24th March, 2011

BANK BRANCH STATUTORY AUDIT –

(SHALIMAR BAGH, CPE STUDY CIRCLE)

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Friends, this is an era of technology. Whatever we are going to present you is <u>not a new invention</u> but the result of the technology of <u>copy & paste</u>.

'BEFORE WE START SOME WORK, ALWAYS ASK OURSELVES THREE QUESTIONS :-

- **Why am I doing it,**
- **What the results might be and**
- **Will I be successful.**

- ***Only when we think deeply and find satisfactory answers to these questions, we should go ahead.'***

- Chanakya quotes (Indian politician, strategist and writer, 350 BC-275 BC)

AUDIT OF BANK BRANCHES

Section 228 of Companies Act, 1956

Section 228(1) ; Where the co. has a branch office, the accounts of that office shall be audited by :

I. Company's Auditor appointed u/s 224

II. A person qualified for appointment u/s 226 (Disqualification – Other Assignments, Indebtedness – Credit Cards, Loans, Guarantees)

Companies (Branch Audit Exemption) Rules, 1961

THE BANKING REGULATION ACT , 1949

Section 29 – Accounts and Balance Sheet
– The Form and Content of FS
Third Schedule

- Form-A - Balance Sheet
- Form-B – P&L

Section 30 – Audit

Section 31 – Submission of Returns

BANK BRANCH AUDIT IMPORTANT PUBLICATIONS

- ICAI Guidance Note

- NIRC Publication
- RBI Master Circular
- Third schedule to the Banking Regulation Act, 1949 :
  - Form A – B/S
  - Form B – P&L

GUIDANCE NOTE ON AUDIT OF BANKS

Published by ICAI New Delhi

- Ist Edition November 1994
- VIth Edition February 2009
- VII th Edition March 2011

GUIDANCE NOTE ON AUDIT OF BANKS (2011 EDITION)

- The AASB has recently brought out the 2011 edition of the Guidance Note on Audit of Banks.
- It incorporates important regulatory changes made by RBI through Master & General circulars.
- Effects of revised Standards on Auditing incorporated.
- Appendices to GN contain the formats of EL, AR, WR, AP etc.
- Price – Rs. 750
- Available – ICAI/Regional office/ Branch

GUIDANCE ON AUDIT OF BANKS (2009 EDITION)

Contents of the Guidance Note :

- **Part I** – Knowledge of the Banking Industry : Banking in India, Legal, Accounting & Auditing Framework and Accounting System
- **Part II** - Risk Assessment & Internal Control : Initial Considerations, Risk Assessment & IC and Special Considerations in a CIS Environment
- **Part III** - Item of Bank's Financial Statements and Auditing aspects : **Advances**, Investments, Cash, Balance with RBI & other Banks, money at call and short notice, fixed & other assets, borrowings & deposits, capital, reserves & surplus, other liabilities & provisions, contingent liabilities & BFC, treasury operations, profit & loss a/c, disclosure requirements in FS, consolidation of branch accounts & inter office transactions.

Contd….

Contents of GN contd…..

- **Part IV** – **Long Form Audit Reports** : LFAR in case of Bank & their Branches

- **Part V** - Special Aspects : Basel II, special purpose reports & certificates, compliance report on fraud & other aspects in banks, compliance with SLR requirements & other aspects.

RBI MASTER CIRCULAR
AN IMPORTANT UPDATE

- ***Master Circulars* are a one-point reference of instructions** **issued by the Reserve Bank of India on a particular subject between July-June.**
- **These are issued on July 1 every year and automatically expire on June 30 next year.**
- **We can access the Master Circulars by clicking the link given below:-**
  - http://mastercirculars.rbi.org.in/

INCOME RECOGNITION & ASSET CLASSIFICATION

- **Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances and also Disclosure in Financial Statements – Notes to Accounts**

~~RBI/2010-11/74~~ DBOD.No.BP.BC.21 /21.04.048/2010-11 dated July 1, 2010

~~Master Circular~~ No. DBOD.BP.BC. No.3/21.04.018/2010-11 dated 1st July 2010

Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

~~MC~~

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11. General Principles and Prudential Norms for Restructured Advances

12. Prudential Norms for Conversion of Principal into Debt / Equity

13. Prudential Norms for Conversion of Unpaid Interest into 'Funded Interest Term Loan' (FITL), Debt or Equity Instruments

14. Special Regulatory Treatment for Asset Classification

15. Miscellaneous

contd…

Part B contd….

16 Disclosures

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Agricultural Debt Waiver and Debt Relief Scheme, 2008 (ADWDRS)- Prudential Norms on Income Recognition, Asset Classification, Provisioning, and Capital Adequacy

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MISTAKES AND MISTAKES

- If a politician makes a mistake,
- It is a New Law

If a scientist makes a mistake,

It is a New Invention

If a tailor makes a mistake,

It is a New Fashion

- If an Auditor makes a mistake,
- It is a **Mistake Only**

- GTB
- Satyam

High Risks

MITRA COMMITTEE ON LEGAL ASPECTS OF BANKS FRAUDS

- RBI Circular dated 03.05.2002 on Liability of Accounting & Auditing profession :-

  If an accounting professional, whether in the course of internal or external audit… finds anything susceptible to be fraud or fraudulent activity or act of excess power or smell any foul play in any transaction, he should refer the matter to the regulator.

  Any deliberate failure on the part of the auditor should render himself liable for action.

COMMON FRAUD RISK FACTORS

- **Management & Employee frauds :-**
  - Deposits –
    - Camouflage of depositors
    - Unrecorded deposits
    - Theft from Dormant A/c's
  - Lending –
    - loans to fictitious borrowers
    - Connected parties transactions
    - Kick Backs & inducements
    - Selling recovered collaterals below MP
    - Bribe taking
    - Theft of collaterals

…….Contd.

…..Contd.

- External Frauds :-
  - Deposits –
    - Money Laundering
    - Fraudulent instructions
    - Counterfeit currency
  - Lending –
    - Impersonation & false information on loan applications
    - Fraudulent valuations
    - Misappropriation of loan funds by agents / customers

BANKING RISKS

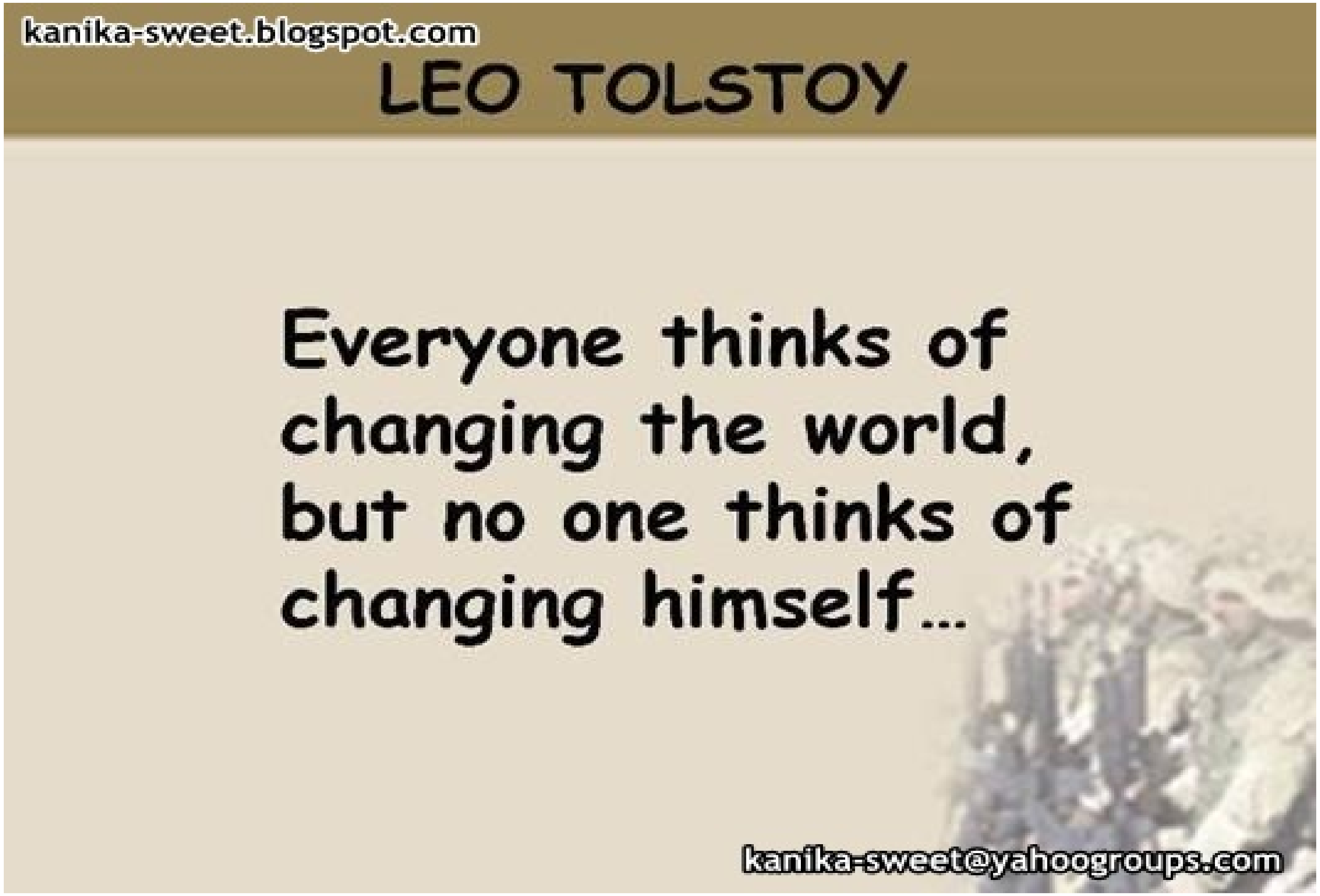
- Banking has became more complex
- subjected to greater Risks
- comments on Risk culture
- assessment of Internal Control,
- accuracy of MIS Reports,
- Preventive in Spirit.
- Solution providing.

Risk identification
Risk Assessment
Risk Measurement
Risk Control
Risk Mitigation
Risk Monitoring

STANDARDS ON AUDITING

- Audit Report …….
- Para (2) states:

"We conducted our audit in accordance with the <u>auditing standards </u>generally accepted in India. Those standards require that <u>we plan & perform</u> the audit to obtain reasonable assurance….."



Standards on Auditing……

We shall have to Divorce the habit of non observance of Standards on Auditing.

STANDARDS ON AUDITING

S.No.	Particulars	SA	AAS
1.	Overall objectives of the Independent auditor & the **Conduct of an Audit** in accordance with Standards on Auditing	200	01 & 02
2.	Agreeing the terms of **Audit Engagement**	210	26
3.	**Quality control** for audit work	220	17
4.	Audit **Documentation**	230	03
5.	The Auditor's **responsibilities relating to fraud** in an audit of financial statements	240	04
6.	Consideration of **law & regulations** in an audit of financial statements	250	21
7.	**Communicating** with those charged with governance	260	27
8.	Knowledge of Business (Deleted w.e.f. 01-04-08)	-	-
9.	Communicating **deficiencies in Internal control** to those charged with Governance & Management	265	-
10.	**Planning** an Audit of financial statements	300	8
11.	**Identifying & assessing the risk** of material misstatement through understanding the entity & it's environment	315	-
12.	**Materiality** in planning & performing an audit	320	13
13.	Auditor's responses to **assessed risks**	330	-

S.No.	Particulars	SA	AAS
15.	**Audit Evidence**	500	5
16.	External confirmations	505	30
17.	Initial audit Engagements – opening balances	510	22
18.	**Analytical Procedures**	520	14
19.	**Audit Sampling**	530	15
20.	Related Parties	550	23
21.	**Subsequent Events**	560	19
22.	**Written Representation**	580	11
23.	**Using the work of an another Auditor**	600	10
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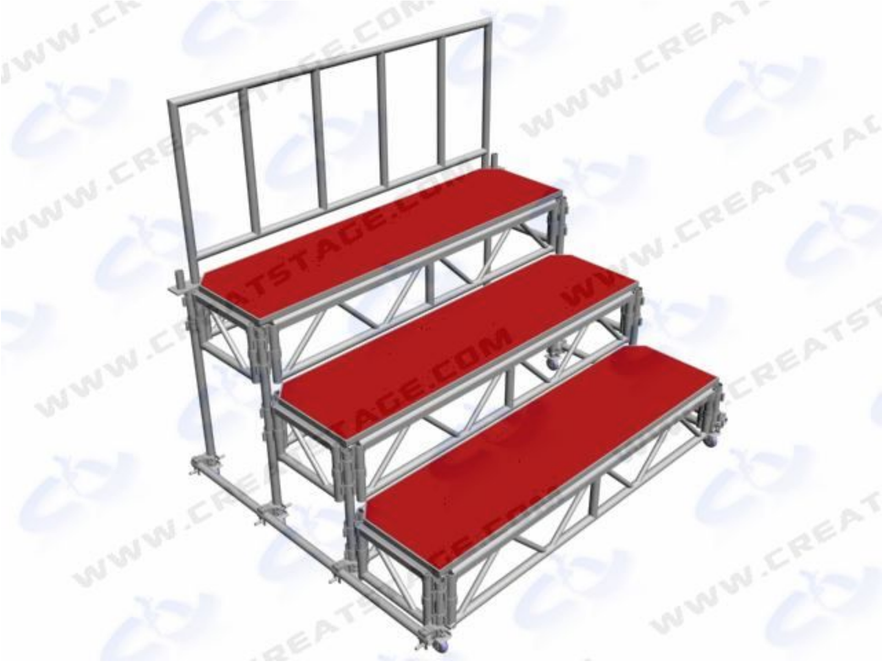
26.	The Auditor's responsibility in relation to other information in documents containing Financial Statements	720	-

AUDIT STAGES - 5

1) Accepting the Audit
2) Planning the Audit
3) Performing the Preliminary Audit
4) Performing the Final Audit
5) Reporting the Audit



STAGE –I: ACCEPTING THE AUDIT

- NOC - Previous auditor.

- Audit engagement letter (AEL)-SA-210. AEL

- Key Informations from the management:
  - Accounting policies & any changes in it.
  - Closing guidelines & instructions
  - Closing activities taken care:
    - Centrally at data centre/ HO &
    - At branches.

Contd…

ACCEPTANCE CONTD…

- Software applications used
- audit exception reports
- policies, system & procedures,
- guidelines & instructions of the controlling authorities.
- Written confirmation of readiness of:
  - records/ information &
  - exception/ analytical reports (Annx. A).

Contd…

ANNEXURE A

- Audit exception / Analytical Reports

- **For B/S and P&L a/c Audit:**

  - Age wise & nature (head) wise classification of all office accounts.
  - Advances disbursed by transferring to deposit accounts.
  - Abnormal transaction in term deposit account.
  - GL error report
  - Accounts having minimum interest rate pegged.
  - Interest applied/ failed report for deposits.
  - Interest applied/ failed report for deposits.
  - Loan accounts with Zero interest rate.

STAGE-II : PLANNING THE AUDIT

Understand the entity & its environment:

- SA 300 revised "planning an audit of financial statement"
- SA 315, "identifying & assessing the risk of material misstatements through understanding the entity & its environment".
- Questionnaire to assess Internal control environment (Letter of requirements) LOR

Contd…

Audit Planning Contd….

- Draft Engagement Letter (~~EL~~)
- Draft Requirement Letter (~~LOR~~)
- Request Physical Verification (~~PV~~)
- Draft Bank Audit Program (~~AP~~)
- Written Representation Letter.
- Tax audit in terms of Sec. 44 AB
- Draft Audit Sampling
- Checklist for Verification of Advances & Reporting In LFAR.

Audit Staff

- Identified & Made familiar with:-
  - Nuances of the Bank Audit
  - Issues generally raised
  - Documentations to be obtained
  - Manner & extent of verification
  - Reporting & certifying requirement
  - Previous year audit files
  - ICAI Guidance Note
  - Conceptual difficulties or queries geared up
  - Applicable RBI Circulars- www.rbi.org.in
  - Bank Audit seminar Compilations

Contd…

Audit Planning Contd….

Certification of :-

- Balance Sheet
- Profit & Loss Account
- Tax Audit Report
- LFAR
- Ghosh & Jilani Committee
- Other Certificates

Contd…

Carrying out preliminary analytical reviews:

- SA-520, "analytical procedures" to identify the risk of material misstatements.
  - Comparing following trends & ratios of current year with that of the previous year:
  - Operating profits to total income (%)
  - Net profit to total incomes (%)
  - Operating expenses to total incomes (%)
  - Non-interest incomes to operating profits (%)
  - Deposits
  - Advances
  - NPA

Contd…

- Comparing near quarter-end figures of deposits & advances.
- Carrying out correlations – would help identifying various errors/ inconsistencies, such as:
  - a) correlation of P&L items with B/S items would reveal accounting errors & inconsistencies.
  - b) correlation of non-financial events with financial events would held reveal error of omission & inconsistencies.

Contd…

Audit Planning Contd….

Initial Audit Discussions

- Comparative Cost of Various category of deposits.
- Comparative Yield on Various category of Advances

Details needed in the LFAR

- Independent Audit Trail.
- Confirmations.
- Copies of expert opinion, if any, relied upon.
- To get familiarized with:-
  - Branch's transactional Volumes,
  - Level of Advances & Deposits,

STAGE III- PERFORMING THE PRELIMINARY AUDIT

- Individual account balances reports – un-located/ un-reconciled/ balances lying therein, ledger accounts opened in appropriate accounts heads/ GL subhead etc…
- Error/ inconsistency in balancing by scrutinizing the GL error report. Comparing B/S of current year with grouping of all sub heads into B/S head.
- Analysis of variance for incomes & expenditures with that of previous year.

Using the work of internal auditor:

- SA-610 (Revised) states "in order for the external auditor", evaluate & perform audit procedures to determine its adequacy.

Contd…

AUDIT EXECUTION

- Orderly & coherent execution of audit procedures,
- Minimizing probabilities of lapses & duplication of work.
- Articles a risk focused systematic approach to plan, perform & report the audit.
- Help managing the time budget, besides documenting the audit simultaneously- results in quality audit in timely fashion

- *The main Borrower Accounts,*
- *Software System in Operation,*
- *Key NPA Accounts,*
- *Key Areas of Concern,*

Contd…

Performing the Preliminary Audit Contd.….

- *Organizational Structure,*
- *Discussion with the branch head & staff,*
- *Entire set of previous year's signed accounts,*
- *Concurrent, Stock, Internal Audit, RBI Inspection, System Audit & other Audit Reports,*
- *Internal Circulars, policies & guidelines of Bank, schedule of Service Charges, Delegation of financial powers, MIS reports generated.*

STAGE IV- PERFORMING THE FINAL AUDIT

- Para 20 of SA 330 "***Auditor's responses to the assessed risks",*** would be worthwhile. Irrespective of the assessed risk of material misstatement, the auditor shall determine & perform substantive procedure for each class of transactions, account balances, & disclosures.

Contd…

Performing the Final Audit Contd…

- **Office accounts:**
  - Sundries, suspense, intermediary accounts, periodical control returns of office accounts, scrutinize the full ledger accounts to examine the correctness of pruning of entries at year end (age wise & nature wise break up).

- **Incomes & Expenditures:**
  - System generated interest applied/ failed reports.

- **Material journal entries/ year end adjustment:**
  - Comparing pre-closing & post-closing trial balance & comparing adjustment account with that of the previous year, would also help identifying any apparent omission/ discrepancies.

STAGE V- REPORTING THE AUDIT

- SA-700 i.e.. qualified. disclaimer or adverse report. **AR** **LFAR**

Disclaimers ?? would be in the nature of:-

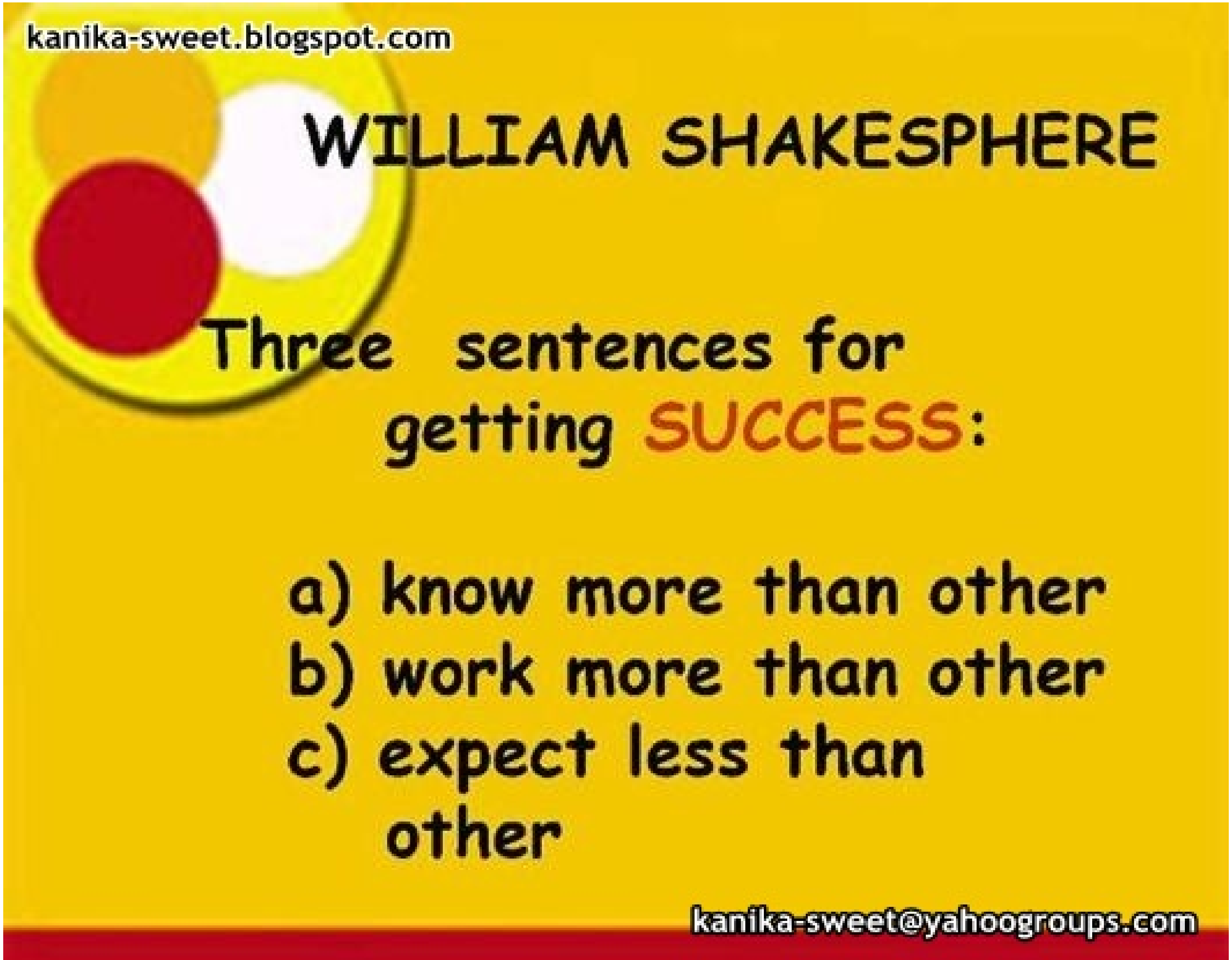
- *Days actually spent on Audit.*
- *Written representations not obtained.*
- *Information's & explanations not received.*
- *Use of audit sampling.*
- *Reliance on other audit reports & MIS.*
- *Reliance on the accuracy of the system rather than system audit in depth.*
- *Other disclaimers increasing audit liability without commensurate availability of audit evidence.*
- *Constraints, if any, on availability of information, internal circulars, guidelines, access to the system, staff seating arrangements, should be reported.*

Contd…

DISCLOSURES TO ANNUAL ACCOUNTS THROUGH NOTES TO ACCOUNTS

To be certified by Statutory Branch Auditor:

1. Asset Liability Management (**ALM**),
2. Non-Performing Assets – Provision,
3. Restructuring undertaken in Advance Accounts,
4. Customer Complaints & awards passed by the Banking Ombudsmen,
5. Unsecured Advances – Collateral intangible securities such as charge over the right, licences, authorizations, etc,
6. Letter of Comfort (**LOCs**),


kanika-sweet.blogspot.com
WILLIAM SHAKESPHERE
Three sentences for getting SUCCESS:
a) know more than other
b) work more than other
c) expect less than other
kanika-sweet@yahoogroups.com

ABBREVIATIONS

- Let us understand some of the important terminologies commonly in use in bank branches to equip ourselves & to enhance our knowledge

(List)

AUDIT WORKING PAPERS AND DOCUMENTATION (SA-230)

- Appointment Letter acceptance,
- Requisite declarations & indemnities,
- NOC from the previous Statutory Auditor,
- Engagement Letter,
- Letter of Requirements
- Pre Audit Meeting with Bank Officials,
- Bank's Yearly Closing Instructions,
- Bank Audit Programme,
- Significant audit observations,
- Accounting Policies followed,
- Written Representations.

AUDIT IN CBS ENVIRONMENT

- Pressure of the management's deadlines - tend to approach auditing frantically, omitting/ duplicating the many audit procedures- poor quality audit, completion delays.

- Effective & timely audit - risk focused planning & systematic management of audit procedures.

KEY POINTS – BANK BRANCH AUDIT

- An early start - adherence to the deadlines
- **KOB**.
- Audit planning – Pre & Post
- Effective Discussions
- Testing of Internal Control
- Risk Assessment
- Audit Working Papers
- Effective Audit Sampling
- Skillful use of MIS Reports
- Management Written Representation
- Obtaining Discussion Certificate

Contd…

KEY POINTS CONTD....

- Ensuring compliance with **RBI** circulars especially regarding **NPA** identification, classification & provisioning.
- Detailed B/S & P&L scrutiny
- Clear & specific replies to questions in:
  - **LFAR**
  - Ghosh/ Jilani committee reports,
  - Mandatory certifications
  - Tax audit report.
  - Giving appropriate disclaimers
  - Qualifications wherever warranted.
  - **MOC** if warranted.

LONG FORM AUDIT REPORT (LFAR)

- ❖ Comments - specific & rational and not vague.
- ❖ Instances of shortcomings/ weaknesses
- ❖ Sufficiently detailed and quantified

- Not exhaustive – any other matter to be reported.
- Specific comments on:
  - The KYC compliance,
  - Disaster recovery policy,
  - Business continuity Planning,
  - Outsourcing policy,
  - Mobile & internet banking policy,
  - Data retention,
  - Security policy - physical security, e-mail policy,
  - Fraud & risk policy – identifying errors & weaknesses, providing remedies & solutions.

Contd…

SPECIFIC DISCLOSURES

- Extent of checking
- Manner of sample selection
- Limitation of documents verified
- Representations received
- Reliance placed on computer system
- Non testing of depth of computer system for its reliability
- Significant problems faced e.g., Availability of information, Computer systems, etc.

LFAR CONTD…..

- **For LFAR Procedure:** (LFAR)
- Overdue stock/ book debts/ QIS statements.
- Overdue review/ renewals of credit limits.
- Expired insurances/ under insurances of securities.
- Overdue inspection of securities.
- Overdue renewals of loan documents.
- Overdue valuations of fixed assets charged in NPA.
- TDRs where lien has been lifted.
- Loans against TDR where lien not marked.
- Cash balance above the cash retention limit.
- Accounts having sanction limit exceeding Rs. 5 cr.

SPECIFIC ISSUES

- L/Yr MOC – Compliance.
- Analytical review :
  - Variances (>20%-YOY) - B/S and P&L.
  - Debit balances in Income a/c,
  - Credit balance in Expense a/c,
  - Debit balance in Liability a/c,
  - Credit balance Asset a/c.
  - Independent bank Balance Confirmations.
  - Detailed proofing of Major B/S items.
  - Ledger scrutiny of Suspense & Sundries a/c.

Contd…

SPECIFIC ISSUES CONTD…

- Bank & Inter-Branch Reconciliation- pipeline entries passed subsequently need to be given effect to by way of MOC.
- Physical verification & numbering of FA.
- Upgradation of NPA – clearance of all over dues.
- Date of classification of NPA – to be strictly reckoned from the due date.
- Regularization of NPA account – a solitary cash or transfer entry close to the year end.
- Ever Greening of accounts- unwarranted restructuring or sanction of additional limits.
- Annexure to the B/S – accuracy & corroboration.

Audit Programme

AP

- Testing of Internal Controls.
- Control/ Exception MIS report, internal policies, rules, procedure & guidelines.
- Audit program drawn pre-audit, then modified post audit.
- Various risks-
  - Operational,
  - Market,
  - Financial,
  - Reputational,
  - Strategic,
  - Business,
  - Systemic,
  - Regulatory, etc..

Contd…

AUDIT PROGRAMME CONTD…..

- **For IRAC Compliance Audit:**
  - Accounts where moratorium period expired & interest flag "N"
  - Sub standards accounts restructured during the year.
  - Standards accounts rescheduled during the year.
  - Transaction turnover in CC account.
  - Report on overdue installments & interest in loan account.
  - Accounts where value of security is less than drawing power.
  - Accounts out of order for more than 90 days.
  - Sub standard NPA upgraded during the year.

Contd…

Monitoring

- Audit progress at the end of every day.
- **LFAR updated on an ongoing basis.**
- MIS reports being generated.
- Audit delays - communicated to RO/ ZO due to :
  - control weaknesses,
  - lack of availability of information,
  - non- cooperation

- Audit issues - regular discussions.
- Doubts – help from CSA.


Thank you

(May be suitably amended according to the circumstances & requirements)

Dated..

Assistant General Manager,
Bank …,
Address…..,

Dear Sir,

Sub :- Statutory Branch Audit 2010-11.
Reg :- Audit Engagement / Management Representations

- We are thankful to your head office to have appointed us as the statutory auditors to audit and report on the accounts of your Branch for the year 2010-11.

- We have already sent our acceptance on the appointment to your Zonal Office on 09.03.2010, and hereby confirm that the audit shall be carried out in accordance with the applicable legal provisions and the regulatory requirements, besides the applicable authoritative pronouncements of the Institute of Chartered Accountants of India, with the objective of expressing an opinion on the Branch financial statements. We are pleased to confirm our understanding of this engagement by means of this letter.

- We will conduct our audit in accordance with the Standards on Auditing (SAs) issued by the Institute of Chartered Accountants of India and with the requirements of the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934 and the guidelines issued under the said statutes from time to time. Those Standards require that we comply with the ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend upon the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

- Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs.

- In making our risk assessments, we consider internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

- For this purpose we shall have to perform sufficient tests to obtain reasonable assurance as to whether the information contained in the accounting records and other source data is reliable and sufficient as the basis for the preparation of the financial statements; and whether the information is properly presented in the said statements.

- We wish to clarify that the responsibility for the preparation of the financial statements including adequate disclosure is that of the Management, and this includes;

    - the maintenance of adequate accounting records and internal controls,
    - the selection and consistent application of appropriate accounting policies, including
    - implementation of applicable accounting standards along with proper explanation relating to any material departures therefrom.

….. 2

- The management is also responsible for making judgments and estimates that are reasonable and prudent, so as to give;

    - a true and fair view of the state of affairs of the Branch at the end of the financial year and
    - of the profit or loss of the Branch for that year, and
    - the safeguard of the assets of the Bank/ Branch.

- We will conduct our audit in accordance with the auditing standards generally accepted in India and with the requirements of law. These Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

- An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

- However, having regard to the test nature of an audit, persuasive rather than conclusive nature of audit evidence together with inherent limitations of any accounting and internal control system, there is an unavoidable risk that even some material misstatements of financial statements, resulting from fraud, and to a lesser extent error, if either exists, may remain undetected.

- In addition to our report on the financial statements, we expect to provide you a separate letter through Long **Form Audit Report (LFAR)**, concerning material weaknesses in accounting and internal control systems, which might come to our notice during our test verifications.

- The responsibility for the preparation of financial statements on a going concern basis is that of the management.

- We also wish to invite your attention to the fact that our audit process is subject to ‘peer review’ under the Chartered Accountants Act, 1949. The reviewer may examine our working papers during the course of our peer review.

….. 3

- **We wish to complete certain audit procedures even prior to the year-end, depending on your state of readiness and your confirming to us so that we are able to complete the audit at an early date.**

- In view of the severe time constraints imposed on us, we are confident you will make available to us, within the dates stipulated, the Branch returns/statements duly completed, pre-reviewed and duly authenticated, to enable us to furnish our reports in the form and manner desired of us by law or by the Reserve Bank of India and not necessarily in the form and manner prescribed by the Bank.

- The Branch returns on which we are expected to furnish our reports, would be the financial statements that correspond to financial year 2010-11, basically consisting of:
  - the Balance Sheet with related details
  - the Profit & Loss Account with related details

- the statement relating to the particulars of Advances and other supporting returns/statements/annexure
  (including those covering the LFAR requirements)

- informations/ clarifications as stated in Annexure "I" to this letter in connection with our assignment, may please also be expedited.

- To enable us to monitor the progress of the audit and completion of the assignment, please indicate/mention, the actual date(s) of completion as well as handing over to us of each statement/return/confirmation required to be prepared by you (as per the contents of the letter of appointment sent to us), by your endorsement on each such statement/return/confirmation; as also on the Management Representation letter required to be furnished by you to us. **This is imperative for our records and necessary action.**

- As part of the audit process, we will expect to receive from the management, written confirmation of the representations made to us **& a written response (Para-wise), to our requirements is imperative, and such response is to be based on your verification of facts**.

….. 4

- Please note that we shall be in a position to take up the audit of the financial statements for the purpose of our report, only upon completion by you, in its entirety, of all the returns/schedules/statements/information sought, and **upon receipt of your response in writing to this communication.**

- We shall be grateful if you could confirm the name(s), telephone numbers and the e-mail address of the Officer(s) designated by the Branch to comply with our requirements in connection with the audit, so that our checking as well as the reports are expedited.

- **We are willing to start the audit exercise from ….nd March, 2011 itself, subject to your suitability and confirmation to be able to complete the audit exercise by 9th April as desired by your Head Office.**

- We shall greatly appreciate your co-operation in the matter.

- Please acknowledge the receipt and **arrange to send us the duplicate copy of this letter as a token of your acceptance of the Audit Engagement Letter along with your confirmatory letter itself.**

Thanking you and assuring you of our best services,

For ……………………………,
Chartered Accountants
(Regn. No - ……….)

Sd/-
Membership No. ……..

REPORT OF THE BRANCH AUDITOR TO THE STATUTORY AUDITORS ON THE AUDIT OF ACCOUNTS OF …………….BRANCH OF, BANK……… FOR THE YEAR 2010-11

We have audited the attached Balance Sheet of the ……….., Branch of Bank…… as at 31.3.2011 and the Profit and Loss Account of the said Branch for the year ended on that date, which has been drawn up in conformity with Forms 'A' and 'B' respectively of the Third Schedule to the Banking Regulation Act, 1949.

The preparation of these financial statements is the responsibility of the Bank's management which includes the design, implementation and maintenance of internal control relevant to the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Our responsibility is to express an opinion on these financial statements, based on our Audit. We conducted our audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material mis-statement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in financial statements. The procedure selected depends on the auditor's judgment, including the assessment or risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to company's preparation and fair presentation of financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness accounting policies used and the reasonableness of the accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence that we have obtained is sufficient and appropriate to provide basis for our audit opinion.

On the basis of the audit indicated herein, and as required by the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, and subject to the limitations of disclosures required therein, we report as under:

Provisions/Adjustments

No adjustments/provisions have been made in the accounts of the Branch in respect of matters dealt with at Head Office, including in respect of:

a) Bonus, ex-gratia, and other similar expenditure and allowances to branch employees;

b) Terminal permissible benefits to eligible employees on their retirement including additional retirement benefits, Gratuity, Pension, liability for accumulated leave encashment benefits and other benefits covered in terms of ‘AS 15 (R)– Employee Benefits’ issued by ICAI;

c) Arrears of salary/wages/allowances as well as staff contractual obligations, if any, payable to staff;

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d) Provisions in respect of advances as per the applicable prudential norms and Guidelines of the Reserve Bank of India and the Bank’s policy in line therewith (including on standard advances, floating, adhoc/generic provisions covering weak standard advances; and

e) Provision for Taxation (subject to adjustments for deferred tax)

f) Items in suspense, Clearing Differences, Credit Cards, Frauds/vigilance cases involving claims/liability or loss to the Bank and other provisions on behalf of the Branches, including for losses arising from frauds discovered if any.

g) Provision for Interest on overdue Term Deposit.

h) Provision for Interest on Saving Bank Deposits beyond the cut off date.

We further state that;

i. Commission Income in respect of government and third party business done by the branch has been accounted for on cash basis. Further such income is advised by the Head Office and in absence of the working details, we are not able to verify the accuracy and correctness of the commission so received by the branch.

ii. The Bank has accounted income of Locker rent on cash basis. .

iii. The interest income and interest expense received and paid to Head Office on average deposits and advances could not be verified in absence of working details thereof, as the entries are stated to have been worked out and transferred by the Head Office.

Subject to what is stated above, the **Memorandum of Changes,** having effect on the financial statements to the extent as quantified as above and to the extent not ascertained at the Branch, including subject to other adjustments usually made at the Central/Head Office of the Bank, in our opinion and to the best of our information and according to the explanations given to us, and as shown by the books of the Branch and read with the Accounting Policies of the Bank (to the extent made known to us and as applicable to the Branch), we report that:

a) the Balance Sheet as at 31.3.2011 of the said Branch of the Bank, as authenticated by us, subject to observations as above, is a full and fair Balance Sheet of the Branch containing the necessary particulars and is properly drawn up so as to exhibit a true and fair view of the affairs of the Branch as at 31.3.2011.

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b) the Profit and Loss Account authenticated by us, subject to observations as above, shows a true balance of the profit of the Branch for the year-ended 31.3.2011.

c) we have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of audit and have found them to be satisfactory.

d) transactions of the Branch, which have come to our notice, have been within the powers of the Bank.

e) the Balance Sheet and Profit and Loss Account of the Branch are in agreement with the books of accounts.

For …………………..,
(Chartered Accountants)
(Regn No. ……..)

Sd/-
(M No. ……)

Place :
Date :

Statutory Bank Audit (F.Yr.10-11)
Banks…….

Audit Program - Advances

Advances :	Remarks
List of advances in excess of 5% of total advances (ITEM 5) – Branch	
List Of Advances For Rs.2.00 Crores And Above (Item 5) Branch Compare Advance Returns With Calender Of Returns	
Chart Of Powers For Advance Sanctions	
Loans Repayable On Demand + ST Loans with maturity upto 1 Year – to be classified as CC/OD/Dl – Sch 9 Item A(Ii) / (C Cir Item 3)	
Credit Appraisal ;	
Procedure/Instructions Followed (Item 5.A) ?	
Credit Facilities sanctioned beyond delegated authority Reported To CA ? (Item 5.B)	
Advances Disbursed Without Complying With Terms & Conditions ? (Item 5.B)	
Facility Released Without Documentation ? (Item 5.C)	
Non Registration Of Charges Non Obtaining Of Guarantee? (Item 5.C)	
All Lien Noted On Deposits ? (Item 5.C) Th. System	
Analysis Of Accounts Overdue For Review/Renewal For ? (Item 5.D) ;	
Six Months One Year	
Over One Year	
Advances Less Than 0.25 Classification NPA ?	
L/Yr Sub Std < 18 Months Doubtful ?	
Prov Std, S\S 10 And Doubtful Unsecured ?	
CCIS Returns Check, Corrections :	
Insurance value & date Correct ?	
Charge Type And Security Correct ?	
Dp's Correctly Calculated Or Taken As Sl	
Irreg Amt And Date Correct ?	
S/L Taken Correctly ?	
Primary\Secondary Sec Correct ?	
Wdv Vehicle, P&M Depreciated Value ?	

Docts In Force ?	
Cr Summations Correct ?	
Corrections NPA Accounts Show S\S	
Last Credit Dates Incorrect ?	
PF Lien taken Tangible/Coll	
Date Of Last Sanction Or Renewal	
ROI Changes Chart\ Circular Ratings Check Full Year –	
Sanctions/Renewals And Documents –	
: Renewals Pending And Quality BR Level –	
: Renewals Pending And Quality ZO Level –	
Credit Process audit conducted by Official from another Branch In respect of Loans Sanctioned For Rs. 50 Lacs And above.	
SS/BD, MSOD And B/S Received Regularly, Scrutinized And Action Taken ? (Item 5.D) –	
Stock Audit Reports Obtained Periodically ? (Item 5.D) –	
Advances Beyond Rs.10.00 Lacs Audited Accounts Obtained S/S Mar Last Variations With Audited B\S Reasons	
BM Discretionery Power Statement For Sanctions Made – Sent Regularly For Advances ;	
: Individual Statemnets For Advances >25000	
: Consolidated For Advances Below <25000	
List of S\S or financial data late receipt penal charged	
March Stock Statements recd for C\Year	
DP Calculations made ignoring CRS ? Considered in sanction	
Law Charges Momorandum Register Updated	
INC Details, Reg Updations Live And Pbrd –	
Phy Inspection Reg And Reports By Off And Mgr ? (Item 5.D)	
Frequent Unauthorised Overdrawings ? (Item 5.D) –	
Insurance adequacy, Bank clause , Renewed, Expired	
Any Lease Finance A/C Guidelines Followed ? (Item 5 D Vii)	
Credit Card Dues Recovered Promptly ?	
Accounts where legal action for recovery or recall authorised by CA but no action taken by branch ? (ITEM 5 D XI)	
NPA Promptly reported to CA ? (ITEM 5 D XII) –	
Status on rehabiliation programme if undertaken	
Claims For DICGC/ECGC duly lodged & Settled Status (Item 5 D Xii)	
Audited Financials Comparison With Projections –	

Audit reports any adverse remarks	
Processing charges Correctly Charged	
Inspection charges correctly charged ? in march ,	
List Of RBI Defaulters – (P 7) IRAC	
PBRD Accounts:	
Fresh TR Approval	
W\Off Approval	
Primary Sec Evidence S\S, Inspection	
Secondary Sec evidence valuation REP	
Suit Filed Reg	
Law Charges Reg Borrowerwise	
DICGC Rtnl Recd Claims Pending	
Inc Reg & Efforts Made	
Qtly CCIS C Authority	
Form L For Large Advances	
Suits Yet To Be Filed	
Decrees Pending Executaion	
Partial Recovery – Booked As Income ??	
Valuation Reports Obtained Once In Three Years ? (Item 5 D Xiii)	
Recovery Policy Followed In Compromise/Settlement Accounts – (Item 5 D Xiv)	
DICGC Claims lodged follow up progress status	
Legal Suit Filed Accounts Progress Decree, Execution	
Write Off Recomondation, Compromise Proposals, Sanctions	
Advances Under Collection – ZO Sanction	
NPA Accounts: …………………………………………	
Identification – Exact Date Of slippage to NPA……………………………	
Intt Derecognised………………………………………………	
Provision……………………………………………………….	
Bills\Cheques Purchased Break Up, Age, Npa…….. ………..	
Educational Loans End Use Receipts	
Allocated Limits Ratings And Other Cnfms	
L\Yr S\S Doubtful 1 3, C\Yr Status – L.Yr A/Cs Recovered Or W/Off	
New T\L DP Correctly calculated by system – –NOT IN CCIS	
Gold Loans Certificate of purity –	
Any time barred documents	
Sale proceeds Routed through A/C	
HO Intt Rectification On Revised Intt Cal	
IR Report BR Level Form A Qtly & CNFM	
IR Low Level Form Monthly And Cnfm –	
Advances Dr\Cr Seperate In Cc Accounts –	
Advance Ag Security Held By Other BR Certificate –	

Any Consortium advance Leader CNFM ?	
Renewals Made Considering Mar, 08 Audited B\S – – .	
EQ Charges @ 10,000 per entry with EQ Reg	
PMRY Capital Subsidy @ 15% Max/Rs 7500 Each Recd Once In Ayr	
SJSRY Capital Subsidy is Ist Claimed, recd & then Loan Disbursed	
Valuation reports for loans AG EQ – Fresh Reports in 3 Years	
EQ Pending Entry –	
Repayements coming timely in fresh loans	
INDL	
Guarantees invoked & funded by Branch (ITEM 5.E)	
L/C'S Funded by branch (ITEM 5.E) –	
Any advance given against other bank TDR	
Credit limits not reviewed / renewed for 180 Days – NPA –	
Stocks statements older than three months – Irregular –	
Stock Statements Older than 180 Days – NPA –	
Valuation reports older than three years	
Comparative Figures Of Last Year.	
: Advance Classification Form CA 19	
: Inc	
: Movement Of NPA (Xvii A)	
:Movement Of NPA Provision (Xvii B)	
NPA Accounts:	
Audit reports for limits Rs.10.00 Lacs & above	
Any leasing finance **Compliance of AS 19**	
Credit card dues more than 60/90 Days	
Accounts With Legal Action Sanctions – Progress –	
Recent valuation reports in NPA Accounts	
Compromise / Settlement Cases RS.50.00 Lacs & above	
Appropriation Of Recovery In NPA Accounts Towards ;	
Charges , interest suspense , unapplied interest & principal	
Source of recovery in NPA not through additional limits	
Suit Filed Accounts Charges Not To Be Debited –	
Interest Charged On Monthly Basis ? Intt On Intt Charged Taking ROI More Than Documented Rate ? If So, Intt On Intt To Be Reversed	
Restructured accounts RBI Guideliness followed	
Any Recovery In W/Off Accounts – Cr To Charges – (P 57) K183	
Status And Details On L/Y NPA Accounts – Downgraded/ Upgraded – over 18 months	
Doubtful – 1 Year , 1 3 Year & above 3 year	
Status And Details On	
Realisable Market Value Of Security ;	

Free Hold as Per Valuation Report	
Lease Hold Terms Of Lease	
Plant & Machinery WDV As Per IT	
Building Cost Less Depreciation As Per Fa Schedule	
Stocks Market Realisable Value	
Bill Discounting Old Bill Replaced By New Bill To Be Treated As Irregular – NPA –	
L/C Devolvement More Than 1880 Days Even Though Paid In Next 180	
Comparison With Audited Balance Sheet And QIS –	
Control Returns For Review/Renewal/Fresh Sanction –	
Allocated Limit Confirmations	
DP Calculated Through System –	
List Of Accounts Written Off – – All L/Yr. NPA's	
Staff Loans :	
Housing, consumer , End Use Invoices –	
Receipts, DPC Certificate, NOC, PF Lien, Share Certificate,	
Valuation	
Insurance Up To Date Bank Clause – Mentioned	
Driving LC	
Regn certificate	
Noting & CNFM PF Liens Master file	
Running irregular	
Trasfer cases Docts Recd	
HSG Loans Phy Construction Status EQ Mortg Created Created	
Insu Premium Dr To Loan A\C Instead Of Recovery From Salary	
EQ Mortgage pending	
Balances Included In Appropriate SA Return SA1, SA2, SA3	
Irregularity report for overdue advances	
Staff Tfd A\C Not Tfd ? – Housing	
PF Lien Mark System	
Related Parties – Declarations Obtained From Borrower.	
Signatures – *Subject To Audit Report (P 42 NIRC)*	

BANK AUDIT - Abbreviations used in the Banking Industry

ALM	Asset-Liability Management
ARC	Asset Reconstruction Company
ATM	Automated Teller Machine
BCP	Business Continuity Planning Process
BIFR	Board for Industrial and Financial Reconstruction
BPLR	Benchmark Prime Lending rate
CBS	Core Banking Solutions
CD	Certificate of Deposit
CDR	Corporate Debt Restructuring
CIBIL	Credit Information Bureau of India Limited
CPC	Cheque Processing Centre
CRAR	Capital to Risk-Weighted Assets ratio
CRR	Cash Reserve Ratio
CTR	Cash Transaction Report
CTS	Cheque Truncation system
DICGC	Deposit Insurance and Credit Guarantee Corporation
DRI	Differential Rate of Interest
DRT	Debt Recovery Tribunal
DTL	Demand and Time Liability
ECGC	Exprot Credit Guarantee Corporation
ECS	Electronic Clearing Service
EFT	Electronic Funds Transfer
FCNR	Foreign Currency Non-Resident
FCNR (B)	Foreign Currency Non-Resident (Banks)
FEDAI	Foreign Exchange Dealers Association of India
FRBM Act	Fiscal Responsibility and Budget Management Act
FRMS	Fraud Reporting and Monitoring System
KYC	Know your Customer
LIBOR	London Inter-Bank Offer Rate
MICR	Magnetic Ink Character Recognition
NDTL	Net Demand and Time Liability
NEFT	National Electronic Fund Transfer
NPA	Non Performing Asset
NRE	Non-Resident External
NRNR	Non Resident Non Repatriable (Account)
NRSR	Non Resident Special Rupee (Account)
OBS	Off-balance Sheet
PLR	Prime Lending Rate
PMLA	Prevention of Money Laundering Act
PMRY	Prime Minister Rojgar Yojna
RTGS	Real time Gross Settlement System

SARFAESI	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest
SGL	Subsidiary General Ledger
SJSRY	Swarna Jayanti Shahari Rojgar Yojna
SLR	Statutory Liquidity Ratio
STR	Suspicious Transaction Report
UCB	Urban Co-operative Bank
VaR	Value at Risk
XBRL	Extensible Business Reporting Language

Bank XXX,

Annex I to letter dated ……………..

Requirements In Connection With The Audit of Accounts For The Year Ended ……………

REPLY BY BRANCH

1. **Latest Reports**:
For our scrutiny, the following **latest reports** on the accounts of your Branch, **as well as the compliance by the Branch** on the observations contained therein:

(a) Branch Audit Report and Accounts;
(b) Long Form Audit Report;
(c) Internal Inspection Report;
(d) Internal/Concurrent Audit Report(s)/Credit Audit Report;
(e) RBI Inspection Report, if such inspection took place;
(f) Income and Expenditure Control Audit/ Revenue Audit Report;
(g) Quarterly review report (compliance);
(h) Snap and Systems Audit Report;
(i) Any special inspection/investigation report; and
(j) IS/Computer/EDP Systems Audit.
(k) Any special inspection/investigation report.

2. **Circulars in connection with Accounts/financial statements :**

REPLY BY BRANCH

Please confirm that you would be in a position to make available, for our ready reference, a list and copy (preferably in a separate folder), of all the HO/CO/RBI circulars, relevant to the accounts for the year under audit.

A copy of year end closing of accounts circular also needs to be given to us.

3. **Accounting Policies:**
We understand that there is no change, since the preceding year, in the Bank's Accounting Policies adopted and applicable for the year under audit.

Should there be a change as compared to the earlier year, we may be duly informed of the same and the financial effect thereof may be computed to enable us to verify the same.

4. **Balancing of books:**
Please confirm the present status of balancing of the subsidiary records with the relevant control accounts.

In case of differences between balances in the control and subsidiary records, please let us know of the steps being taken to reconcile/balance the same.

This information may please be given head -wise for the relevant control accounts, indicating the dates of arrears of balancing.

The year-end status of balancing may be reconfirmed.

Any balancing differences reconciled after the year-end, if any, may please be brought to our notice in the course of audit.

5. <u>Accounts, if maintained on Computer/ in the EDP environment</u> :

REPLY BY BRANCH

(a) In case the financial information/data is being prepared in an EDP environment at the Branch, please confirm:

(i) whether, and the extent to which:

– the Branch record s are not yet computerised, and

– outstanding balances picked up at the time of initial computerisation, remain unadjusted/unreconciled. **Head -wise figures taken over from the manual system, an d included in the balances as at the beginning of the year and which continue till date may be confirmed, with status of their analysis/adjustment during the year.**

ii) the kind/nature of **software package(s) currently installed** at the Branch; and whether there are any changes/ modifications in the package(s) since the preceding year both as regards the systems as well as changes brought about by virtue of regulatory/statutory amendments and H.O. Circulars, including due to applicability of revised interest rates on deposits, advances etc.

The nature of such modifications, the basis thereof and the effective dates of the modifications, may please be confirmed to us.

(iii) **Please let us have a confirmation that the print-out of books is taken and is**

REPLY BY BRANCH

available for our examination, simultaneously with the branch returns/statements at the time of the

start of audit; unless otherwise stated in our letter, or where some matters can be explained/dealt with prior to the year-end.

(b) Please confirm the precise procedures for computer security systems and data security, back-ups, off-site storage (including locations and personnel in charge), contingency and disaster recovery system/plans and adherence thereto at the Branch.

Offsite storage locations may be indicated along with information as to the periodicity of testing the data, and whether such periodicity was adhered to.

Any adverse features observed during the year may be confirmed, along with the remedial action taken.

(c) Please keep ready for our examination, the **daily exception reports** on the **"system"** as well as "transactions", to enable us to examine the manner of disposal of the reports generated; as also the report for the month-end/day-end procedures as at the year-end.

6. Deposits

(a) Overdue/matured Term Deposits:

(i) We understand that as per your H.O. circulars and in keeping with the circulars of the RBI, you have introduced a system for automatic/suomoto renewal of term deposits on maturity.

REPLY BY BRANCH

The cut-off date(s) beyond which these instructions apply may be intimated to us, indicating as to the status and basis of interest accretion, if any, on the amounts held as Overdue Deposits in the Accounts of the Branch.

Please confirm whether there are any credit balances comprising overdue /matured Term Deposits in various categories, as at the year-end, which continue to be shown as Term Deposits, particularly where the Branch does not have any instructions/communication for renewal of such deposits from the account holders.

(ii) In case of automatic renewal of old matured deposits in terms of your H.O. circulars, please confirm as to the basis adopted at the Branch for computation of the interest component (added to the original principal), for purpose of renewal, i.e. whether it is on:

- simple interest since maturity of the Original / initial deposit; or
- based on interest rate applicable on the date of maturity of the deposit; or
- based on the rate of interest on the date of renewal of the deposit.

and whether any excess/short provision relating to the prior periods i.e. up to 31.3.20xx is considered in the accounts under review.
The computation of interest may be evidenced for our verification.
The number and amount of such deposits may be confirmed, both for Rupee denominated as well as for foreign currency deposits.

(iii) Please let us have a list of deposits, which have been received/ suomoto renewed but where:

REPLY BY BRANCH

- deposit receipts are not physically issued, although book entries have been made as per the computerized system,
- deposit receipts are physically issued but not dispatched to deposit holders (particularly where the amounts received in foreign currency are to be covered by Deposit Receipts from another foreign exchange authorized Link Branch.

  A list of such unissued/undespatched Deposit Receipts in the physical custody of the Branch needs to be given and the Receipts produced for our verification at the year end.
- renewals have been made by endorsement of renewal on the existing Deposit Receipts of the deposit holders.

  This may be substantiated from your record.

For the above, information may be prepared for deposits:

- in Rupees
- held in foreign currencies -FCN R (B) Deposits
- in external accounts (NRE accounts, if any).

(iv) Please also confirm whether any deposits have been renewed other than in the name(s) of the original holder e.g. in the case of deceased depositors.
In such cases, it may be confirmed to us as to whether the Branch holds the necessary evidence on record.

(b) Tax Deduction at Source

Please confirm the system followed by the Bank with regard to deduction of tax at source on interest on deposits and whether:

- in respect of interest (based on credit or payment whichever is earlier), including in respect of cumulative Deposit Schemes and on renewals of

REPLY BY BRANCH

matured deposits, Tax as required to be deducted at source was so deducted on due dates and deposited within the prescribed period; and

– the automatically renewed deposits are net of the Tax deducted at source.

Cases of delay/default may be listed for our review and incorporated in Form 3CD (Tax Audit Reporting Format).

(c) Back-ended or other subsidies adjustable against advances

Please confirm whether Deposits include any amounts received under specific schemes. If so, the amount thereof and interest, if any, paid thereon during the year, may be confirmed; and whether interest on advances is calculated net of Govt. subsidies in such schemes .

(d) Deposits held as margins:

Please confirm whether against issue of guarantees/LCs, the Branch holds any cash margins by way of fixed deposits, shown as part of the 'Deposits' portfolio. **If so, the aggregate amount of such deposits may be made known to us.**

(e) Inoperative Deposit Accounts:

Please confirm the procedure followed at the Branch with regard to identification of Inoperative Accounts and safeguards as to operations therein; and whether the identified accounts are segregated/maintained in separate distinct ledgers. Please let us have information as regards:

- Aggregate Opening Balance
- Additions/Accounts identified during the year
- Less: Payments out of such accounts
- Balance Outstanding at the year end

REPLY BY BRANCH

7. **Advances :**

(a) Please confirm whether the aggregate of the advances as per the Branch Balance Sheet as at 31.3.20xx reconciles with the Particulars of Advances (Portfolio) statement after including credit card dues and making adjustments for any foreign exchange differences (if on a decentralized basis); as well as after considering the unadjusted/unappropriated credit balances (whether in specific or nominal accounts) and requiring adjustments/netting off against the borrowers' accounts **which would include accounts like "Interest Suspense", DICGC claims Received" and unappropriated recoveries in Advances in litigation and subsidies (and interest thereon, to the extent requiring adjustment).**

A summary of the particulars of Advances as per Annexure-II may be provided to us.

(b) A list of all Advances, each with outstandings above 5% of the total Advances Portfolio of the Branch or Rs.200 lakhs whichever is lower, indicating their classification.

The year-end Status Report on each large borrower in detail, may be given as per Annexure III, III.1 and III.2, which includes information as per the LFAR.

The aforesaid information, (which must also cover accounts adversely commented upon by Bank's internal/concurrent auditors/RBI inspection/ special audit/credit audit/previous statutory auditors -i.e . in the Reports as per refer Para I of this Annexure), **may please be prepared keeping in view the applicable RBI circulars, and kept ready and be made available to us along with the Branch returns.**

(c) Please confirm whether :	**REPLY BY BRANCH**

The borowers' accounts have been classified according to the latest RBI norms applicable for the year, with particular care being taken to identify Non-Performing Assets (NPA) [**classified as Sub-Standard, Doubtful or Loss assets**], and, in case a computerized package is being used for such an exercise, **whether the statements are being prepared with the applicable latest parameters as per the prudential norms of the Reserve Bank of India.**

You have examined the accounts based on documentation security/guarantee/operations aspects etc. to determine the status borrower-wise and not account-wise for categorizing the accounts, as above;

The classification as at the year-end of borrowal accounts under consortium arrangements with other participating banks, has been done on the basis of operations of the accounts as per your Bank, without the necessity of relying on classification made by other participating banks; **however, making known to us, the status of the borrower, if adverse, in case of other lenders.**

The borrower's CLASSIFICATION AT THE branch is uniform for the Bank as a whole, based on the applicable RBI norms, in case of sub-limits/transferred limits and where advances are transferred from another branch.

REPLY BY BRANCH

d) Valuation/market value of tangible Assets: Please confirm :

Whether in respect of the advances secured against tangible securities, the bank holds evidence **of existence and market value** of the relevant securities as at the year-end.

Whether the existence/market value is evidenced, based on physical inspections or otherwise through stock audit or other verification procedures applied nearer the balance sheet date; and the same may be produced for our examination.

In case of NPA, the periodicity of valuation, and the basis of which valuation is arrived at in respect of advances for the year under audit, particularly in case the security valuation reports/dates are older than one year.

In respect of facilities of Rs.5.00 cores and above, whether stock audit has been got conducted.

Whether and in which cases was the stock audit was required to be conducted. Please furnish us;

- **List of accounts where stock audit was required, but not conducted; and**

- **Cases in which stock audit was conducted where adverse features noticed have not been addressed and whether it has any effect on classification of any** borrowers; and whether the same has been duly considered.

REPLY BY BRANCH

e) **Besides providing us information as per Annexure II, may we request you to provide us with a list of the:**

(I) Top 25 NPAs and their status as at 31.3.20xx and 31.3.20xx;

(ii) Borrowers identified/classified as NPAs during the period 1.4.20xx to 31.3.20xx and whether and extent to which unrealized income on such accounts is reversed/derecognized.

(iii) NPAs upgraded to Standard classification during the period 1.4.20xx to 31.3.20xx, justifying reasons for the same; **also indicating the amount of any unapplied interest in such accounts (not debited/charged to the borrower);**

(iv) Accounts where there was rehabilitation/reschedulement/ restructuring, indicating in each case, **the number of times the same has been done,** and accounts in which the Bank needs to exercise its right to recompense, indicating the amount, also giving reasons for non-recovery thereof;
{The aggregate of such amounts due (party-wise), and the dates on which recoupment is to be made, may please be made known}.

(v) Cases covered by Paras 4.2.15 and 4.2.17 of the RBI Master Circular (DBOD No.BP.BC.20/21.04.048/2008-09 dated 1-7-2008), where pursuant to restructuring, borrowers were granted FITL facilities or where the interest unrealized was converted to investments by the Bank.

(vi) Cases of rehabilitated/restructured borrowal accounts at the Branch, where the classification is not as per RBI norms; or where any amount of sacrifice is not computed/provided.
Information on accounts restructured may be provided as per **Annexure IV**.

REPLY BY BRANCH

(vii) List of Borrowers, where one time settlement was sanctioned, but there is a default in repayment or in compliance of the terms thereof;

(viii) Particulars of Advances where there is divergence of opinion between the Branch Management and the RBI/Inspection/Internal/Concurrent audit Reports etc., indicating as to how this has been addressed by the Branch.

(ix) The aggregate of the amounts of advances in the standard category which have the status of "critical amount due"; and whether any amounts comprised therein are over 90 days in default as at 31.3.20xx. **A list of such accounts may be made available and quantified, for our review.**

(x) Borrowal accounts (in standard category), which have not been reviewed/renewed for 180 days since the due date of their last renewal, or where there is a default on the part of the borrower in submission of stock statements, for a period of 90 days beyond any period of default/irregularity, **including that commencing prior to 31.3.20xx;** and if so, whether such borrowers are classified as NPAs. **Particulars of accounts overdue for review/renewal between 6 months and 1 year, and those over 1 year may be provided.**

(xi) accounts which do not fall within the definition of advances, such as interest free employee advances, but have been shown as such in the accounts of the Branch may be listed for our review.

(xii) advances accounts which have been identified as of the nature of NPAs, and where, pending formal sanction of the higher authorities, the relevant amounts have yet to be reclassified/

REPLY BY BRANCH

recategorised for the purpose of provision/write off. **This covers all accounts identified by the Bank or internal/external auditors or by RBI inspectors but the amount has not been written off wholly or partly.**

(xiii) accounts in which the Bank, or the Branch has itself recommended legal or other coercive action for recovery of dues and, where no such action has been taken up to the year-end against the borrowers. A list of such borrowers' accounts may be furnished to us, particularly if such accounts are in standard or sub standard category.

(xiv) borrowal accounts in the "Standard" or "Sub Standard" category which are the subject matter of reference to BIFR/DRT or in litigation.

(xv) Advances to borrowers on the list of willful defaulters (as per the latest list and guidelines of the RBI).

(xvi) all accounts where the default resulted in WCTL, FITL, WCDL etc . and whether the advances would be NPAs but for such facilities.

(xvii) whether there are any agricultural loans where borrowers are entitled as per the government directions to any relief/waiver upto the year end and if so the particulars thereof.

(f) **Upgradation of classification :**

Please let us have a list of borrowers' accounts (including projects under implementation and restructured accounts), where classification made as at the end of the previous year (31-3-20xx), has been changed to a better classification, stating reasons for the same; and whether provision (including for the Interest sacrifice, if made), on the

REPLY BY BRANCH

borrowal accounts, is sought to be reversed contrary to RBI's master circular dated 1-7-20xx.

Please confirm whether Advances comprising Funded Interest, if already recognized as income, is fully provided for and not reckoned as income till realization/redemption of securities. (This would also apply to funded interest where the same is converted into securities (equity, debentures or other instruments), if held at the branch.

{Refer also to Paras 4.1.15 (v) (g) (i) and (ii) and (h) of the RBI Master Circular dated 1-7-20xx, relating to Restructuring and Rescheduling of Loans}

(g) Devolved Letters of Credit (LCs)/ co-acceptances, and guarantees :

Please confirm:

– the precise procedure followed for accounting treatment of devolved, LCs.

– whether in categorising the borrowers' accounts as standard, substandard, doubtful or loss assets, the amount in default on account of devolved LCs has been reckoned, as per the applicable RBI norms.

– whether there are any devolved LCs upto the year-end.

Please also confirm whether the debits have been raised in separate distinct accounts of the borrowers or to the normal cash credit/overdraft accounts of the borrowers; and if not, whether these are considered for classification of the borrower.

For Information on guarantees invoked, and outstanding LCs/co-acceptances. Refer format in Para 5(e) of Part 1 of the LFAR questionnaire.

REPLY BY BRANCH

(h) Please confirm:

(i) Whether in computing the Drawing Power (DP), Sundry Creditors comprising unpaid for stocks, are reduced prior to application of margin as stipulated.

A list of cases where such reduction was not specifically made **(including by the leader bank in consortium)**, may be made known and particularly where it has an adverse effect on the borrowers' status. Please review all cases of the stock confirmations/ certificates issued by the borrowers to the Bank to determine if, and to the extent, the DP is required to be modified on this account and as may have a bearing on the limits/drawing power. This may also be evidenced for us.

(ii) In case of one time settlement proposals under consideration or where rehabilitation/ rephasement is being done, whether the amount of sacrifice including anticipated sacrifice is provided fully.

Particulars of accounts where the borrowers have defaulted in their commitments after sanction of the compromise proposal, indicating classification of the amounts, may be made available to us. The extent of provision/adjustment, if any, made may be communicated.

(iii) Whether the Bank has a recovery policy in cases of compromise/ settlement / write off and is the policy available at the Branch.

Particulars of cases of compromise/ settlement/write off involving write off/waiver,

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each in excess of Rs.25 lacs, may please be furnished.

(iv) the particulars of any borrowal accounts with working capital limits of Rs.10.00 lacs and above, as also in case where audit is compulsorily required as per any statute, where the latest audited accounts are not on record.

(v) Compliance by the Branch of the RBI Master Circular (No.DBOD No. Dir.BC.17/ 13.03.00/2008-09 dated 1-7-2008), relating to statutory and other restrictions as regards Loans and Advances.

In particular it may be confirmed as to whether:

- there are any loans and advances against security of the Bank's own shares.
- there is any laid down procedure as regards identification of directors/ officers and their relatives and of directors of other banks for purposes of sanction of loans to the more to concerns in which directors are interested, as per the said circular.

- loans have been given to companies for buy back of their shares/ securities.

(i) <u>Advances to share brokers/NBFCs</u>:
Please confirm whether at the Branch, there are advances to:

– share brokers; if so, the total amount of limits granted and the aggregate advance due as at the year-end.

– NBFCs; if so please confirm whether the Reserve Bank of India has taken any adverse view as regards their registration or otherwise.

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The status on advances to NBFCs may please be made known, along with their classification.

(j) Advances to Staff
Please confirm:

– the procedure with regard to Advances to Staff (interest/non -interest bearing), by the Bank, both in its capacity as a banker and as an employer; also whether such interest-bearing advances are being disclosed as Advances.

– the verification procedures followed in respect of Staff Housing Loans, and in particular, whether the original documents are held at the Branch and can be produced for our examination.

(k) Credit Cards:
Please confirm the system followed at the Bank/Branch for recovery of credit card dues; and whether, and the extent to which, there are:

– Any debits in the Branch on account of credit card facilities, and whether the amount is being reflected as part of the ADVANCES portfolio or as part of OTHER ASSETS;

– Any arrears/defaults in collection of such dues; **and**
– Unadjusted debits up to the year end, against the Credit Card holders' Current/Savings Accounts.

8. Outstanding in Suspense/Sundries:
Please let us have a summary of the year-wise break up of amounts:

– debited to Suspense Account (or similar account) indicating the number of entries and the amount thereof, with reasons for non-adjustment of old/large/unusual entries. **The amount of provision for doubtful debits may be confirmed.**

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– credited to Sundries/Sundry Deposit Accounts, indicating the reasons for non-adjustment of items included therein, particularly in respect of items which are over 3 years old.

(Information may please be provided in the formats as per the revised LFAR).

9. Provisions/Liabilities remaining unadjusted against corresponding advances :

Please confirm whether:

– provisions for known liabilities, including for Fringe Benefits Tax, up to the yearend have been made (also, based on subsequent entries made) ; and
– there are any advances (e.g. Travel Advance) against such provisions/liabilities that require to be netted off for purpose of the financial statements.
– If so, the same may be made known to us, to the extent unadjusted at the Branch.

10. Inter-branch/Office Accounts/Head Office Account:

(a) Please let us have a statement of entries (head-wise) which originated prior to the year end at other branches, but were responded after the year-end at the Branch.

This statement may please be prepared upto a cut off date if stipulated by Head Office, and if not, upto the date of completion of audit but before submission of our report. (Format at **Annexure VI** may please be used and handed over).

(b) Date-wise details of debits in various nominal or other sub-heads relating to Inter-branch transactions, with reasons, particularly for large outstanding amounts, including those which are pending for over 30 days as at the Balance Sheet date.

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(c) **Please confirm:**

– **whether, and the extent to which, there are (under any sub-head), any debits outstanding over 6 months as at the year -end,** and whether provisions are being considered against the same at the Branch level;

- whether the Branch has effectively complied with the centralised Reconciliation Cell, all their queries in relation to unmatched entries. **Communications as are pending action may be made available for our review.**

– the number of old unadjusted entries and the aggregate amount as at the year-end comprising unlinked debits in respect of Drafts and TTs, MTs paid, which remain outstanding at the Branch; and whether, and the extent to which, provision is being considered for the same.

Please confirm the period upto, which the Reconciliation Cell has sent the statements of unmatched entries (head-wise).

11. <u>Foreign Currency outstanding transactions</u> :

If the system of conversion of foreign exchange entries has been decentralized, the precise yearend adjustments made in the Branch Accounts **(head-wise)** may please be made known to us.

Please confirm whether all balances (including off-balance sheet items) outstanding in foreign currencies as at the year-end have been converted as at the year-end rates as applicable; or at the rate(s) as at the date(s) of origination thereof. **Evidence/basis of the rates as applied may be made available.**

12. <u>Contingent Liabilities etc.</u>:

Please confirm whether:

- other than for advances, there are any matters involving the Branch in any claims (both statutory, contractual or otherwise) in litigation, arbitration or

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other disputes in which there may be some financial implications, including claims from customers, fraud cases, for staff claims, municipal taxes, local levies etc. If so, these may be listed and evidenced for our verification, and you may confirm whether you have included these as contingent liabilities in the Branch financial statements.

- guarantees are being disclosed in the Branch Balance Sheet, **net of cash margins and term deposits**, or otherwise; and whether, and the extent to which, expired letters of credit, and guarantees **where the claim period has also expired**, continue to be disclosed in the Branch returns. The amount of such expired obligations may be made known.

- there are any other obligations assumed, e.g. **Letters of comfort;** of so, whether the amount of such obligations is being disclosed in the Branch financial statements.

- there are any outstanding contracts on capital account (including for fixed assets to be acquired/constructed). Details thereof may be given.

- there are any awards in arbitration/litigation or disputes involving any liability (including based on any awards by the Banking Ombudsman)

13. <u>Interest Income/Expenditure</u>:

(a) Please let us have a statement showing the rates of interest applicable during the year on various
 - Advances Accounts
 - Deposits Accounts

 giving reference of the relevant circulars of the Head Office, and indicating the effective dates and periodicity of application of the interest rates; and evidencing that the computer programme was modified from such effective date(s).

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This information may be sent now, and changes hereafter may be communicated later as and when these take place.
Please confirm whether interest being debited at the end of each month on advances, is also being compounded for levy of further interest on a monthly basis. Rectification, in respect of interest if not properly charged up to the date of modification of the interest rates during the year, may please be advised to us, along with the changes/modifications, if carried out in the software programme.

Please confirm whether the changes are reflected in the contracted rates as per documentation.

(b) **System of appropriation of recoveries in NPAs :**
Please confirm the basis on which recoveries in NPA Accounts are being appropriated, in particular where recoveries are in excess of "Interest Suspense"– **whether priority is being given towards principal or unapplied interest.**

Please confirm whether there is any amount of **"Interest Suspense" or "Unapplied Interest" or a "right of recompense"** in borrowal accounts classified as "Standard".

If so, details thereof may please be given to us.

(c) As regards advances (including bills), whether:
- any income has been adjusted/recorded to revenue, contrary to the norms of income recognition issued by the Reserve Bank of India and/or Head Office circulars issued in this regard; and particularly where the chances of recovery/realisability of the income are remote.

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– in respect of accounts classified as NPA during the year, including as at 31.3.20xx, the income remaining to be realized for the preceding year is reversed to income or provided for; and that for the year 20xx-xx such unrealized income is derecognised.

– any income has been recorded on Non Performing Accounts (including overdue bills) other than on actual **realisation** from the borrowers, or out of fresh limits sanctioned by the Bank.

– the reversal of interest income (i.e.derecognised income), is recorded through «Interest Suspense » or similar account.

- unapplied interest has been computed and recorded upto date.

(Please confirm whether the contractual or any other interest rates are the basis of computation of unapplied interest).

– Unrealized fees, commission and other charges in respect of accounts identified as NPAs during the year, are reversed for all earlier periods.

Amount of income accrued, if any, as at 31.3.20xx on NPAs may please be made known.

– whether interest adjustments on inter branch balances as communicated by Head Office, have been duly recorded in the Profit & Loss Account. Relevant evidence thereof may please be made available to us.

14. Commission on Govt. business

Please confirm whether at the Branch, income is being accounted on cash basis or on accrual basis.

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Income accrued upto 31.3.20xx but not claimed/recorded/received may please be confirmed to us, together with computation thereof.

Income Receivable by the Branch based on business done upto 31.3.20xx may be got computed and made known, if the same is required to be recorded at the Branch.

15. Interest Provision:

Please confirm:

(a) whether interest provision has been made on deposits etc. in accordance with the latest instructions of the Head Office.

A copy of these instructions may be made available for our information. the amount of interest accrued and due but not applied (since the date of last application) on Savings Bank Account deposits; and further let have the basis of such computation for each code head .

(b) Whether interest accrued and due on deposits only forms part of the deposits portfolio (under the respective subheads) and that interest accrued and not due is reflected as part of **other liabilities.**

16. Employee/Staff Payments and benefits

Please confirm that all payments due to the Branch employees upto the year end, have been duly computed and recorded under the respective sub heads, including incremental liability towards arrears, if any.

17. Rent, Rates and Taxes

Please confirm that the rents, rates and taxes are recorded up to the year end, based on:

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- rent/lease agreements for the time being in force and liability has been considered on the basis of claims/demands and contractual enhancements due;
- municipal taxes and levies are adjusted/provided up to the year-end, based on the demands accepted ; and
- in case of disputed liabilities, if any, the related contingent liability has been disclosed.

18. **Penalties/fines etc:**

Please confirm whether any fines or penalties have been imposed on the Branch, or incurred or paid by the Branch during the year as arising out of any defaults to meet statutory or regulatory requirements or otherwise. If so, the particulars thereof may be made known; as these would require separate disclosure in the financial statements of the Bank and for consideration in the Tax Audit Report.

19. **Balance(s) with other Banks (including RBI/SBI) :**

Please confirm the status of reconciliation as at 31.3.20xx, of accounts with other banks in your Branch; as also whether there are any entries arising there from as have effect on revenue up to 31.3.20xx, which remain to be adjusted till the year end. For this purpose you may let us know how the pending items in reconciliation were adjusted after 31.3.20xx, and whether these are considered in the MOC.

20. **Frauds etc.:**

Please confirm whether for the purpose of provisioning, the relevant particulars have been prepared at the Branch and whether:

– there are any frauds reported/recorded upto 31.3.20xx;

REPLY BY BRANCH

- there are any transactions or events involving cases of suspected frauds.

– there are any cases of vigilance or similar enquiry, or financial claims from customers/others in respect of the Branch. The relevant records of these may please be made available.

– any enquiries have been initiated for any suspected frauds/aberrations. If so, particulars thereof may be furnished.

– the Branch has complied with the reporting requirements of RBI and communicated the same as per the requisite formats including where central investigating agencies have initiative criminal proceedings or where RBI had directed that a matter may be treated as fraud.

Recommendations of the Mitra Committee – Bank Frauds

While drawing you attention to the contents of the SA 240 issued by the Institute of Chartered Accountants of India, particularly in that the responsibility for the prevention and detection of fraud and error rests with the management through the implementation and continued operation of an adequate system of internal control, we would request you to confirm whether, in relation to the operations/activities of the Branch, anything has come to light which is in the nature of a fraud, any fraudulent activity, or any matter susceptible to fraud or foul play, which should receive our attention; and particularly, if there is anything which invokes, or is the subject matter of any vigilance, enquiry, investigation or examination as regards any transaction or event that is suggestive of attracting compliance or for reporting to the competent authorities within the Bank, or to the regulatory authorities.

This would include matters that could arise out of inadequacies in, or absence/breach of the laid down

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internal control systems and procedures (both accounting and administrative).
Your attention is drawn to the RBI Circular DBS.FrMC.BC.No.15/23.04.001/2008-09 dated 1.7.2008 relating to Frauds – Classification and Reporting.

21. Asset Liability Management:
Please let us have, duly authenticated, the financial information regarding the additional disclosures to be made as at 31.3.20xx, as required by the RBI, indicating the procedure followed to arrive at the financial data.

Instructions from the Controlling Authority, in this behalf, may be made known.

22. LFAR-Branch response to the Questionnaire:
In connection with the LFAR, please let us have complete information, and evidence, as regards each item in the questionnaire, to enable us to verify the same for the purpose of our audit.

Reference may also be made to the important items as per **Annexure VII.**

23. Tax Audit in terms of section 44AB of the Income -Tax Act, 1961:
Please let us have the information required for Tax Audit to enable us to verify the same for the purpose of our report thereon.

24. Compliance of Ghosh and Jilani Committee recommendations
Please confirm whether the Branch has duly complied with the requirements of the Ghosh and Jilani Committees and whether such compliance has been got verified from the Bank's Inspection Division and/or the Concurrent Auditors, if any.

REPLY BY BRANCH

It may be confirmed as to whether there are any adverse observations in respect of any requirements; and if so, these may please be made known to us.

25. **Consideration of laws and regulations for the purpose of the audit of financial statements :**
Please confirm as to whether the Branch is maintaining a codified list of the related laws and regulations applicable to the Bank in respect of its operations/activities to cover all transactions and events, with which it is concerned; and whether the Branch management has come across, or is aware of anything that needs to be brought to our notice for our consideration or anything suggesting that there is fundamental effect on the branch's state of affairs or operations on account of non-compliance of these.

26. **Other Certification**
Please let us have, duly authenticated, information as regards other matters which, as per the letter of appointment, require certification/ validation.

The certificates relating to the following (besides the data as the letter of appointment and assistance may be sought from the Annexures indicated):

(a) DICGC
(b) PMRY
(c) 12 odd dates data for verification of SLR (Refer Annex A VIII)
(d) Additional Disclosures
(e) Implementation of the Ghosh and Jilani Committee recommendations
(f) Movement Chart of NPAs and Provision of NPAs (Refer Annexure A II)
(g) Information relating to restructuring etc., if any, undertaken during the year

REPLY BY BRANCH

BCTT : Please confirm whether the Branch maintains the prescribed records relating to the cash withdrawals beyond the prescribed limits and whether tax has been collected and remitted to the authorities within the prescribed time.

27. **Transactions and events after the Balance sheet date**

Please let us have a statement of any significant transactions or events accruing after the Balance sheet date but which relate to the period prior to 31-3-20xx, **whether or not yet recognized or recorded in the accounts of the Branch.** This would include items of income or expense or capitalization etc. relating to the period prior to the year end. (particularly also, these are reported in the inspection/internal/concurrent audit reports relating up to March 20xx), which need to be incorporated in the MOC.

28. **Investments:**

In case the Branch holds any investments on behalf of the Bank:

(a) these may be produced for physical verification and/or evidence of holding the same be made available.

(b) stock of unused security paper stationery/numbered forms like B/Rs, SGL Forms etc. may please be produced for physical verification.

(c) it may be confirmed whether income accrued/collected has been accounted as per the laid down procedure, and is not reckoned as income of the Branch.

The procedure may please be confirmed to us.

BANSAL DALMIA & CO.
CHARTERED ACCOUNTANTS

Informations duly completed in respect of Paras 21 to 28 should be made available simultaneously with the returns/statements/schedules, as committed by the Head Office to be given by the Branch on the date of start the audit.	**REPLY BY BRANCH**

Seal of the Branch & Signature of the Branch Manager :-

Th : Courier/Hand Delivery

Date

Assistant General Manager,
Bank ………………..

N.D.- …………..
.

Sub :- Statutory Branch Audit 2010-11
Reg :- Physical Verification

Dear Sir,

We wish to convey that we shall be deputing our team in connection with physical verification of followings as at the close of year i.e. 31.3.2011.

A. Cash and other balances

a) Cash in hand (including with tellers);
b) Cash at sub offices
c) Cash in ATM(s), if operated/controlled; and if any with authorized agencies for stuffing;
d) Petty Cash/ imprest balances;
e) Postage in hand
f) Tokens, if any
g) Foreign Currency, if any.

In connection with the above, please ensure that you will be getting the verification done simultaneously, and at all locations, of the balances for the aforesaid items and produce for our verification the following;

a) Foreign Currency parcels, if any, lying at the Branch.
b) Sealed covers containing cash, if any.
c) Petty Cash and imprest balances held with various officers.

B. Security Paper Stationery/Forms

1. We would be undertaking the physical verification of the unused/ blank security paper, stationery/ forms lying at the branch, including those issued and are in hand i.e. for the following:

- Time/Term Deposits;
- Deposits under various schemes
- Travellers' Cheques
- Drafts

….. 2

- Pay Orders/Banker's Cheques,
- Gift cheques etc. and
- Cheque Books / Withdrawal Slips

We would request you to keep ready, a list of stock of all stationery in hand of the nature and type referred to above, so that verification thereof is conveniently carried out;

Further please ensure that the relevant registers are also up-to-date to enable us to verify the balances therein.

2. Instruments of the above nature issued but lying in physical custody of the Branch may also be listed and got verified.

C. Bills for Collection/Purchased

All bills in hand for collection as well as purchased may be listed out and got physically verified along with the respective documents.

D. Fixed Deposit Receipts

Undespatched receipts in physical custody of the Branch, in respect of Deposits received or renewed may be produced.

E. Your formal confirmations for our record

Upon completion of the exercise involving physical verification as aforesaid, we would request you to let us have a confirmation of the balances as at the close of the business as at the year-end duly signed by the authorized signatories.

F. External confirmations

May we request you obtain and to let us have, balance confirmation certificates in respect of:

a) balances with other banks as at the year-end along with
b) reconciliation statements, in evidence of outstandings with such banks (including, if any, with the Reserve Bank of India);
c) borrowings, if any, recorded at the Branch (banks/institutions)

We expect these certificates/reconciliation statements, duly authenticated, to be handed over to us along with the Branch returns.

We shall be thankful for your co-operation.

We shall be willing to visit you on 2nd April 2011 or the earliest date as convenient to you subject to your sending us the confirmation in this respect.

We shall wait for your reply and the confirmation to make our program accordingly.

Thanking You

For …………………….

(…………………)
Partner

Master Circular - Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

Part A

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 nonperforming and the availability of security and the realisable value thereof.**

1.3 Banks are urged to ensure that while granting loans and advances, realistic repayment schedules may be fixed on the basis of cash flows with borrowers. This would go a long way to facilitate prompt repayment by the borrowers and thus improve the record of recovery in advances.

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. 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.**

2.1.2 **A non performing asset (NPA) is 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' as indicated at paragraph 2.2 below, 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. the instalment of principal or interest thereon remains overdue for two crop seasons for short duration crops,

v. the instalment of principal or interest thereon remains overdue for one crop season for long duration crops,

vi. the amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken in terms of guidelines on securitisation dated February 1, 2006.

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

2.1.3 Banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.

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 90 days** 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 nonperforming 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 renegotiations or rescheduling of outstanding debts **should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.**

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, the entire interest accrued and credited to income account in the past periods, should be reversed 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 with respect to past periods, if uncollected.

3.2.3 Leased Assets

The *finance charge* component of finance income [as defined in 'AS 19 Leases' issued by the Council of the Institute of Chartered Accountants of India (ICAI)] on the leased asset which has accrued and was credited to income account before the asset became nonperforming, and remaining unrealised, should be reversed or provided for in the current accounting period.

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**

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

3.5 **Computation of NPA levels**

Banks are advised to compute their Gross Advances, Net Advances, Gross NPAs and Net NPAs, as per the format in **Annex -1**.

4. ASSET CLASSIFICATION

4.1 **Categories of NPAs**

Banks are required to classify nonperforming 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:

i. **Substandard Assets**

ii. **Doubtful Assets**

iii. **Loss Assets**

4.1.1 Substandard Assets

With effect from 31 March 2005, a substandard asset would be one, **which has remained NPA for a period less than or equal to 12 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

With effect from March 31, 2005, an asset would be classified as doubtful **if it has remained in the substandard category for a period of 12 months.** A loan classified as doubtful has all the weaknesses inherent in assets that were classified as 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 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 purpose of treating an advance as NPA or otherwise, except to the extent provided in Para 4.2.9, as income recognition is based on record of recovery.

4.2.4 Accounts with temporary deficiencies

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 nonrenewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines:

i) 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 90 days even though the unit may be working or the borrower's financial position is satisfactory.

ii) 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.***

4.2.5 Upgradation of loan accounts classified as NPAs

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts. With regard to upgradation of a restructured/ rescheduled account which is classified as NPA contents of paragraphs 11.2 and 14.2 in the Part B of this circular will be applicable.

4.2.6 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.

4.2.7 Asset Classification to be borrowerwise and not facilitywise

i) It is difficult to envisage a situation when only one facility to a borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a bank to a borrower and investment in all the

securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment 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.

iii) The bills discounted under LC favouring a borrower may not be classified as a Non-performing advance (NPA), when any other facility granted to the borrower is classified as NPA. However, in case documents under LC are not accepted on presentation or the payment under the LC is not made on the due date by the LC issuing bank for any reason and the borrower does not immediately make good the amount disbursed as a result of discounting of concerned bills, the outstanding bills discounted will immediately be classified as NPA with effect from the date when the other facilities had been classified as NPA.

iv) The overdue receivables representing positive mark-to-market value of a derivative contract will be treated as a non-performing asset, if these remain unpaid for 90 days or more. In case the overdues arising from forward contracts and plain vanilla swaps and options become NPAs, all other funded facilities granted to the client shall also be classified as non-performing asset following the principle of borrower-wise classification as per the existing asset classification norms. Accordingly, any amount, representing positive mark-to-market value of the foreign exchange derivative contracts (other than forward contract and plain vanilla swaps and options) that were entered into during the period April 2007 to June 2008, which has already crystallised or might crystallise in future and is / becomes receivable from the client, should be parked in a separate account maintained in the name of the client / counterparty. This amount, even if overdue for a period of 90 days or more, will not make other funded facilities provided to the client, NPA on account of the principle of borrower-wise asset classification, though such receivable overdue for 90 days or more shall itself be classified as NPA, as per the extant IRAC norms. The classification of all other assets of such clients will, however, continue to be governed by the extant IRAC norms.

v) If the client concerned is also a borrower of the bank enjoying a Cash Credit or Overdraft facility from the bank, the receivables mentioned at item (iv) above may be debited to that account on due date and the impact of its non-payment would be reflected in the cash credit / overdraft facility account. The principle of borrower-wise asset classification would be applicable here also, as per extant norms.

vi) In cases where the contract provides for settlement of the current mark-to-market value of a derivative contract before its maturity, only the current credit exposure (not the potential future exposure) will be classified as a non-performing asset after an overdue period of 90 days.

vii) As the overdue receivables mentioned above would represent unrealised income already booked by the bank on accrual basis, after 90 days of overdue period, the amount already taken to 'Profit and Loss a/c' should be reversed.

4.2.8 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.

4.2.9 Accounts where there is erosion in the value of security/frauds committed by borrowers

In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment the asset should be straightaway classified as doubtful or loss asset as appropriate:

i. 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.

4.2.10 Advances to PACS/FSS ceded to Commercial Banks

In respect of agricultural advances as well as advances for other purposes granted by banks to 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 crop seasons in case of short duration crops and one crop season in case of long duration crops, 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 onlending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

4.2.11 Advances against Term Deposits, NSCs, KVP/IVP, etc

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

4.2.12 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 do not become NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.

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.

4.2.13 Agricultural advances

i. A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season. For the purpose of these guidelines, "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops, would be treated as "short duration" crops. 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. 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.

The above norms should be made applicable to all direct agricultural advances as listed at items 1.1.1, 1.1.2, 1.1.3, 1.1.4, 1.1.5, 1.1.6 and 1.2.1, 1.2.2 and 1.2.3 of Master Circular on lending to priority sector RPCD. No.Plan. BC. 2 /04.09.01/ 2009-2010 dated July 1, 2009. An extract of the list of these items is furnished in the **Annex 2**. In respect of agricultural loans, other than those specified in the Annex 2 and term loans given to nonagriculturists, identification of NPAs would be done on the same basis as nonagricultural advances, which, at present, is the 90 days delinquency norm.

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 reschedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines contained in RBI circular RPCD. No.PLFS.BC.6/ 05.04.02/ 200405 dated July 1, 2005.

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 overdue for two crop seasons for short duration crops and for one crop season for long duration crops. 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" would be treated as "short duration" crops.

iv. The debts as on March 31, 2004 of farmers, who have suffered production and income losses on account of successive natural calamities, i.e., drought, flood, or other calamities which might have occurred in the districts for two or more successive years during the past five years may be rescheduled/ restructured by the banks, provided the State Government concerned has declared such districts as calamity affected. Accordingly, the interest outstanding/accrued in the accounts of such borrowers (crop loans and agriculture term loans) up to March 31, 2004 may be clubbed with the principal outstanding therein as on March 31, 2004, and the amount thus arrived at shall be repayable over a period of five years, at current interest rates, including an initial moratorium of two years. As regards the crop loans and agricultural term loans which have already been restructured on account of natural calamities as per the standing guidelines, only the overdue instalments including interest thereon as on March 31, 2004 may be taken into account for the proposed restructuring. On restructuring as above, the farmers concerned will become eligible for fresh loans. The rescheduled/restructured loans as also the fresh loans to be issued to the farmers may be treated as current dues and need not be classified as NPA. While the fresh loans would be governed by the NPA norms as applicable to agricultural loans, in case of rescheduled/restructured loans, the NPA norms would be applicable from the third year onwards, i.e., on expiry of the initial moratorium period of two years.

v. In case of Kharif crop loans in the districts affected by failure of the South-West monsoon as notified by the State Government, recovery of any amount either by way of principal or interest during the financial year 2002-03 need not be effected. Further, the principal amount of crop loans in such cases should be converted into term loans and will be recovered over a period of minimum 5 years in case of small and marginal farmers and 4 years in case of other farmers. Interest due in the financial year 2002-03 on crop loans should also be deferred and no interest should be charged on the deferred interest. In such cases of conversion or re-schedulement of crop loans into term loans, the term loans 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 and conditions and would be treated as NPA if interest and / or instalment of principal remain overdue for two crop seasons.

vi. While fixing the repayment schedule in case of rural housing advances granted to agriculturists under Indira Awas Yojana and Golden Jubilee Rural Housing Finance Scheme, banks should ensure that the interest/instalment payable on such advances are linked to crop cycles.

4.2.14 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. The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirements in respect of State Government guaranteed exposures. With effect from the year ending 31 March 2006 State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the bank remains overdue for more than 90 days.

4.2.15 Projects under implementation

4.2.15.1 For all projects financed by the FIs/ banks **after 28th May, 2002**, the date of completion of the project should be clearly spelt out at the time of financial closure of the project.

4.2.15.2 Project Loans

There are occasions when the completion of projects is delayed for legal and other extraneous reasons like delays in Government approvals etc. All these factors, which are beyond the control of the promoters, may lead to delay in project implementation and involve restructuring / reschedulement of loans by banks. Accordingly, the following asset classification norms would apply to the project loans before commencement of commercial operations. ***These guidelines will, however, not be applicable to restructuring of advances covered under the paragraph 14.1 of this Master Circular (Advances classified as Commercial Real Estate exposures; Advances classified as Capital Market exposure; and***

<u>Consumer and Personal Advances) which will continue to be dealt with in terms of the extant provisions i.e paragraph 14.1 of the circular.</u>

For this purpose, all project loans have been divided into the following two categories :

(a) Project Loans for infrastructure sector

(b) Project Loans for non-infrastructure sector

'Project Loan' would mean any term loan which has been extended for the purpose of setting up of an economic venture. Banks must fix a Date of Commencement of Commercial Operations (DCCO) for all project loans at the time of sanction of the loan / financial closure (in the case of multiple banking or consortium arrangements).

4.2.15.3 <u>Project Loans for Infrastructure Sector</u>

(i) A loan for an infrastructure project will be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue), unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (v) below.

(ii) A loan for an infrastructure project will be classified as NPA if it fails to commence commercial operations within two years from the original DCCO, even if it is regular as per record of recovery, unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (v) below.

(iii) If a project loan classified as 'standard asset' is restructured any time during the period up to two years from the original date of commencement of commercial operations (DCCO), in accordance with the provisions of Part B of this Master Circular, it can be retained as a standard asset if the fresh DCCO is fixed within the following limits, and further provided the account continues to be serviced as per the restructured terms.

(a) *Infrastructure Projects involving court cases*

Up to another 2 years (beyond the existing extended period of 2 years i.e total extension of 4 years), in case the reason for extension of date of commencement of production is arbitration proceedings or a court case.

(b) *Infrastructure Projects delayed for other reasons beyond the control of promoters*

Up to another 1 year (beyond the existing extended period of 2 years i.e. total extension of 3 years), in other than court cases.

(iv) It is re-iterated that the dispensation in para 4.2.15.3 (iii) is subject to adherence to the provisions regarding restructuring of accounts as contained in the Master Circular which would inter alia require that the application for restructuring should be received before the expiry of period of two years from the original DCCO and when the account is still standard as per record of recovery. The other conditions applicable would be :

a. In cases where there is moratorium for payment of interest, banks should not book income on accrual basis beyond two years from the original DCCO, considering the high risk involved in such restructured accounts.

b. Banks should maintain provisions on such accounts as long as these are classified as standard assets as under :

Until two years from the original DCCO	0.40%
During the third and the fourth years after the original DCCO.	1.00%

(v) For the purpose of these guidelines, mere extension of DCCO will also be treated as restructuring even if all other terms and conditions remain the same.

4.2.15.4 <u>Project Loans for Non-Infrastructure Sector</u>

(i) A loan for a non-infrastructure project will be classified as NPA during any time before commencement of commercial operations as per record of recovery (90 days overdue), unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (v) below.

(ii) A loan for a non-infrastructure project will be classified as NPA if it fails to commence commercial operations within six months from the original DCCO, even if is regular as per record of recovery, unless it is restructured and becomes eligible for classification as 'standard asset' in terms of paras (iii) to (v) below.

(iii) In case of non-infrastructure projects, if the delay in commencement of commercial operations extends beyond the period of six months from the date of completion as determined at the time of financial closure, banks can prescribe a fresh DCCO, and retain the "standard" classification by undertaking restructuring of accounts in accordance with the provisions contained in this Master Circular, provided the fresh DCCO does not extend beyond a period of twelve months from the original DCCO. This would among others also imply that the restructuring application is received before the expiry of six months from the original DCCO, and when the account is still "standard" as per the record of recovery.

The other conditions applicable would be :

a. In cases where there is moratorium for payment of interest, banks should not book income on accrual basis beyond six months from the original DCCO, considering the high risk involved in such restructured accounts.

b. Banks should maintain provisions on such accounts as long as these are classified as standard assets as under :

Until the first six months from the original DCCO	0.40%
During the next six months	1.00%

(iv) For this purpose, mere extension of DCCO will also be treated as restructuring even if all other terms and conditions remain the same.

4.2.15.5 Other Issues

(i) All other aspects of restructuring of project loans before commencement of commercial operations would be governed by the provisions of Part B of Master Circular on Prudential norms on Income Recognition, Asset Classification and Provisioning Pertaining to Advances. Restructuring of project loans after commencement of commercial operations will also be governed by these instructions.

(ii) Any change in the repayment schedule of a project loan caused due to an increase in the project outlay on account of increase in scope and size of the project, would not be treated as restructuring if :

(a) The increase in scope and size of the project takes place before commencement of commercial operations of the existing project.

(b) The rise in cost excluding any cost-overrun in respect of the original project is 25% or more of the original outlay.

(c) The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCP.

(d) On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch.

(iii)These guidelines would apply to those cases where the modification to terms of existing loans, as indicated above, are approved by banks from the date of this circular.

4.2.15.6 Income recognition

(i) Banks may recognise income on accrual basis in respect of the projects under implementation, which are classified as 'standard'.

(ii) Banks should not recognise income on accrual basis in respect of the projects under implementation which are classified as a 'substandard' asset. Banks may recognise income in such accounts only on realisation on cash basis.

Consequently, banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s). As regards the regulatory treatment of 'funded interest' recognised as income and 'conversion into equity, debentures or any other instrument' banks should adopt the following:

a) Funded Interest: Income recognition in respect of the NPAs, regardless of whether these are or are not subjected to restructuring/ rescheduling/ renegotiation of terms of the loan agreement, should be done strictly on cash basis, only on realisation and not if the amount of interest overdue has been funded. If, however, the amount of funded interest is recognised as income, a provision for an equal amount should also be made simultaneously. In other words, any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.

b) Conversion into equity, debentures or any other instrument: The amount outstanding converted into other instruments would normally comprise principal and the interest components. If the amount of interest dues is converted into equity or any other instrument, and income is recognised in consequence, full provision should be made for the amount of income so recognised to offset the effect of such income recognition. Such provision would be in addition to the amount of provision that may be necessary for the depreciation in the value of the equity or other instruments, as per the investment valuation norms. However, if the conversion of interest is into equity which is quoted, interest income can be recognised at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity. Such equity must thereafter be classified in the "available for sale" category and valued at lower of cost or market value. In case of conversion of principal and /or interest in respect of NPAs into debentures, such debentures should be treated as NPA, ab initio, in the same asset classification as was applicable to loan just before conversion and provision made as per norms. This norm would also apply to zero coupon bonds or other instruments which seek to defer the liability of the issuer. On such debentures, income should be recognised only on realisation basis. The income in respect of unrealised interest which is converted into debentures or any other fixed maturity instrument should be recognised only on redemption of such instrument. Subject to the above, the equity shares or other instruments arising from conversion of the principal amount of loan would also be subject to the usual prudential valuation norms as applicable to such instruments.

4.2.15.7 Provisioning

While there will be no change in the extant norms on provisioning for NPAs, banks which are already holding provisions against some of the accounts, which may now be classified as 'standard', shall continue to hold the provisions and shall not reverse the same.

4.2.16 Takeout Finance

Takeout finance is the product emerging in the context of the funding of longterm 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 predetermined basis. In view of the timelag 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.

4.2.17 Postshipment Supplier's Credit

i. In respect of postshipment credit extended by the banks covering export of goods to countries for which the ECGC's cover is available, EXIM Bank has introduced a guaranteecum-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 nonperforming asset for asset classification and provisioning purposes.

4.2.18 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.

4.2.19 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 renegotiated unless the package of renegotiated 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 substandard 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.***

Section 15 of Banking Regulation Act, 1949 – Requiring bank concerned to make adequate provisions for bad debts to the satisfaction of its auditors.

5.1.2 In conformity with the prudential norms, provisions should be made on the nonperforming 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 substandard assets, doubtful assets and loss assets as below:

5.2 Loss assets

Loss assets should be written off. If loss 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 100 percent 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
One to three years	30
More than three years	100

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 **Substandard assets**

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

(ii) ***The 'unsecured exposures' which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 20 per cent on the outstanding balance***. However, in view of certain safeguards such as escrow accounts available in respect of infrastructure lending, infrastructure loan accounts which are classified as sub-standard will attract a provisioning of 15 per cent instead of the aforesaid prescription of 20 per cent. To avail of this benefit of lower provisioning, the banks should have in place an appropriate mechanism to escrow the cash flows and also have a clear and legal first claim on these cash flows. The provisioning requirement for unsecured 'doubtful' assets is 100 per cent. Unsecured exposure is defined as an exposure where the realisable value of the security, as assessed by the bank/approved valuers/Reserve Bank's inspecting officers, is not more than 10 percent, *ab-initio*, of the outstanding exposure. 'Exposure' shall include all funded and non-funded exposures (including underwriting and similar commitments). 'Security' will mean tangible security properly discharged to the bank and will not include intangible securities like guarantees (including State government guarantees), comfort letters etc.

(iii) ***In order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the banks' balance sheet, it is advised that the following would be applicable from the financial year 2009-10 onwards :***

a) ***For determining the amount of unsecured advances for reflecting in schedule 9 of the published balance sheet, the rights, licenses, authorisations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security. Hence such advances shall be reckoned as unsecured.***

b) However, banks may treat annuities under build-operate-transfer (BOT) model in respect of road / highway projects and toll collection rights, where there are provisions to compensate the project sponsor if a certain level of traffic is not achieved, as tangible securities subject to the condition that banks' right to receive annuities and toll collection rights is legally enforceable and irrevocable.

b) Banks should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure may be made under a separate head in "Notes to Accounts". This would differentiate such loans from other entirely unsecured loans.

5.5 **Standard assets**

(i) The provisioning requirements for all types of standard assets stands amended as below, with effect from November 5, 2009. Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis:

(a) direct advances to agricultural and SME sectors at 0.25 per cent;

(b) advances to Commercial Real Estate (CRE) Sector at 1.00 per cent;

(c) all other loans and advances not included in (a) and (b) above at 0.40 per cent

(ii) The revised norms would be effective prospectively but the provisions held at present should not be reversed. However, in future, if by applying the revised provisioning norms, any provisions are required over and above the level of provisions currently held for the standard category assets, these should be duly provided for.

(iii) While the provisions on individual portfolios are required to be calculated at the rates applicable to them, the excess or shortfall in the provisioning, vis-a-vis the position as on any previous date, should be determined on an aggregate basis. If the provisions on an aggregate basis required to be held with effect from November 5, 2009 are less than the provisions already held, the provisions rendered surplus should not be reversed to P&L and should continue to be maintained at the existing level. In case of shortfall determined on aggregate basis, the balance should be provided for by debit to P&L.

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

(v) ***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 **Prudential norms on creation and utilisation of floating provisions**

5.6.1 Principle for creation of floating provisions by banks

The bank's board of directors should lay down approved policy regarding the level to which the floating provisions can be created. The bank should hold floating provisions for 'advances' and 'investments' separately and the guidelines prescribed will be applicable to floating provisions held for both 'advances' & 'investment' portfolios.

5.6.2 Principle for utilisation of floating provisions by banks

i. The floating provisions should not be used for making specific provisions as per the extant prudential guidelines in respect of nonperforming assets or for making regulatory provisions for standard assets. The floating provisions can be used only for contingencies under extraordinary circumstances for making specific provisions in impaired accounts after obtaining board's approval and with prior permission of RBI. The boards of the banks should lay down an approved policy as to what circumstances would be considered extraordinary.

ii. To facilitate banks' boards to evolve suitable policies in this regard, it is clarified that the extra-ordinary circumstances refer to losses which do not arise in the normal course of business and are exceptional and non-recurring in nature. These extra-ordinary circumstances could broadly fall under three categories viz. General, Market and Credit. Under general category, there can be situations where bank is put unexpectedly to loss due to events such as civil unrest or collapse of currency in a country. Natural calamities and pandemics may also be included in the general category. Market category would include events such as a general melt down in the markets, which affects the entire financial system. Among the credit category, only exceptional credit losses would be considered as an extra-ordinary circumstance.

iii. In terms of the Agricultural Debt Waiver and Debt Relief Scheme, 2008, lending institutions shall neither claim from the Central Government, nor recover from the farmer, interest in excess of the principal amount, unapplied interest, penal interest, legal charges, inspection charges and miscellaneous charges, etc. All such interest / charges will be borne by the lending institutions. In view of the extraordinary circumstances in which the banks are required to bear such interest / charges, banks are allowed, as a one time measure, to utilise, at their discretion, the Floating Provisions held for 'advances' portfolio, only to the extent of meeting the interest / charges referred to above.

5.6.3 Accounting

Floating provisions cannot be reversed by credit to the profit and loss account. They can only be utilised for making specific provisions in extraordinary circumstances as mentioned above. Until such utilisation, these provisions can be netted off from gross NPAs to arrive at disclosure of net NPAs. Alternatively, they can be treated as part of Tier II capital within the overall ceiling of 1.25 % of total risk weighted assets.

5.6.4 Disclosures

Banks should make comprehensive disclosures on floating provisions in the "notes on accounts" to the balance sheet on (a) opening balance in the floating provisions account, (b) the quantum of floating provisions made in the accounting year, (c) purpose and amount of draw down made during the accounting year, and (d) closing balance in the floating provisions account.

5.7 Additional Provisions for NPAs at higher than prescribed rates

The regulatory norms for provisioning represent the minimum requirement. A bank may voluntarily make specific provisions for advances at rates which are higher than the rates prescribed under existing regulations, to provide for estimated actual loss in collectible amount, provided such higher rates are approved by the Board of Directors and consistently adopted from year to year. Such additional provisions are not to be considered as floating provisions. The additional provisions for NPAs, like the minimum regulatory provision on NPAs, may be netted off from gross NPAs to arrive at the net NPAs

5.8 Provisions on Leased Assets

i) Substandard assets

a) 10 percent of the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component. The terms 'net investment in the lease', 'finance income' and 'finance charge' are as defined in 'AS 19 Leases' issued by the ICAI.

b) Unsecured lease exposures, as defined in paragraph 5.4 above, which are identified as 'substandard' would attract additional provision of 10 per cent, i.e., a total of 20 per cent.

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 is to be estimated on a realistic basis. In addition to the above provision, provision at the following rates should be made on the sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component of the secured portion, depending upon the period for which asset has been doubtful:

Period for which the advance has remained in 'doubtful' category	Provision requirement (%)
Up to one year	20
One to three years	30
More than three years	100

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 sum of the net investment in the lease and the unrealised portion of finance income net of finance charge component should be provided for.

5.9 **Guidelines for Provisions under Special Circumstances**

5.9.1 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 substandard 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 Section IV (Para 2.8) of RPCD circular RPCD.PLNFS.BC. No 83 /06.02.31/20042005 dated 1 March 2005] 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.

5.9.2 Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs, gold ornaments, government & other securities and life insurance policies would attract provisioning requirements as applicable to their asset classification status.

5.9.3 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.

5.9.4 Advances covered by ECGC guarantee

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

Example

Outstanding Balance	Rs. 4 lakhs

ECGC Cover	50 percent
Period for which the advance has remained doubtful	More than 3 years remained doubtful (as on March 31, 2004)
Value of security held (excludes worth of Rs.)	Rs. 1.50 lakhs

<u>Provision required to be made</u>

Outstanding balance	Rs. 4.00 lakhs
Less: Value of security held	Rs. 1.50 lakhs
Unrealised balance	Rs. 2.50 lakhs
Less: ECGC 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 (as on March 31, 2005)	Rs.0.90 lakhs (@ 60 per cent of the secured portion)
Total provision to be made	Rs.2.15 lakhs (as on March 31, 2005)

5.9.5 <u>Advance covered by CGTSI guarantee</u>

In case the advance covered by CGTSI guarantee becomes nonperforming, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for nonperforming advances. Two illustrative examples are given below:

<u>Example I</u>

Asset	**Doubtful – More than 3 years (as on March**

classification status:	**31, 2004)**	
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%)	Rs. 6.38 lakh	
Net unsecured and uncovered portion:	Rs. 2.12 lakh	
		<u>Provision Required</u>(as on March 31, 2005)
Secured portion	Rs.1.50 lakh	Rs. 0.90 lakh (@ 60%)
Unsecured & uncovered portion	Rs.2.12 lakh	Rs. 2.12 lakh (100%)
Total provision required		Rs. 3.02 lakh

<u>Example II</u>

Asset classification status	**Doubtful – More than 3 years (as on March 31, 2005)**	
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	Rs.10.00 lakh	

Security		
Balance outstanding	Rs.40.00 lakh	
Less Realisable value of security	Rs. 10.00 lakh	
Unsecured amount	Rs. 30.00 lakh	
Less CGTSI cover (75%)	Rs. 18.75 lakh	
Net unsecured and uncovered portion:	Rs. 11.25 lakh	
		Provision Required (as on March 31, 2005)
Secured portion	Rs.10.00 lakh	Rs. 10.00 lakh (@ 100%)
Unsecured & uncovered portion	Rs.11.25 lakh	Rs.11.25 lakh (100%)
Total provision required		Rs. 21.25 lakh

5.9.6 Takeout finance

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

5.9.7 Reserve for Exchange Rate Fluctuations Account (RERFA)

When exchange rate movements of Indian rupee turn adverse, the outstanding amount of foreign currency denominated loans (where actual disbursement was made in Indian Rupee) which becomes overdue, 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.

5.9.8 Provisioning for country risk

Banks shall make provisions, with effect from the year ending 31 March 2003, on the net funded country exposures on a graded scale ranging from 0.25 to 100 percent according to the risk categories mentioned below. To begin with, banks shall make provisions as per the following schedule:

Risk category	ECGC Classification	Provisioning Requirement (per cent)
Insignificant	A1	0.25
Low	A2	0.25
Moderate	B1	5
High	B2	20
Very high	C1	25
Restricted	C2	100
Offcredit	D	100

Banks are required to make provision for country risk in respect of a country where its net funded exposure is one per cent or more of its total assets.

The provision for country risk shall be in addition to the provisions required to be held according to the asset classification status of the asset. In the case of 'loss assets' and 'doubtful assets', provision held, including provision held for country risk, may not exceed 100% of the outstanding.

Banks may not make any provision for 'home country' exposures i.e. exposure to India. The exposures of foreign branches of Indian banks to the host country should be included. Foreign banks shall compute the country exposures of their Indian branches and shall hold appropriate provisions in their Indian books. However, their exposures to India will be excluded.

Banks may make a lower level of provisioning (say 25% of the requirement) in respect of shortterm exposures (i.e. exposures with contractual maturity of less than 180 days).

5.9.9 Excess Provisions on sale of Standard Asset / NPAs

(a) If the sale is in respect of Standard Asset and the sale consideration is higher than the book value, the excess provisions may be credited to Profit and Loss Account.

(b) Excess provisions which arise on sale of NPAs can be admitted as Tier II capital subject to the overall ceiling of 1.25% of total Risk Weighted Assets. Accordingly, these excess provisions that arise on sale of NPAs would be eligible for Tier II status in terms of paragraph 4.3.2 of Master Circular DBOD.No.BP.BC.73/21.06.001/2009-10 dated February 8, 2010 on Prudential guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF) and paragraph 2.1.1.2.C of Master Circular DBOD.No.BP.BC.6/21.01.002/2009-10 dated July 1, 2009 on Prudential Norms on Capital adequacy - Basel I Framework.

5.9.10 Provisions for Diminution of Fair Value

Provisions for diminution of fair value of restructured advances, both in respect of Standard Assets as well as NPAs, made on account of reduction in rate of interest and / or reschedulement of principal amount are permitted to be netted from the relative asset.

5.9.11 Provisioning norms for Liquidity facility provided for Securitisation transactions

The amount of liquidity facility drawn and outstanding for more than 90 days, in respect of securitisation transactions undertaken in terms of our guidelines on securitisation dated February 1, 2006, should be fully provided for.

5.9.12 Provisioning requirements for derivative exposures

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

5.10 **Provisioning Coverage Ratio**

i. At present, the provisioning requirements for NPAs range between 10 per cent and 100 per cent of the outstanding amount, depending on the age of the NPAs and the security available. Banks can also make additional specific provisions subject to a consistent policy based on riskiness of their credit portfolios, because the rates of provisioning stipulated for NPAs are the regulatory minimum. It has been observed that there is a wide heterogeneity and variance in the level of provisioning coverage ratio across different banks.

ii. Currently there is a realisation from a macro-prudential perspective that banks should build up provisioning and capital buffers in good times i.e. when the profits are good, which can be used for absorbing losses in a downturn. With this in view, there is a need for improving the provisioning cover as the banking system is currently making good profits. This will enhance the soundness of individual banks, as also the stability of the financial sector. It has therefore been decided that banks should augment their provisioning cushions consisting of specific provisions against NPAs as well as floating provisions, and ensure that their total provisioning coverage ratio, including floating provisions, is not less than 70 per cent.

iii. Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to gross non-performing assets and indicates the extent of funds a bank has kept aside to cover loan losses. Banks are advised to compute the PCR as per the format given in Annex – 3.

iv. Banks should achieve this norm not later than end-September 2010. Also, the PCR should be disclosed in the Notes to Accounts to the Balance Sheet.

6. Guidelines on sale of financial assets to Securitisation Company (SC)/ Reconstruction Company (RC) (created under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act,2002) and related issues

6.1 Scope

These guidelines would be applicable to sale of financial assets enumerated in paragraph 6.3 below, by banks/ FIs, for asset reconstruction/ securitisation under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

6.2 Structure

The guidelines to be followed by banks/ FIs while selling their financial assets to SC/RC under the Act ibid and investing in bonds/ debentures/ security receipts offered by the SC/RC are given below. The prudential guidelines have been grouped under the following headings:

i) Financial assets which can be sold.

ii) Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects.

iii) Prudential norms, in the following areas, for banks/ FIs for sale of their financial assets to SC/ RC and for investing in bonds/ debentures/ security receipts and any other securities offered by the SC/RC as compensation consequent upon sale of financial assets:

a) Provisioning / Valuation norms

b) Capital adequacy norms

c) Exposure norms

iv) Disclosure requirements

6.3 Financial assets which can be sold

A financial asset may be sold to the SC/RC by any bank/ FI where the asset is:

i) A NPA, including a non-performing bond/ debenture, and

ii) A Standard Asset where:

(a) the asset is under consortium/ multiple banking arrangements,

(b) at least 75% by value of the asset is classified as non-performing asset in the books of other banks/FIs, and

(c) at least 75% (by value) of the banks / FIs who are under theconsortium / multiple banking arrangements agree to the sale of the asset to SC/RC.

6.4. Procedure for sale of banks'/ FIs' financial assets to SC/ RC, including valuation and pricing aspects

(a) The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) allows acquisition of financial assets by SC/RC from any bank/ FI on such terms and conditions as may be agreed upon between them. This provides for sale of the financial assets on 'without recourse' basis, i.e., with the entire credit risk associated with the financial assets being transferred to SC/ RC, as well as on 'with recourse' basis, i.e., subject to unrealized part of the asset reverting to the seller bank/ FI. Banks/ FIs are, however, directed to ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank/ FI and after the sale there should not be any known liability devolving on the banks/ FIs.

(b) Banks/ FIs, which propose to sell to SC/RC their financial assets should ensure that the sale is conducted in a prudent manner in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, *inter alia*,

i. Financial assets to be sold;

ii. Norms and procedure for sale of such financial assets;

iii. Valuation procedure to be followed to ensure that the realisable value of financial assets is reasonably estimated;

iv. Delegation of powers of various functionaries for taking decision on the sale of the financial assets; etc.

(c) Banks/ FIs should ensure that subsequent to sale of the financial assets to SC/RC, they do not assume any operational, legal or any other type of risks relating to the financial assets sold.

(d) (i) Each bank / FI will make its own assessment of the value offered by the SC / RC for the financial asset and decide whether to accept or reject the offer.

(ii) In the case of consortium / multiple banking arrangements, if 75% (by value) of the banks / FIs decide to accept the offer, the remaining banks / FIs will be obligated to accept the offer.

(iii) Under no circumstances can a transfer to the SC/ RC be made at a contingent price whereby in the event of shortfall in the realization by the SC/RC, the banks/ FIs would have to bear a part of the shortfall.

(e) Banks/ FIs may receive cash or bonds or debentures as sale consideration for the financial assets sold to SC/RC.

(f) Bonds/ debentures received by banks/ FIs as sale consideration towards sale of financial assets to SC/RC will be classified as investments in the books of banks/ FIs.

(g) Banks may also invest in security receipts, Pass-through certificates (PTC), or other bonds/ debentures issued by SC/RC. These securities will also be classified as investments in the books of banks/ FIs.

(h) In cases of specific financial assets, where it is considered necessary, banks/ FIs may enter into agreement with SC/RC to share, in an agreed proportion, any surplus realised by SC/RC on the eventual realisation of the concerned asset. In such cases the terms of sale should provide for a report from the SC/RC to the bank/ FI on the value realised from the asset. No credit for the expected profit will be taken by banks/ FIs until the profit materializes on actual sale.

6.5. Prudential norms for banks/ FIs for the sale transactions

(A) <u>Provisioning/ valuation norms</u>

(a) (i) When a bank / FI sells its financial assets to SC/ RC, on transfer the same will be removed from its books.

(ii) If the sale to SC/ RC is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

(iii) If the sale is for a value higher than the NBV, the excess provision will not be reversed but will be utilized to meet the shortfall/ loss on account of sale of other financial assets to SC/RC.

(iv) When banks/ FIs invest in the security receipts/ pass-through certificates issued by SC/RC in respect of the financial assets sold by them to the SC/RC, the sale shall be recognised in books of the banks / FIs at the lower of:

- the redemption value of the security receipts/ pass-through certificates, and
- the NBV of the financial asset.

The above investment should be carried in the books of the bank / FI at the price as determined above until its sale or realization, and on such sale or realization, the loss or gain must be dealt with in the same manner as at (ii) and (iii) above.

(b) *The securities (bonds and debentures) offered by SC / RC should satisfy the following conditions:*

(i) The securities must not have a term in excess of six years.

(ii) The securities must carry a rate of interest which is not lower than 1.5% above the Bank Rate in force at the time of issue.

(iii) The securities must be secured by an appropriate charge on the assets transferred.

(iv) The securities must provide for part or full prepayment in the event the SC / RC sells the asset securing the security before the maturity date of the security.

(v). The commitment of the SC / RC to redeem the securities must be unconditional and not linked to the realization of the assets.

(vi) Whenever the security is transferred to any other party, notice of transfer should be issued to the SC/ RC.

(c) *Investment in debentures/ bonds/ security receipts/ Pass-through certificates issued by SC/ RC*

All instruments received by banks/FIs from SC/RC as sale consideration for financial assets sold to them and also other instruments issued by SC/ RC in which banks/ FIs invest will be in the nature of non SLR securities. Accordingly, the valuation, classification and other norms applicable to investment in non-SLR instruments prescribed by RBI from time to time would be applicable to bank's/

FI's investment in debentures/ bonds/ security receipts/PTCs issued by SC/ RC. However, if any of the above instruments issued by SC/RC is limited to the actual realisation of the financial assets assigned to the instruments in the concerned scheme the bank/ FI shall reckon the Net Asset Value (NAV), obtained from SC/RC from time to time, for valuation of such investments.

(B) Exposure Norms

Banks'/ FIs' investments in debentures/ bonds/ security receipts/PTCs issued by a SC/RC will constitute exposure on the SC/RC. As only a few SC/RC are being set up now, banks'/ FIs' exposure on SC/RC through their investments in debentures/ bonds/security receipts/PTCs issued by the SC/ RC may go beyond their prudential exposure ceiling. In view of the extra ordinary nature of event, banks/ FIs will be allowed, in the initial years, to exceed prudential exposure ceiling on a case-to-case basis.

6.6. Disclosure Requirements

Banks/ FIs, which sell their financial assets to an SC/ RC, shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

Details of financial assets sold during the year to SC/RC for Asset Reconstruction

a. No. of accounts

b. Aggregate value (net of provisions) of accounts sold to SC / RC

c. Aggregate consideration

d. Additional consideration realized in respect of accounts transferred in earlier years

e. Aggregate gain / loss over net book value.

6.7. Related Issues

(a) SC/ RC will also take over financial assets which cannot be revived and which, therefore, will have to be disposed of on a realisation basis. Normally the SC/ RC will not take over these assets but act as an agent for recovery for which it will charge a fee.

(b) Where the assets fall in the above category, the assets will not be removed from the books of the bank/ FI but realisations as and when received will be credited to the asset account. Provisioning for the asset will continue to be made by the bank / FI in the normal course.

7. <u>Guidelines on purchase/ sale of Non - Performing Financial Assets</u>

In order to increase the options available to banks for resolving their non performing assets and to develop a healthy secondary market for nonperforming assets, where securitisation companies and reconstruction companies are not involved, guidelines have been issued to banks on purchase / sale of NonPerforming Assets. Since the sale/purchase of nonperforming financial assets under this option would be conducted within the financial system the whole process of resolving the non performing assets and matters related thereto has to be initiated with due diligence and care warranting the existence of a set of clear guidelines which shall be complied with by all entities so that the process of resolving nonperforming assets by sale and purchase of NPAs proceeds on smooth and sound lines. Accordingly guidelines on sale/purchase of nonperforming assets have been formulated and furnished below. The guidelines may be placed before the bank's /FI's /NBFC's Board and appropriate steps may be taken for their implementation.

Scope

7.1 These guidelines would be applicable to banks, FIs and NBFCs purchasing/ selling non performing financial assets, from/ to other banks/FIs/NBFCs (excluding securitisation companies/ reconstruction companies).

7.2 A financial asset, including assets under multiple/consortium banking arrangements, would be eligible for purchase/sale in terms of these guidelines if it is a nonperforming asset/non performing investment in the books of the selling bank.

7.3 The reference to ‘bank’ in the guidelines on purchase/sale of nonperforming financial assets would include financial institutions and NBFCs.

Structure

7.4 The guidelines to be followed by banks purchasing/ selling nonperforming financial assets from / to other banks are given below. The guidelines have been grouped under the following headings:

i) Procedure for purchase/ sale of non performing financial assets by banks, including valuation and pricing aspects.
ii) Prudential norms, in the following areas, for banks for purchase/ sale of non performing financial assets:

a) Asset classification norms
b) Provisioning norms
c) Accounting of recoveries
d) Capital adequacy norms
e) Exposure norms

iii) Disclosure requirements

7.5 **Procedure for purchase/ sale of non performing financial assets, including valuation and pricing aspects**

i) A bank which is purchasing/ selling nonperforming financial assets should ensure that the purchase/ sale is conducted in accordance with a policy approved by the Board. The Board shall lay down policies and guidelines covering, *inter alia*,

a) Non performing financial assets that may be purchased/ sold;

b) Norms and procedure for purchase/ sale of such financial assets;

c) Valuation procedure to be followed to ensure that the economic value of financial assets is reasonably estimated based on the estimated cash flows arising out of repayments and recovery prospects;

d) Delegation of powers of various functionaries for taking decision on the purchase/ sale of the financial assets; etc.

e) Accounting policy

ii) While laying down the policy, the Board shall satisfy itself that the bank has adequate skills to purchase non performing financial assets and deal with them in an efficient manner which will result in value addition to the bank. The Board should also ensure that appropriate systems and procedures are in place to effectively address the risks that a purchasing bank would assume while engaging in this activity.

iii) Banks should, while selling NPAs, work out the net present value of the estimated cash flows associated with the realisable value of the available securities net of the cost of realisation. The sale price should generally not be lower than the net present value arrived at in the manner described above. (Same principle should be used in compromise settlements. As the payment of the compromise amount may be in instalments, the net present value of the settlement amount should be calculated and this amount should generally not be less than the net present value of the realisable value of securities.)

iv) The estimated cash flows are normally expected to be realised within a period of three years and at least 10% of the estimated cash flows should be realized in the first year and at least 5% in each half year thereafter, subject to full recovery within three years.

v) A bank may purchase/sell nonperforming financial assets from/to other banks only on 'without recourse' basis, i.e., the entire credit risk associated with the nonperforming financial assets should be transferred to the purchasing bank. Selling bank shall ensure that the effect of the sale of the financial assets should be such that the asset is taken off the books of the bank and after the sale there should not be any known liability devolving on the selling bank.

vi) Banks should ensure that subsequent to sale of the non performing financial assets to other banks, they do not have any involvement with reference to assets sold and do not assume operational, legal or any other type of risks relating to the financial assets sold. Consequently, the specific financial asset should not enjoy the support of credit enhancements / liquidity facilities in any form or manner.

vii) Each bank will make its own assessment of the value offered by the purchasing bank for the financial asset and decide whether to accept or reject the offer.

viii) Under no circumstances can a sale to other banks be made at a contingent price whereby in the event of shortfall in the realization by the purchasing banks, the selling banks would have to bear a part of the shortfall.

ix) A nonperforming asset in the books of a bank shall be eligible for sale to other banks only if it has remained a nonperforming asset for at least two years in the books of the selling bank.

x) Banks shall sell nonperforming financial assets to other banks only on cash basis. The entire sale consideration should be received upfront and the asset can be taken out of the books of the selling bank only on receipt of the entire sale consideration.

xi) A nonperforming financial asset should be held by the purchasing bank in its books at least for a period of 15 months before it is sold to other banks. Banks should not sell such assets back to the bank, which had sold the NPFA.

(xii) Banks are also permitted to sell/buy homogeneous pool within retail non-performing financial assets, on a portfolio basis provided each of the non-performing financial assets of the pool has remained as nonperforming financial asset for at least 2 years in the books of the selling bank. The pool of assets would be treated as a single asset in the books of the purchasing bank.

xiii) The selling bank shall pursue the staff accountability aspects as per the existing instructions in respect of the nonperforming assets sold to other banks.

7.6. **Prudential norms for banks for the purchase/ sale transactions**

(A) <u>Asset classification norms</u>

(i) The nonperforming financial asset purchased, may be classified as 'standard' in the books of the purchasing bank for a period of 90 days from the date of purchase. Thereafter, the asset classification status of the financial asset purchased, shall be determined by the record of recovery in the books of the purchasing bank with reference to cash flows estimated while purchasing the asset which should be in compliance with requirements in Para 7.5 (iv).

(ii) The asset classification status of an existing exposure (other than purchased financial asset) to the same obligor in the books of the purchasing bank will continue to be governed by the record of recovery of that exposure and hence may be different.

(iii) Where the purchase/sale does not satisfy any of the prudential requirements prescribed in these guidelines the asset classification status of the financial asset in the books of the purchasing bank at the time of purchase shall be the same as in the books of the selling bank. Thereafter, the asset classification status will continue to be determined with reference to the date of NPA in the selling bank.

(iv) Any restructure/reschedule/rephrase of the repayment schedule or the estimated cash flow of the nonperforming financial asset by the purchasing bank shall render the account as a nonperforming asset.

(B) Provisioning norms

Books of selling bank

i) When a bank sells its nonperforming financial assets to other banks, the same will be removed from its books on transfer.

ii) If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.

iii) If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/ loss on account of sale of other nonperforming financial assets.

Books of purchasing bank

The asset shall attract provisioning requirement appropriate to its asset classification status in the books of the purchasing bank.

(C) Accounting of recoveries

Any recovery in respect of a nonperforming asset purchased from other banks should first be adjusted against its acquisition cost. Recoveries in excess of the acquisition cost can be recognised as profit.

(D) Capital Adequacy

For the purpose of capital adequacy, banks should assign 100% risk weights to the nonperforming financial assets purchased from other banks. In case the non-performing asset purchased is an investment, then it would attract capital charge for market risks also. For NBFCs the relevant instructions on capital adequacy would be applicable.

(E) Exposure Norms

The purchasing bank will reckon exposure on the obligor of the specific financial asset. Hence these banks should ensure compliance with the prudential credit exposure ceilings (both single and group) after reckoning the exposures to the obligors arising on account of the purchase. For NBFCs the relevant instructions on exposure norms would be applicable.

7.7. **Disclosure Requirements**

Banks which purchase nonperforming financial assets from other banks shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

A. Details of nonperforming financial assets purchased:

(Amounts in Rupees crore)

1. (a) No. of accounts purchased during the year
(b) Aggregate outstanding

2. (a) Of these, number of accounts restructured during the year
(b) Aggregate outstanding

B. Details of nonperforming financial assets sold:

(Amounts in Rupees crore)

1. No. of accounts sold
2. Aggregate outstanding
3. Aggregate consideration received

C.The purchasing bank shall furnish all relevant reports to RBI, CIBIL etc. in respect of the nonperforming financial assets purchased by it.

8. Writing off of NPAs

8.1 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.

8.2 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.

8.3 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.

8.4 **Write-off at Head Office Level**

Banks may writeoff 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.

PART B

Prudential Guidelines on Restructuring of Advances by Banks

9. Background

9.1 The guidelines issued by the Reserve Bank of India on restructuring of advances (other than those restructured under a separate set of guidelines issued by the Rural Planning and Credit Department (RPCD) of the RBI on restructuring of advances on account of natural calamities) are divided into the following four categories :

(i) Guidelines on restructuring of advances extended to industrial units.

(ii) Guidelines on restructuring of advances extended to industrial units under the Corporate Debt Restructuring (CDR) Mechanism

(iii) Guidelines on restructuring of advances extended to Small and Medium Enterprises (SME)

(iv) Guidelines on restructuring of all other advances.

In these four sets of guidelines on restructuring of advances, the differentiation has been broadly made based on whether a borrower is engaged in an industrial activity or a non-industrial activity. In addition an elaborate institutional mechanism has been laid down for accounts restructured under CDR Mechanism. The major difference in the prudential regulations lies in the stipulation that subject to certain conditions, the accounts of borrowers engaged in industrial activities (under CDR Mechanism, SME Debt Restructuring Mechanism and outside these mechanisms) continue to be classified in the existing asset classification category upon restructuring. This benefit of retention of asset classification on restructuring is not available to the accounts of borrowers engaged in non-industrial activities except to SME borrowers. Another difference is that the prudential regulations covering the CDR Mechanism and restructuring of advances extended to SMEs are more detailed and comprehensive than that covering the restructuring of the rest of the advances including the advances extended to the industrial units, outside CDR Mechanism. Further, the CDR Mechanism is available only to the borrowers engaged in industrial activities.

9.2 Since the principles underlying the restructuring of all advances were identical, the prudential regulations needed to be aligned in all cases. Accordingly, the prudential norms across all categories of debt restructuring mechanisms, other than those restructured on account of natural calamities which will continue to be covered by the extant guidelines issued by the RPCD were harmonised in August 2008. These prudential norms applicable to all restructurings including those under CDR Mechanism are laid down in para 11. The details of the institutional / organizational framework for CDR Mechanism and SME Debt Restructuring Mechanism are given in Annex-4.

It may be noted that while the general principles laid down in para 11 inter-alia stipulate that 'standard' advances should be re-classified as 'sub-standard' immediately on restructuring, all borrowers, with the exception of the borrowal categories specified in para 14.1 below (i.e consumer and personal advances,

advances classified as capital market and real estate exposures), will be entitled to retain the asset classification upon restructuring, subject to the conditions enumerated in para 14.2.

9.3 The CDR Mechanism (Annex 4) will also be available to the corporates engaged in non-industrial activities, if they are otherwise eligible for restructuring as per the criteria laid down for this purpose. Further, banks are also encouraged to strengthen the co-ordination among themselves in the matter of restructuring of consortium / multiple banking accounts, which are not covered under the CDR Mechanism.

10. Key Concepts

Key concepts used in these guidelines are defined in Annex-5.

11. General Principles and Prudential Norms for Restructured Advances

The principles and prudential norms laid down in this paragraph are applicable to all advances including the borrowers, who are eligible for special regulatory treatment for asset classification as specified in para 14. In these cases, the provisions of paras 11.1.2, 11.2.1 and 11.2.2 would stand modified by the provisions in para 14.

11.1 Eligibility criteria for restructuring of advances

11.1.1 Banks may restructure the accounts classified under 'standard', 'sub-standard' and 'doubtful' categories.

11.1.2 Banks can not reschedule / restructure / renegotiate borrowal accounts with retrospective effect. While a restructuring proposal is under consideration, the usual asset classification norms would continue to apply. The process of re-classification of an asset should not stop merely because restructuring proposal is under consideration. The asset classification status as on the date of approval of the restructured package by the competent authority would be relevant to decide the asset classification status of the account after restructuring / rescheduling / renegotiation. In case there is undue delay in sanctioning a restructuring package and in the meantime the asset classification status of the account undergoes deterioration, it would be a matter of supervisory concern.

11.1.3 Normally, restructuring can not take place unless alteration / changes in the original loan agreement are made with the formal consent / application of the debtor. However, the process of restructuring can be initiated by the bank in deserving cases subject to customer agreeing to the terms and conditions.

11.1.4 No account will be taken up for restructuring by the banks unless the financial viability is established and there is a reasonable certainty of repayment from the borrower, as per the terms of restructuring package. The viability should be determined by the banks based on the acceptable viability benchmarks determined by them, which may be applied on a case-by-case basis, depending on merits of each case. Illustratively, the parameters may include the Return on Capital Employed, Debt Service Coverage Ratio, Gap between the Internal Rate of Return and Cost of Funds and the amount of provision required in lieu of the diminution in the fair value of the restructured advance. The accounts not considered viable should not be restructured and banks should accelerate the recovery measures in respect of such accounts. Any restructuring done without looking into cash flows of the borrower and assessing the viability of the projects / activity financed by banks would be treated as an attempt at ever greening a weak credit facility and would invite supervisory concerns / action.

11.1.5 While the borrowers indulging in frauds and malfeasance will continue to remain ineligible for restructuring, banks may review the reasons for classification of the borrowers as wilful defaulters specially in old cases where the manner of classification of a borrower as a wilful defaulter was not transparent and satisfy itself that the borrower is in a position to rectify the wilful default. The restructuring of such cases may be done with Board's approval, while for such accounts the restructuring under the CDR Mechanism may be carried out with the approval of the Core Group only.

11.1.6 BIFR cases are not eligible for restructuring without their express approval. CDR Core Group in the case of advances restructured under CDR Mechanism / the lead bank in the case of SME Debt Restructuring Mechanism and the individual banks in other cases, may consider the proposals for restructuring in such cases, after ensuring that all the formalities in seeking the approval from BIFR are completed before implementing the package.

11.2 **Asset classification norms**

Restructuring of advances could take place in the following stages :

(a) before commencement of commercial production / operation;

(b) after commencement of commercial production / operation but before the asset has been classified as 'sub-standard';

(c) after commencement of commercial production / operation and the asset has been classified as 'sub-standard' or 'doubtful'.

11.2.1 The accounts classified as 'standard assets' should be immediately re-classified as 'sub-standard assets' upon restructuring.

11.2.2 The non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-restructuring repayment schedule.

11.2.3 All restructured accounts which have been classified as non-performing assets upon restructuring, would be eligible for up-gradation to the 'standard' category after observation of 'satisfactory performance' during the 'specified period' (Annex-5).

11.2.4 In case, however, satisfactory performance after the specified 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.

11.2.5 Any additional finance may be treated as 'standard asset', up to a period of one year after the first interest / principal payment, whichever is earlier, falls due under the approved restructuring package. However, in the case of accounts where the prerestructuring facilities were classified as 'sub-standard' and 'doubtful', interest income on the additional finance should be recognised only on cash basis. If the restructured asset does not qualify for upgradation at the end of the above specified one year period, the additional finance shall be placed in the same asset classification category as the restructured debt.

11.2.6 In case a restructured asset, which is a standard asset on restructuring, is subjected to restructuring on a subsequent occasion, it should be classified as substandard. If the restructured asset is a sub-standard or a doubtful asset and is subjected to restructuring, on a subsequent occasion, its asset classification will be reckoned from the date when it became NPA on the first occasion. However, such advances restructured on second or more occasion may be allowed to be upgraded to standard category after one year from the date of first payment of interest or repayment of principal whichever falls due earlier in terms of the current restructuring package subject to satisfactory performance.

11.3 **Income recognition norms**

Subject to provisions of paragraphs 11.2.5, 12.2 and 13.2, interest income in respect of restructured accounts classified as 'standard assets' will be recognized on accrual basis and that in respect of the accounts classified as 'non-performing assets' will be recognized on cash basis.

11.4 **Provisioning norms**

11.4.1 ***Normal provisions***

Banks will hold provision against the restructured advances as per the existing provisioning norms.

11.4.2 ***Provision for diminution in the fair value of restructured advances***

(i) Reduction in the rate of interest and / or reschedulement of the repayment of principal amount, as part of the restructuring, will result in diminution in the fair value of the advance. Such diminution in value is an economic loss for the bank and will have impact on the bank's market value of equity. It is, therefore, necessary for banks to measure such diminution in the fair value of the advance and make provisions for it by debit to Profit & Loss Account. Such provision should be held in addition to the provisions as per existing provisioning norms as indicated in para 11.4.1 above, and in an account distinct from that for normal provisions.

For this purpose, the erosion in the fair value of the advance should be computed as the difference between the fair value of the loan before and after restructuring. Fair value of the loan before restructuring will be computed as the present value of cash flows representing the interest at the existing rate charged on the advance before restructuring and the principal, discounted at a rate equal to the bank's BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring. Fair value of the loan after restructuring will be computed as the present value of cash flows representing the interest at the rate charged on the advance on restructuring and the principal, discounted at a rate equal to the bank's

BPLR as on the date of restructuring plus the appropriate term premium and credit risk premium for the borrower category on the date of restructuring.

The above formula moderates the swing in the diminution of present value of loans with the interest rate cycle and will have to follow consistently by banks in future. Further, it is reiterated that the provisions required as above arise due to the action of the banks resulting in change in contractual terms of the loan upon restructuring which are in the nature of financial concessions. These provisions are distinct from the provisions which are linked to the asset classification of the account classified as NPA and reflect the impairment due to deterioration in the credit quality of the loan. Thus, the two types of the provisions are not substitute for each other.

(ii) In the case of working capital facilities, the diminution in the fair value of the cash credit / overdraft component may be computed as indicated in para (i) above, reckoning the higher of the outstanding amount or the limit sanctioned as the principal amount and taking the tenor of the advance as one year. The term premium in the discount factor would be as applicable for one year. The fair value of the term loan components (Working Capital Term Loan and Funded Interest Term Loan) would be computed as per actual cash flows and taking the term premium in the discount factor as applicable for the maturity of the respective term loan components.

(iii) In the event any security is taken in lieu of the diminution in the fair value of the advance, it should be valued at Re.1/- till maturity of the security. This will ensure that the effect of charging off the economic sacrifice to the Profit & Loss account is not negated.

(iv) The diminution in the fair value 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.

(v) If due to lack of expertise / appropriate infrastructure, a bank finds it difficult to ensure computation of diminution in the fair value of advances extended by small / rural branches, as an alternative to the methodology prescribed above for computing the amount of diminution in the fair value, banks will have the option of notionally computing the amount of diminution in the fair value and providing therefor, at five percent of the total exposure, in respect of all restructured accounts where the total dues to bank(s) are less than rupees one crore till the financial year ending March 2011. The position would be reviewed thereafter.

11.4.3 The total provisions required against an account (normal provisions plus provisions in lieu of diminution in the fair value of the advance) are capped at 100% of the outstanding debt amount.

12. <u>Prudential Norms for Conversion of Principal into Debt / Equity</u>

12.1 **Asset classification norms**

A part of the outstanding principal amount can be converted into debt or equity instruments as part of restructuring. The debt / equity instruments so created will be classified in the same asset classification category in which the restructured advance has been classified. Further movement in the asset classification of these instruments would also be determined based on the subsequent asset classification of the restructured advance.

12.2 **Income recognition norms**

12.2.1 ***Standard Accounts***

In the case of restructured accounts classified as 'standard', the income, if any, generated by these instruments may be recognised on accrual basis.

12.2.2 ***Non- Performing Accounts***

In the case of restructured accounts classified as non-performing assets, the income, if any, generated by these instruments may be recognised only on cash basis.

12.3 **Valuation and provisioning norms**

These instruments should be held under AFS and valued as per usual valuation norms. Equity classified as standard asset should be valued either at market value, if quoted, or at break-up value, if not quoted (without considering the revaluation reserve, if any,)which is to be ascertained from the company's latest balance sheet. In case the latest balance sheet is not available the shares are to be valued at Rs 1. Equity instrument classified as NPA should be valued at market value, if quoted, and in case where equity is not quoted,it should be valued at Rs. 1. Depreciation on these instruments should not be offset against the appreciation in any other securities held under the AFS category.

13. Prudential Norms for Conversion of Unpaid Interest into 'Funded Interest Term Loan' (FITL), Debt or Equity Instruments

13.1 **Asset classification norms**

The FITL / debt or equity instrument created by conversion of unpaid interest will be classified in the same asset classification category in which the restructured advance has been classified. Further movement in the asset classification of FITL / debt or equity instruments would also be determined based on the subsequent asset classification of the restructured advance.

13.2 **Income recognition norms**

13.2.1 The income, if any, generated by these instruments may be recognised on accrual basis, if these instruments are classified as 'standard', and on cash basis in the cases where these have been classified as a non-performing asset.

13.2.2 The unrealised income represented by FITL / Debt or equity instrument should have a corresponding credit in an account styled as "Sundry Liabilities Account (Interest Capitalization)".

13.2.3 In the case of conversion of unrealised interest income into equity, which is quoted, interest income can be recognized after the account is upgraded to standard category at market value of equity, on the date of such up gradation, not exceeding the amount of interest converted into equity.

13.2.4 Only on repayment in case of FITL or sale / redemption proceeds of the debt / equity instruments, the amount received will be recognized in the P&L Account, while simultaneously reducing the balance in the "Sundry Liabilities Account (Interest Capitalisation)".

13.3 **Valuation & Provisioning norms**

Valuation and provisioning norms would be as per para 12.3 above. The depreciation, if any, on valuation may be charged to the Sundry Liabilities (Interest Capitalisation) Account.

14. <u>Special Regulatory Treatment for Asset Classification</u>

14.1 The special regulatory treatment for asset classification, in modification to the provisions in this regard stipulated in para 11, will be available to the borrowers engaged in important business activities, subject to compliance with certain conditions as enumerated in para 14.2 below. Such treatment is not extended to the following categories of advances:

i. Consumer and personal advances;

ii. Advances classified as Capital market exposures;

iii. Advances classified as commercial real estate exposures

The asset classification of these three categories accounts as well as that of other accounts which do not comply with the conditions enumerated in para 14.2, will be governed by the prudential norms in this regard described in para 11 above.

14.2 **Elements of special regulatory framework**

The special regulatory treatment has the following two components :

(i) Incentive for quick implementation of the restructuring package.

(ii) Retention of the asset classification of the restructured account in the pre-restructuring asset classification category

14.2.1 ***Incentive for quick implementation of the restructuring package***

As stated in para 11.1.2, during the pendency of the application for restructuring of the advance with the bank, the usual asset classification norms would continue to apply. The process of reclassification of an asset should not stop merely because the application is under consideration. However, as an incentive for quick implementation of the package, if the approved package is implemented by the bank as per the following time schedule, the asset classification status may be restored to the position which existed when the reference was made to the CDR

Cell in respect of cases covered under the CDR Mechanism or when the restructuring application was received by the bank in non-CDR cases:

(i) Within 120 days from the date of approval under the CDR Mechanism.

(ii) Within 90 days from the date of receipt of application by the bank in cases other than those restructured under the CDR Mechanism.

14.2.2 **Asset classification benefits**

Subject to the compliance with the undernoted conditions in addition to the adherence to the prudential framework laid down in para 11:

(i) In modification to para 11.2.1, an existing 'standard asset' will not be downgraded to the sub-standard category upon restructuring.

(ii) In modification to para 11.2.2, during the specified period, the asset classification of the sub-standard / doubtful accounts will not deteriorate upon restructuring, if satisfactory performance is demonstrated during the specified period.

However, these benefits will be available subject to compliance with the following conditions:

i) The dues to the bank are 'fully secured' as defined in Annex 5. The condition of being fully secured by tangible security will not be applicable in the following cases:

(a) SSI borrowers, where the outstanding is up to Rs.25 lakh.

(b) Infrastructure projects, provided the cash flows generated from these projects are adequate for repayment of the advance, the financing bank(s) have in place an appropriate mechanism to escrow the cash flows, and also have a clear and legal first claim on these cash flows.

ii) The unit becomes viable in 10 years, if it is engaged in infrastructure activities, and in 7 years in the case of other units.

iii) The repayment period of the restructured advance including the moratorium, if any, does not exceed 15 years in the case of infrastructure advances and 10 years in the case of other advances. The aforesaid ceiling of 10 years would not be applicable for restructured home loans; in these cases the Board of Director of the banks should prescribe the maximum period for restructured advance keeping in view the safety and soundness of the advances. Lending to individuals meant for acquiring residential property which are fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented are risk weighted as under the new capital adequacy framework, provided the LTV is not more than 75% , based on board approved valuation policy. However, the restructured housing loans should be risk weighted with an additional risk weight of 25 percentage points to the risk weight prescribed already.

iv) Promoters' sacrifice and additional funds brought by them should be a minimum of 15% of banks' sacrifice. The term 'bank's sacrifice' means the amount of "erosion in the fair value of the advance", to be computed as per the methodology enumerated in para 11.4.2 (i) above. Further, the additional funds required to be brought in by the promoter should be brought up front and not be phased over a period of time.

v) Personal guarantee is offered by the promoter except when the unit is affected by external factors pertaining to the economy and industry.

vi) The restructuring under consideration is not a 'repeated restructuring' as defined in para (v) of Annex 5.

15. <u>Miscellaneous</u>

15.1 The banks should decide on the issue regarding convertibility (into equity) option as a part of restructuring exercise whereby the banks / financial institutions shall have the right to convert a portion of the restructured amount into equity, keeping in view the statutory requirement under Section 19 of the Banking Regulation Act, 1949, (in the case of banks) and relevant SEBI regulations.

15.2 Acquisition of equity shares / convertible bonds / convertible debentures in companies by way of conversion of debt / overdue interest can be done without seeking prior approval from RBI, even if by such acquisition the prudential capital market exposure limit prescribed by the RBI is breached. However, this will be subject to reporting of such holdings to RBI, Department of Banking Supervision (DBS), every month along with the regular DSB Return on Asset Quality. Nonetheless, banks will have to comply with the provisions of Section 19(2) of the Banking Regulation Act, 1949.

15.3 Acquisition of non-SLR securities by way of conversion of debt is exempted from the mandatory rating requirement and the prudential limit on investment in unlisted non-SLR securities, prescribed by the RBI, subject to periodical reporting to the RBI in the aforesaid DSB return.

15.4 Banks may consider incorporating in the approved restructuring packages creditor's rights to accelerate repayment and the borrower's right to pre-pay. The right of recompense should be based on certain performance criteria to be decided by the banks.

15.5 Since the spillover effects of the global downturn had also started affecting the Indian economy particularly from September 2008 onwards creating stress for the otherwise viable units / activities, certain modifications were made in the guidelines on restructuring as a onetime measure and for a limited period of time i.e. up to June 30, 2009. These relaxations have ceased to operate from July 1, 2009; however the same have been consolidated in Annex 8.

16. Disclosures

Banks should also disclose in their published annual Balance Sheets, under "Notes on Accounts", information relating to number and amount of advances restructured, and the amount of diminution in the fair value of the restructured advances in Annex-7. The information would be required for advances restructured under CDR Mechanism, SME Debt Restructuring Mechanism and other categories separately. Banks must disclose the total amount outstanding in all the accounts / facilities of borrowers whose accounts have been restructured along with the restructured part or facility. This means even if only one of the facilities / accounts of a borrower has been restructured, the bank should also disclose the entire outstanding amount pertaining to all the facilities / accounts of that particular borrower.

17. Illustrations

A few illustrations on the asset classification of restructured accounts are given in Annex-7.

18. We re-iterate that the basic objective of restructuring is to preserve economic value of units, not evergreening of problem accounts. This can be achieved by banks and the borrowers only by careful assessment of the viability, quick detection of weaknesses in accounts and a time-bound implementation of restructuring packages.

Part C

Agricultural Debt Waiver and Debt Relief Scheme, 2008 - Prudential Norms on
Income Recognition, Asset Classification, Provisioning, and Capital Adequacy

19. The Background

The Hon'ble Finance Minister, Government of India, in his Budget Speech (paragraph 73) for 2008-09 has announced a debt waiver and debt relief scheme for farmers, for implementation by, inter alia, all scheduled commercial banks (SCBs), and Local Area Banks (LABs). The detailed scheme announced by the Government of India was communicated to the SCBs and LABs vide our circular RPCD.No.PLFS.BC.72/05.04.02/2007-08 dated May 23, 2008. The guidelines pertaining to Income Recognition, Asset Classification and Provisioning, and Capital Adequacy as applicable to the loans covered by the captioned scheme, are furnished below.

20. Prudential Norms for the Borrowal Accounts Covered under the Agricultural Debt Waiver and Debt Relief Scheme, 2008 (ADWDRS)

As advised vide the circular RPCD.No.PLFS.BC.72/05.04.02/2007-08 dated May 23, 2008, while the entire 'eligible amount' shall be waived in the case of a small or marginal farmer, in the case of 'other farmers', there will be a one time settlement scheme (OTS) under which the farmer will be given a rebate of 25 per cent of the 'eligible amount' subject to the condition that the farmer repays the balance of 75 per cent of the 'eligible amount'.

20.1 **Norms for the Accounts subjected to Debt Waiver**

20.1.1 As regards the small and marginal farmers eligible for debt waiver, the amount eligible for waiver, as defined in the Para 4 of the enclosure to the aforesaid circular, pending receipt from the Government of India, may be transferred by the banks to a separate account named "Amount receivable from

Government of India under Agricultural Debt Waiver Scheme 2008". The balance in this account should be reflected in Schedule 9 (Advances) of the Balance sheet.

20.1.2 The balance in this account may be treated by the banks as a "performing" asset, provided adequate provision is made for the loss in Present Value (PV) terms, computed under the assumption that such payments would be received from Government of India in the following installments :

a) 32% of the total amount due by September 30, 2008,

b) 19% by July 31, 2009,

c) 39% by July 2010, and

d) the remaining 10% by July 2011.

However, the provision required under the current norms for standard assets, need not be provided for in respect of the balance in this account.

20.1.3 The discount rate for arriving at the loss in PV terms as at para 20.1.2 above should be taken as 9.56 per cent, being the yield to maturity on 364-day Government of India Treasury Bill, prevailing as on the date of the circular DBOD.No.BP.BC.26/21.04.048/2008-09 dated July 30, 2008.

20.1.4 The prudential provisions held in respect of the NPA accounts for which the debt waiver has been granted may be reckoned for meeting the provisions required on PV basis.

20.1.5 In case, however, the amount of prudential provision held is more than the amount of provision required on PV basis, such excess provision may be reversed in a phased manner. This phased reversal may be effected in the proportion of 32%, 19%, 39%, and 10% during the years ended March 2009, 2010, 2011 and 2012, respectively, only after the installments due from the Government, for the relative years, have been received.

20.1.6 On receipt of the final instalment from the Government, the provision made for loss in PV terms may be transferred to the General Reserves, below the line.

20.1.7 In case the claim of a farmer is specifically rejected at any stage, the asset classification of the account should be determined with reference to the original date of NPA (as if the account had not been treated as performing in the interregnum based on the transfer of the loan balance to the aforesaid account) and suitable provision should be made. The provision made on PV basis may also be reckoned against the NPA-provisions required, consequent upon the account being treated as NPA due to the rejection of the claim.

20.2. **Norms for the Accounts subjected to the Debt Relief**

20.2.1 Under the scheme, in the case of 'other' farmers, the farmer will be given a rebate of 25% of the "eligible amount", by the Government by credit to his account, provided the farmer pays the balance of 75% of the 'eligible amount'. The Scheme provides for payment of share of 75% by such farmers in three instalments and the first two instalments shall be for an amount not less than one-third of the farmer's share. The last dates of payment of the three instalments will be September 30, 2008; March 31, 2009 and June 30, 2009, respectively.

Asset Classification

20.2.2 Where the farmers covered under the Debt Relief Scheme have given the undertaking, agreeing to pay their share under the OTS, their relevant accounts may be treated by banks as "standard" / "performing" provided :

(a) adequate provision is made by the banks for the loss in PV terms for all the receivables due from the borrowers as well as the Government; and

(b) such farmers pay their share of the settlement within one month of the due dates

However, no grace period is allowed for the last instalment and the entire share of the farmer is payable by June 30, 2009 (cf Para 21.2)

Provisioning

20.2.3 Provisioning for Standard Assets

The accounts subject to debt relief would stand classified as standard assets after receipt of the aforesaid undertaking from the borrowers. Accordingly, such accounts would also attract the prudential provisioning as applicable to standard assets.

20.2.4 Provisioning on PV Basis

For computing the amount of loss in PV terms under the Scheme, the cash flows receivable from the farmers, as per the repayment schedule vide para 20.2.1 above, as well as from the government should be discounted to the present value. It may be assumed in this context that the Government's contribution would be received by June 30, 2010. The discount rate to be applied for the purpose should be the interest rate at which the loan was granted including the element of interest subsidy, if any, available from the Government.

20.2.5 The prudential provisions held in respect of the NPA accounts, for which the debt relief has been granted, may be reckoned for meeting the provisions required on PV basis as well as for the standard assets (pursuant to classification of these loans as standard) and shortfall, if any, may be provided for. Thus, the total provisions held would comprise the provisions required on PV basis, provision for standard assets and excess prudential provisions, if any, towards NPA.

20.2.6 Provisioning in case of down-gradation of accounts:

As mentioned at para 20.2.2 (b) above, the accounts subject to Debt Relief Scheme would be classified as standard / performing assets only if the farmers pay their share of the settlement within one month of the pre-specified due dates. In case, however, the payments are delayed by the farmers beyond one month of the respective due dates, the outstanding amount in the relevant accounts of such farmers shall be treated as NPA. The asset classification of such accounts shall be determined with reference to the original date of NPA, (as if the account had not been treated as performing in the interregnum based on the aforesaid undertaking). On such down-gradation of the accounts, additional provisions as per the extant prudential norms should also be made.

For meeting this additional provisioning requirement, the excess prudential provisions, if any, held; the amount of provisions held for standard assets (as per para 3.3 above) together with the provision made on PV basis, all in respect of such downgraded account, could be reckoned. Such additional prudential provisions too should be continued to be held and reversed only as per the stipulation at para 20.2.7 below.

20.2.7 Reversal of Excess Prudential Provisions

In case the amount of the prudential NPA provisions held are larger than the aggregate of the provision required on PV basis and for the standard assets (pursuant to classification of these loans as standard), such excess prudential provision should not be reversed but be continued to be held till the earlier of the two events, viz., :

(a) till the entire outstanding of the borrower stands repaid - at which point, the entire amount could be reversed to the P/L account; or

(b) when the amount of such excess provision exceeds the amount outstanding on account of the repayments by the borrower - at which point, the amount of provision in excess of the outstanding amount could be reversed to the P/L account.

20.2.8 Reversal of the Provisions made on PV Basis

The provision made on PV basis represents a permanent loss to the bank on account of delayed receipt of cash flows and hence, should not be reversed to the P/L Account. The amount of such provision should, therefore, be carried till the account is finally settled and after receipt of the Government's contribution under the Scheme, the amount should be reversed to the General Reserves, below the line.

20.3 Grant of Fresh Loans to the Borrowers covered under the ADWDRS

20.3.1 A small or marginal farmer will become eligible for fresh agricultural loans upon the eligible amount being waived, in terms of para 7.2 of the enclosure to the circular RPCD.No.PLFS.BC.72/05.04.02/2007-08 dated May 23, 2008. The fresh loan may be treated as "performing asset", regardless of the asset classification of the loan subjected to the Debt Waiver, and its subsequent asset classification should be governed by the extant IRAC norms.

20.3.2 In case of "other farmers" eligible for fresh short-term production loans and investment loans, as provided for in Para 7.6 and 7.7, respectively, of the enclosure to the circular RPCD.No.PLFS.BC.72/05.04.02/2007-08 dated May 23, 2008, these fresh loans may be treated as "performing assets", regardless of the asset classification of the loan subjected to the Debt Relief, and its subsequent asset classification should be governed by the extant IRAC norms.

20.4 Capital Adequacy

The amount outstanding in the account styled as "Amount receivable from Government of India under Agricultural Debt Waiver Scheme 2008" shall be treated as a claim on the Government of India and would attract zero risk weight for the purpose of capital adequacy norms. However, the amount outstanding in the accounts covered by the Debt Relief Scheme shall be treated as a claim on the borrowers and risk weighted as per the extant norms. This treatment would apply under the Basel I as well as Basel II Frameworks.

21. Subsequent Modifications to the Prudential Norms

21.1 Interest payment by the GOI

The Government of India has subsequently decided to pay interest on the 2nd, 3rd, and 4th instalments, payable by July 2009, July 2010, and July 2011 respectively, at the prevailing Yield to Maturity Rate on 364-day Government of India Treasury Bills. The interest will be paid on these instalments from the date of the reimbursement of the first instalment (i.e. November 2008) till the date of the actual reimbursement of each instalment.

In view of the above, in supersession of the instructions contained in paragraphs 20.1.2 to 20.1.7, 20.2.2 (a), and 20.2.4 to 20.2.8 above, it has been decided that the banks need not make any provisions for the loss in Present Value (PV) terms for moneys receivable only from the Government of India, for the accounts covered under the Debt Waiver Scheme and the Debt Relief Scheme.

21.2 Change in instalment schedule of "other farmers" under the Debt Relief Scheme

In view of the recent drought in some States and the severe floods in some other parts of the country, the Government of India, as announced in the Union Budget 2010-11, has now decided to extend the last date of payment of 75% of overdue portion by the 'other farmer' under Debt Relief Scheme (under ADWDR) up to June 30, 2010. The eligible "other farmers" may be allowed to repay this amount in one or more instalments up to June 30, 2010. The banks will not charge any interest on the eligible amount for the period from February 29, 2008 to June 30, 2009. However, they may charge normal rate of interest on the eligible amount from July 01, 2009 up to the date of settlement. Further, no interest shall be paid by the Government of India to the lending institutions for this extension under the

Scheme while reimbursing the 25% amount to the lending institutions as per the delayed reimbursement schedule

The Government of India has also advised that the banks / lending institutions are allowed to receive even less than 75% of the eligible amount under OTS provided the banks / lending institutions bear the difference themselves and do not claim the same either from the Government or from the farmer. The Government will pay only 25% of the actual eligible amount under debt relief.

21.3 In case, however, the payments are delayed by the farmers beyond June 30, 2010, the outstanding amount in the relevant accounts of such farmers shall be treated as NPA. The asset classification of such accounts shall be determined with reference to the original date of NPA, (as if the account had not been treated as performing in the interregnum based on the aforesaid undertaking). On such down-gradation of the accounts, additional provisions as per the extant prudential norms should also be made.

21.4 Please refer to the paragraph 20.1.1 which provides that in case of small and marginal farmers eligible for debt waiver, the amount eligible for waiver, pending receipt from the Government of India may be transferred by the banks to a separate account named "Amount receivable from Government of India under Agricultural Debt Waiver Scheme 2008", and the balance in this account should be reflected in Schedule 9 (Advances) of the Balance Sheet. It is now clarified that in case of 'other farmers' eligible for debt relief, after the 'other farmer' has paid his entire share of 75%, banks may open an account for Debt Relief Scheme, similar to the one opened for the receivables from GOI under the Debt Waiver Scheme, and bearing the nomenclature "Amount receivable from Government of India under Agricultural Debt Relief Scheme 2008". This amount may also be reflected in Schedule 9 (Advances) of the Balance Sheet.

RBI/2010-11/41

DBOD.BP.BC No. 3/21.04.018/2010-11 July 1, 2010

The Chairmen/Chief Executives of
All Scheduled Commercial Banks
(Excluding RRBs & LAB)

Dear Sir,

Master Circular - Disclosure in Financial Statements - Notes to Accounts

Please refer to the Master Circular DBOD.BP.BC.No.22/21.04.018/2009-10 dated July 1, 2009 consolidating all operative instructions issued to banks till June 30, 2009 on matters relating to disclosures in the 'Notes to Accounts' to the Financial Statements. The Master Circular has now been suitably updated by incorporating instructions issued upto June 30, 2010. The Master Circular has also been placed on the RBI web-site (http://www.rbi.org.in).

2. It may be noted that all relevant instructions on the above subject contained in the circulars listed in the Annex have been consolidated. In addition, disclosure requirements contained in "Master Circular – Prudential Guidelines on Capital Adequacy and Market Discipline - Implementation of the New Capital Adequacy Framework (NCAF)" will be applicable.

Yours faithfully,

(B. Mahapatra) Chief General Manager-In-Charge

Purpose

To provide a detailed guidance to banks in the matter of disclosures in the 'Notes to Accounts' to the Financial Statements.

Classification

A statutory guideline issued by the Reserve Bank of India under Section 35A of the Banking Regulation Act 1949.

Previous Guidelines superseded

Master Circular on 'Disclosure in Financial Statements – Notes to Accounts' issued vide DBOD.BP.BC No.22/21.04.018/2009-10 dated July 1, 2009

Scope of application

To all scheduled commercial banks (excluding RRBs & LABs)

Structure

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1. Introduction

The users of the financial statements need information about the financial position and performance of the bank in making economic decisions. They are interested in its liquidity and solvency and the risks related to the assets and liabilities recognised on its balance sheet and to it's off balance sheet items. In the interest of full and complete disclosure, some very useful information is better provided, or can only be provided, by notes to the financial statements. The use of notes and supplementary information provides the means to explain and document certain items, which are either presented in the financial statements or otherwise affect the financial position and performance of the reporting enterprise. Recently, a lot of attention has been paid to the issue of market discipline in the banking sector. Market discipline, however, works only if market participants have access to timely and reliable information, which enables them to assess banks' activities and the risks inherent in these activities. Enabling market discipline may have several benefits. Market discipline has been given due importance under Basel II by recognizing it as one of its three Pillars.

2.1 Presentation

'Summary of Significant Accounting Policies' and 'Notes to Accounts' may be shown under Schedule 17 and Schedule 18 respectively, to maintain uniformity.

2.2 Minimum Disclosures

At a minimum, the items listed in the circular should be disclosed in the 'Notes to Accounts'. Banks are also encouraged to make more comprehensive disclosures than the minimum required under the circular if they become significant and aid in the understanding of the financial position and performance of the bank. The disclosure listed is intended only to supplement, and not to replace, other disclosure requirements under relevant legislation or accounting and financial reporting standards. Where relevant, a bank should comply with such other disclosure requirements as applicable.

2.3 Summary of Significant Accounting Policies

Banks should disclose the accounting policies regarding key areas of operations at one place (under Schedule 17) along with notes to accounts in their financial statements. A suggestive list includes - Basis of Accounting, Transactions involving foreign exchange, Investments – classification, valuation, etc, Advances and Provisions thereon, Fixed Assets and Depreciation, Revenue Recognition, Employee Benefits, Provision for Taxation, Net Profit, etc, etc.

2.4 Disclosure Requirements

In order to encourage market discipline, Reserve Bank has over the years developed a set of disclosure requirements which allow the market participants to assess key pieces of information on capital adequacy, risk exposures, risk assessment processes and key business parameters which provide a consistent and understandable disclosure framework that enhances comparability. Banks are also required to comply with the Accounting Standard 1 (AS I) on Disclosure of Accounting Policies issued by the Institute of Chartered Accountants of India (ICAI). The enhanced disclosures have been achieved through revision of Balance Sheet and Profit & Loss Account of banks and enlarging the scope of disclosures to be made in "Notes to Accounts". In addition to the 16 detailed prescribed schedules to the balance sheet, banks are required to furnish the following information in the "Notes to Accounts":

3.1 Capital

(Amount in Rs. crore)

Particulars	*Current Year*	*Previous Year*
i) CRAR (%) ii) CRAR - Tier I Capital (%) iii) CRAR - Tier II Capital (%) iv) Percentage of the shareholding of the Government of India in nationalized banks v) Amount raised by issue of IPDI vi) Amount raised by issue of Upper Tier II instruments*		

* The total eligible amount of HO borrowings shall be disclosed in the balance sheet under the head 'Upper Tier II capital raised in the form of Head Office borrowings in foreign currency'.

3.2 Investments

(Amount in Rs. crore)

Particulars	*Current Year*	*Previous Year*
(1) Value of Investments		
(i) Gross Value of Investments		
(a) In India		
(b) Outside India,		
(ii) Provisions for Depreciation		
(a) In India		
(b) Outside India,		
(iii) Net Value of Investments		
(a) In India		
(b) Outside India.		
(2) Movement of provisions held towards depreciation on investments**.**		
(i) Opening balance		
(ii) Add: Provisions made during the year		
(iii) Less: Write-off/ write-back of excess provisions during the year		
(iv) Closing balance		

3.2.1 Repo Transactions (in face value terms)

(Amount in Rs. crore)

Minimum outstanding during the year	*Maximum outstanding during the year*	*Daily Average outstanding during the year*	*Outstanding as on March 31*

Securities sold under repo i. Government securities ii. Corporate debt securities
Securities purchased under reverse repo i. Government

securities ii. Corporate debt securities

3.2.2. Non-SLR Investment Portfolio

i) Issuer composition of Non SLR investments

(Amount in Rs. crore)

No.	*Issuer*	*Amount*	*Extent of Private Placement*	*Extent of 'Below Investment Grade' Securities*	*Extent of 'Unrated' Securities*	*Extent of 'Unlisted' Securities*
(1)	(2)	(3)	(4)	(5)	(6)	(7)
(i)	PSUs					
(ii)	FIs					
(iii)	Banks					
(iv)	Private Corporate					
(v)	Subsidiaries/ Joint Ventures					
(vi)	Others					
(vii)	Provision held towards depreciation	X X X	X X X	X X X	X X X	
Total *****						

Note: (1) *Total under column 3 should tally with the total of Investments included under the following categories in Schedule 8 to the balance sheet:

a) Shares
b) Debentures & Bonds
c) Subsidiaries/joint ventures
d) Others

(2) Amounts reported under columns 4, 5, 6 and 7 above may not be mutually exclusive.

ii) Non performing Non-SLR investments

(Amount in Rs. crore)

Particulars
Opening balance
Additions during the year since 1st April
Reductions during the above period
Closing balance
Total provisions held

3.3 Derivatives

3.3.1 Forward Rate Agreement/ Interest Rate Swap

(Amount in Rs. crore)

Particulars	*Current year*	*Previous year*
i) The notional principal of swap agreements		
ii) Losses which would be incurred if counterparties failed to fulfill their obligations under the agreements		
iii) Collateral required by the bank upon entering into swaps		
iv) Concentration of credit risk arising from the swaps **$**		
v) The fair value of the swap book @		

Note: Nature and terms of the swaps including information on credit and market risk and the accounting policies adopted for recording the swaps should also be disclosed.

$ Examples of concentration could be exposures to particular industries or swaps with highly geared companies.

@ If the swaps are linked to specific assets, liabilities, or commitments, the fair value would be the estimated amount that the bank would receive or pay to terminate the swap agreements as on the balance sheet date. For a trading swap the fair value would be its mark to market value.

3.3.2 Exchange Traded Interest Rate Derivatives

(Amount in Rs. crore)

S.No.	*Particulars*
(i)	Notional principal amount of exchange traded interest rate derivatives undertaken during the year (instrument-wise) a) b) c)
(ii)	Notional principal amount of exchange traded interest rate derivatives outstanding as on 31st March ….. (instrument-wise) a) b) c)
(iii)	Notional principal amount of exchange traded interest rate
derivatives outstanding and not "highly effective" (instrument-wise) a) b) c)	
(iv)	Mark-to-market value of exchange traded interest rate derivatives outstanding and not "highly effective" (instrument-wise) a) b) c)

3.3.3 Disclosures on risk exposure in derivatives

Qualitative Disclosure

Banks shall discuss their risk management policies pertaining to derivatives with particular reference to the extent to which derivatives are used, the associated risks and business purposes served. The discussion shall also include:

a) the structure and organization for management of risk in derivatives trading,

b) the scope and nature of risk measurement, risk reporting and risk monitoring systems,

c) policies for hedging and/ or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges / mitigants, and

d) accounting policy for recording hedge and non-hedge transactions; recognition of income, premiums and discounts; valuation of outstanding contracts; provisioning, collateral and credit risk mitigation.

Quantitative Disclosures

(Amount in Rs. crore)

Sl.No	*Particular*	*Currency Derivatives*	*Interest rate derivatives*
(i)		Derivatives (Notional Principal Amount)	
a) For hedging			
b) For trading			
(ii)	Marked to Market Positions [1]		
a) Asset (+)			
b) Liability (-)			
(iii)	Credit Exposure [2]		
(iv)	Likely impact of one percentage change in interest rate (100*PV01)		
a) on hedging derivatives			
b) on trading derivatives			
(v)	Maximum and Minimum of 100*PV01 observed during the year		
a) on hedging			
b) on trading			

3.4 Asset Quality

3.4.1 Non-Performing Assets

(Amount in Rs. crore)

Particulars	*Current Year*	*Previous Year*
(i) Net NPAs to Net Advances (%)		
(ii) Movement of NPAs (Gross)		
(a) Opening balance		
(b) Additions during the year		
(c) Reductions during the year		
(d) Closing balance		
(iii) Movement of Net NPAs		
(a) Opening balance		
(b) Additions during the year		
(c) Reductions during the year		
(d) Closing balance		
(iv) Movement of provisions for NPAs (excluding provisions on standard assets)		
(a) Opening balance		
(b) Provisions made during the year		
(c) Write-off/ write-back of excess provisions		
(d) Closing balance		

3.4.2 Particulars of Accounts Restructured

(Amount in Rs. crore)

<table>
<tr><th>CDR Mechanism</th><th colspan="2">SME Debt Restructuring</th><th>Others</th></tr>
<tr><td colspan="2" rowspan="3">Standard advances restructured</td><td colspan="2">No. of Borrowers</td></tr>
<tr><td colspan="2">Amount outstanding</td></tr>
<tr><td colspan="2">Sacrifice (diminution in the fair value)</td></tr>
</table>

Sub-standard advances restructured	No. of Borrowers	
	Amount outstanding	
	Sacrifice (diminution in the fair value)	
Doubtful advances restructured	No. of Borrowers	
	Amount outstanding	
	Sacrifice (diminution in the fair value)	
TOTAL	No. of Borrowers	
	Amount outstanding	
	Sacrifice (diminution in the fair value)	

<u>Note</u>: Banks must disclose the total amount outstanding in all the accounts / facilities of borrowers whose accounts have been restructured along with the restructured part or facility. This means even if only one of the facilities / accounts of a borrower has been restructured, the bank should also disclose the entire outstanding amount pertaining to all the facilities / accounts of that particular borrower.

3.4.3 Details of financial assets sold to Securitisation/ Reconstruction Company for Asset Reconstruction

(Amount in Rs. crore)

Particulars	*Current year*	*Previous Year*
(i) No. of accounts		
(ii) Aggregate value (net of provisions) of accounts sold to SC/RC		
(iii) Aggregate consideration		
(iv) Additional consideration realized in respect of accounts transferred in earlier years		
(v) Aggregate gain/loss over net book value		

3.4.4 Details of non-performing financial assets purchased/sold Banks which purchase non-performing financial assets from other banks shall be required to make the following disclosures in the Notes on Accounts to their Balance sheets:

A. <u>Details of non-performing financial assets purchased:</u>

(Amount in Rs. crore)

Particulars	*Current year*	*Previous Year*
1. (a) No. of accounts purchased during the year		
(b) Aggregate outstanding		
2. (a) Of these, number of accounts restructured during the year		
(b) Aggregate outstanding		

B. <u>Details of non-performing financial assets sold:</u>

(Amount in Rs. crore)

Particulars	*Current year*	*Previous Year*
1. No. of accounts sold		
2. Aggregate outstanding		
3. Aggregate consideration received		

3.4.5 Provisions on Standard Assets

(Amount in Rs. crore)

Particulars	*Current year*	*Previous Year*
Provisions towards Standard Assets		

Note: Provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Provisions against Standard Assets', under 'Other Liabilities and Provisions - Others' in Schedule No. 5 of the balance sheet.

3.5. Business Ratios

Particulars	*Current year*	*Previous Year*

(i) Interest Income as a percentage to Working Funds **$**
(ii) Non-interest income as a percentage to Working Funds

(iii) Operating Profit as a percentage to Working Funds **$**
(iv) Return on Assets@
(v) Business (Deposits plus advances) per employee # (Rs.in crore)
(vi) Profit per employee (Rs. in crore)

$ Working funds to be reckoned as average of total assets (excluding accumulated losses, if any) as reported to Reserve Bank of India in Form X under Section 27 of the Banking Regulation Act, 1949, during the 12 months of the financial year.

@ 'Return on Assets would be with reference to average working funds (i.e. total of assets excluding accumulated losses, if any).

For the purpose of computation of business per employee (deposits plus advances) inter bank deposits may be excluded.

3.6 Asset Liability Management

Maturity pattern of certain items of assets and liabilities

(Amount in Rs. crore)

Day 1	*2 to 7 days*	*8 to 14 days*	*15 to 28 days*	*29 days to 3 Month*	*Over 3 month & up to 6 month*	*Over 6 Month & up to 1 year*	*Over 1 year & up to 3 years*	*Over 3 years & up to 5 years*	*Over 5 years*	*Total*
Deposits										
Advances										
Investments										
Borrowings										
Foreign Currency assets										
Foreign Currency liabilities										

3.7 Exposures

3.7.1 Exposure to Real Estate Sector

(Amount in Rs. crore)

Category	*Current year*	*Previous Year*
a) Direct exposure (i) Residential Mortgages – Lending fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented; (Individual housing loans eligible for inclusion in priority sector advances may be shown separately) (ii) Commercial Real Estate – Lending secured by mortgages on commercial real estates (office buildings, retail space, multi-purpose commercial premises, multi-family residential buildings, multi-tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction, etc.). Exposure would also include non-fund based (NFB) limits; (iii) Investments in Mortgage Backed Securities (MBS) and other securitised exposures – a. Residential, b. Commercial Real Estate. *b) Indirect Exposure* Fund based and non-fund based exposures on National Housing Bank (NHB) and Housing Finance Companies (HFCs).		
Total Exposure to Real Estate Sector		

3.7.2 Exposure to Capital Market

(Amount in Rs. crore)

Particulars	*Current year*	*Previous Year*
(i) direct investment in equity shares, convertible bonds, convertible debentures and units of equity-oriented mutual funds the corpus of which is not exclusively invested in corporate debt; (ii) advances against shares/bonds/ debentures or other securities or on clean basis to individuals for investment in shares (including IPOs/ESOPs), convertible bonds, convertible debentures, and units of equity-oriented mutual funds; (iii) advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary security; (iv) advances for any other purposes to the extent secured by the collateral security of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds i.e. where the primary security other than shares/convertible bonds/convertible debentures/units of equity oriented mutual funds `does not fully cover the advances; (v) secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers; (vi) loans sanctioned to corporates against the security of shares / bonds/debentures or other securities or on clean basis for meeting promoter's contribution to the equity of new companies in anticipation of raising resources; (vii) bridge loans to companies against expected equity flows/issues; (viii) underwriting commitments taken up by the banks in respect of primary issue of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds; (ix) financing to stockbrokers for margin trading; (x) all exposures to Venture Capital Funds (both registered and unregistered)		
Total Exposure to Capital Market		

3.7.3 Risk Category wise Country Exposure

(Amount in Rs. crore)

*Risk Category**	*Exposure (net) as at March… (Current Year)*	*Provision held as at March… (Current Year)*	*Exposure (net) as at March… (Previous Year)*	*Provision held as at March… (Previous Year)*
Insignificant				
Low				
Moderate				
High				
Very High				
Restricted				
Off-credit				
Total				

*Till such time, as banks move over to internal rating systems, banks may use the seven category classification followed by Export Credit Guarantee Corporation of India Ltd. (ECGC) for the purpose of classification and making provisions for country risk exposures. ECGC shall provide to banks, on request, quarterly updates of their country classifications and shall also inform all banks in case of any sudden major changes in country classification in the interim period.

3.7.4 Details of Single Borrower Limit (SGL)/ Group Borrower Limit (GBL) exceeded by the bank.

The bank should make appropriate disclosure in the 'Notes to Account' to the annual financial statements in respect of the exposures where the bank had exceeded the prudential exposure limits during the year. The sanctioned limit or entire outstanding, whichever is high, shall be reckoned for arriving at exposure limit and for disclosure purpose.

3. 7.5 Unsecured Advances

In order to enhance transparency and ensure correct reflection of the unsecured advances in Schedule 9 of the banks' balance sheet, it is advised as under:

a) For determining the amount of unsecured advances for reflecting in Schedule 9 of the published balance sheet, the rights, licenses, authorisations, etc., charged to the banks as collateral in respect of projects (including infrastructure projects) financed by them, should not be reckoned as tangible security. Hence such advances shall be reckoned as unsecured.

b) Banks should also disclose the total amount of advances for which intangible securities such as charge over the rights, licenses, authority, etc. has been taken as also the estimated value of such intangible collateral. The disclosure may be made under a separate head in "Notes to Accounts". This would differentiate such loans from other entirely unsecured loans.

3.8 Miscellaneous

3.8.1 Amount of Provisions made for Income-tax during the year:

(Amount in Rs. crore)

Particulars	*Current year*	*Previous year*
Provision for Income Tax		

3.8.2 Disclosure of Penalties imposed by RBI

At present, Reserve Bank is empowered to impose penalties on a commercial bank under the provision of Section 46 (4) of the Banking Regulation Act, 1949, for contraventions of any of the provisions of the Act or non-compliance with any other requirements of the Banking Regulation Act, 1949; order, rule or condition specified by Reserve Bank under the Act. Consistent with the international best practices in disclosure of penalties imposed by the regulator, it has been decided that the details of the levy of penalty on a bank in public domain will be in the interests of the investors and depositors. It has also been decided that strictures or directions on the basis of inspection reports or other adverse findings should be placed in the public domain. The penalty should also be disclosed in the "Notes on Accounts" to the Balance Sheet.

4. Disclosure Requirements as per Accounting Standards where RBI has issued guidelines in respect of disclosure items for 'Notes to Accounts:

4.1 Accounting Standard 5 – Net Profit or Loss for the period, prior period items and changes in accounting policies. Since the format of the profit and loss account of banks prescribed in Form B under Third Schedule to the Banking Regulation Act 1949 does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss, such disclosures, wherever warranted, may be made in the 'Notes to Accounts' to the balance sheet of banks.

4.2 Accounting Standard 9 – Revenue Recognition

This Standard requires that in addition to the disclosures required by Accounting Standard 1 on 'Disclosure of Accounting Policies' (AS 1), an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

4.3 Accounting Standard 15 – Employee Benefits

Banks may follow the disclosure requirements prescribed under AS 15 (revised), 'Employees Benefit' issued by ICAI.

4.4 Accounting Standard 17 – Segment Reporting

While complying with the above Accounting Standard, banks are required to adopt the following:

a) The business segment should ordinarily be considered as the primary reporting format and geographical segment would be the secondary reporting format.

b) The business segments will be ‘Treasury’, ‘Corporate/Wholesale Banking’, ‘Retail Banking’ and ‘Other banking operations’.

c) ‘Domestic’ and ‘International’ segments will be the geographic segments for disclosure.

d) Banks may adopt their own methods, on a reasonable and consistent basis, for allocation of expenditure among the segments.

Accounting Standard 17 - Format for disclosure under segment reporting

Part A: Business segments

(Amount in Rs. crore)

Business Segments	*Treasury*		*Corporate/ Wholesale Banking*		*Retail Banking*		*Other Banking Operations*		*Total*	
Particulars	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous year*	*Current Year*	*Previous Year*
Revenue										
Result										
Unallocated expenses										
Operating profit										
Income taxes										
Extraordinary profit/ loss										
Net profit										
Other Information:										
Segment assets										
Unallocated assets										
Total assets										
Segment liabilities										
Unallocated liabilities										

Total liabilities

Note: No disclosure need be made in the shaded portion

Part B: Geographic segments

(Amount in Rs. crore)

Domestic		*International*		*Total*	
Current Year	*Previous Year*	*Current Year*	*Previous Year*	*Current Year*	*Previous Year*
Revenue					
Assets					

4.5 Accounting Standard 18 – Related Party Disclosures

This Standard is applied in reporting related party relationships and transactions between a reporting enterprise and its related parties. The illustrative disclosure format recommended by the ICAI as a part of General Clarification (GC) 2/2002 has been suitably modified to suit banks. The illustrative format of disclosure by banks for the AS 18 is furnished below:

Accounting Standard 18 - Format for Related Party Disclosures

The manner of disclosures required by paragraphs 23 and 26 of AS 18 is illustrated below. It may be noted that the format is merely illustrative and is not exhaustive.

(Amount in Rs. crore)

Items/Related Party	*Parent (as per ownership or control)*	*Subsidiaries*	*Associates/ Joint ventures*	*Key Management Personnel @*	*Relatives of Key Management Personnel*	*Total*
Borrowings #						
Deposit#						
Placement of deposits #						
Advances #						
Investments#						
Non-funded commitments#						
Leasing/HP arrangements availed #						
Leasing/HP arrangements provided #						
Purchase of fixed assets						

Sale of fixed assets
Interest paid
Interest received
Rendering of services *
Receiving of services *
Management contracts*

Note: Where there is only one entity in any category of related party, banks need not disclose any details pertaining to that related party other than the relationship with that related party [c.f. Para 8.3.1 of the Guidelines]

* Contract services etc. and not services like remittance facilities, locker facilities etc.

@ Whole time directors of the Board and CEOs of the branches of foreign banks in India.

The outstanding at the year-end and the maximum during the year are to be disclosed.

<u>Illustrative disclosure of names of the related parties and their relationship with the bank</u>

1. Parent A Ltd
2. Subsidiaries B Ltd and C Ltd
4. Associates P Ltd, Q Ltd and R Ltd
5. Jointly controlled entity L Ltd
6. Key Management Personnel Mr.M and Mr.N
7. Relatives of Key Management Personnel Mr.D and Mr.E

4.6 Accounting Standard 21 – Consolidated Financial Statements (CFS)

As regards disclosures in the ‘Notes to Accounts’ to the Consolidated Financial Statements, banks may be guided by general clarifications issued by Institute of Chartered Accountants of India from time to time.

A parent company, presenting the CFS, should consolidate the financial statements of all subsidiaries - domestic as well as foreign, except those specifically permitted to be excluded under the AS-21. The reasons for not consolidating a subsidiary should be disclosed in the CFS. The responsibility of determining whether a particular entity should be included or not for consolidation would be that of the Management of the parent entity. In case, its Statutory Auditors are of the opinion that an entity, which ought to have been consolidated, has been omitted, they should incorporate their comments in this regard in the "Auditors Report".

4.7 Accounting Standard 22 – Accounting for Taxes on Income

This Standard is applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements. Adoption of AS 22 may give rise to creation of either a deferred tax asset

(DTA) or a deferred tax liability (DTL) in the books of accounts of banks and creation of DTA or DTL would give rise to certain issues which have a bearing on the computation of capital adequacy ratio and banks' ability to declare dividends. In this regard it is clarified as under:

- DTL created by debit to opening balance of Revenue Reserves on the first day of application of the Accounting Standards 22 or to Profit and Loss account for the current year should be included under item (vi) 'others (including provisions)' of Schedule 5 - 'Other Liabilities and Provisions' in the balance sheet. The balance in DTL account will not be eligible for inclusion in

Tier I or Tier II capital for capital adequacy purpose as it is not an eligible item of capital.

- DTA created by credit to opening balance of Revenue Reserves on the first day of application of Accounting Standards 22 or to Profit and Loss account for the current year should be included under item (vi) 'others' of Schedule 11 'Other Assets' in the balance sheet.

- The DTA computed as under should be deducted from Tier I capital:
    - i) DTA associated with accumulated losses; and
    - ii) The DTA (excluding DTA associated with accumulated losses), net of DTL. Where DTL is in excess of the DTA (excluding DTA associated with accumulated losses), the excess shall neither be adjusted against item (i) nor added to Tier I capital.

4.8 Accounting Standard 23 – Accounting for Investments in Associates in Consolidated Financial Statements

This Accounting Standard sets out principles and procedures for recognising, in the consolidated financial statements, the effects of the investments in associates on the financial position and operating results of a group. A bank may acquire more than 20% of voting power in the borrower entity in satisfaction of its advances and it may be able to demonstrate that it does not have the power to exercise significant influence since the rights exercised by it are protective in nature and not participative. In such a circumstance, such investment may not be treated as investment in associate under this Accounting Standard. Hence the test should not be merely the proportion of investment but the intention to acquire the power to exercise significant influence.

4.9 Accounting Standard 24 – Discontinuing Operations

Merger/ closure of branches of banks by transferring the assets/ liabilities to the other branches of the same bank may not be deemed as a discontinuing operation and hence this Accounting Standard will not be applicable to merger / closure of branches of banks by transferring the assets/ liabilities to the other branches of the same bank.

Disclosures would be required under the Standard only when:

a) discontinuing of the operation has resulted in shedding of liability and realisation of the assets by the bank or

decision to discontinue an operation which will have the above effect has been finalised by the bank and

b) the discontinued operation is substantial in its entirety.

4.10 Accounting Standard 25 – Interim Financial Reporting

The half yearly review prescribed by RBI for public sector banks, in consultation with SEBI, vide circular DBS. ARS. No. BC 13/ 08.91.001/ 2000-01 dated 17th May 2001 is extended to all banks (both listed and unlisted) with a view to ensure uniformity in disclosures. Banks may adopt the format prescribed by the RBI for the purpose.

4.11 Other Accounting Standards

Banks are required to comply with the disclosure norms stipulated under the various Accounting Standards issued by the Institute of Chartered Accountants of India.

5. Additional Disclosures

5.1 Provisions and Contingencies

To facilitate easy reading of the financial statements and to make the information on all Provisions and Contingencies available at one place, banks are required to disclose in the 'Notes to Accounts' the following information:

(Amount in Rs. crore)

Break up of 'Provisions and Contingencies' shown under the head Expenditure in Profit and Loss Account	*Current Year*	*Previous Year*
Provisions for depreciation on Investment		
Provision towards NPA		
Provision towards Standard Asset		
Provision made towards Income tax		
Other Provision and Contingencies (with details)		

5.2 Floating Provisions

Banks should make comprehensive disclosures on floating provisions in the "notes to accounts" to the balance sheet as follows:

(Amount in Rs. crore)

Particulars	*Current year*	*Previous year*
(a) Opening balance in the floating provisions account		
(b) The quantum of floating provisions made in the accounting year		
(c) Amount of draw down made during the accounting year		
(d) Closing balance in the floating provisions account		

Note: The purpose of draw down made during the accounting year may be mentioned

5.3 Draw Down from Reserves

Suitable disclosures are to be made regarding any draw down of reserves in the 'Notes to Accounts' to the Balance Sheet.

5.4 Disclosure of complaints

Banks are also advised to disclose the following brief details along with their financial results:

A. Customer Complaints

(a)	No. of complaints pending at the beginning of the year
(b)	No. of complaints received during the year
(c)	No. of complaints redressed during the year
(d)	No. of complaints pending at the end of the year

B. Awards passed by the Banking Ombudsman

(a)	No. of unimplemented Awards at the beginning of the year
(b)	No. of Awards passed by the Banking Ombudsmen during the year
(c)	No. of Awards implemented during the year
(d)	No. of unimplemented Awards at the end of the year

5.5 Disclosure of Letters of Comfort (LoCs) issued by banks

Banks should disclose full particulars of all the Letters of Comfort (LoCs) issued by them during the year, including their assessed financial impact, as also their assessed cumulative financial obligations under the LoCs issued by them in the past and outstanding, in its published financial statements, as part of the 'Notes to Accounts".

5.6 Provisioning Coverage Ratio (PCR)

The PCR (ratio of provisioning to gross non-performing assets) should be disclosed in the Notes to Accounts to the Balance Sheet.

5.7 Bank assurance Business

Banks should disclose in the 'Notes to Accounts', from the year ending March 31, 2010, the details of fees/remuneration received in respect of the bancassurance business undertaken by them.

5.8 Concentration of Deposits, Advances, Exposures and NPAs

5.8.1 Concentration of Deposits

(Amount in Rs. crore)

Total Deposits of twenty largest depositors
Percentage of Deposits of twenty largest depositors to Total Deposits of the bank

5.8.2 Concentration of Advances*

(Amount in Rs. crore)

Total Advances to twenty largest borrowers
Percentage of Advances to twenty largest borrowers to Total Advances of the bank

*Advances should be computed as per definition of Credit Exposure including derivatives furnished in our Master Circular on Exposure Norms.

5.8.3 Concentration of Exposures**

(Amount in Rs. crore)

Total Exposure to twenty largest borrowers/customers
Percentage of Exposures to twenty largest borrowers/customers to Total Exposure of the bank on borrowers/customers

**Exposures should be computed based on credit and investment exposure as prescribed in our Master Circular on Exposure Norms.

5.8.4 Concentration of NPAs

(Amount in Rs. crore)

Total Exposure to top four NPA accounts

5.9 Sector-wise NPAs

Sl. No.	**Sector**	**Percentage of NPAs to Total Advances in that sector**
1	Agriculture & allied activities	
2	Industry (Micro & small, Medium and Large)	
3	Services	
4	Personal Loans	

5.10 Movement of NPAs

(Amount in Rs. crore)

Particulars
Gross NPAs* as on 1st April of particular year (Opening Balance)
Additions (Fresh NPAs) during the year
Sub-total (A)
Less:-
(i) Upgradations
(ii) Recoveries (excluding recoveries made from upgraded accounts)
(iii) Write-offs
Sub-total (B)
Gross NPAs as on 31st March of following year (closing balance) (A-B)

*Gross NPAs as per item 2 of Annex to DBOD Circular DBOD.BP.BC.No.46/21.04.048/ 2009-10 dated September 24, 2009

5.11 Overseas Assets, NPAs and Revenue

(Amount in Rs. crore)

Particulars
Total Assets
Total NPAs
Total Revenue

5.12 Off-balance Sheet SPVs sponsored (which are required to be consolidated as per accounting norms)

Name of the SPV sponsored	
Domestic	**Overseas**

Annex

List of Circulars consolidated by the Master Circular

No	Circular No.	Date	Relevant Para No of the circular	Subject	Para No of the Master Circular
1	DBOD.No.BP.BC.78/C.686-91	Feb 06, 1991	3,4	Revised Format of the Balance Sheet and Profit & Loss Account	2
2.	DBOD.No.BP.BC.91/C.686-91	Feb 28, 1991	All	Accounting Policies - Need for Disclosure in the Financial Statements of Banks	2
3	DBOD.No.BP.BC.59/21.04.048/97	May 21, 1997	1,2,3	Balance Sheets of Banks – Disclosures	3.1(i)(iv)(v);3.2.(1):3.4.1(i)3.8.1
4	DBOD.No.BP.BC.9 /21.04.018/98	Jan 27, 1998	2	Balance Sheet of Banks – Disclosures	3.1(ii)(iii) 3.5(i) to (vi)
5	DBOD.No.BP.BC.32 /21.04.018/98	Apr 29, 1998	(ii)(a)(b)	Capital Adequacy- Disclosures in Balance Sheets	3.5(i) to (vi)
6	DBOD.No.BP.BC.9 /21.04.018/99	Feb 10, 1999	3,4	Balance Sheet of Banks - Disclosure of Information	3.4.1(ii)(iii); 3.6
7	MPD.BC.187 /07.01. 279 /1999-2000	July 7, 1999	1,Annex 3 (v)	Forward Rate Agreements / Interest Rate Swaps	3.3.1
8	DBOD.No.BP.BC. 164/21.04.048/2000	Apr 24, 2000	3	Prudential Norms on Capital Adequacy,	3.4.5

				Income Recognition, Asset	
Classification and Provisioning etc.					
9	DBOD.No.BP.BC.73 /21.04.018/ 2000-01	Jan 30, 2001	2.6	Voluntary Retirement Scheme (VRS) Expenditure - Accounting and Prudential Regulatory Treatment	4.3
10	DBOD.BP.BC.27 /21.04.137/2001	Sep 22, 2001	6	Bank Financing for Margin Trading	3.7.2 (vi)
11	DBOD.BP.BC.38 /21.04.018/2001-2002	Oct 27, 2001	2(i)(ii)	Monetary and Credit Policy Measures - Mid-Term Review for the year 2001-2002 - Balance Sheet Disclosures	3.2(2); 3.4.1(iv)
12	DBOD.No.IBS.BC. 65/23.10.015/ 2001-02	Feb 14, 2002	1,10	Subordinated Debt for Inclusion in Tier II Capital - Head Office Borrowings in Foreign Currency by Foreign Banks Operating in India	3.1 explanation
13	DBOD.No.BP.BC. 84 /21.04.018/ 2001-02	Mar 27, 2002	2	Balance Sheet of Banks – Disclosure of Information	3.2(2)
14	DBOD.No.BP.BC.68 /21.04.132/ 2002-03	Feb 05, 2003	1, Annex 6	Corporate Debt Restructuring (CDR)	3.4.2
15	DBOD.BP.BC.71 /21.04.103/ 2002-03	Feb 19, 2003	Annex 24(a) (b)	Guidelines on Country Risk Management by banks in India	3.7.3
16	DBOD.No.BP.BC.72 /21.04.018/ 2001-02	Feb 25, 2003	16	Guidelines for Consolidated Accounting and Other Quantitative Methods to Facilitate Consolidated Supervision	4.6
17	IDMC.3810/11.08.10 /2002-03	Mar 24, 2003	1,5(v)	Guidelines for Uniform Accounting for Repo/ Reverse Repo Transactions	3.2.1
18	DBOD.No.BP.BC.89 /21.04.018/ 2002-03	Mar 29, 2003	4.3.2, 5.1, 6.3.1, 7.3.2, 8.3.1	Guidelines on Compliance with Accounting Standards (AS) by Banks	4.1 to 4.5
19	DBOD.No.BP.BC.96 /21.04.048/ 2002-03	Apr 23, 2003	1, Annex 6	Guidelines on Sale of Financial Assets to SC/RC (Created under the SARFAESI Act, 2002) and	3.4.3

				Related Issues	
20	IDMC.MSRD.4801 /06.01.03/2002-03	Jun 3, 2003	4(x)	Guidelines on Exchange Traded Interest Rate Derivatives	3.3.2
21	DBOD.BP.BC.44 /21.04.141/ 2003-04	Nov 12, 2003	Appendix 11 (4)	Prudential Guidelines on Banks' Investment in Non-SLR Securities	3.2.2
22	DBOD.No.BP.BC.82 /21.04.018/ 2003-04	Apr 30, 2004	4.3.2	Guidelines on compliance with Accounting Standards (AS) by banks	4.9
23	DBOD.No.BP.BC. 100 /21.03.054 /2003-04	Jun 21, 2004	2(v)	Annual Policy Statement for the year 2004-05 - Prudential Credit Exposure Limits by Banks	3.7.4
24	DBOD.BP.BC.49 /21.04.018/ 2004 -2005	Oct 19, 2004	5	Enhancement of Transparency on Bank's Affairs through Disclosure	3.8.2
25	DBOD.No.BP.BC.72 /21.04.018/ 2004-05	Mar 3, 2005	Annex	Disclosures on risk exposure in derivatives	3.3.3
26	DBS.CO.PP.BC.21/11.01.005/ 2004-05	Jun 29, 2005	2. (a) (b)	Exposure to Real Estate Sector	3.7.1
27	DBOD.NO.BP.BC. 16/21.04.048/2005- 06	Jul 13 2005	7	Guidelines on purchase/sale of Non Performing Assets	3.4.4
28	DBOD.BP.BC.86/ 21.04.018/2005-06	May 29, 2006	3	Disclosure in Balance Sheets – Provisions and Contingencies	4.12.1
29	DBOD.NO.BP. BC.89/21.04.048/ 2005-06	Jun 22, 2006	2.(iv)	Prudential norms on creation and utilisation of floating provisions	4.12.2
30	DBOD.BP.BC.31/ 21.04.018/ 2006-07	Sep 20, 2006	3.(iii)	Section 17 (2) of Banking Regulation Act, 1949 – Appropriation from Reserve Fund	4.12.3
31	DBOD.No.Dir.BC.47/13.07.05/2006-2007	Dec 15, 2006	2.1	Banks' exposure to Capital Markets – Rationalization of Norms	3.7.2
32	DBOD.No.Leg BC.60/09.07.005/ 2006-07	Feb 22, 2007	3.	Analysis and Disclosure of complaints - Disclosure of complaints / unimplemented awards of Banking Ombudsmen along with Financial Results	4.12.4

33	DBOD.No.BP.BC. 81 / 21.04.018/ 2006-07	Apr18, 2007	4	Guidelines - Accounting Standard 17(Segment Reporting) – Enhancement of disclosures	4.4
34	DBOD.No.BP.BC. 90/20.06.001/ 2006-07	Apr 27, 2007	10	"Implementation of the New Capital Adequacy Framework"	
35	DBOD No. BP.BC. 65/21.04.009/ 2007-08	Mar 4, 2008	2.(iv)	Prudential Norms for Issuance of Letters of Comfort by Banks regarding their Subsidiaries	4.12.5
36	DBOD.No.BP.BC.37/ 21.04.132/2008-09	Aug 27, 2008	Annex 3	Prudential Guidelines on Restructuring of Advances by Banks	3.4.2
37	DBOD.No.BP.BC.. 124/21.04.132/2008-09	Apr 17, 2009	Annex	Prudential guidelines on restructuring of advances	3.4.2
38	DBOD.No.BP.BC. 125 /21.04.048/ 2008-09	Apr 17, 2009	2	Prudential Norms on Unsecured Advances	3.7.5
39	DBOD.No.BP.BC. 64/21.04.048/ 2009-10	Dec 1, 2009	5	Second Quarter Review of Monetary Policy for the Year 2009-10 –Provisioning Coverage for Advances	5.6
40	DBOD.No.FSD.BC.67 /24.01.001/ 2009-10 dated	Jan 7, 2010	2	Disclosure in Balance Sheet – Bancassurance Business	5.7
41	DBOD.BP.BC.79/ 21.04.018/2009-10	Mar 15, 2010	Annex	Additional Disclosures by banks in Notes to Accounts	5.8
42	IDMD/4135/11.08.43/ 2009-10	Mar 23, 2010	9	Guidelines for Accounting of Repo / Reverse Repo Transactions	3.2.1