

Income Recognition and Asset Classification Norms (IRAC)

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What is a Non- Performing Asset?

- a) As asset including a leased asset, becomes non- performing when it ceases to generate income for the Bank.

- b) A non-performing asset is a loan/or an advance where:
 - 1) Interest and /instalment of Principal remains **overdue** for a period of more than 90days in respect of a Term Loan.
 - 2) The account remains **out of order** in respect of overdraft/cash credit.
 - 3) The bill remains **overdue** for a period of more than 90 days in the case of bills purchased and discounted.
 - 4) Interest /instalment of Principal remains overdue for two crop seasons for short duration crops.
 - 5) Interest/instalment of Principal remains overdue for one crop season for long term crops.
 - 6) Amount due to Bank under any facility is overdue for a period of more than 90 days.
 - 7) Account where regular/adhoc credit facilities have not been renewed /reviewed within 180 days from the due date /date of sanction.

What is a Non- Performing Asset?

c) Overdue

Any amount due to the Bank under any facility is overdue if it is not paid on the due date fixed by the Bank.

- 1) In the case of temporary overdraft, the outstanding will not be overdue up to 7 days. Hence the temporary overdraft if remaining outstanding for more than 7 days only should be reported as overdue.
- 2) in the case of excess over sanctioned limit/drawing power the accounts become overdue from the date of such excess.
- 3) in the case of Term loans and loans repayable on demand the instalments become overdue from the due date of instalments.
- 4) interest due and charged remaining unadjusted becomes overdue from the last day of the quarter irrespective of interest charged at monthly intervals.
- 5) A bill becomes overdue from its due date. In case of sight bills they become overdue if it remains unpaid on presentation.

What is a Non- Performing Asset?

d) Out of Order status

1. An account should be treated as out of order if:
 - a) the outstanding balance remains continuously in excess of the sanctioned limit /drawing power.
 - b) 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 date of Balance sheet or credits are not enough to cover the interest debited during the same period.

Software Package:

- Various types of software package used by Banks on CBS platform automatically generate the report on classification of advances based on RBI norms.
- Manual intervention by Bank staff for identification and classification is not normally permitted in such software package.
- Although Banks have switched over to system driven classification of advances it is absolutely necessary for the auditors to verify each and every account for its correct classification as per IRAC norms and do not give any scope to the Statutory auditors for issuing MOC and reversal of income.
- Verification of appropriate classification of advances and accordingly appropriate accounting of income and other charges forms very important part of audit.

- Other aspects

- a) Solitary or few credits before the Balance sheet date.
 - b) Cheque discounting/ additional facilities granted to recover critical amount.
- Asset classification is borrower wise and not facility wise.
- Outstandings in devolved L/Cs / invoked B/G if parked in a separate account, same should be clubbed with o/s in CC account for determining asset classification.
- Percolated NPA/ NPI – (Treasury operations)

- Government guaranteed accounts: Such accounts are classified as NPA only if the Central Government repudiates its guarantee when invoked. This exemption is not available to accounts backed by State Government Guarantees.
- Consortium Accounts: Classification of such advances should be based on record of recovery by each member Bank. Status of the account with Lead bank will not be the criteria.
- Advance against Term Deposits/ NSC/ KVP/ : Such advances are exempted from NPA norms provided adequate margin is available in the accounts. Advance against gold ornaments/ Government securities are not exempted.
- Net worth of borrower/ guarantor or availability of Security: Since income recognition is based on recoveries, net worth of the borrower/ guarantor is irrelevant for the purpose of treating its account as NPA or otherwise

- Advances to Staff: Interest bearing advances should be included as part of advance portfolio. In case of Loans/advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the 1st quarter onwards.
- Income Recognition:
 - Internationally income from NPA is not recognized as income on accrual base but is booked as income only when it is actually received.
 - On the account turning NPA branch should reverse the interest already charged and not collected by debiting P&L account and stop further application of interest. However the same should be recorded in Dummy Ledger.
 - Interest on advances against Term Deposits ,KVP,LIC etc may be taken to income on due date provided adequate margin is available.
 - In the case of Govt guaranteed accounts turning NPA interest on such advances should not be taken to income unless the interest is realized
- Appropriation in NPA Accounts: Appropriation is done normally as per the internal policy of each Bank/ AS 9.As per RBI guidelines ,Banks are required to adopt an accounting policy and exercise the right of appropriation in a uniform and consistent manner

- Classification of Advances:
 - Standard
 - Sub-standard
 - Doubtful assets
 - Loss Assets
- Classification is meant for the purpose of computing the amount of provision to be made in respect of advance.
- Up gradation of Loan accounts earlier classified as NPA.
- If **all** arrears of interest and principal are paid by the borrower in the case of NPA accounts, such accounts may be upgraded as standard. It should be ensured that no additional facility/excess/adhoc is permitted to regularise the arrears.

- Provisioning for Loans and Advances (RBI Circular 2014)

Classification	Provision
A) Standard Assets	0.25% (SME) 1.00% (CRE) 0.75% (CRE – Residential Housing) 0.40% others
Restructured Accounts classified as Standard will attract higher provision (3.50% - 5.00%)	
B) Sub-standard Assets	15% (Secured) 25% (Unsecured)
C) Doubtful Assets	
Upto 1 Year	25%
More than 1 year upto 3 years	40%
More than 3 years	100%
D) Loss Assets	100%