubtful for more than 3 years: 100% of unsecured portion plus 50% of secured portion (v) Loss: 100%.</p>

		<p>on March 31, 2006</p> <ul style="list-style-type: none"> • 50 percent up to March 31, 2006. • 60 per cent as on March 31, 2007 • 75 per cent as on March 31, 2008 • 100 per cent as on March 31, 2009 <p>Advances classified as 'doubtful more than three years' on or after April 1, 2006 -100 %.</p> <p>(v) Loss: 100%.</p>	<p>Note:</p> <p>Implementation of the instructions requiring classification of substandard account into doubtful category after 12 months and 100 % provisioning for secured portion of doubtful assets of over 3 years would be deferred by three years. As such the banks should build up adequate provisions over this period to facilitate smooth transition.</p>
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**Master Circular
on
Income Recognition, Asset Classification,
Provisioning & Other Related Matters**

**A. List of Circulars as of June 30, 2006 consolidated in the
Master Circular**

Sr. No	Circular No.	Date	Subject
1.	UBD.PCB.Cir.57/09.11.600/05-06	15.06.2006	Annual Policy Statement for the Year 2006-07-additional provisioning requirements for standard assets.
2.	UBD.PCB.Cir..20/09.11.600/05-06	24.11.2005	Mid Term Review of Annual Policy Statement for the year 2005-06-additional provisioning requirement for standard assets
3.	UBD.PCB.Cir. 1/09.140.00/05-06	04.07.2005	Income recognition and asset classification norms
4.	UBD.PCB.Cir 42/09.140.00/04-05	30.03.2005	Prudential Norm in respect of Income recognition, asset classification, provisioning and other related matters-procedure for accounting of accrued interest
5.	UBD.PCB.Cir26/09.140.00/04-05	01.11.2004	Prudential Norms-State Government Guaranteed Exposures.
6.	UBD. PCB.Cir 21/12.05.05/04-05	27.09.2004	Annual Policy Statement for the Year 2004-05-additional provisioning requirements for NPAs.
7.	UBD.PCB.cir22/12.05.05/04-05	27.09.2004	Income recognition, asset classification, provisioning-adoption of 90 days norms

8.	UBD.PCB.Cir 17/13.04.00/04-05	04.09.2004	Income recognition, asset classification, provisioning- adoption of 90 days norms
9.	UBD.PCB.Cir 9/13.04.00/04-05	04.08.2004	Income recognition, asset classification, provisioning- adoption of 90 days norms
10.	UBD.PCB.Cir.No.55/12.05.05/2003-04	30-06-2004	Annual Policy Statement for the year 2004-05. Additional Provisioning requirement for NPAs.
11.	UBD.PCB.Cir.No.53/13.05.03/2003-04	30-06-2004	Annual Policy Statement for the year 2004-05. Prudential Norms for Agricultural Advances
12.	UBD.PCB.No.49/12.05.03/2003-04	01-06-2004	Income recognition, asset classification, provisioning norms
13.	UBD.CIR.48/13.04.00/2002-03	22-05-2003	Income recognition, asset classification, provisioning – 90 days norm for recognition of loan impairment – exemptions
14.	UBD.BSD-I No.15/12.05.05/2002-03	11-09-2002	Income recognition, asset classification, provisioning and other related matters
15.	UBD.BSD.I.15/12.05.05/2002-03	11-09-2002	Income recognition, asset classification, provisioning – 12 months norms
16.	UBD.BSD.I.PCB.No.44/12.05.05/2001-02	21-05-2002	-do- Classification of Agricultural Advances
17.	UBD.BSD.I.PCB.22/12.05.05/2001-02	12-11-2001	-do- Treatment of restructured accounts
18.	UBD.No.BSD.I.PCB.13/12.05.05/2001-02	06-10-2001	Divergence in asset classification and provisioning
19.	UBD.No.BSD.I.PCB.12/12.05.05/2001-02	05-10-2001	Income Recognition and asset classification – Adoption of 90 days norm

20.	UBD.No.BSD.I.16/12.05.05/2000-2001	08-12-2000	Income Recognition and asset classification, provisioning and related matters – "Past Due" concept.
21.	UBD.No.BSD.I.PCB/14/12.05.05/2000-01	20-11-2000	Income recognition, Asset Classification and Provisioning
22.	UBD.CO.No.BSD-I.PCB(Cir)34/12.05.05/99-2000	24-05-2000	Income Recognition, Asset Classification, Provisioning and Valuation of Investments
23.	UBD.No.BSD.PCB./25/12.05.05/1999-2000	28-02-2000	Income Recognition, Asset Classification, Provisioning and other related matters
24.	UBD.No.BSD.I/22/12.05.00/99-2000	08-02-2000	Prudential Norms on Income Recognition, Asset Classification and Provisioning – Agricultural loans affected by natural calamities
25.	UBD.No.BSD.I/11/12.05.00/1999-2000	12-10-1999	Clarification on classification of gold loans into Non-performing Assets
26.	UBD.No.BSD.I/2/12.05.05/1999-2000	28-07-1999	Income Recognition, Asset Classification and Provisioning – Concept of Commencement of Commercial Production
27.	UBD.No.BSD-I.29/12.05.05/98-99	23-04-1999	Income recognition asset classification and other related matters
28.	UBD.No.BSD-I.2/12.05.01/98-99	17-07-1998	Prudential norms for Income Recognition, Asset classification and provisioning – Agricultural Advances
29.	UBD.No.I&L.(PCBs)42/12.05.00/96-97	20-03-1997	Prudential norms – Income Recognition, Asset Classification, Provisioning

			and other related matters.
30.	UBD.No.I&L.(PCBs)68/12.05.00/95-96	10-06-1996	Income Recognition, assets classification, provisioning and other related matters Clarifications
31.	UBD.No.I&L (PCB)61/12.05.00/94-95	06-06-1995	Income recognition, asset classification, provisioning and other related matters Valuation of investment and others
32.	UBD.No.I&L(PCB)46/12.05.00/94-95	28-02-1995	Prudential Norms in respect of Income recognition, assets classification, provisioning and other related matters – Procedure for accounting accrued interest
33	UBD.I&L (PCB)37/12.05.00/94-95	09-01-1995	Income recognition, assets classification, provisioning and other related matters
34.	UBD.No.I&L 86/12.05.00/93-94	28-06-1994	Income recognition, assets classification, provisioning and other related matters
35	UBD.No.I&L 63/12.05.00/93-94	01-03-1994	Income recognition, assets classification, provisioning and other related matters
36	UBD.No.48/12.05.00/93-94	14-01-1994	Income recognition, assets classification, provisioning and other related matters
37	UBD.No.45/12.05.00/93-94	24-12-1993	Income recognition, asset classification, provisioning and other related matters clarification regarding credit facilities backed by Government Guarantees
38	UBD.I&L.71/J.1/92-93	17-06-1993	Income recognition assets classification, provisioning and other related matters – clarification
39	UBD.No.I&L.63J-I/92-93	16-04-1993	Income recognition, assets

			classification, provisioning and other related matters
40	UBD.No.I&L.38/J.1-92/93	09-02-1993	Income recognition, assets classification, provisioning and other related matters
41	UBD.No.I&L 51/J.1-90/91	23-02-1991	Classification of Non-Performing Loans

B. List of Other Circulars from which instructions have also been consolidated in the Master Circular

No.	Circular No.	Date	Subject
1.	UBD.No.DS.PCB.Cir.3/13.04.00/2002-03	20-07-2002	Charging of interest at monthly rests
2.	UBD.No.POT.PCB.CIR.No.45/09.116.00/2000-01	25-04-2001	Application of Capital Adequacy Norms to PCBs
3.	UBD.No.DS.PCB.20/13.04.00/97-98	10-11-1997	Compounding of Interest by Primary Co-operative Banks on Agricultural Advances
