OVERVIEW OF CREDIT MANAGEMENT

CHAPTER 17 MODULE C PART 5 By Ashish Sir

INCOME RECOGNITION AND ASSET CLASSIFICATION

- One of the important functions of **RBI is to ensure the stability of financial sector** and thus ensuring the interests of the depositors.
- A crucial factor, affecting the health of a bank, is the quality of its assets.
- These assets are **formed mainly with depositors' money** (bank's capital in formation of these assets can be as low as 9 per cent, which is the mandatory CAR), even a small deterioration in the quality of these assets can affect the interests of the depositors very badly.
- RBI has prescribed guidelines for the banks to classify their assets depending on the conduct of each account.
- A provision, out of bank's profit, has to be made to provide for the possibility of default.
- The amount of provision depends on the classification of the asset.

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- Similarly, **there are norms prescribed for not recognizing some of the perceived incomes so that the profit of the bank is not inflated unduly.**
- For example, in an account where the principal itself is doubtful of recovery, there is no point in considering the interest receivable as part of the accrued income.

Modification in Extent of Guarantee Cover for Credit Facilities

The **Credit Guarantee Scheme** has been enhanced to provide greater support to underserved and weaker segments, particularly **ZED-certified MSEs**, units in **Aspirational Districts**, and **Women/ SC/ ST Entrepreneurs**. The key updates regarding the **extent of guarantee coverage** are as follows:

Revised Guarantee Coverage Structure:

Category	Up to ₹5 Lakhs	Above ₹5 Lakhs & Up to ₹50 Lakhs	Above ₹50 Lakhs & Up to ₹200 Lakhs
Micro Enterprises	85%	75%	75%
MSEs in North East Region (incl. Sikkim)	80%		
Women Entrepreneurs	85%		
MSEs in Aspirational Districts	85%		
ZED Certified MSEs	85%		

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SC/ST Entrepreneurs	85%
Other Borrowers	75%

1. **General Borrowers**: For other borrowers, the guarantee coverage remains at **75%**.
2. **Effective Date**: These revised guidelines are applicable to all guarantees approved **on or after December 1, 2022**.
3. **Exclusions**: The revised guarantee coverage will **not apply** in cases where an **existing working capital account** (already under the scheme) is enhanced.

Aligning Guarantee Coverage for Retail and Wholesale Trade under CGS

The Credit Guarantee Scheme (CGS) for **Retail and Wholesale Trade**, categorized as eligible activities, has been **aligned with other activities** of CGS-I to better address the growing credit needs of **Micro and Small Enterprises (MSEs)** in trading. Key modifications include:

Key Changes in Guarantee Coverage:

1. **Increased Credit Limit**: The **credit guarantee ceiling** has been **increased from ₹100 Lakhs to ₹200 Lakhs** for MSEs engaged in **Retail and Wholesale Trade**.
2. **Uniform Guarantee Coverage**:

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- The **extent of guarantee coverage** for Retail and Wholesale Trade is now **aligned with other activities** under CGS-I:
  - Coverage percentages will follow the same rules as other sectors (e.g., Micro Enterprises, Women Entrepreneurs, etc.).

3. **Uniform Annual Guarantee Fee**: The **rate of the annual guarantee fee** for Retail and Wholesale Trade is now **at par with other activities** under the CGS.

Important Exclusions:

The **revised guarantee coverage** (aligned with other activities) will **not apply** to:

- **Enhancement of existing working capital accounts** already covered under the Guarantee Scheme.
- Such cases will remain at **50% guarantee coverage**.

Transfer of Borrowal Accounts from One Bank to Another

To address complaints about the **lack of transparency and inadequate sharing of critical information during the transfer of borrowal accounts** between banks, the **Reserve Bank of India (RBI)** has issued specific guidelines in its circular dated **May 10, 2012**.

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Guidelines for Transfer of Borrowal Accounts:

1. **Board-Approved Policy for Account Takeover**:
    - Banks are required to have a **Board-approved policy** for taking over accounts from another bank.
    - The policy must include:
        - Norms regarding the **types of accounts** eligible for takeover.
        - **Authority levels** for sanctioning takeovers.
        - Mechanisms for **monitoring taken-over accounts**.
        - Conducting a **credit audit** of taken-over accounts.
        - Reviewing **staff accountability**, particularly in cases of **quick mortality** (early defaults after account transfer).
        - Periodic reviews of taken-over accounts at the **Board/ Board Committee/ Top Management levels**.
2. **Credit Information Sharing**:
    - Before taking over an account, the **transferee bank** must:
        - Obtain **necessary credit information** from the transferor bank in the format prescribed in the ***RBI circular dated December 8, 2008***, *on "Lending under Consortium Arrangement/ Multiple Banking Arrangements."*
        - Ensure full awareness of any **irregularities or issues** in the borrower's account(s) with the transferor bank.

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- The **transferor bank** must:
  - Provide the requested credit information to the transferee bank **at the earliest** in the prescribed format.

Fair Practices Code

RBI has issued guidelines on fair practices code for lending. These are to be compulsorily followed by all banks in India. These guidelines pertain to:

(i) Application for loans and their processing

(ii) Loan appraisal and terms/conditions

(iii) Disbursements of loans

(iv) Post disbursement supervision

(v) General guidelines relating to discrimination based on sex, caste and religion, harassment in recovery etc.

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Periodicity of Charging Interest on Advances

1. General Guidelines

- **Monthly Rest:**
  - Banks are required to charge interest at **monthly rests** for most advances, subject to specific conditions.
  - Interest amounts must be **rounded off to the nearest rupee**.

2. Agricultural Advances

- **Not Applicable for Monthly Rests:**
  - The guidelines for charging interest at monthly rates are not applicable to **agricultural advances**.
- **Crop-Specific Practices:**
  - For **long-duration crops**, banks should charge interest **annually**, considering the crop seasons.
  - For **short-duration crops** and allied activities (e.g., dairy, fishery, poultry, piggery, beekeeping), interest and compounding should align with:
    - **Due dates** based on fluidity with the borrower.

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    - **Harvesting/marketing seasons.**

- **Interest Limit:**
    - For **short-term loans** to **small and marginal farmers**, the **total interest debited** to an account should **not exceed the principal amount**.

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ANALYSIS OF FINANCIAL STATEMENTS

ABM MODULE C CH – 18 By Ashish Sir

Net worth of the applicant is the excess of assets over his liabilities. ***Net worth helps the bank in deciding the level of activity*** which may be desirable by the applicant and the amount of money which can be lent to him.

Repayment capacity: information like income (salary, interest, dividend etc) as also the expenditure including repayments of existing borrowings are taken into account so to check the repaying capacity.

Viability: Bank loan is normally intended to increase the income of the borrower. Scrutinizing the existing activity's financial records helps banks to assess whether the proposed bank loan will be viable in increasing the operations or not.

Availability of securities: The audited financial statements indicate the type of charge on the assets of the borrower. Bank can assess the level of unencumbered securities.

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Which are the Financial Statements?

There are **two basic statements which every business enterprise is required to prepare**.

(a) Balance sheet

(b) Profit and loss account. (Income and Expenditure statement in case of non-profit organization.

- Apart from these the **Auditor's report**, explanatory schedules and notes on accounts are to be provided to the bank only if applicable.
- **Funds Flow Statement** also provide useful information but it can be derived from the above two financial statements by the analyst/ banker himself.
- It indicates the changes in the assets and liability position, during a given period.
- **Accounting Standard - 3 (AS-3)** makes it mandatory for certain organizations which are listed on stock exchange or which having turnover for the accounting period above Rs.50 cr to prepare **cash flow statement.**
- They have also to do segment-wise reporting as per AS-17.

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USERS OF FINANCIAL STATEMENTS

The financial statements are used by

(a) Creditors and lenders

(b) Investors

(c) Govt agencies

(d) Rating agencies

(e) Customers

(f) Employees

(g) General public

(h) Analysts

BASIC CONCEPTS USED IN PREPARATION OF FINANCIAL STATEMENTS

- **Entity concept –** business concern is considered to be a separate entity from the promoters, owners, share-holders, investors etc.

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- **Money measurement concept –** accounting is done only for those transactions which can be expressed in monetary terms which makes them comparable.
- **Going-concern concept –** that the entity would remain a going concern i.e. continue to be in business for an indefinitely long period.
- **Cost concept -** Assets that an entity acquire are generally to be recorded at their cost. So as the unrealized profit is not accounted for and if no cost is incurred, the item is not taken into books.
- **Conservation concept –** states that no profit should be anticipated but all possible losses may be accounted for.
- **Dual aspect concept –** that the resources owned by an entity should be equal to the liability because each entry has two aspects.
- **Accounting period concept –** the business is segmented into appropriate parts to check the performance. Such segment is called accounting period.

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- **Accrual concept –** that the income/ expense to be recorded as when they become due and not on transaction basis.
- **Realisation concept -** that revenue can only be recognized once the underlying goods or services associated with the revenue have been delivered or rendered, respectively. Thus, revenue can only be recognized after it has been earned.
- **Matching concept -** Incomes and expenses in an accounting period must be recongnised as and when they accrue (arise) and not when they are received or settled respectively.

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