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PRUDENTIAL NORMS FOR NBFCs

KEY WORDS:

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ABSTRACT

Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on **cash basis**. Income from dividend on shares of corporate bodies may be taken into account on **accrual basis** when such dividend has been declared by the corporate body in its annual general meeting and the non-banking financial company's right to receive payment is established.Prior to 1991 different companies have been adopting different income recognition norms. With the onset of financial sector reforms income recognition norms have also changed. Firstly, income recognition norms must be the same for all firms and secondly, they should be prudent. The following income recognition norms must be followed consistently for all NBFCs:

INCOME RECOGNITION NORMS

(1) The income recognition must be based on recognized accounting Principles.

(2) Income including interest/discount of any other charges on NPA shall be recognized only when it is actually realised. Any such income recognized before the asset became non-performing and remaining unrealized shall be reversed.

(3) In respect of hire purchase assets, where installments are overdue for more than 12 months, income shall be recognized only when hire charges are actually received. Any such income taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised, shall be reversed.

(4) In respect of lease assets, where lease rentals are overdue for more than 12 months, the income shall be recognized only when lease rentals are actually received. The net lease rentals taken to the credit of profit and loss account before the asset became non-performing and remaining unrealised shall be reversed.

Explanation - For the purpose of this paragraph, 'net lease rentals' mean gross lease rentals as adjusted by the lease adjustment account debited/ credited to the profit and loss account and as reduced by depreciation at the rate applicable under Schedule XIV of the Companies Act, 1956.

INCOME FROM INVESTMENTS

(1) Income from dividend on shares of corporate bodies and units of mutual funds shall be taken into account on cash basis.

(2) Income from dividend on shares of corporate bodies may be taken into account on accrual basis when such dividend has been declared by the corporate body in its annual general meeting and the non-banking financial company's right to receive payment is established.

(3) Income from bonds/debentures of corporate bodies and from Government securities may be taken into account on accrual basis: Provided that the interest rate on these instruments is pre-determined and interest is serviced regularly and is not in arrears.

(4) Income on securities of corporate bodies or public sector undertakings, the payment of interest and repayment of principal of which have been guaranteed by Central Government or a State Government may be taken into account on accrual basis.

CLASSIFICATION OF ADVANCES AND PROVISIONING

Every Non-Banking Financial Company shall, after taking into account the time lag between an accounts becoming non-performing, its recognition as such, the realization of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets as provide hereunder:

(1)Loans, Advances and Other Credit Facilities Including Bills Purchased and Discounted – The provisioning requirement in respect of loans, advances and other credit facilities including bills purchased and discounted shall be as under:

(i)Loss Assets – The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100 per cent of the outstanding should be provided for;

(ii)Doubtful Assets – (a) 100 per cent provision to the extent to which the advance is not covered by the realisable value of the security to which the non-banking financial company has a valid recourse shall be made. The realizable value is to be estimated on a realistic basis; (b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20 per cent to 50 per cent of the secured portion (i.e. estimated realisable value of the outstanding) shall be made on the following basis:-

Period for which the asset has Been considered as doubtful	Percent of provisions
Up to one year	20
One to three years	30
More than three years	50

(I) Sub-Standard Assets – A general provision of 10 per cent of total outstanding shall be made.

(1) Lease and Hire Purchase Assets – The provisioning requirements in respect of hire purchase and leased assets shall be as under:

(ii) Hire Purchase Assets – In respect of hire purchase assets, the total dues (overdue and future installments taken together) as reduced by (a) The Finance charges not credited to the profit and loss account and carried forward as unmatured finance charges; and (b) The depreciated value of the underlying asset shall be provided for.Disclosure in the Balance Sheet

(1) Every non-banking financial company shall separately disclose in its balance sheet the provisions made as per without netting them from the income or against the value of assets.

(2) The provisions shall be distinctly indicated under separate

(i). Provisions for bad and doubtful debts; and

(ii). Provisions for depreciation in investments.

(2) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the non-banking financial company.

(3) Every non-banking financial company shall separately disclose in its balance sheet the provisions made as per without netting them from the income or against the value of assets.

(4) Every non-banking financial company shall separately disclose in its balance sheet the provisions made as per without netting them from the income or against the value of assets.

(5) The provisions shall be distinctly indicated under separate heads of account as under:

(I). Provision for bad and doubtful debts; and

(ii). Provisions for depreciation in investments.

(6) Such provisions shall not be appropriated from the general provisions and loss reserves held, if any, by the non-banking financial company.
(7) Such provisions for each year shall be debited to the profit and loss account. The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against them.