After a close reading of the RBI circular titled "Prudential Treatment of Bad and Doubtful Debt Reserve (BDDR) by Co-operative Banks" issued on August 2, 2024 (RBI/2024-25/58), few pertinent issues arise and that have caused lots of confusion amongst the cooperative banks. Here is a comprehensive analysis of the key provisions, interpretational contradictions, and the anomalies that are creating confusion among stakeholders.

Purpose of the Circular:

The RBI aims to standardize how BDDR (Bad and Doubtful Debt Reserve) is treated, especially:

- **Its accounting treatment in the Profit & Loss (P&L) account,**
- **Its impact on Net NPAs and regulatory capital,**
- **And to align it with Accounting Standard 5 (Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies) and IRACP (Income Recognition, Asset Classification, Provisioning and Other Related Matters) norms.**

What the Circular Prescribes (in essence):

1. Going Forward (FY 2024–25 Onwards):

- **All NPA provisions (as per IRACP norms) must be charged as expense in the P&L—even if they're recorded under "BDDR" or any other head.**
- **The eligibility of such provisions towards regulatory capital shall be governed by the existing guidelines on Capital Adequacy.**
- **After charging applicable provisions as per IRACP Norms, banks may appropriate profits below the line to BDDR if required by State laws or internal policy.**

2. One-Time Transition Provision:

Banks who previously (till FY 2023–24) made required NPA provisions directly from appropriation of net profit (below the line) to BDDR (and not as an expense) must:

- **Identify the BDDR2024 balance (provisions not routed through P&L).**
- **By March 31, 2025, pass rectification entries by:**
    - **Transferring from General Reserves or P&L (below the line) to "Provisions for NPA" (liability).**

- **Then, these provisions can be deducted from Gross NPAs to arrive at Net NPAs.**

- **Remaining BDDR (not required for provisioning) may be transferred to General Reserve or P & L Account (below the line).**
- **After these adjustments, the balance in the BDDR can be reckoned as Tier 1 Capital but cannot be netted from Gross NPA to arrive at Net NPA.**

Key Anomalies and Confusions Identified:

1. Contradictory Treatment of BDDR for Net NPA Computation

- **Point 3(c)(ii) says: BDDR**2024 **once transferred to "Provisions for NPA" can be deducted from GNPAs to arrive at NNPAs.**
- **Point 3(c)(iii) says: Balance in BDDR not required as per applicable statute can also be transferred to General Reserve or P&L (below the line).**
- **But Point 3(c)(iv) says: BDDR balances shall not be reduced from Gross NPAs to calculate Net NPAs.**

Conflict: There appears to be contradiction in all the 3 clauses which needs to be sorted out. The word "BDDR" being used at multiple places but in different context is creating confusion. The fallout of the confusion is : which BDDR balance is deductible from GNPAs?

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2. Ambiguity Between 'Provision' and 'Reserve'

- **The circular switches interchangeably between "reserves" and "provisions" [(Clause c(ii)], despite clear accounting differences:**
    - **Provisions are expenses (which are done by debiting P&L above the line).**
    - **Reserves are appropriations from profit (i.e. Distributable Profit).**

Result: This creates confusion about what constitutes regulatory provision and what counts as Tier 1 capital, especially when provisions are "moved into" or "out of" BDDR.

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3. Impact on Tier 1 Capital Not Consistently Defined

- **It states: "After passing the above entries, balances in BDDR can be reckoned as Tier 1 capital."**
- **But doesn't clarify:**

- **Whether this applies only to residual balances not used for provisioning.**
- **Or to the entire BDDR balance post adjustments.**
- **(It further states : The balance in the BDDR shall not be reduced from Gross NPA to arrive at Net NPA.)**

Concern: Banks might overstate Tier 1 Capital by including entire BDDR balances.

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4. Ambiguity regarding Compliance

- **The circular is dated 2nd August, 2024 and is applicable with immediate effect but also says that rectification to be carried out as at March 31, 2025, but:**
  - **It does not clarify whether quarterly reporting of BDDR*2024* is required during FY 2024–25.**
  - **Leaves uncertainty for statutory auditors and managements.**

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5. If any Conflict with State Co-op Laws?

- **Point 4 states banks must comply with the provisions of respective State Co-op Acts/MSCS Act, 2002.**
- **But what if State Acts mandate BDDR to be created by appropriation of profits?**

  Conflict: RBI's directive to recognize all IRACP provisions through P&L may contradict such statutory mandates. No clarity is given on resolution of such legal conflicts.

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6. Lack of Reporting Format or Disclosure Norms

- **No guidance is provided on:**
  - **How banks must disclose BDDR adjustments in financial statements,**
  - **Whether separate schedules or notes are expected,**
  - **Any audit confirmation requirements.**

Suggestions for Clarity:

1. **RBI may consider issuing FAQs or a follow-up clarification, especially on:**
   - **BDDR deduction from GNPAs**
   - **Tier 1 capital inclusion**

    - **State Act overrides**
    - **Interim period disclosures**
2. **Provide model journal entries and accounting illustrations.**
3. **Standardize disclosure formats in balance sheets and notes.**

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