CHAPTER 6

ACCOUNTING TREATMENT FOR

RESTRUCTURING ACCOUNTS
6.1 BEFORE COMMENCEMENT OF COMMERCIAL PRODUCTION

COMMERCIAL PRODUCTION DATE\(^1\):

In order to arrive at a decision as to whether the unit / project has achieved regular commercial production, the main guiding factor be whether the unit has achieved cash break-even in order to service the loan. Whether the unit's production has stabilized to service the loan or not shall be decided as per the broad parameters laid down by the individual Bank's Board of Directors.

The date of reckoning the account as Doubtful assumes utmost significance since (generally) Standard or Sub-standard accounts can be considered. The account can be considered as Standard, provided the account does not qualify for being classified as loss asset, only up to a period of TWO years from the relevant date and thereafter, the IRAC-norms are to apply as usual subject to the exception that the Sub-standard Asset can be up-graded to Standard Asset. The relevant date is as under:

A. Where the projects have achieved financial closure and it is formally documented. The date of completion of the project as envisaged at the time of original financial closure.

\(^1\) Accounting Standards and Corporate Accounting Practices – T.P. Ghosh
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B. Where the project:
   a. Cost of Rs.100 crore or more
   b. Was sanctioned before 1947;
   c. Could not achieve formally documented financial closure.

Deemed date of completion of the project on a project-by-project basis is to be decided by an Independent Group, drawing experts from F.Is. and Banks. (The said Group’s reports are available with the F.Is.)

C. Where the project:
   a. Cost was less than Rs.100 crore
   b. Was sanctioned before 1947;
   c. Could not achieve formally documented financial closure.

Deemed date of completion of the project would be as originally envisaged at the time of sanction.

D. Where the project:
   a. Was sanctioned after 1947;
   b. Could not achieve formally documented financial closure.

THE TERM “FINANCIAL CLOSURE” SIGNIFIES –

A. For a Greenfield project, legally binding commitment by all the project funders for 90% or more of the project cost; and

B. For other projects, legally binding commitment by all the project funders for 100% or more of the project cost;
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AND

C. Where the promoters have fully crystallized their legally binding commitments to provide standby support for cost overruns in the project.

Computations of sacrifice and waiver

Step - I. : Find the documented interest rate (DIR) applicable just prior to the "Restructuring". Penal rate, if applied / stipulated, is to be ignored.

Step - II. : Find the interest rate proposed to be charged as per the terms of "Restructuring". (PR).

Step - III. : Find the usually applicable interest rate (AR) that is the interest rate appropriate to the risk category of the borrower. This rate will be the current PLR of the Bank plus appropriate credit risk load for the borrower as per his latest credit rating.

Step - IV. : Interest calculated respectively @ DR and @ PR need to be discounted @ AR to arrive at NPA respectively of documented interest amount and of proposed interest amount.

Step - V. : The difference between the NPV of the interest component

@ DR; and

@ PR is the amount of Sacrifice / Waiver, which needs to be provided for / or written off.
RESTRUCTURING/RESCHEDULING OF LOANS

In the context of restructuring of accounts, the following stages at which the restructuring / rescheduling / renegotiation of the terms of loan agreement could take place are identified:

- Before commencement of commercial production;
- After commencement of commercial production but before the asset has been classified as sub-standard;
- After commencement of commercial production and after the asset has been classified as sub-standard.

In each of the above-mentioned three phases rescheduling etc. may take place with or without sacrifice of any portion of principal or interest. Given below is treatment of restructured accounts:

<table>
<thead>
<tr>
<th>Type of Stages</th>
<th>Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restructured standard Stages -1&amp;2 Rescheduling of principal installments of accounts alone</td>
<td>If the loan facility is fully secured, it is classified as standard asset after rescheduling.</td>
</tr>
<tr>
<td>Restructured standard Stages -1&amp;2 Rescheduling of interest element accounts</td>
<td>Account is not downgraded to substandard category if the amount of sacrifice in the interest element is measured in terms of present value and is either written off or provision is</td>
</tr>
</tbody>
</table>

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Restructured Stage-3 standard accounts

Rescheduling of installments of principal and interests

Find out amount of sacrifice in terms of present value. Either write off the amount or create provision. See Example 45.2.

Restructured Fully substandard secured accounts

Rescheduling of the installments of principal alone

Sub-standard asset is eligible to be continued in the sub-standard category for the specified period.

Restructured substandard of accounts installments of interest element

Account is continued in the substandard category if the amount of sacrifice in the interest element is measured in terms of present value and is either written off or provision is made. Discount factor is PLR+ appropriate credit risk premium. See Example 45.1.

made. Discount factor is PLR+ appropriate credit risk premium. See Example 45.1.
Restructured of substandard accounts installments of interest element Even if sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as substandard.

UPGRADATION OF RESTRUCTURED ACCOUNTS

Rescheduling of installments or principals Eligible for up gradation only after one year after the date when first payment of interest or of principal, whichever is earlier. Falls due subject to satisfactory performance during the period.

Amount of provision made earlier could be reversed after the one year period.

In case satisfactory performance is evidenced during the year, then prudential norms is applied for the purpose of asset classification.
6.2 **AFTER COMMENCEMENT OF COMMERCIAL PRODUCTION BUT BEFORE THE ASSET HAS BEEN CLASSIFIED AS 'SUB-STANDARD'**

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**TREATMENT OF 'STANDARD' ACCOUNTS RESTRUCTURED UNDER CDR**

A rescheduling of the installments of principal alone, at any of the aforesaid first two stages would not cause a standard asset to be classified in the sub-standard category, provided prescribed conditions are complied with and the loan / credit facility is fully secured.

A rescheduling of interest element at any of the foregoing first two stages provided the prescribed conditions are complied with would not cause an asset to be downgraded to sub-standard category on writing off/providing for the amount of sacrifice, if any, in the element of interest measured in present value terms. For this purpose, the sacrifice should be computed as the difference between the present value of future interest income reckoned based on the current 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 and the interest charged as per the restructuring package discounted by the current BPLR as on the date of restructuring plus appropriate term premium and credit risk premium as on the date of restructuring.
AUDIT PROCEDURE FOR ACCOUNTS FALLING UNDER CDR PROGRAMME

Following initial audit procedures are to be carried out to assess / gain an understanding about the borrower account.

(a) Study / Review credit appraisal made at the time of sanction of the credit facilities and latest renewal/review report of the borrower account to gain knowledge about the history of the account and the present position of the account.

(b) Review the operations in the account with respect to periodical stock statements, concurrent audit / internal audit reports, stock audit report, audited and un audited financial statements, quarterly and half-yearly performance reports by way of submission of QIS I FFR reports. Review of these data of the borrower account enables the auditor to gain knowledge about the borrower account, industry in which it is operating and reasons for delinquency.

(c) Review the latest position of the borrower account with respect to individual credit facilities sanctioned and out standings in the accounts.

(d) Review the present classification of the account under IRAC norms adopted by the bank and corresponding provision made in the books of accounts, if any. Also examine and ascertain whether the borrower account has

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1 Compendium of Accounting Standards
slipped into NPA category or not irrespective of the lender bank classification of the account as NPA or not. This step is prima facie required for further classification and categorization of the account under CDR scheme.

PROGRAM

Study I Review the application submitted by the borrower to CDR cell along with the rehabilitation program and ensure that the cell has found the proposal prima facie feasible and the application has been admitted.

Ascertain whether the borrower account is eligible for CDR scheme as the scheme will cover only multiple banking accounts I syndication I consortium accounts with outstanding exposure of RS.20 crores and above by banks and institutions. RBI vide circular no: DBOD.No.BP.BC.45 I 21.04.132 I 2005-06 dated November 10, 2005 has made certain modifications which states that the scheme is extended to entities with outstanding exposure of RS.10 crores and more. Review the Debtor Creditor Agreement (DCA) and Inter Creditor Agreement (ICA) with respect to availability of such agreements and necessary provisions in the agreement for reference to CDR cell in case of necessity, penal clauses, stand-still clause, to abide by the various elements of CDR system etc., (DCA may be entered into at the time of original sanction of loan or at the time of reference to CDR)

Study / Review the detailed rehabilitation program prepared by the cell / lenders primarily with respect to assessment / appraisal of projected financials, various ratios,
details of security, value of security, revised repayment schedule, sacrifices / write-offs, if any, assumed in the rehabilitation program. The review of the rehabilitation program with respect to reasons for earlier delinquency and the manner in which they are addressed for rectification of the same in the rehabilitation program will enable the auditor to reasonably satisfy himself about the working of the rehabilitation program. A review of the Flash Report submitted by the lender(s) to CDR Cell will enable the auditor to understand the terms of reference, cut-off date, history / background of the borrower company, nature of business activity, group companies, financial position, borrowings, reasons for default, business projections, rehabilitation program, sacrifices, revised payment schedule, etc.,

Auditor has to ascertain the terms of rehabilitation along with the sacrifices, if any, assumed in the rehabilitation program to verify whether such sacrifices have been accounted in the books of accounts of the lender. Ascertain whether any additional financing / conversion of loan into equity has been envisaged in the rehabilitation restructuring program.

There are two Categories of CDR system namely Category 1 CDR system and Category 2 CDR system. Category 1 CDR system covers borrower accounts classified as 'Standard' and 'Sub-Standard' assets whereas Category 2 CDR system covers advances classified as 'Doubtful' asset. Corporate classified as willful defaulter, indulging in fraud or misfeasance even in a single bank will not be considered for CDR scheme. Auditor to ascertain whether the borrower account falls under Category 1 CDR system or Category 2 CDR system or classified as willful defaulter, fraud etc.,
Auditor to ascertain whether account has been referred to BIFR, as such cases are not eligible for restructuring under CDR system. Large value BIFR cases may be eligible for restructuring under CDR if specifically recommended by core group. Auditor has to verify the necessary approvals / recommendations by CDR core group if auditor comes across any BIFR cases.

Auditor has to ensure that accounts wherein recovery suits have been filed, the initiative to resolve under CDR system is taken by at least by 75% of the lenders by value provided the account meets the basic criteria for becoming eligible under CDR mechanism.

CONVERSION OPTION

The CDR Empowered Group, while deciding the restructuring package, 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.

Equity acquired by way of conversion of debt / overdue interest under the CDR mechanism is allowed to be taken up without seeking prior approval from RBI, even if by such acquisition the prudential capital market exposure limit prescribed by the RBI is breached, subject to reporting such holdings to RBI, Department of Banking Supervision (DBS), every month along with the regular DSB Return on Asset Quality. However, banks will have to comply with the provisions of Section 19(2) of the Banking Regulation Act,1949.
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 RBI in the aforesaid DSB return.

**CATEGORY 2 CDR SYSTEM**

There have been instances where the projects have been found to be viable by the lenders but the accounts could not be taken up for restructuring under the CDR system as they fell under 'doubtful' category. Hence, a second category of CDR is introduced for cases where the accounts have been classified as 'doubtful' in the books of creditors, and if a minimum of 75% (by value) and 60% (by number) of the lenders satisfy themselves of the viability of the account and consent for such restructuring, subject to the following conditions:

It will not be binding on the creditors to take up additional financing worked out under the debit restructuring package and the decision to lend or not to lend will depend on each credit bank/FI separately. In other words, under the proposed second category of the CDR mechanism, the existing loans will only be restructured and it would be up to the promoter to firm up additional financing arrangement with new or existing creditors individually. All other norms under the CDR mechanism such as the standstill clause, asset classification status during the pendency of restructuring under CDR etc., will continue to be applicable to this category also.

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No individual case should be referred to RBI. CDR Group may take a final decision whether a particular case falls under the CDR guidelines or it does not. All the other features of the CDR system as applicable to the First Category will also be applicable to cases restructured under the Second Category.

The asset classification and provisioning norms under CDR would continue to be bank-specific based on record of recovery of each bank, as per the prudential norms applicable to banks. Reference may be made to the Master Circular on Income Recognition, Asset Classification and Provisioning.
6.3 AFTER COMMENCEMENT OF COMMERCIAL PRODUCTION AND THE ASSET HAS BEEN CLASSIFIED AS 'SUB-STANDARD' OR 'DOUBTFUL'

TREATMENT OF ACCOUNTS RESTRUCTURED UNDER CDR PROGRAM: CLASSIFICATION AND PROVISIONING

The criteria for classification of accounts will be on the basis of record of recovery as per the existing prudential norms. The asset classification will be as per the lender bank's record of recovery and will be bank specific.

Ensure that the lender has applied the usual asset classification norms pending outcome of the account with the CDR Cell. The asset classification status should be restored to the position, which existed at the time of reference to the cell if the restructuring under the CDR system takes place.

As stated at Para ________ (d) auditor has to ensure the asset classification status of the account under reference and decide about the further classify as per the procedure mentioned below:

Auditor has to ascertain whether the restructuring has been done
(a) Before commencement of commercial production
(b) After commencement of commercial production but before the asset has been classified as 'Sub-Standard Asset'

3 Text of Accounting Standards
(c) After commencement of commercial production and the asset has been classified as 'Sub-Standard' or 'Doubtful' asset.

Auditor has to ensure that an account classified as Standard Asset need not be downgraded in case the installments of the principal alone at any of the stages mentioned under (a) and (b) has taken place provided the account is fully secured?

Account need not be downgraded if interest rescheduling at any of stages mentioned under stages (a) and (b) above provided that the amount of interest sacrifice, if any measured in present value terms is either written off or provision is made to the extent of sacrifice involved. An account classified as 'Sub-Standard' or 'Doubtful' wherein rescheduling of the installments of principal alone can be continued in the same category for the specified period provided the loan credit facility is fully secured. An account classified as 'Sub-Standard' or 'Doubtful' wherein rescheduling of the interest has taken place can be continued in the same category for the specified period provided the amount of interest sacrifice, if any, measured in present value terms is either written off or provision is made to the extent of sacrifice involved.

UPGRADATION OF ACCOUNT:

Auditor has to ensure that any upgrading of accounts classified as 'Sub-Standard' or 'Doubtful' category wherein restructuring of principal or interest has taken place should be upgraded to the 'Standard Asset' category after a period of one year after the date when first payment of interest or of principal,
whichever is earlier, falls due under the rescheduled terms, subject to satisfactory performance during the period.

The amount of provision made earlier, net of the amount provided for interest sacrifice in present value terms can be reversed after the one-year period.

**POST RESTRUCTURING CLASSIFICATION OF THE ACCOUNTS CLASSIFIED AS 'SUB-STANDARD', 'DOUBTFUL' ASSET**

The classification of the accounts classified as 'Sub-standard' / 'Doubtful' asset will be maintained in the same status during the one year period if satisfactory performance is demonstrated during the period. Auditor has to ensure that the classification of the restructured account will be as per the applicable prudential norms with reference to the pre-restructuring payment schedule in case satisfactory performance is not demonstrated during the one-year period.

**DISCLOSURE**

Auditor has to ensure that lender discloses in their published annual Balance Sheets, under 'Notes on Accounts" the following information in respect of Corporate Debt Restructuring undertaken during the year:

(a) Total amount of loan assets subjected to restructuring under CDR.

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

(b) The amount of standard assets subjected to CDR.
(c) The amount of sub-standard assets subjected to CDR. (d) The amount of doubtful assets subjected to CDR.

a. All Standard or Sub–standard and “Doubtful” advance accounts in which:
   - More than one Bank; or,
   - One Bank and one Financial Institutions; or
   - More than one Financial Institutions.
   - Have exposure (outstanding) aggregating to Rs. 20 crore or more.

b. All advance accounts classified as “Standard” and “Sub–Standard” in the books of the lenders, will be categorized as Category – 1.

c. All advance accounts, classified as “Doubtful” in the books of all the majority of the lenders, will be categorized as Category – 2. In such a situation Corporate Debt Restructuring may be implemented if a minimum of 75 percent (by value) of the lenders satisfy themselves of the viability of the account and consent for such restructuring, subject to the following conditions:

   - It will not be binding on the Creditors to take up additional financing worked out under the debt restructuring package and the decision to lend or not to lend will depend on each Creditors Bank / Financial Institutions separately. In other words under the proposed second categorized of the CDR mechanism, the existing loans will only be restructured and it would be up to the
promoter to firm up additional financing arrangement with new of existing lenders individually.

All other norms under the CDR mechanism (such as the "stand-still" clause) during the pendency of restructuring under Corporate Debt Restructuring etc. will continue to be applicable to this category also.

d. There may be situation where a small portion of debt by a Bank might be classified as doubtful. In that situation, if the account has been classified as "Standard or Sub-standard" in the books of at least 90% of lenders (by value), the same would be treated as Standard or Sub-standard only for the purpose of judging, the account as eligible for Corporate Debt Restructuring, in the books of the remaining 10% of lenders as category - 1.

e. There would be no requirement of the account / Company being sick, NPA or being in default for a specified period before reference to the Corporate Debt Restructuring system.

f. However, potentially viable cases of NPAs will get priority.

g. In no case, the request of any corporate indulging in willful default, fraud or misfeasance, even in a single Bank, will be considered for restructuring under Corporate Debt Restructuring system.

h. The accounts where recovery suits have been filed by the lenders against the Company, may be eligible for consideration under the Corporate Debt Restructuring system provided, initiative to resolve the cases under the
Corporate Debt Restructuring system is taken by at least 75 percent of the lenders (by value). However, for restructuring for such accounts under the Corporate Debt Restructuring system, it should be ensured that the account meets the basic criteria for becoming eligible under the Corporate Debt Restructuring mechanism.

i. BIFR cases are generally not eligible for restructuring under the Corporate Debt Restructuring system. However, large value BIFR cases may be eligible for restructuring under the Corporate Debt Restructuring system if specifically recommended by the Corporate Debt Restructuring Core Group. The Core Group recommended exceptional BIFR cases on a case to case basis for consideration under the Corporate Debt Restructuring system. It should be ensured that the lending institutions complete all the formalities in seeking the approval from BIFR before implementing the package.

**DISCLOSURE:**

Banks / Financial Institutions should also disclose in their published annual Balance Sheets, under "Notes on Accounts", the following information in respect of corporate debt restructuring undertaken during the year:

a) Total amount of loan assets subjected to restructuring under CDR. 

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

b) The amount of standard assets subjected to CDR.

c) The amount of sub-standard assets subjected to CDR.

d) The amount of doubtful assets subjected to CDR.