

**Prudential Norms on Income Recognition, Asset Classification and Provisioning -
Pertaining to Advances**

Reserve Bank Of India
Department of Banking Operations & Development,
Central Office, Mumbai.

DBOD No. BP.BC/ 20 /21.04.048 /2001-2002

September 1, 2001

Chief Executives of all Commercial Banks
(excluding RRBs and LABs)

Dear Sir

Master Circular- Prudential Norms on Income recognition, Asset Classification and Provisioning pertaining to the Advances Portfolio

As you are aware, the Reserve Bank of India has, from time to time, issued a number of circulars containing instructions/guidelines to banks on matters relating to prudential norms on income recognition, asset classification and provisioning. In order to enable the banks to have all the existing operating instructions on the subject at one place, this Master Circular has been prepared.

2. It may be noted that all the instructions contained in circulars listed in Part A of the Appendix as well as in the relevant paragraphs indicated in Column 3 of Part B of the Appendix have been consolidated. We advise that this master Circular is a compilation of all the instructions contained in these circulars issued by the RBI, which are operational as on the date of this circular.

Yours faithfully

(M.R.Srinivasan)
Chief General Manager- in- Charge

Encl: As above

**Prudential Norms on Income Recognition, Asset Classification and Provisioning -
Pertaining to Advances**

1. General
2. Definitions
3. Income Recognition
4. Asset Classification
5. Provisioning Norms

1. GENERAL

1.1 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.

1.2 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. Also, the provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realisable value thereof.

1.3 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. under the Health Code system also cease to be a supervisory requirement. Banks may, however, continue the system at their discretion as a management information tool.

2. DEFINITIONS

2.1 Non-performing assets

2.1.1 An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. A 'non-performing asset' (NPA) was defined as a credit facility in respect of which the interest and/ or instalment of principal has remained 'past due' for a specified period of time. The specified period was reduced in a phased manner as under:

<u>Year ending March 31</u>	<u>Specified period</u>
1993	four quarters
1994	three quarters
1995 onwards	two quarters

2.1.2 An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvements in the payment and settlement systems, recovery climate, upgradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept, with effect from March 31, 2001. Accordingly, as from that date, a Non-performing Asset (NPA) shall be an advance where

- i) interest and/or instalment 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) interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and
- v) any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

2.1.3 With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days' overdue' norm for

identification of NPAs, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where;

- i) interest and/ or instalment 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) interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and
- v) any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

2.2 'Out of Order' status

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 six months as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as '**out of order**'.

2.3 '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.

3. INCOME RECOGNITION

3.1 Income recognition - Policy

3.1.1 The policy of income recognition has to be objective and based on the record of recovery. Internationally 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.

3.1.2 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.

3.1.3 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.

3.1.4 If Government guaranteed advances become NPA, the interest on such advances should **not** be taken to income account unless the interest has been realised.

3.2 Reversal of income

3.2.1 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.**

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

3.2.3 Leased Assets

- i) The net lease rentals (finance charge) on the leased asset accrued and credited to income account before the asset became non-performing, and remaining unrealised, should be reversed or provided for in the current accounting period.
- ii) The term 'net lease rentals' would mean the amount of finance charge taken to the credit of Profit & Loss Account and would be worked out as gross lease rentals adjusted by amount of statutory depreciation and lease equalisation account.
- iii) As per the '**Guidance Note on Accounting for Leases**' issued by the Council of the Institute of Chartered Accountants of India (ICAI), a separate Lease Equalisation Account should be opened by the banks with a corresponding debit or credit to Lease Adjustment Account, as the case may be. Further, Lease Equalisation Account should be transferred every year to the Profit & Loss Account and disclosed separately as a deduction from/addition to gross value of lease rentals shown under the head 'Gross Income'.

3.3 **Appropriation of recovery in NPAs**

3.3.1 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.

3.3.2 In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

3.4 **Interest Application**

There is no objection to the banks using their own discretion in debiting interest to an NPA account taking the same to Interest Suspense Account or maintaining only a record of such interest in proforma accounts.

3.5 **Reporting of NPAs**

3.5.1 Banks are required to furnish a Report on NPAs as on 31st March each year after completion of audit. The NPAs would relate to the banks' global portfolio, including the advances at the foreign branches. The Report should be furnished as per the prescribed format given in the Annexure.

3.5.2 While reporting NPA figures to RBI, the amount held in interest suspense account, should be shown as a deduction from gross NPAs as well as gross advances while arriving at the net NPAs. Banks which do not maintain Interest Suspense account for parking interest due on non-performing advance accounts, may furnish the amount of interest receivable on NPAs as a foot note to the Report.

3.5.3. Whenever NPAs are reported to RBI, the amount of technical write off, if any, should be reduced from the outstanding gross advances and gross NPAs to eliminate any distortion in the quantum of NPAs being reported.

4. ASSET CLASSIFICATION

4.1 Categories of NPAs

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

- a) Sub-standard Assets
- b) Doubtful Assets
- c) Loss Assets

4.1.1 Sub-standard Assets

A sub-standard asset was one, which was classified as NPA for a period not exceeding two years. With effect from 31 March 2001, a sub-standard asset is one, which has remained **NPA for a period less than or equal to 18 months**. In such cases, the current net worth of the borrower/ guarantor 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 an asset 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.

4.1.2 Doubtful Assets

A doubtful asset was one, which remained NPA for a period exceeding two years. With effect from 31 March 2001, an asset is to be classified as doubtful, if it has remained **NPA for a period exceeding 18 months**. A loan classified as doubtful has all the weaknesses inherent in assets that were 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.

4.1.3 Loss Assets

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.

4.2 Guidelines for classification of assets

4.2.1 Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realisation of dues.

4.2.2 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. Responsibility and validation levels for ensuring proper asset classification may be fixed by the banks.

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.

4.2.3 Accounts with temporary deficiencies

(i) The classification of an asset as NPA should be based on the record of recovery. Bank should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

- a) 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. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the 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 180 days even though the unit may be working or the borrower's financial position is satisfactory.
- b) 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.

4.2.4 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. 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.

4.2.5 Asset Classification to be borrower-wise and not facility-wise

- i) It is difficult to envisage a situation when only one facility to a borrower becomes a problem credit and not others. Therefore, all the facilities granted by a bank to a borrower will have to be treated as NPA and not the particular facility or part thereof which has become irregular.

- ii) If the debits 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.

4.2.6 Advances under consortium arrangements

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.

4.2.7 Accounts where there is erosion in the value of security

- i) A NPA need not go through the various stages of classification in cases of serious credit impairment and such assets should be straightaway classified as doubtful or loss asset as appropriate. Erosion in the value of security can be reckoned as significant when the realisable 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.
- ii) 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 or fully provided for by the bank.

4.2.8 Advances to PACS/FSS ceded to Commercial Banks

In respect of agricultural advances as well as advances for other purposes granted by banks to ceded PACS/ FSS under the on-lending system, only that particular credit facility granted to PACS/ FSS which is in default for a period of two harvest seasons (not exceeding two half years)/two quarters, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS. The other direct loans & advances, if any, granted by the bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

4.2.9 Advances against Term Deposits, NSC's, KVP/IVP, etc

Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.

4.2.10 Loans with moratorium for payment of interest

- i) 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 NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.
- ii) 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

4.2.11 Agricultural advances

- i) In respect of advances granted for agricultural purpose where interest and/or instalment of principal remains unpaid after it has become past due for two harvest seasons but for a period not exceeding two half-years, such an advance should be treated as NPA. The above norms should be made applicable only in respect of short term agricultural loans for production and marketing of seasonal agricultural crops such as paddy, wheat, oilseeds, sugarcane etc. In respect of other activities like horticulture, floriculture or allied activities such as animal husbandry, poultry farming etc., assessment of NPA would be done as in the case of other advances.
- ii) 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, subject to various guidelines contained in RBI circulars RPCD.No.PLFS.BC.128/05.04.02/97-98 dated 20.06.98 and RPCD.No.PLFS.BC.9/05.01.04/98-99 dated 21.07.98.
- iii) 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 NPA. The asset classification of these loans would thereafter be governed by the revised terms & conditions and would be treated as NPA if interest and/or instalment of principal remains unpaid, after it has become past due, for two harvest seasons but for a period not exceeding two half years.

4.2.12 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. With effect from 1st April 2000, advances sanctioned against State Government guarantees should be classified as NPA in the normal course, if the guarantee is invoked and remains in default for more than two quarters. With effect from March 31, 2001 the period of default is revised as more than 180 days.

4.2.13 Restructuring/ Rescheduling of Loans

i) A standard asset where the terms of the loan agreement regarding interest and principal have been renegotiated or rescheduled after commencement of production should be classified as sub-standard and should remain in such category for at least one year of satisfactory performance under the renegotiated or rescheduled terms. In the case of sub-standard and doubtful assets also, rescheduling does not entitle a bank to upgrade the quality of advance automatically unless there is satisfactory performance under the rescheduled / renegotiated terms. Following representations from banks that the foregoing stipulations deter the banks from **restructuring of standard and sub-standard loan** assets even though the modification of terms might not jeopardise the assurance of repayment of dues from the borrower, the norms relating to restructuring of standard and sub-standard assets were reviewed in March 2001. In the context of restructuring of the accounts, the following stages at which the restructuring / rescheduling / renegotiation of the terms of loan agreement could take place, can be identified:

- a) before commencement of commercial production;
- b) after commencement of commercial production but before the asset has been classified as sub standard,
- c) after commencement of commercial production and after the asset has been classified as sub standard.

In each of the foregoing three stages, the rescheduling, etc., of principal and/or of interest could take place, with or without sacrifice, as part of the restructuring package evolved.

ii) Treatment of Restructured Standard Accounts

- a) A rescheduling of the instalments of **principal alone**, at any of the aforesaid first two stages would not cause a standard asset to be classified in the sub standard category provided the loan/credit facility is fully secured.
- b) A rescheduling of **interest element** at any of the foregoing first two stages 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. For the purpose, the future interest due as per the original loan agreement 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 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.
- c) In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be **written off or provision made** to the extent of the sacrifice involved.

iii) Treatment of restructured sub-standard accounts

- a) A rescheduling of the instalments 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**.
- b) 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, **measured in present value terms**, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement 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 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.

- c) In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved. 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.

- iv) Upgradation of restructured accounts

The sub-standard accounts which have been subjected to restructuring etc., whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only 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, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, could also be reversed after the one year period. During this one year period, the sub-standard asset will not deteriorate in its classification 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.

4.2.14 Availability of security/ net worth of borrower/guarantor

The availability of security or net worth of borrower/ guarantor should not be taken into account for the propose of treating an advance as NPA or otherwise, as income recognition is based on record of recovery.

4.2.15 Take-out Finance

Takeout finance is the product emerging in the context of the funding of long-term infrastructure projects. Under this arrangement, the institution/the bank financing infrastructure projects will have an arrangement with any financial institution for transferring to the latter the outstanding in respect of such financing in their books on a pre-determined basis. In view of the time-lag involved in taking-over, the possibility of a default in the meantime cannot be ruled out. The norms of asset classification will have to be followed by the concerned bank/financial institution in whose books the account stands as balance sheet item as on the relevant date. If the lending institution observes that the asset has turned NPA on the basis of the record of recovery, it should be classified accordingly. The lending institution should not recognise income on accrual basis and account for the same only when it is paid by the borrower/ taking over institution (if the arrangement so provides). The lending institution should also make provisions against any asset turning into NPA pending its take over by taking over institution. As and when the asset is taken over by the

taking over institution, the corresponding provisions could be reversed. However, the taking over institution, on taking over such assets, should make provisions treating the account as NPA from the actual date of it becoming NPA even though the account was not in its books as on that date.

4.2.16 Post-shipment Supplier's Credit

- (i) In respect of post-shipment credit extended by the banks covering export of goods to countries for which the ECGC's cover is available, EXIM Bank has introduced a guarantee-cum-refinance programme whereby, in the event of default, EXIM Bank will pay the guaranteed amount to the bank within a period of 30 days from the day the bank invokes the guarantee after the exporter has filed claim with ECGC.
- (ii) Accordingly, to the extent payment has been received from the EXIM Bank, the advance may not be treated as a non-performing asset for asset classification and provisioning purposes.

4.2.17 Export Project Finance

- i) In respect of export project finance, there could be instances where the actual importer has paid the dues to the bank abroad but the bank in turn is unable to remit the amount due to political developments such as war, strife, UN embargo, etc.
- ii) In such cases, where the lending bank is able to establish through documentary evidence that the importer has cleared the dues in full by depositing the amount in the bank abroad before it turned into NPA in the books of the bank, but the importer's country is not allowing the funds to be remitted due to political or other reasons, the asset classification may be made after a period of one year from the date the amount was deposited by the importer in the bank abroad.

4.2.18 Advances under rehabilitation approved by BIFR/ TLI

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, Asset Classification norms will become applicable after a period of one year from the date of disbursement.

5. PROVISIONING NORMS

5.1 General

5.1.1 The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors. The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.

5.1.2 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 paragraphs 4 supra. 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 sub-standard assets, doubtful assets and loss assets as below:

5.2 Loss assets

The entire asset should be written off. If the assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.

5.3 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 20 percent to 50 percent of the secured portion depending upon the period for which the asset has remained doubtful:

Period for which the advance has been considered as doubtful	Provision requirement (%)
Up to one year	20
One to three years	30
More than three years	50

- iii) Additional provisioning consequent upon the change in the definition of doubtful assets (vide para 4.1.2 above) effective from March 31, 2001 has to be made in phases as under:
 - ? As on **31.03.2001**, 50 percent of the additional provisioning requirement on the assets which became doubtful on account of new norm of 18 months for transition from sub-standard asset to doubtful category.
 - ? As on **31.03.2002**, balance of the provisions not made during the previous year, in addition to the provisions needed, as on **31.03.2002**.

Note: Valuation of Security for provisioning purposes

With a view to bringing down divergence arising out of difference in assessment of the value of security, in cases of NPAs with balance of Rs. 5 crore and above stock audit at annual intervals by external agencies appointed as per the guidelines approved by the Board would be mandatory in order to enhance the reliability on stock valuation. 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.

5.4 Sub-standard assets

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

5.5 Standard assets

- i) From the year ending **31.03.2000**, the banks should make a general provision of a minimum of 0.25 percent on standard assets on **global loan portfolio** basis.
- ii) 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.

5.6 Floating provisions

Some of the banks make a 'floating provision' over and above the specific provisions made in respect of accounts identified as NPAs. The floating provisions, wherever available, could be set-off against provisions required to be made as per above stated provisioning guidelines. Considering that higher loan loss provisioning adds to the overall financial strength of the banks and the stability of the financial sector, banks are urged to voluntarily set apart provisions much above the minimum prudential levels as a desirable practice.

5.7 Provisions on Leased Assets

- i) Sub-standard assets
 - (a) 10 percent of the '**net book value**'.
 - (b) As per the 'Guidance Note on Accounting for Leases' issued by the ICAI, '**Gross book value**' of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. Statutory depreciation should be shown separately in the Profit & Loss Account. Accumulated depreciation should be deducted from the Gross Book Value of the leased asset in the balance sheet of the lessor to arrive at the '**net book value**'.
 - (c) Also, balance standing in 'Lease Adjustment Account' should be adjusted in the 'net book value' of the leased assets. The amount of adjustment in respect of each class of fixed assets may be shown either in the main balance sheet or in the Fixed Assets Schedule as a separate column in the section related to leased assets.
- ii) Doubtful assets

100 percent of the extent to which the finance is not secured by the realisable value of the leased asset. Realisable value to be estimated on a realistic basis. **Over and above** provision as per (a) above, the following provision on the **net book value** of the **secured portion** should be made, depending upon the period for which asset has been doubtful:

Period	%age of provision
Up to one year	20
One to three years	30
More than three years	50

- iii) 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 '**net book value**' should be provided for.

5.8 Guidelines for Provisions under Special Circumstances

5.8.1 Government guaranteed advances

- i) With effect from 31 March 2000, in respect of advances sanctioned against State Government guarantee, if the guarantee is invoked and remains in default for more than two quarters (180 days at present), the banks should make normal provisions as prescribed in paragraph 4.1.2 above.
- ii) As regards advances guaranteed by State Governments, in respect of which guarantee stood invoked as on **31.03.2000**, necessary provision was allowed to be made, in a phased manner, during the financial years ending **31.03.2000** to **31.03.2003** with a minimum of 25 percent each year.
- 5.8.2 Advances granted under rehabilitation packages approved by BIFR/term lending institutions
- i) In respect of advances under rehabilitation package approved by BIFR/term lending institutions, the provision should continue to be made in respect of dues to the bank **on the existing credit facilities** as per their classification as sub-standard or doubtful asset.
- ii) As regards the additional facilities sanctioned as per package finalised by BIFR and/or term lending institutions, provision on additional facilities sanctioned need not be made for a period of **one year** from the date of disbursement.
- iii) In respect of additional credit facilities granted to SSI units which are identified as sick [as defined in paragraph 5(a) of RPCD circular No.PLNFS.BC.99/06.02.031/92-93 dated 17.04.93] 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.
- 5.8.3 Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs, and life policies are exempted from provisioning requirements.

5.8.4 However, advances against gold ornaments, government securities and all other kinds of securities are not exempted from provisioning requirements.

5.8.5 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.

5.8.6 Advances covered by ECGC/DICGC guarantee

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 percent
Period for which the advance has remained doubtful	More than 3 years remained doubtful
Value of security held (excludes worth of Rs.)	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 percent of unsecured portion)
Provision for secured portion of advance	Rs. 0.75 lakhs (@ 50 percent of secured portion)
Total provision required to be made	Rs. 2.00 lakhs

5.8.7 Advance covered by CGTSI guarantee

In case the advance covered by CGTSI guarantee becomes non-performing, 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 advances. Two illustrative examples are given below:

Example I

Asset classification status:	Doubtful – More than 3 years;	
CGTSI Cover	75% of the amount outstanding or 75% of the unsecured amount or Rs.18.75 lakh, whichever is the least:	
Realisable value of Security	Rs.1.50 lakh	
Balance outstanding	Rs.10.00 lakh	
<u>Less</u> Realisable value of security	Rs. 1.50 lakh	
Unsecured amount	Rs. 8.50 lakh	
<u>Less</u> CGTSI cover (75%)	<u>Rs. 6.38 lakh</u>	
Net unsecured and uncovered portion:	Rs. 2.12 lakh	
		<u>Provision Required</u>
Secured portion	Rs.1.50 lakh	Rs. 0.75 lakh (@ 50%)
Unsecured & uncovered portion	Rs.2.12 lakh	<u>Rs. 2.12 lakh</u> (100%)
Total provision required		Rs. 2.87 lakh

Example II

Asset classification status :	Doubtful – More than 3 years;	
CGTSI Cover	75% of the amount	

	outstanding or 75% of the unsecured amount or Rs.18.75 lakh, whichever is the least	
Realisable value of Security	Rs.10.00 lakh	
Balance outstanding	Rs.40.00 lakh	
<u>Less</u> Realisable value of security	Rs. 10.00 lakh	
Unsecured amount	Rs. 30.00 lakh	
<u>Less</u> CGTSI cover (75%)	<u>Rs. 18.75 lakh</u>	
Net unsecured and uncovered portion:	Rs. 11.25 lakh	
		<u>Provision Required</u>
Secured portion	Rs.10.00 lakh	Rs. 5.00 lakh (@ 50%)
Unsecured & uncovered portion	Rs.11.25 lakh	<u>Rs.11.25 lakh</u> (100%)
Total provision required		Rs. 16.25 lakh

5.8.8 Take-out finance

The lending institution should make provisions against a 'take-out finance' turning into NPA pending its take-over by the taking-over institution. As and when the asset is taken-over by the taking-over institution, the corresponding provisions could be reversed.

5.8.9 Reserve for Exchange Rate Fluctuations Account (RERFA)

When exchange rate movements of Indian rupee turn adverse, the outstanding amount of foreign currency dominated loans (where actual disbursement was made in Indian Rupee) which becomes past due, goes up correspondingly, with its attendant implications of provisioning requirements. Such assets should not normally be revalued. In case such assets need to be revalued as per requirement of accounting practices or for any other requirement, the following procedure may be adopted:

? The loss on revaluation of assets has to be booked in the bank's Profit & Loss Account.

? Besides the provisioning requirement as per Asset Classification, banks should treat the full amount of the Revaluation Gain relating to the corresponding assets, if any, on account of Foreign Exchange Fluctuation as provision against the particular assets.

5.9 Writing-off of NPAs

5.9.1 In terms of Section 43(D) of the Income Tax Act 1961, income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the RBI in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the bank's profit and loss account or received, whichever is earlier.

5.9.2 This stipulation is not applicable to provisioning required to be made as indicated above. In other words, amounts set aside for making provision for NPAs as above are not eligible for tax deductions.

5.9.3 Therefore, the banks should either make full provision as per the guidelines or write-off such advances and claim such tax benefits as are applicable, by evolving appropriate methodology in consultation with their auditors/tax consultants. Recoveries made in such accounts should be offered for tax purposes as per the rules.

5.10 Write-off at Head Office Level

Banks may write-off advances at Head Office level, even though the relative advances are still outstanding in the branch books. However, it is necessary that provision is made as per the classification accorded to the respective accounts. In other words, if an advance is a loss asset, 100 percent provision will have to be made therefor.

**Reporting Format for Non-Performing
Assets – Gross and Net Position**

[Vide paragraph 3.5]

Name of the Bank:

Position as on

(Rupees in crore up to two decimals)

Particulars	Amount
1. GROSS ADVANCES *	
2. Gross NPAs *	
3. GROSS NPAS AS A PERCENTAGE OF GROSS ADVANCES	
4. Total Deductions (i+ii+iii+iv)	
i) Balance in Interest Suspense account\$	
ii) DICGC/ECGC claims received and held pending adjustment	
iii) Part payment received and kept in suspense account	
iv) Total provisions held **	
5. Net advances (1-4)	
6. Net NPAs (2-4)	
7. NET NPAS AS A PERCENTAGE OF NET ADVANCES	

*excluding Technical write off of Rs. crore.

** excluding amount of technical write off (Rs..... ..crores) and provision on standard assets (Rs.....crore)

\$ banks which do not maintain an Interest Suspense account to park the accrued interest on NPAs, may furnish the amount of interest receivable on NPAs as a foot note to this statement

Note: For the purpose of this Statement, 'gross advances' mean all outstanding loans and advances including advances for which refinance has been received but excluding rediscounted bills, and advances written off at Head Office level (Technical write off).

Appendix

**Master Circular
PRUDENTIAL NORMS**

Part-A

List of Circulars superseded by the Master Circular

No.	Circular No.	Date	Subject	Para No.
1.	DBOD No.BP.BC. 132/ 21.04.048/2000-2001	14.06.2001	Income Recognition, Asset Classification and Provisioning for Advances	4.2.2, 4.2.3, 4.2.4, 4.2.5(ii), 4.2.6, 4.2.7
2.	DBOD No. BP.BC. 128/ 21.04.048/00-01	07.06.2001	SSI Advances Guaranteed by CGTSI –Risk-weight and provisioning norms	5.8.7

No.	Circular No.	Date	Subject	Para No.
3.	DBOD No. BP. BC. 116 /21.04.048/ 2000-2001	02.05.2001	Monetary & Credit Policy Measures 2001-02	2.1.2, 2.1.3
4.	DBOD No. BP. BC. 98/ 21.04.048/ 2000-2001	30.03.2001	Treatment of Restructured Accounts	4.2.13
5.	DBOD No. BP. BC. 40 / 21.04.048/ 2000-2001	30.10.2000	Income Recognition, Asset Classification and Provisioning - Reporting of NPAs to RBI	3.5
6.	DBOD.No.BP.BC.161/21.04.048/ 2000	24.04.2000	Prudential Norms on Capital Adequacy, Income Recognition, Asset Classification and Provisioning, etc.	5.5
7.	DBOD.No.BP.BC.144/21.04.048/ 2000	29.02.2000	Income Recognition, Asset Classification and Provisioning and Other Related Matters and Adequacy Standards - Takeout Finance	4.2.15, 5.8.8
8.	DBOD.No.BP.BC.138/21.04.048/ 2000	07.02.2000	Income Recognition, Asset Classification and Provisioning - Export Project Finance	4.2.17
9.	DBOD.No.BP.BC.103/21.04.048/ 99	21.10.99	Income Recognition, Asset Classification and Provisioning - Agricultural Finance by Commercial Banks through Primary Agricultural Credit Societies	4.2.8
10.	DBOD.No.FSC.BC.70/24.01.001/ 99	17.07.99	Equipment Leasing Activity - Accounting/ Provisioning Norms	3.2.3, 5.7
11.	DBOD.No.BP.BC.45/21.04.048/99	10.05.99	Income Recognition, Asset Classification and Provisioning - Concept of Commencement of Commercial Production	4.2.13
12.	DBOD.No.BP.BC.120/21.04.048/ 98	29.12.98	Prudential Norms on Income Recognition, Asset Classification and Provisioning - Agricultural Loans Affected by Natural Calamities	4.2.11(ii) & (iii)
13.	DBOD.No.BP.BC.103/21.01.002/ 98	31.10.98	Monetary & Credit Policy Measures	4.1.1, 4.1.2, 5.5, 5.8.1

No.	Circular No.	Date	Subject	Para No.
14.	DBOD.No.BP.BC.17/21.04.048/98	04.03.98	Prudential Norms on Income Recognition, Asset Classification and Provisioning - Agricultural Advances	4.2.11
15.	DBOD.No.BP.BC.29/21.04.048/97	09.04.97	Income Recognition, Asset Classification and Provisioning - Agricultural Advances	4.2.11
16.	DBOD.No.BP.BC.14/21.04.048/97	19.02.97	Income Recognition, Asset Classification and Provisioning - Agricultural Advances	4.2.11
17.	DBOD.No.BP.BC.9/21.04.048/97	29.01.97	Prudential Norms - Capital Adequacy, Income Recognition, Asset Classification and Provisioning	4.2.3, 4.2.4, 4.2.6
18.	DBOD.No.BP.BC.163/21.04.048/ 96	24.12.96	Classification of Advances with Balance Less than Rs. 25,000/-	4.1
19.	DBOD.No.BP.BC.65/21.04.048/96	04.06.96	Income Recognition, Asset Classification and Provisioning	4.2.6
20.	DBOD.No.BP.BC.26/21.04.048/96	19.03.96	Non-Performing Advances - Reporting to RBI	3.5
21.	DBOD.No.BP.BC.25/21.04.048/96	19.03.96	Income Recognition, Asset Classification and Provisioning	4.2.6, 4.2.12, 5.10
22.	DBOD.No.BP.BC.134/21.04.048/ 95	20.11.95	EXIM Bank's New Lending Programme Extension of Guarantee-cum-Refinance to Commercial Bank in respect of Post-shipment Supplier's Credit	4.2.16
23.	DBOD.No.BP.BC.36/21.04.048/95	03.04.95	Income Recognition, Asset Classification and Provisioning	3.2.2, 3.3, 4.2.18, 5.8.2(i), (ii)
24.	DBOD.No.BP.BC.134/21.04.048/ 94	14.11.94	Income Recognition, Asset Classification, Provisioning and Other Related Matters	4.2.16, 5.8.2
25.	DBOD.No.BP.BC.58/21.04.048-94	16.05.94	Income Recognition, Asset Classification and Provisioning and Capital Adequacy Norms - Clarifications	5.8.6
26.	DBOD.No.BP.BC.50/21.04.048/94	30.04.94	Income Recognition, Asset Classification and Provisioning	5.8.6

No.	Circular No.	Date	Subject	Para No.
27.	DOS.BC.4/16.14.001/93-94	19.03.94	Credit Monitoring System - Health Code System for Borrowal Accounts	1.3
28.	DBOD.No.BP.BC.8/21.04.04 3/94	04.02.94	Income Recognition, Provisioning and Other Related Matters	3.1.2, 3.4, 4.2.9, 4.2.18, 5.6,5.8.3, 5.8.4, 5.8.5
29.	DBOD.No.BP.BC.195/21.04. 048/ 93	24.11.93	Income Recognition, Asset Classification and Provisioning - Clarifications	4.2.12
30.	DBOD.No.BP.BC.95/21.04.0 48/93	23.03.93	Income Recognition, Asset Classification, Provisioning and Other Related Matters	5.9.1 to 5.9.3
31.	DBOD.No.BP.BC.59/21.04.0 43-92	17.12.92	Income Recognition, Asset Classification and Provisioning - Clarifications	2.1.2,3.2.1, 3.2.2, 4.2.5(i), 4.2.6, 4.2.7(ii), 4.2.10, 4.2.11, 4.2.12, 4.2.14
32.	DBOD.No.BP.BC.129/21.04. 043-92	27.04.92	Income Recognition, Asset Classification, Provisioning and Other Related Matters	1.1, 1.2, 2.1.1, 2.2, 3.1.1,3.1.3, 4.1, 4.1.1, 4.1.2, 4.1.3, 4.2, 5.1, 5.1.2, 5.2, 5.3, 5.4
33.	DBOD.No.BP.BC.42/C.469(W)-90	31.10.90	Classification of Non-Performing Loans	3.1.1
34.	DBOD.No.Fol.BC.136/C.249 -85	07.11.85	Credit Monitoring System - Introduction of Health Code for Borrowal Accounts in Banks	1.3

Part-B
**List of Other Circulars containing Instructions/
 Guidelines/Directives related to Prudential Norms**

No.	Circular No.	Paragraph in the circular which is superseded	Date	Subject	Para No.
1.	DBOD.No.BP.BC.3 5/21.01.002/99	2(iii)	24.04.99	Monetary & Credit Policy Measures	4.2.13(i), 4.2.13 (iv)
2.	DBOD.No.FSC.BC. 18/24.01.001/ 93-94	1(ii), 1(v)	19.02.94	Equipment Leasing, Hire Purchase, Factoring, etc. Activities	2.1, 3.2.3