3.1 INTRODUCTION

Due to the banking sector reforms initiated since 1992 in this country, the banks are facing new challenges in the ever-changing scenario. Challenges are many. Amongst them, vital challenges are from 4 Cs i.e. Credit (including NPA), Customer, Computer and Capital Restructuring. In the changing scenario, the banks are under tremendous pressure to redefine their priorities in order to manage effectively these challenges for their survival and growth. Priorities are many, but resources and time are very limited. With the constraints of the means, the main goal of the banks to achieve sustained profit by adopting international standards of the banking practices can be achieved by proper prioritization of priorities. The top most priority for any bank is to manage its NPA at the international prescribed level of 5% on a gross basis and 2.5% on net basis or below. More ever, the R.B.I, is going to implement in phases all the stringent international standards for NPA classification in second generation of reforms as per the recommendations of the Narasimham Committee's second report. Non-performing assets are likely the flab, which causes inconvenience to any financial sector. It is therefore, very important to maintain and manage such assets in order to facilitate the cash rotation and drive profit out of the investment. A non-performing asset arises out of the loans or financial assistance given by the lender to the borrower, when borrower is unable to pay his monthly installment, inclusive of principle and interest. The efficiency of a company and the percentage of the non-performing assets are invasively related. The higher percentage of the non-performing assets the lower is the efficacy. Modern banks and financial institutions play a very important role in economy growth of a country. In a Modern economy banks and financial institutions are considered as initiates and
essentials of development. Development of a country is integrally linked with
development of banking and financial sector.

Non-performing asset arises out of the loans and financial assistance given by the
lender to the borrower, when borrowers are unable to pay equated monthly installments
inclusive of principle and interest. It is a known fact that the banks and financial institutions
are in big problem of swelling non-performing assets (NPA) and the issue is becoming
more and more unmanageable. In order to bring situation under control, some steps have
been taken recently i.e., "Securitisation and Reconstruction of financial assets and
enforcement of securities interest Act, 2002" was passed by parliament, which is an
important step towards elimination or reduction of NPA's. Banks are identified as
financial centres specialized in the art of lending out funds mobilized from the customers.
The evil effect of lending is clearly stated in a saying "Neither be a borrower, nor a
lender". If you, your friend, the statement indicates just how difficult it is to get back the
money once again. Banks have certain social obligations to fulfill as per government
directives and in such a situation the position of banks is lend that much of money which
it can afford to lose, irrespective of the little set backs the role of "credit has done more to
enrich the nations then all the gold mines in the world put together". "Credit is like
putting paste out of a tooth paste, it is easy to get it but recovery is some what difficult,
like putting that paste back into the tube". It is very difficult task indeed.

That is the reason why good money lent, some times becomes bad and doubtful, in
banking parlance it is called as Non-Performing Asset (NPA). the management of NPA is
a Herculean task before the banks , financial institutions in the present post financial
reformed scenario think and find alternative for recover or NPA's. Profitability is
considered as a benchmark for evaluating performance of any business enterprise including the banking industry. However, increasing non-performing assets have a direct impact on profitability of banks and financial institution. Legally speaking banks and financial institutions are not allowed to book income on such account and at the same time they are forced to make provision on such assets. The income recognition norms laid down that, only the amount of interest which is realized, will be treated as income. Further the account which does not serve debt for one quarter, will be viewed as a NPA and classified as substandard. A substandard asset over two years gets classified as doubtful asset. In view of potential loss from such assets where the risk stands enhanced on account of NPA character, adequate provision is required to be made to take care banks liability to the depositors. If the profits generated are inadequate to cover provision requirements it would result in less i.e., erosion in capital. As per present RBI, a provision of 100% of amount outstanding has to be made for substandard assets and depending on the age doubtful assets, a provision equal to shortfall in realizable value (RVS) vice-versa. Outstanding balance plus 20% or 30% or 50% of RVS has to be made. In case of NPA with little or no security (loss assets). 100% of outstanding amount is required to be provided. It is pertinent to note that if every particular facility granted to a borrower reflects NPA character, all facilities have to be treated as NPA.

With the existing guidelines the position of NPA in the Indian Banking System is now alarming, let us visualise what the position will be when all the above recommendations are implemented. High level of NPA has many ill effects on the banking industry. And also it has devastating effects on the financial as well as economic condition of the country as evidenced by South East Asia Crisis. Containing NPAs to the
minimum level is a major challenge to the Bankers. The NPA menace cannot be tackled by any quick-fix method. It is now necessary to manage the NPA cancer in a more scientific and objective manner for survival on the long run.

3.2 CONCEPT OF NPA

A bank creates an asset by lending 50% to 90% of the project cost. The bank has major stake in an asset than the borrower, so it should be the responsibility of the bank to see and maintain the health of the asset. While creating an asset, the bank wants that the asset should be performing one from the beginning and remains so till its liquidation. But, sooner or latter, it becomes or tends to become NPA; unless managed properly; due to various reasons. Then it becomes a problematic asset and needs intensive care.

**The objectives of NPA management should be**

I) To make more assets performing;  
II) To reduce quantum of NPAs and  
III) To minimize the amount of provision requirements.

The said objectives can be achieved  
Firstly by preventing slippage of performing assets; Secondly by upgrading non-performing assets and Thirdly by liquidating non-performing assets. NPA management means managing of loan assets of a bank, financial institution in such a manner that the quantum of NPAs are contained at the bare minimum or at least at the international prescribed level of 5% gross NPA and 2.5% net NPA.

Effective NPA Management Involves the Following Aspects  
Understanding of NPA gamut  
- Understanding of NPA Concept,
- Understanding of Income Recognition Norms,
- Understanding of Asset Classification Norms,
- Understanding of Provisioning Norms,
- Understanding of Asset Cycle.

**Identification of NPAs**

- Term Loans,
- Agricultural advances,
- Cash credit & Overdraft credit facilities,
- Bills purchased & discounted,
- Other credit facilities.

**Prevention of NPAs**

- Credit Risk Management,
- Credit Marketing,
- Management of Potential NPAs,
- Replacement of Loans

**Proper NPA Accounting System**

- Accounting system in NPA accounts,
- Maintenance of NPA Records.

**Up-gradation of Fresh NPAs**

- Recovery of Critical Amount,
- Replacement of NPA accounts.

**Liquidation of Chronic NPAs**

- Cash Recovery through
• the Bank staff,
• the Govt. agencies,
• the Private recovery agents,
• The Legal bodies, methods.
• Settlement of claims with DICGC, ECGC
• Compromise,
• Write-off.
• Use of MIS & IT in NPA management.
• Formulation of Comprehensive NPA Management Policy, Strategies.
• Rating of NPA management.

The banks in their books have different kind of assets; such as Cash in hand, Balances with other banks, investment, loans & advances, fixed assets & other assets. Here the NPA concept is restricted to loans & advances. As long as an asset generates the income expected from it, it is treated as a “performing asset” and when it fails to generate income, it becomes “non-performing asset”. In other words, a loan asset becomes Non-performing (NPA) when it ceases to generate income, i.e. interest, fees, commission etc. to the bank. In lines of the recommendations of Narsimham Committee, the Reserve bank of India issued certain guidelines for treating a credit facility as "Non-performing Asset" commencing from the accounting year 1992-93. These guidelines were implemented in phases & revised time & again.

An amount due under any credit facility is to be treated as past due when it remains outstanding or unpaid for 30 days beyond due date. Due date is the date fixed or
stipulated in the loan sanction letter for repayment of loan installment or interest. Due to the improvements in the payment and settlement systems, recovery climate, upgradation of technology in the banking system, etc., it was decided by RBI to dispense with ‘past due’ concept, with effect from March 31, 2001. Accordingly, as from that date, a Non-Performing Asset (NPA) shall be defined as an advance or credit facility where

- Interest and installment of principal remain overdue for a period of more than ISO days in respect of a Term Loan,
- The account remains “out of order” for a period of more than ISO days, in respect of an Overdraft, Cash Credit (CC,OD),
- The bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,
- Interest and installment of principal remains overdue for two harvest seasons but for a period not extending two half years in the case of an advance granted for agricultural purposes, and
- Any amount to be received remains overdue for a period of more than 180 days in respect of other accounts.

Adoption of 90 days Norm for Recognition of Loan Impairment from March 31, 2005. With a view to moving towards international best practices and to ensure greater transparency, it has been decided by the RBI to adopt the “90 days overdue” norm for identification of NPAs, from the year ending March 31, 2004. Accordingly, with effect from March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where

- Interest and installment of principal remain overdue for a period of more than 90 days in respect of a Term Loan,
- The account remains 'out of order' for a period of more than 90 days, in respect of an Overdraft, Cash Credit (CC, OD),
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
- Interest and installment of principal remains overdue for two harvest seasons but for a period not extending two half years in the case of an advance granted for agricultural purposes, and
- Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

In this connection, the RBI has advised that the banks are, therefore, required to chalk out an appropriate transition path for smoothly moving over to the 90 days norm. As a facilitating measure, banks should move over to charging of interest at monthly by April 1, 2002. Banks would have to substantially upgrade their existing Management Information System (MIS) for collecting data on loans, where interest and/or installment of principal remains overdue for a period of more than 90 days in order to crystallize NPAs on a 90 days norm.
3.3 ASSET CYCLE

Understanding of asset cycle will help in effective management of NPA. The asset cycle depicted in the next page shows how an asset moves to different positions depending upon the recovery, security and risk associated with it. However, the recovery is the main criterion for determination of its status in the asset cycle. The Bank gets cash, fund by way of deposits from the depositors. On sanction of a loan the bank converts its cash into a loan asset. At the beginning, every loan asset is (supposed to be) a performing one; which generates income to the Bank. This performing asset is known as Standard Asset, which does not carry any problem other than normal business risk. When it shows symptoms of delay in recovery of due amount and it will become NPA as on the coming balance sheet date unless the symptom is rectified, it becomes a Potential NPA. The period of remaining in Potential NPA may vary from one quarter to 4 quarters depending upon the nature of the account. If the due amount is recovered before the next balance sheet date, it remains in the performing zone; otherwise it crosses the Laxman Rekha of NPA & slips into the non-performing zone as on the balance sheet date. Then it is known as Substandard Asset. Unless the critical overdue amount is recovered, it remains as Substandard Asset up to for a period of less than or equal to 12 months with effect from March 31, 2005 and then it becomes Doubtful Asset. It remains as Doubtful Asset so long it is not declared as Loss Asset by the auditors, RBI inspectors. The Standard Asset, Potential NPA and Substandard Asset may slip into Doubtful, Loss Asset when there is substantial loss of security or it carries more than normal business risk. A Loss Asset can be converted to Doubtful Asset, Substandard Asset, Potential NPA, Standard Asset depending upon its age of NPA by addition of substantial security, bringing under normal
business risk and recovery of critical overdue amount, A Doubtful Asset cannot be converted to Substandard Asset but to Potential NPA, Standard Asset by recovery of critical past due, overdue amount. Similarly, a Substandard Asset can be converted to Potential NPA, Standard Asset by recovery of critical overdue amount.

In the normal process, the Standard Asset converts to Cash in an asset cycle by recovery of due amounts as per the sanction. But Substandard Asset as well as Doubtful Asset can convert into Cash by cash recovery, legal process, compromise. Similarly a Loss Asset can be converted into Cash or liquidated by write-off, compromise, legal process, cash recovery. Incase of write-off and compromise the bank pays cash from its profit.

Fig. 1: Asset Cycle

➤ Sanction of Loan
➤ Default In Installment, Interest or Out of Order
➤ Age of NPA more than 3 months or 90 days
➤ Loss of Security & more than Normal Business Risk
➤ Recovery of Critical overdue Amount
➤ Recovery of Critical Due Amount
➤ Liquidation by Cash Recovery
➤ Liquidation by Cash Recovery, Legal Method, Compromise
➤ Liquidation by Write Off, Compromise, Legal Methods, Cash Recovery.

3.4 HISTORY AND NEW DEVELOPMENT NORMS OF NON PERFORMING ASSETS

The monetary and banking policies and external situation has influenced the evolution. Banks occupy a essential place in the payment system for government, business and households. Thus they play a vital role in the economic and financial life of the country. They are, therefore, accountable to the government, RBI as well as to the public who are keeping their funds with the banks by reposing trust in the ability of the banks that they will not put the depositors’ interest to peril. The banks are using the deposits in lending and investment business. The risk of business loss is equally associated with the lending activities as in other business. The primary role for Govt. RBI is to limit the risk and loss to depositors and thus maintain public confidence as well as prevent crumple of the banking system. Therefore, Reserve Bank of India, as a regulatory authority, is issuing from time to time various guidelines to the banks and financial institutions for proper credit administration. In the year 1980 RBI introduced “Health
Code” system for credit administration. Under health code system, the bank’s loan assets were being classified under eight categories such as

HC-1 Satisfactory, HC-2 Irregular, HC-3 Sick but viable, HC-4 Sick but non-viable, HC-5 Recalled, HC-6 Suit-field, HC-7 Decreed and HC-8 Bad and doubtful. In respect of loans which were categorized under health codes 5 to 8, interest on accrual basis should not be charged and booked to profit and loss account. However, charging of interest and provisioning were left to be decided by the bank management. The banks continued to book income by charging interest on accrual basis even on those loan assets, which had shown symptoms of loss. This was not a prudential business practice; as the banks paid tax and dividend on these incomes, which were never realized. These guidelines were subjective and did not reflect the true picture of the banks health. The Reserve Bank, as an authority for bank supervision in India, felt the need to introduce more objectivity in the assessment of the bad debts of the banks and to standardize the relative accounting norms as per the international standards for maintaining sound banking system in this country. Further, if a balance sheet is to reflect a bank’s actual financial health, a proper system for recognition of income, classification of assets and provisioning for bad debts on a prudential basis is necessary. The Committee on financial system, popularly known as Narasimham committee, examined the above issue in 1991 and recommended the following

The policy of income recognition should be objective and based on record of recovery rather than on any subjective consideration. The classification of assets should be done on the basis of objective criteria which would ensure a uniform and consistent application of norms and Provisions should be made on the basis of classification of loan
assets into four different categories. The Reserve Bank of India accepted these recommendations with certain modifications and laid down norms to be implemented in a phased manner over a three-year period commencing from 1st April, 1992. These guidelines are commonly referred to as the Prudential Accounting Norms, which are essentially based on the concept of Non-performing Assets (NPA). The bankers are, now, familiar with this ‘NPA’ term. In 1998 the Narasimham committee has submitted its 2nd report for further tightening of the prudential accounting norms. A retrospect of the events clearly indicates that the Indian banking sector has come far away from the days of nationalization. The Narasimham Committee and the Verma Committee laid the foundation for the reformation and improvement of the Indian banking. At a macro level the reforms brought structural changes in the financial sector and succeeded in easing external constraints on its operation i.e. reduction in CRR and SLR reserves, capital adequacy norms, restructuring and recapitulating banks and enhancing the competitive element in the market through the entry of new banks. The reforms also include increase in the number of banks due to the entry of new private and foreign banks, increase in the transparency of the banks balance sheets through the introduction of prudential norms and increase in the role of the market forces due to the deregulated interest rates these have significantly affected the operational environment of the Indian banking sector.

To encourage speedy recovery of Non-performing assets, the Narasimham committee laid directions to introduce special tribunals which lead to the creation of an Asset Reconstruction Fund for revival of weak banks and to maintain macroeconomic stability and also RBI has introduced the Asset Liability Management System. The bank under study KGB is a collaborative management of Government of India, Government of
Karnataka and State Bank of India it is operating throughout Gulbarga, Bidar and Yadgiri districts of Karnataka. It has bagged Third prize from NABARD for best performance in SHG Bank Linkage Programme in Karnataka state during 2005-06. The bank is at I position among RRBs sponsored by SBI since from last three years business volume has increased from Rs.1916 crores as on march 2009 to Rs. 2708 crores as on march 2012. Managing the NPA is becoming a major concern to the bank as it has registered an increase in proportion of gross NPAs from 1.37 percent to 1.74 percent during last years. Hence in order to meet the present requirements of financial and banking sector drastic measures need to be taken, perhaps measures like restructuring of the public sector banks to reinforce the Indian financial system. The current course of reforms and the strategy for new policies in this regard will have to focus mainly to make the banking industry more sustainable and proficient so that it could respond positively to boost the economy. And to ensure best of the services to its clients and customers in general the strategy should be in the direction of broadening the horizons towards new segments like E-banking, Insurance, Retail Banking and Virtual Banking. Further banking in India is governed by various Acts amended in parliament from time to time.

Non-performing assets is one which does not yield periodically interest income regularly.

- An asset, in respect of which, interest has remained overdue for a period of 3 months or more.
- A term loan inclusive of unpaid interest, when the installment is overdue for a period of 3 Months or more on which interest amount remained overdue for a period of 3 months or more.
A demand or call loan, which remained overdue for a period of 3 months or more from the date of demand or call or on which interest amount remained overdue for a period of 3 months or more.

A bill which is overdue for a period of 3 months or more.

The interest in respect of a debt of the income on receivable under the head other current assets in the nature or short term loans, advances, which facility remained overdue for a period of 3 months or more.

Any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of 3 months or more.

The lease sector and hire purchase installment which has become overdue for a period of 3 months or more.

In respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower, beneficiary when any of the above credit facilities become non-performing assets.

### 3.5 NON PERFORMING ASSETS IN INDIAN BANKS

Undoubtedly the world economy has slowed down, recession is at its peak, globally stock markets have tumbled and business itself is getting hard to do. The Indian economy has much affect due to high fiscal deficit, poor infrastructure facilities, sticky legal system, and cutting of exposures to emerging markets etc.

Further, international rating agencies like, standard and poor have lowered India's rating to sub investment grade. Such negative aspects have often outweighed positives such as increasing and manageable information rate. Under such situation, it goes without saying
that banks are no exception and are bound to face the heat of a global downturn. One would be surprised to know that of banks and financial institution in India hold non-performing assets worth round about 116.64 billion during the year 2011-2012 bankers have realize that unless the level of NPA's is reduced drastically, they will find it difficult to survive.

The origin of the problem of burgeoning NPA's lies in the quality of managing credit risk by the bank concerned. It is necessary to have adequate preventive measures in place namely, fixing pre-sanctioning appraisal responsibility and having effective post disbursement supervision. Banks concerned should continuously monitor loans to identify accounts that have potential to become non-performing.

To start with, performance in terms of profitability is a benchmark for any business enterprise including the banking industry. However, increasing NPA's have a direct impact on banks are not allowed to make provision on such assets as per the reserve bank of India (RBI) guidelines. Also with increasing deposits made by the public in banking system. The banking industry cannot afford defaults by borrower a since NPA's affects the repayment of banks. Further, Reserve Bank of India (RBI) successfully creates excess liquidity in the system through various rate cuts and banks fail to utilize thus benefit to its advantage due to the fear of burgeoning non-performing assets.
## Table-3.1
### COMPOSITION OF NPAS OF PUBLIC SECTOR BANKS – 2003 TO 2012

(Amount in Billion)

<table>
<thead>
<tr>
<th>Bank group, Years</th>
<th>Priority Sector</th>
<th>Non-priority Sector</th>
<th>Public Sector</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Percent share</td>
<td>Amount</td>
<td>Percent share</td>
</tr>
<tr>
<td>2003</td>
<td>249.39</td>
<td>47.23</td>
<td>267.81</td>
<td>50.71</td>
</tr>
<tr>
<td>2004</td>
<td>238.41</td>
<td>47.54</td>
<td>256.98</td>
<td>51.24</td>
</tr>
<tr>
<td>2005</td>
<td>233.97</td>
<td>49.05</td>
<td>238.49</td>
<td>50.00</td>
</tr>
<tr>
<td>2006</td>
<td>223.74</td>
<td>54.07</td>
<td>180.72</td>
<td>43.68</td>
</tr>
<tr>
<td>2007</td>
<td>229.54</td>
<td>59.92</td>
<td>148.61</td>
<td>38.80</td>
</tr>
<tr>
<td>2008</td>
<td>252.87</td>
<td>63.86</td>
<td>140.15</td>
<td>35.39</td>
</tr>
<tr>
<td>2009</td>
<td>241.68</td>
<td>54.88</td>
<td>193.94</td>
<td>44.04</td>
</tr>
<tr>
<td>2010</td>
<td>308.46</td>
<td>53.84</td>
<td>259.23</td>
<td>45.25</td>
</tr>
<tr>
<td>2011</td>
<td>412.88</td>
<td>58.09</td>
<td>295.14</td>
<td>41.52</td>
</tr>
<tr>
<td>2012</td>
<td>562.01</td>
<td>49.96</td>
<td>552.46</td>
<td>49.11</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>295.29</strong></td>
<td><strong>53.84</strong></td>
<td><strong>253.35</strong></td>
<td><strong>44.97</strong></td>
</tr>
</tbody>
</table>

Source: Off-site returns (domestic & provisional) of banks, Department of Banking Supervision, RBI.
By looking at table and graph 3.1 the composition of non-performing assets in Indian public sector banks, it has been categorized into 3 types.

- Priority sector.
- Non-priority sector and
- Public sector.

It is very much clear from the outset that higher percentage of NPA is observed in case of priority sector on an average i.e. 53.84 percentage amounting to Rs. 295.29 billion. At the same time by looking at the non-priority sector on an average 44.97 percentage of NPA is created and it is amounting to Rs. 253.35 billion. Lastly in case of public sector lending the proposition of NPA when compared with other two categories of NPA it is low i.e. 1.109 percentage on an average and it is amounting to Rs. 5.36 billion.
Put together the total amount of non performing asset in Indian public sector banks on an average from last 10 year is Rs. 551.312 billion and Rs. 1116.64 billion during year 2011-2012 it indicating an alarming signal to Reserve Bank of India and Government of India which is badly impacting on economy of the nation. Authorities need to make an immediate action to bring down the proportion of NPA by taking strict and hard decision against the defaulters.

The Non-Performing Assets (NPAs) of the Indian banking sector have been incessantly rising in the past six months. Historically, in 1997, NPAs were 15.8% of loans for the banking sector, which nosedived to 2.4% in 2008. This figure stands at 2.94% of loans in 2012. In absolute figures, NPAs have doubled from 2009 to 2012 and assets under reconstruction had trebled during the same period. India's biggest lender, State Bank of India, is experiencing an NPA level of 4.99% of total loans. According to a recently published Credit Suisse Group AG report, 10 large industrial houses account for 13% of total assets financed by the Banking system, which means that bank lending is getting increasingly skewed. Further, of the total reconstructed assets, 8.24% belong to the large manufacturing sector, 3.99% are from the services sector while 1.45% are from the agricultural sector.

Reasons for growing NPAs

- Economic slowdown - The global economy is still in the throes of an economic crisis that is looming large both in the US and Europe. There is a general slackening of domestic economic activity in India both in manufacturing and the services sectors. A sluggish economy will have a direct impact on the balance sheets and profitability of many firms who have availed of loans from the banking
industry. Over a period of time, some of the hard hit firms will be compelled to default on their loans. There is a groundswell of expert opinion in India that NPAs are more an outcome of economic factors rather than any internal systemic failures.

- High interest rates - It is a known fact that interest rates have been revised upwards, 10 times in the past two years with a view to curb inflation. High interest rate increases the cost of funds to the credit users and has a debilitating effect especially on the repayment capacity of small and medium enterprises. Banks need to maintain their Net Interest Margin and hence pass on any interest rate hike to the borrowers. A high rate of inflation dilutes the quality of assets of the banking sector. Weak supply demand scenario, high borrowing or leveraging and intense competition contribute to loan defaults.

- New reporting system - Indian banks are to report NPAs from April 2012 in a computer recognized, identified format. It is stated that almost 90% of all banks' loan portfolio is under the computerized system of NPA reporting or system based reporting. The discretion of bank managers in classifying assets according to their local judgment is eliminated. This change in reporting pattern makes identification of NPAs a machine driven objective activity. However, credit risk analysis does have a subjective and judgmental element to it.

- Aviation sector - The Indian banking system has a total exposure of around Rs. 40,000 crores to the ailing aviation sector. SBI alone has an exposure of 5,000 crores to the aviation industry. It is common knowledge that many airlines are either in the red or marginally profitable. According to an RBI report, nearly
three-fourths of the top Banks' loans to the aviation sector are either impaired or restructured. Kingfisher airlines and Air India have been the significant aviation borrowers whose performance is below par.

Unfortunately, signals emanating from the power and telecom sects are not very encouraging and could further accentuate the problem of asset impairment.

3.6. **RBI GUIDELINES ON INCOME RECOGNITION**

Income Recognition Income from Non Performing Assets should not recognize on accrual basis but should be booked as income only when it is actually received. Therefore interest should not be charged and taken into income account till the account become standard asset.

- Interest charged to be stopped
- Provision to be made

Past due an amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate up gradation of technology in banking system etc.

Due date Interest installment becomes 'due' on the date it is debited to the loan account, scheduled to be paid. In case of loans, interest becomes due along with "principal* loan amount. In case of amount where moratorium, gestation is available for payment interest, payment of interest become due only after the moratorium, gestation period is over. Over due any amount due to the Bank under any credit facility is "Over due" if it is not paid on the due date fixed by the Bank.
Out of Order  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 Bank's Balance Sheet or Where are credits are not enough to cover the interest debited during the same period.

A Non Performing Asset shall be an advance where
Term Loan Interest and installment of principal remain "over due" for a period of more than 90 days.
Cash Credit, Over Draft If the account remains out of order for a period more than 90 days.
Bills Overdue for a period of more than 90 days.
Other accounts Any amount to be received remains overdue for a period of more than 90 days.

3.7 ASSETS CLASSIFICATION

The entire advances portfolio of the bank will have to classify in to two broad categories i.e. performing asset and non performing assets. Performing asset will have to be further classified into three categories Viz. Sub-standard, doubtful and loss assets depending upon the period for which the assets has renamed as non performing assets

Performing assets

Those goods borrower accounts which are regular in all respects and performing the function of earning regular income to the bank and do not carry more than the normal
risk of banking business will be eligible for classification under the category of standard assets i.e. performing assets.

Non-performing assets

An amount under any credit facility i.e. credit, overdrafts, term loans and other accounts is to be treated as "Past due" when it remains outstanding for 30 days beyond "Due date". A performing asset is defined as any credit facility in respect of interest or installment of principal is in arrears for 180 days during the accounting year ended 31st March 2001, 90 days during the year ending 31st March 2005 and onwards.

Assets wise

Standard asset

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

Sub standard asset

With effect from March 31, 2005 an asset would be classified as sub-standard if it remained NPA for a period less than or equal to 12 months in such cases the current net worth of the borrower or guarantors or the current market value of the securities charged is not enough to ensure recovery of the dues to the banks in full.

Doubtful assets

With effect from 31, 2005 an asset, is required to classified as doubtful, if it has remained NPA for more than 12 months. For tier 1 banks, the 12 month’s period of classification of a substandard asset in doubtful category is effective from April 1, 2009. as in the case of sub standard assets, rescheduling does not entitle the bank to upgrade the quality of an advantage automatically. A loan classified as doubtful has all the weakness
in resent as that classified as sub standard, with the added characteristic that the weakness make collection or liquidation in full on the basis of currently known fact.

Loss assets

A loss asset is one were loss has been identified by the bank or internal or external auditors, co-operation department or by the reserve bank of India inspection but the amount has not been written off wholly or partly.

Table 3.2
ASSET WISE CLASSIFICATION OF NPAS

<table>
<thead>
<tr>
<th>Year</th>
<th>Standard assets</th>
<th>Sub standard assets</th>
<th>Doubt full assets</th>
<th>Loss assets</th>
<th>Total NPA</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-08</td>
<td>7987876</td>
<td>72992</td>
<td>56825</td>
<td>4707</td>
<td>142635</td>
<td>1.75</td>
</tr>
<tr>
<td>2008-09</td>
<td>9005008</td>
<td>106697</td>
<td>70429</td>
<td>3945</td>
<td>181071</td>
<td>1.97</td>
</tr>
<tr>
<td>2009-10</td>
<td>1089254</td>
<td>78062</td>
<td>63345</td>
<td>8153</td>
<td>149560</td>
<td>1.30</td>
</tr>
<tr>
<td>2010-11</td>
<td>1208011</td>
<td>82883</td>
<td>74797</td>
<td>9752</td>
<td>167432</td>
<td>1.37</td>
</tr>
<tr>
<td>2011-12</td>
<td>1282825</td>
<td>77835</td>
<td>138326</td>
<td>34500</td>
<td>250661</td>
<td>1.91</td>
</tr>
<tr>
<td>Average</td>
<td>1055875</td>
<td>83694</td>
<td>80744</td>
<td>12211</td>
<td>178272</td>
<td>1.66</td>
</tr>
<tr>
<td>Percent</td>
<td>97.601</td>
<td>0.773</td>
<td>0.746</td>
<td>0.112</td>
<td>1.6</td>
<td>--</td>
</tr>
</tbody>
</table>

Sources: Annual audited report KGB

By looking at table 3.2 the asset wise classification of non performing assets in KGB has been categorized in to 4 types.
 ➢ Standard assets.
 ➢ Substandard assets.
 ➢ Doubtful assets.
 ➢ Loss assets.

It is clear from the very outset that on an average 97.601 percentage 1,05,58,759 is standard assets by looking at proportion of substandard on an average 0.773 percentage amounting to Rs. 83694. at the same time the proportion of doubtful assets on an average it is 0.746 percentage amounting to Rs. 80744 and the proportion of loss assets on an average it is 0.112 percentage amounting to Rs. 12211. Put together the proportion of non performing assets on an average is 1.6 amounting to Rs. 1,78,272, which is quiet alarming to the bank, appropriate measures need to take in order to bring down the proportion non performing assets which existed with KGB.

3.8 GUIDELINES FOR PROVISIONING & ASSET CLASSIFICATION

 ➢ The value of security means the current market value of both primary & collateral securities held validly by the bank excluding the worth of borrower,guarantor & the realizable value of security means the Bank's portion of the security available after the share of DICGC,ECGC where their guarantee is available.

 ➢ The provision requirement against each & every NPA account will be calculated on cumulative basis as on the balance sheet date in order to find out the total provision requirement. The provision held in the past year is not be excluded in an individual account so as to reflect what the total provision requirement should be as on a balance sheet date as per the guidelines. At Head Office level of each bank, the total provision requirement is maintained by making additional
provision, writing back as necessary depending upon the balance outstanding in the provision account.

➢ All facilities sanctioned to a borrower should be given one asset classification & provisioning should be done accordingly.

➢ Advances granted under rehabilitation packages approved by BIFR, TLI

- In respects of advances under rehabilitation package approved by BIFR, term lending institutions (TLI), the provision should continue to be made in respect of dues to the bank on the existing credit facilities as per their classification as sub-standard or doubtful asset.

- Provision need not be made for a period of one year from the date of disbursement in respect of additional facilities sanctioned under rehabilitation packages approved by BIFR, term lending institutions.

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

Government guaranteed advances

RBI has decided to introduce provisioning norm in respect of advances guaranteed by State Governments where guarantee has been invoked and has remained in default for 90 days. This measure would be effective in respect of advances sanctioned against State Government guarantee with effect from 31st March 2006. As regards provisioning requirement for advances guaranteed by State Governments which would stand invoked as on March 31, 2006.
Floating Provisions

It has been practice of some of the banks to make 'floating provision' over and above the specific provisions made in respect of accounts identified as NPAs. Such floating provisions wherever available can be set off against provisions required to be made under present guidelines for provisioning. Considering that higher loan loss provisioning adds to the overall financial strength of the banks and the stability of the financial sector, banks are urged to voluntarily set apart provisions much above the minimum prudential levels as a desirable practice.

Interest Suspense Account

Where provisions are required to be made as per RBI guidelines, the amounts held in the 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 provisioning as per the norms should be made on the balances after such deductions.

Advances against Deposits, Securities, etc.

Advances against term deposits, NSCs eligible for surrender, ICPs, KVPs and life policies are exempted from provisioning requirements. However, advances against gold ornaments, government securities and all other kinds of securities are not exempted from provisioning requirements.

Take-out finance

The lending institution should make provisions against a 'take-out finance' turning into NPA pending its take-over by the taking-over institution. As and when the asset is taken over by the taking-over institution, the corresponding provisions could be reversed.
Reserve for Exchange Rate Fluctuations Account (RERFA)

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

Advance covered by CGTSI Guarantee

In case the advance covered by CGTSI (Credit Guarantee Fund Trust for Small Industries) guarantee becomes non-performing, no provision needs to be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the guidelines on provisioning for non-performing advances. Two illustrative examples are given below

In the monetary and credit policy of April 2001 the RBI has stated that it is constantly reviewing the regulatory requirements in respect of prudential provisions and it is proposed to gradually enhance provisioning requirements in future. Considering that higher loan loss provisioning adds to the overall financial strength of the banks and the
stability of the financial sector, banks are urged to voluntarily set apart provisions much above the minimum prudential levels prescribed by RBI as a desirable practice.

The provision requirement can be reduced by infusion of additional securities and removing excess credit risk above the normal business risk above the normal business risk in case of loss asset and doubtful assets where realizable value of securities has fallen down.

Provisioning Norms (Tabular Form)

<table>
<thead>
<tr>
<th>Asset Category</th>
<th>Provision Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Loss Asset</td>
<td>100% of the outstanding balance</td>
</tr>
<tr>
<td>2) Doubtful Asset</td>
<td>a) 100% of the unsecured portion PLUS</td>
</tr>
<tr>
<td></td>
<td>b) Depending upon the age of Doubtfulness</td>
</tr>
<tr>
<td></td>
<td>Doubtful period of the secured portion</td>
</tr>
<tr>
<td></td>
<td>More than 3 years (DIII) as on March 2010</td>
</tr>
<tr>
<td></td>
<td>Up to 1 year</td>
</tr>
<tr>
<td></td>
<td>(with effect from March 31st March 2011)</td>
</tr>
<tr>
<td></td>
<td>60%</td>
</tr>
<tr>
<td></td>
<td>1 to 3 years</td>
</tr>
<tr>
<td></td>
<td>(with effect from March 31st March 2012)</td>
</tr>
<tr>
<td></td>
<td>75%</td>
</tr>
<tr>
<td></td>
<td>More than 3 Years</td>
</tr>
<tr>
<td></td>
<td>(with effect from March 31st March 2013)</td>
</tr>
<tr>
<td></td>
<td>100%</td>
</tr>
<tr>
<td>3) Substandard Asset</td>
<td>10% of the total outstanding balance</td>
</tr>
<tr>
<td>4) Standard Asset</td>
<td>Minimum 0.25% on standard assets on global loan portfolio basis.</td>
</tr>
</tbody>
</table>
## Table 3.3
NON PERFORMING ASSETS AND RESERVE PROVISION

<table>
<thead>
<tr>
<th>Year</th>
<th>NPA</th>
<th>Res. Provision</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-08</td>
<td>142635</td>
<td>78347</td>
<td>54.92</td>
</tr>
<tr>
<td>2008-09</td>
<td>181071</td>
<td>59172</td>
<td>32.67</td>
</tr>
<tr>
<td>2009-10</td>
<td>149560</td>
<td>41098</td>
<td>27.47</td>
</tr>
<tr>
<td>2010-11</td>
<td>167432</td>
<td>60170</td>
<td>35.93</td>
</tr>
<tr>
<td>2011-12</td>
<td>227574</td>
<td>109010</td>
<td>47.90</td>
</tr>
<tr>
<td>Average</td>
<td>173654.4</td>
<td>69559.4</td>
<td>39.70</td>
</tr>
</tbody>
</table>

*Sources Annual audited report KGB*

By looking at table 3.3 containing details of non performing assets and reserve provision created during the year 2007-2008 it was 54.92 percentage when compare to amount of non performing assets in the year 2008-2009 the reserve provision reduced to 32.67 percentage. Again in the year 2009-2010 the reserve provision reduced considerably to 27.47 percentage. At the same time the reserve provision during year 2010-2011 was increased to 35.93 percentage and during the year 2011-2012 the percentage of reserve provision against non performing asset increased to 47.90 percentage.

Put together the average reserve provision against average non performing assess during last five years stood at 39.70 percentage.

### Writing-off NPAs

- 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 of 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.

- 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.

- Therefore, the banks should either make full provision as per the guidelines or writ-off such advances and claim such 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.

**Write-off at Head Office Level**

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

**Reporting of NPAs**

- Banks are required to furnish a report on NPAs as on 31<sup>st</sup> March each year after completion of audit. The NPAs would relate to the bank’s global portfolio, including the advances at the foreign branches.

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

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

- Over a period, banks were advised to disclose in the 'Notes on Accounts' in the balance sheet, the details of movements in NPAs. As a further step in ensuring transparency and credibility of their financial positions, it has been decided that banks should furnish also movements of provisions held towards NPAs in the 'Notes on Accounts' in their balance sheet, from the year ending March 2002.

3.9 RULES & EXCEPTIONS RELATING TO NPA GUIDELINES

- The recovery (credit entries) in any loan account will be first appropriated towards the repayment of first overdue interest and then, overdue installment of previous quarters, financial years and there after next overdue interest & installment till the recovery amount is exhausted.

- Accounts with temporary deficiencies

    The classification of an asset as NPA should be based on the record of recovery. A loan account need not be classified as NPA merely due to existence of some deficiencies, which are of temporary nature, such as, non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily owing to application of interest or payment of statutory dues, non-submission
of stock statements and renewal of the limits on the due date, etc. Only when there is a threat of loss or the recoverability of the advance is in doubt, the asset should, however, be classified as NPA. In the matter of classification of accounts with such deficiencies banks may follow the following guidelines

- 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 assessed on the basis of the current stock statement. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining the 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 borrower 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.

- Regular and ad hoc credit limits need to be reviewed, regularized 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 90 days from the date of ad hoc sanction will be treated as NPA.
Accounts regularized near about the balance sheet date

The asset classification of borrow! 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, Inspectors about the manner of regularization of the account to eliminate doubts on their performing status.

Asset Classification to be borrower-wise but not facility-wise

It is difficult to envisage a situation when only one facility to a borrower becomes a problem credit and not others. Therefore, if one of the accounts of a particular borrower (i.e. person,firm,company under the same constitution with the same name & same right) is NPA, all other accounts (though eligible for classification as performing asset) of the same borrower are also to be classified as NPA. If the debits arising out 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.

Advances under Consortium Arrangements

In respect of financing of borrowers under multiple banking arrangements as well as under consortium, each bank may classify the account according to its own record of recovery 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.

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

- Advances against Term Deposits, NSC, KVP, IVP, etc.
  
  Advances against the Bank's term deposits, NSCs eligible for surrender, Indira Vikas Patras, Kisan Vikas Patras, Life Insurance Policies, etc. need not be treated as NPA. It may be noted that advances against gold ornaments, government securities and all other kind of securities are not exempted and hence to be treated at par with other loans for determining its NPA status. However, advances secured by Gold Biscuits, Primary Gold are to be excluded.
- **Project finance, loans with moratorium for payment of interest**

  In case of project finance, educational loans, housing loans, agricultural plantation loans, where moratorium is available for payment of interest, installment, payment of interest, installment becomes due only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected. 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 installment of principal or payment of interest on the respective due dates.

- **Agricultural advances**

  - In respect of advances to agriculture, where payment of interest, installment is synchronized with the harvesting of the crop, the advance should be treated as NPA if interest, installment remains overdue for the two harvest seasons but for a period not exceeding two half-years. The above norms should be made applicable only in respect of direct agricultural loans including short-term loans for production and marketing of seasonal crops such as paddy, wheat, oilseeds, sugarcane, etc. As per the recent RBI circular, direct agricultural loan will include loans for agricultural equipment & machinery, development of irrigation potentials, purchase and installation of pump, reclamation of land, construction of farm buildings and storage facilities. In respect of other activities like horticulture,
floriculture or allied activities such as animal husbandry, poultry farming, etc., assessment of NPA would be done as in the case of other advances.

- Where natural calamities have impaired the repaying capacity of the agricultural borrowers, the existing, converted term loan as well as fresh short-term loan (sanctioned as a part of the relief measure in terms of the extant guidelines) may be treated as current dues and need not be classified as NPA. The asset classification of these loans would therefore be governed by the revised terms & conditions and would be treated as NPA if revised interest and, or installment remains unpaid after it has become overdue for two harvest seasons but for a period not exceeding two half-years.

- Government guaranteed advances

  The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income. With effect from 1st March 2006, advances sanctioned against State Government guarantees should be classified as NPA in the normal course, if the guarantee is invoked and remains in default for more than 90 days.

- 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, as income recognition is based on record of recovery.
➢ Take-out Finance

Takeout finance is the product emerging in the context of the funding of long-term infrastructure projects. Under this arrangement, the institution, the bank financing infrastructure projects will have an arrangement with any financial institution for transferring to the latter the outstanding in respect of such financing in their books on a predetermined basis. In view of the time lag involved in taking-over, the possibility of a default in the meantime cannot be ruled out. The norms of asset classification will have to be followed by the concerned bank, financial institution in whose books the account stands as balance sheet item as on the relevant date. If (he 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 recognize 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 mat date.

➢ Export Project Finance

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. 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.

- Post-shipment Supplier's Credit

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

- Kisan Credit Card Account

In terms of Government decisions the banks are issuing Credit Cards to the farmers and sanctioning limits in cash credit accounts for a certain period. This credit card account can be treated as NPA if it remains out of order for two crop seasons or two half-years, whichever is earlier, on the date of balance sheet as under

- The outstanding balance remains continuously in excess of limit or
• The credits in the account are not sufficient even to cover the interest amount debited during the same period.

➤ Ever-greening

Banks & Financial Institutions should avoid the practice of ever-greening. Ever-greening means giving another loan to the borrower with the help of which it can pay the due interest on the original loan in order to avoid classifying problem assets as NPAs. However, transfer of funds from cash credit account for payment of due is permitted, if the account is regular, i.e., within the sanctioned limit and drawing power

➤ Staff loans

All Staff Loans sanctioned under various staff loan schemes including housing loan, conveyance loan, consumer loan, personal loan, etc. should not be normally treated as NPA.

3.10 REASONS FOR ASSETS BECOMING NPA

A multiplicity of factor is responsible forever increasing size of NPA's in banks. "Reserve Bank of India" on NPA's and ICAI Accounting Standard non-revenue recognition consistent with each other Only when it is actually realized, whether the aforesaid with respect to recognition of interest income on NPA's on realization basis is consistent with accounting standards - 9 revenue recognition. For this purpose, the issued norms by the RBI for creating certain assets as NPA's seems to be based on as assumption that the collection of interest on such asset is uncertain. Therefore, complying with as a interest income is not recognized based on uncertainty involved but is recognized at a stage when actually realized thereby complying with RBI as well. In
order to ensure proper appreciation of financial statement, banks should disclose the accounting policies adopted in respect of determination of NPA’s and basis on which income is recognized with other significant accounting policies. RBI on classification of bank advances. Reserve Bank of India (RBI) has issued on provisioning requirement with respect to bank advances. In terms of these bank advances are mainly classified into.

A few prominent reasons for assets becoming NPA’s are as under.

- Poor credit appraisal system
- Lack of proper monitoring
- Reckless in advances to achieve the budgetary targets.
- There is no or lack of corporate culture in the bank. In adequate legal provisions on foreclosure and bankruptcy.
- Change in economic(policies)environment.
- No transparent accounting policy and poor auditing practices.
- Lack of coordination between banks.
- Directed lending to certain sectors.
- Failure on the part of the promoters to bring their portion of equity form their own source or public issue due to market turning lukewarm.

Apart from the above some of the important internal and external factor have been enlisted below

- Internal factors
- External factors

Internal factors

- Funds borrowed for a particular purpose but not use for the said purpose.
➤ Project not completed in time.
➤ Poor recovery of receivables.
➤ Excess capacities created on non-economic costs.
➤ In-ability of the corporate to raise capital through the issue of equity or other debt instrument from capital markets.
➤ Business failures.
➤ Diversion of funds for expansion\setting up new project helping or promoting sister concerns.
➤ Willful defaults, siphoning of funds, disputes, management disputes, miss-appropriation etc.,
➤ Deficiencies on the part of the banks viz. in credit appraisal, monitoring and follow-ups, delay in settlement of payments\ subsidiaries by Government bodies etc.

External factors
➤ Sluggish legal system - Long legal tangles changes that had taken place in labor laws Lack of sincere effort.
➤ Scarcity of raw material, power and other resources.
➤ Industrial recession.
➤ Shortage of raw material, raw material\input price escalation, power shortage, industrial recession, excess capacity, natural calamities like floods, accidents.
➤ Failures, non-payment\over dues in other countries, recession in other countries, externalization problems, adverse exchange rates etc.
➤ Government policies like excise duty changes, import duty changes etc.
3.11 METHODS OF MANAGEMENT OF NPA’s

The management of NPA is the difficult task in practice. Management of NPA’s account in the books. In simple it focuses on the methods of settlement of NPA’s account. The methods differ from bank to bank. The following paragraph explains some general methods of management of NPA’s by the books.

- Compromise
- Legal remedies
- Regular Training Program
- Recovery Camps
- Rehabilitation of potentially viable
- Write offs
- Spot Visit
- Other Methods

Methods of Management of NPA’s
Compromise

The dictionary meaning of the term compromise is "settlement of dispute reached by mutual concessions. The following are the detailed guidelines for compromise, negotiated settlements of NPA's.

- The compromise should be a negotiated settlement under which the bank should ensure recovery of its dues to the maximum extent possible of minimum expenses.
- Proper distinction should be made between willful defaulters and borrowers defaulting in repayments due to circumstances beyond their control.
- Where security is available for assessing the realizable value, proper weight age should be given to the location, condition and marketable title and possession of sub security.
- All compromise proposals approved by any functionary should be promptly reported to the next higher authority for post facto scrutiny.
- Special recovery cells should be set up at all regional levels.

Legal remedies

The legal remedies are one of the methods of management of NPA’s. the banks observed that the borrower is making willful default; no more time should be lost instituting appropriate recovery proceedings. The legal remedies are filling of civil suits.

Regular Training Program

All the levels of executives should undergo the regular training program on credit and NPA management. It is very useful and helpful and to the executives for dealing the NPAs properly.
Recovery Camps

The bank should conduct the regular or periodical recovery camps in the bank premises or some other common places; such type of recovery camps reduces the level of NPA's in the Banks.

Rehabilitation of potentially viable units

The unit is sick due to technical obsolescence and inefficient management or financial irregularities. When the bank settles the dues, of such, companies through the compromise or through the legal actions the better is to be followed.

Write offs

Write offs is also one of the common management techniques of NPAs. The assets are treated as loss assets, when the bank writes off the balances. The ultimate aim of the write off is to cleaning the balance sheet.

Spot Visit

The bank officials should visit the borrower's business place or borrowers field regularly or periodically. It is also help full to the bank to control or reduce the NPAs limit.

Other Methods

- Persistent phone calls.
- Media announcement.

Apart from the things discussed in this chapter exhaustively an attempt has been made in order to enhance further on some of the relevant issues specifically addressed in the next chapter "Management of Non Performing Assets".
REFERENCES

- Bankers Economists' Meet. Karkal, G.L. 0982): "Profit and Profitability in Banking", IB A
- Bhatt, P.R. (1999), 'Profitability of Commercial Banks in India', Indian Journal of Economics, (March), pp. 202-21
- Cooper, WW., Seiford, L.M. and Tone, K. (2000): Data Envelopment Analysis,


Kulkarni, R. V. (2000), 'Changing Face of Banking From Brick and Mortar Banking to Banking'. IBA Bulletin (Jan.)


Essential Tool of Indian Banking & financial Sector", Indian Banking in the New Millennium, Anmol Publications Pvt. Ltd., New Delhi,
