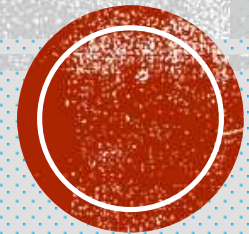


# **INCOME RECOGNITION, ASSET CLASSIFICATION & PROVISIONING (IRAC)**

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# OBJECTIVE

LFAR compliance

Post audit Supervision

Asset Quality

Impact on Financial Statements

Views on Reclassification of Assets

How to find tensed advances



# RELATION BETWEEN BASEL NORMS & IRAC

- Issued by RBI to regulate asset classification and provisioning.
- Ensures income recognition and risk management in banks.
- Categorizes assets into Standard, Substandard, Doubtful, and Loss assets.
- international banking regulations aimed at strengthening the financial system by setting minimum capital requirements, liquidity standards, and risk management practices for banks
- IRAC norms classify NPAs, increasing risk-weighted assets.
- - Basel norms require banks to maintain capital based on RWAs.
- - Higher NPAs lead to higher capital requirements under Basel.



# IRAC

## Assets



## NPA



## Income Recognition



## Other Aspects under IRAC



The Income Recognition and Asset Classification (IRAC) norms were introduced by the Reserve Bank of India (RBI) in 1992 as part of banking sector reforms recommended by the Narasimham Committee (1991).

IRAC is applicable to all scheduled commercial banks (SCBs), regional rural banks (RRBs), small finance banks (SFBs), payment banks and all Lending Institutions Regulated by RBI like NABARD, SIDBI, and EXIM Bank



# WHAT ARE ASSETS IN BANKING?

Definition of Assets in Banking as per RBI

In banking, an asset refers to any financial resource owned by a bank that generates income or holds value. RBI classifies bank assets into different categories based on their risk profile and recovery status.

For the purpose of ascertaining default, we can classify the assets broadly into two types

- Term Loan ( E.g. WCTL, Home Loan, Etc.)
- Limit-based facilities (CC/OD)





# FEATURES & STRUCTURE

Feature	Term Loan	Limit-Based Facilities (CC/OD)
<b>Nature of Loan</b>	Loan sanctioned for a fixed tenure with scheduled repayments.	Revolving credit facility where funds can be used up to a sanctioned limit.
<b>Disbursement</b>	Given as a lump sum and repaid in EMIs or scheduled instalments.	Withdrawn as needed within the sanctioned limit.
<b>Repayment Mode</b>	Paid in monthly/quarterly instalments (principal + interest).	Requires regular credits to the account to maintain balance within limits.
<b>Interest Charging</b>	Charged on the entire outstanding principal.	Charged only on the utilized amount (not the full limit).



# CATEGORIES: IRAC

- Standard Assets
- Sub-standard Assets
- Loss Assets





# HOW TO FIND STRESSED ACCOUNTS ?

- Non-Submission of Financials
- Irregular Repayments
- Excessive Overdraft Usage
- Operational Red Flags
- Cheque Bounces & Defaults
- Frequent Restructuring



# WHAT ARE STANDARD ASSETS?

No default in  
repayment of

Principal

Interest



# CLASSIFICATION OF STANDARD ASSETS AS PER RBI (SMA FRAMEWORK)

SMA Category	Overdue Period	Indicates
SMA-0	1 to 30 days	Early stress, first sign of financial trouble.
SMA-1	31 to 60 days	Increasing risk, borrower facing short-term financial difficulties.
SMA-2	61 to 90 days	High risk of default, borrower struggling to make payments.
NPA	More than 90 days overdue	Account officially classified as Non-Performing Asset (NPA).



# WHY IS SMA CLASSIFICATION IMPORTANT?

- Early Warning System
- Prevents Financial Losses
- Regulatory Compliance
- Credit Risk Management



# **NON PERFORMING ASSETS (NPA)**



# NON PERFORMING ASSETS (NPA)

- The system should ensure that identification of NPAs is done on an on-going basis and accounts are classified as NPA immediately, as soon as they turn into NPA, without waiting till the end of quarter/financial year.
- Banks should also make provisions for NPAs as at the end of each calendar quarter i.e. as at the end of March / June / September / December, so that the income and expenditure account for the respective quarters as well as the P&L account and balance sheet for the year end reflects the provision made for NPAs.



# NON PERFORMING ASSETS (NPA)

- The borrower accounts shall be flagged as overdue by banks as part of their day-end processes for the due date, irrespective of the time of running such processes.
- Similarly, classification of borrower accounts as well as NPA shall be done as part of day-end process for the relevant date and the SMA or NPA classification date shall be the calendar date for which the day end process is run. In other words, the date of SMA/NPA shall reflect the asset classification **status of an account at the day-end of that calendar date.**
- SMA as well as NPA shall be done as part of day-end process for the relevant date and the SMA or NPA classification date shall be the calendar date for which the day end process is run. In other words, **the date of SMA/NPA shall reflect the asset classification status of an account at the day-end of that calendar date.**





# NON PERFORMING ASSETS (NPA)

- An account is classified as NPA if the principal or interest remains overdue for 90 days.
- The account remains 'out of order' for more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC)
- Non-fund-based facilities (e.g., bank guarantees) also require classification if they devolve into funding obligations.
- The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.
- The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction



# NON PERFORMING ASSETS (NPA)

Example:

- ✓ If due date of a loan account is Oct 31,2024, and full dues are not received before the bank runs the day-end process for this date, the date of overdue shall be Oct 31, 2024. If it continues to remain overdue, then this account shall get tagged as SMA-1 upon running day-end process on April 30, 2024 i.e. upon completion of 30 days of being continuously overdue.
- ✓ Accordingly, the date of SMA-1 classification for that account shall be Nov 30,2024.
- ✓ If the account continues to remain overdue, it shall get tagged as SMA-2 upon running day-end process on Dec 30,2024 and
- ✓ if continues to remain overdue further, it shall get classified as NPA upon running day-end process on Jan 29,2025.



# AGRICULTURAL ADVANCE (NPA)

(i) In respect of all direct agricultural advances, as specified in Annex 1:

a) A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.

b) A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

(ii) "long duration" crops would be crops with crop season longer than one year.

(iii) The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each state.

- (iv) Depending upon the duration of crops raised by an agriculturist, the above NPA norms would also be made applicable to agricultural term loans availed by him.
- (v) Banks should ensure that while granting loans and advances, realistic repayment schedules are fixed on the basis of cash flows / fluidity with the borrowers.



# CONCEPT OF DEFAULT & NPA

## CLASSIFICATION

Aspect	Term Loan	Limit-Based Facilities (CC/OD)
<b>Default Definition</b>	When the borrower fails to pay EMI or interest within due date.	When the account is classified as "out of order" (defined below).
<b>NPA Classification</b>	If interest/principal remains overdue for more than 90 days, it becomes an NPA.	If the account remains out of order for more than 90 days, it becomes an NPA.
<b>"Out of Order" Condition</b>	✗ Not applicable	✓ Account is "out of order" if: <ul style="list-style-type: none"><li>- Outstanding balance remains above the sanctioned limit for 90+ days.</li><li>- No credits (deposits) for 90 continuous days.</li><li>- Credits received are insufficient to cover interest debited.</li></ul>



# PRACTICAL EXAMPLE OF DEFAULT & NPA CLASSIFICATION

## Cash Credit/Overdraft:

- A company has a sanctioned CC/OD limit of **₹10 lakh** but o/s balance exceeding the limit.
- No credits (repayments) are made for **90 days**.
- Even if the balance remains within the limit but **no deposits are made for 90 days**, it becomes an **NPA**.
- Review and renewal of Accounts – Short review (1,2,3)
- Non Submission of Stock Statement.

■



# RESTRUCTURING OF NPA

- Restructuring involves modifying the terms of an existing loan, including changes in repayment schedule, interest rate, tenure or converting debt into equity.
- An account classified as NPA remains NPA after restructuring and can be upgraded only after satisfactory performance for at least 12 months.
- Provisioning For NPA accounts restructured- Higher provisioning (15%-25%) based on the delay in resolution.



# UPGRADATION

- Upgradation to a standard asset- On payment of arrears of interest and principal.
- Loans backed by government guarantees - upon the invocation and receipt of the guarantee payment.
- Crop loans - if past dues are cleared for two crop seasons (short-term crops) or one season (long-term crops).





# INCOME RECOGNITION



# INCOME RECOGNITION

- Income recognition should be objective and recovery-based.
- No interest to be taken to income account for NPAs.
- Exception:

Interest on advances secured by Term Deposits, NSCs, KVPs, and Life Insurance can be recognised if an adequate margin is available.



# REVERSAL OF INCOME ON NPA'S

- Interest credited to income in past periods should be reversed if not realized.- Applies to ***Government guaranteed accounts*** as well.
- If loans with a moratorium on payment of interest (permitted at the time of sanction of the loan) become NPA after the moratorium period is over, the capitalized interest, if any, ***corresponding to the interest accrued during such moratorium period need not be reversed.***
- For NPA accounts fees, commissions, and similar incomes should cease to accrue in the current period and should be reversed with respect to past periods if uncollected.
- Leased assets: Unrealized finance income must be reversed.



# APPROPRIATION OF RECOVERY IN NPA'S

- Interest on NPAs can be recognized only if credits are **not from fresh loans**.
- In absence of a specific agreement, banks should have a **consistent accounting principle** for appropriating recoveries.
- In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.
- On a technical ground, no haircut in principal should be allowed; principal should be recovered first and reminder if any should be appropriated to interest.



# OTHER ASPECTS UNDER IRAC



# EVERGREENING

- Evergreening refers to the practice where banks artificially keep a stressed or non-performing loan account as "standard" by offering additional credit or restructuring it in a way that hides its true financial condition. This is done to avoid classifying the loan as a Non-Performing Asset (NPA) and to prevent provisioning requirements from increasing.



# COMMON EVERGREENING TECHNIQUES

- Fresh Loans to Pay Off Old Loans
- Adjusting Loan Limits
- Structured Deals with Related Parties
- Longer Moratorium Periods
- Technical Write-Offs





# AUDITOR'S APPROACH

- Scrutiny of Loan Accounts - Frequent Disbursement & Repayment Patterns
- Whether new loans are sanctioned frequently and previous overdue loans are settled just before the NPA classification date
- Check if multiple loans are given to the same borrower or related entities.



# QUICK MORTALITY

"Quick Mortality" refers to loan accounts that turn Non-Performing Assets (NPA) within a short period after disbursement, typically within 12 months.

It is often an indicator of weak credit appraisal, fraudulent transactions, fund diversion, or evergreening practices.



# KEY INDICATORS OF QUICK MORTALITY IN LOAN ACCOUNTS

- Early Default Post-Disbursement
- Diversion of Funds
- Absence of Business Operations
- Evergreening Tactics
- Shell Companies & Dummy Borrowers
- Abnormal Transactions Post-Disbursement



# QUICK MORTALITY & RBI IRAC NORMS

## 1. Asset Classification for Quick Mortality Loans

- If a loan defaults within 90 days of disbursement
- If restructuring is done within one year of disbursement, the loan remains NPA until satisfactory repayment for 12 months.

## 2. Higher Provisioning for Newly Classified NPAs

- Substandard Asset: 15% Provision.
- Doubtful Asset: 25%-100% based on security status.

## 3. Loan Write-Off & Fraud Classification

- If an account turns NPA within 6 months of disbursement and fraud is suspected, conduct a forensic audit.
- Classify the loan as a Loss Asset if fraud is proven.



# OTHER ISSUES

- Top up loans – Enhancement of Limit.
- Fraud Loans
- Temporary Advances
- Short Repayments
- Advance Instalments



# PROJECT FINANCE — IRAC NORMS

## **NPA Classification for Delayed Projects & Provisioning:**

- If the project fails to commence operations within the allowed extension period, the entire loan must be classified as NPA immediately.
- Once classified as NPA, banks must follow usual IRAC provisioning norms:
  - Substandard Asset (Up to 12 months in NPA) → 15%
  - Provision Doubtful Asset (12+ months in NPA) → 25%-100%
  - Provision Loss Asset (If non-recoverable) → 100% Provision.



# PROJECT FINANCE — IRAC NORMS

## **Income Recognition for Project Loans:**

- **No Income Recognition on NPA Accounts:** If the loan becomes an NPA, interest income cannot be booked unless actually received.
- **Moratorium & Capitalization of Interest:** Banks may capitalize interest during construction, but it must be as per approved restructuring norms.





# CREDIT CARD FACILITY — IRAC NORMS

## **NPA Classification for Credit Card Dues:**

- A credit card account is classified as Non-Performing Asset (NPA) if the minimum amount due remains unpaid for more than 90 days.
- Once classified as NPA, the following actions take place:
  - No further interest income can be recognized unless actually received.
  - Provisioning requirements apply as per RBI guidelines (detailed below).



# CREDIT CARD FACILITY — IRAC NORMS

## **Standard Asset Classification for Credit Card Dues:**

- Credit card dues are considered Standard Assets if the minimum payment is made regularly.
- Even if a cardholder pays only the minimum amount due (MAD), the account remains standard and does not become an NPA.



# CREDIT CARD FACILITY — IRAC NORMS

## **Standard Asset Classification for Credit Card Dues:**

- Credit card dues are considered Standard Assets if the minimum payment is made regularly.
- Even if a cardholder pays only the minimum amount due (MAD), the account remains standard and does not become an NPA.



# CONSORTIUM FINANCE — IRAC NORMS

- Consortium Finance refers to a lending arrangement where two or more banks jointly provide credit to a borrower under a common agreement. This is usually done for large projects that require funding beyond the capacity of a single lender. The banks share the risk and returns in proportion to their exposure to the borrower.
- This is usually done for large projects that require funding beyond the capacity of a single lender.



# CONSORTIUM FINANCE — IRAC NORMS

## NPA Classification in Consortium Lending

- Each bank must classify the borrower's account independently based on its own exposure and repayment history.
- If the borrower defaults to one bank, it does not automatically mean the loan is an NPA for all consortium members.
- However, RBI's guidelines state that if one lender classifies the account as NPA, it must inform all consortium members to ensure uniform classification if default signs are visible across banks.



# CONSORTIUM FINANCE — IRAC NORMS

## Income Recognition for Agricultural Loans.

- Interest income on NPA loans cannot be recognized unless actually received.
- If an agricultural loan remains overdue beyond the NPA threshold, banks must stop accruing interest income.
- Restructured loans remain in the same asset classification (NPA) until satisfactory performance for one year.



# CRYSTALLIZATION OF LIABILITY IN NON-FINANCIAL ADVANCES ?

- Crystallization occurs when a bank is required to honor its commitment under a Letter of Credit (LC) or Bank Guarantee (BG) due to borrower default.
- Once crystallized, it is treated as a **funded advance** and subject to **IRAC norms**.
- If repayment remains overdue **for 90 days** from crystallization, it is classified as **NPA**
- Provisions are made based on asset classification: **Substandard, Doubtful, or Loss Asset**.



# NPA'S IN EXPORT FINANCES.

- Export Finance refers to **financial assistance provided to exporters** to facilitate the production, shipment, and realization of export proceeds. It helps exporters manage **working capital needs** and enhances their global competitiveness.
- Export finance becomes **NPA if overdue for 90 days** beyond prescribed due date.
- In case of **delay in realization of export proceeds**, an extension may be granted by **AD banks (Authorized Dealers)** or RBI.





# PROVISIONS RELATING TO NPA IN FRAUD ACCOUNTS.

- Accounts classified as **fraud by banks or regulatory authorities** are treated as **NPA immediately**, irrespective of their overdue status.
- Such accounts are subject to **accelerated provisioning** as per RBI norms.
- **100% provisioning** is required for outstanding exposures (funded & non-funded) over a **maximum period of 4 quarters** from fraud identification.
- Banks can make provisions **in one go or spread over four quarters**, starting from the quarter in which the fraud is detected.



# PROVISIONING



# PROVISIONING NORMS - IRAC

## Provisioning for Standard Assets (Regular Loans)

- ✓ Retail Loans, Agriculture, and SME Loans → 0.40%
- ✓ Commercial Real Estate (CRE) Loans → 1.00%
- ✓ CRE – Residential Housing → 0.75%
- ✓ Housing Loans above ₹75 Lakh (LTV > 80%) → 2.00%
- ✓ Restructured Standard Loans → 5.00%



# PROVISIONING NORMS - IRAC

## Provisioning for Non-Performing Assets (NPAs):

Asset Classification	Definition	Provisioning Requirement
<b>Substandard Assets</b>	Loans classified as NPA for less than 12 months	15% general provision
<b>Unsecured Substandard</b>	If unsecured portion exists	25% provision
<b>Doubtful Assets – Up to 1 Year</b>	NPAs for more than 12 months	25% provision
<b>Doubtful Assets – 1 to 3 Years</b>	If NPA remains doubtful for 1-3 years	40% provision
<b>Doubtful Assets – Over 3 Years</b>	NPA continues beyond 3 years	100% provision on unsecured portion
<b>Loss Assets</b>	Loans identified as unrecoverable	100% provision required



# PROVISIONING NORMS - IRAC

## Special Provisioning Norms for Restructured Loans

- ✓ Restructured Standard Loans → 5% Provision
- ✓ Restructured Substandard Loans → 15% (Secured), 25% (Unsecured)



# PROVISIONING NORMS - IRAC

## Provisioning for Fraudulent & Wilful Default Accounts

- ✓ **100% provision required immediately** upon detection of fraud.
- ✓ If fraud accounts are detected after disbursement, **full provisioning must be done within 4 quarters.**



# PROVISIONING NORMS - IRAC

## Provisioning for Agricultural Loans

### ✓ Short-Term Crop Loans:

- If overdue **for 2 cropping seasons**, it becomes an **NPA**.
- **Provisioning follows the standard NPA norms.**

### ✓ Long-Term Agricultural Loans:

- If overdue **for 1 year**, it becomes an **NPA**.
- **Standard NPA provisioning applies.**



# ACCELERATED PROVISIONING

- Banks must maintain a **5% provisioning** for standard loans/exposures to companies whose directors (excluding government/financial institution nominees) appear **more than once** in the willful defaulters list
- However, the treatment changes if such accounts are classified as NPA, the same is presented in the next slide.





# ACCELERATED PROVISIONING

Asset Classification	Period as NPA	Regular provisioning (%)	Accelerated provisioning (%)
Sub- standard (secured)	Up to 6 months	15	No change
	6 months to 1 year	15	25
Sub-standard (unsecured ab-initio)	Up to 6 months	25 (other than infrastructure loans)	25
		20 (infrastructure loans)	
	6 months to 1 year	25 (other than infrastructure loans)	40
		20 (infrastructure loans)	
Doubtful I	2nd year	25 (secured portion)	40 (secured portion)
		100 (unsecured portion)	100 (unsecured portion)
Doubtful II	3rd & 4th year	40 (secured portion)	100 for both secured and unsecured portions
		100 (unsecured portion)	
Doubtful III	5th year onwards	100	100



# Thanks for being with us



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