

CHAPTER 6

FINANCIAL STATEMENTS OF BANKING COMPANIES

BASIC CONCEPTS

Bank is an important organ of the modern trade and commerce. Banks in India are regulated by the Banking Regulation Act, 1949. The banking activities in India are regulated by the Banking Regulations Act, 1949. Under Section 5(b) of the said Act “Banking” means, the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.

Every bank should maintain a minimum capital adequacy ratio based on capital funds and risk assets. As per the prudential norms, all Indian scheduled commercial banks (excluding regional rural banks) as well as foreign banks operating in India are required to maintain capital adequacy ratio (or capital to Risk Weighted Assets Ratio) which is specified by RBI from time to time.

A Bank's advances are to be classified into performing assets and non-performing assets (NPA). The international practice is not to consider interest income from NPA on accrual basis but to consider such income as and when it is actually received.

An asset becomes non-performing when the bank does not receive income from it for a certain period. In concept, any credit facility (assets) becomes non-performing “when it ceases to generate income for a bank.” The Reserve Bank of India has issued detailed guidelines to banks regarding the classification of advances between performing and non-performing assets which have been revised from time to time.

The banks have to classify their advances into four broad groups (i) standard assets, (ii) sub-standard assets, (iii) doubtful assets and (iv) loss assets.

➤ Provisions

Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of the security and the erosion over time in the value of security charged to the banks, it has been decided that banks should make provision against sub-standard assets, doubtful assets and loss assets on the following basis:

- (a) **Loss assets** : Loss assets should be written off. If loss assets are permitted to remain in the books for any reason, 100 percent of the outstanding should be provided for.
- (b) **Doubtful assets** : Doubtful Advances will attract 100% provision to the extent the advance is not covered by the realisable value of the security to which the bank has a

valid recourse and the realisable value is estimated on a realistic basis. However, in respect of the secured portion, following provisioning requirements will be applicable:

Period for which the advance has been considered as doubtful	% of provision on secured portion
Upto 1 year	25%
More than 1 year and upto 3 years	40%
More than three years	100%

(c) **Sub-standard assets:** Advances classified as “sub-standard” will attract a provision of 15 per cent. The “unsecured exposures” classified as sub-standard assets will attract an additional provision of 10 per cent, *i.e.*, a total of 25 per cent. However, “unsecured exposures” in respect of Infrastructure loan accounts classified as sub-standard, in case of which certain safeguards such as escrow accounts are available will attract an additional provision of 5 per cent only *i.e.* a total of 20 per cent.

(d) **Standard assets:**

The provisioning requirements for all types of standard assets stands amended as below, with effect from November 5, 2009. Banks should make general provision for standard assets at the following rates for the funded outstanding on global loan portfolio basis:

- (a) direct advances to agricultural and SME sectors at 0.25 per cent;
- (b) advances to Commercial Real Estate (CRE) Sector at 1.00 per cent;
- (c) all other loans and advances not included in (a) and (b) above at 0.40 per cent

The revised norms would be effective prospectively but the provisions held at present should not be reversed.

The provisions on standard assets should not be reckoned for arriving at net NPAs.

The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions Others' in Schedule 5 of the balance sheet.

Question 1

Non-Performing Assets.

(November, 1999 & May, 2001)

Answer

An asset is classified as non-performing asset (NPA) if dues in the form of principal and interest are not paid by the borrower for a period of 90 days. If any advance or credit facility granted by a bank to a borrower becomes non-performing, then the bank will have to treat all

the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

Income from the non-performing assets can only be accounted for as and when it is actually received. In concept, any credit facility (assets) becomes non-performing when it ceases to generate income. The RBI has issued guidelines to commercial banks regarding the classification of advances between performing and non-performing assets.

A term loan is treated as a non-performing assets (NPA) if interest and/or instalments of principal remains over due for a period of more than 90 days. A cash credit/overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated as 'out of order' if any of the following conditions is satisfied:

- (a) the outstanding balance remains continuously in excess of the sanctional limit/drawing power.
- (b) though the outstanding balance is less than the sanctioned limit/drawing power—
 - (i) there are credits continuously for more than 90 days as on the date of balance sheet or
 - (ii) credits during the aforesaid periods are not enough to cover the interest debited during the same period.

Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days. Necessary provision should be made for non-performing assets after classifying them as sub-standard, doubtful or loss asset as the case may be.

Question 2

Classification of advances in the case of a Banking Company. (May, 2000 & November, 2000)

Answer

Banks have to classify their advances into four broad groups:

- (i) **Standard Assets**—Standard assets is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset is not a NPA as discussed earlier.
- (ii) **Sub-standard Assets**—Sub-standard asset is one which has been classified as NPA for a period not exceeding 12 months. In the case of term loans, those where instalments of principal are overdue for period exceeding one year should be treated as sub-standard. In other words, such an asset will have well-defined credit weaknesses that jeopardise the liquidation of the debt and are characterised by the distinct possibility that the bank will sustain some loss, if deficiencies are not corrected.
- (iii) **Doubtful Assets**—A doubtful asset is one which has remained sub-standard for a period exceeding 12 months. A loan classified as doubtful has all the weaknesses inherent in

that classified as sub-standard with added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

- (iv) **Loss Assets**—A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspectors but the amount has not been written off, wholly or partly.

The classification of advances should be done taking into account (i) Degree of well defined credit worthiness and (ii) Extent of dependence on collateral security.

The above classification is meant for the purpose of computing the amount of provision to be made in respect of advances and not for the purpose of presentation of advances in the balance sheet.

Question 3

Slip system of posting and double voucher system.

(May, 2000 & May, 2002)

Answer

Slip system of posting : Under this system used in the case of banking companies, entries in the personal ledgers are made directly from vouchers instead of being posted from the day book. Pay-in-slips (used by the customers at the time of making deposits) and the cheques are used as slips which form the basis of most of the transactions directly recorded in the accounts of customers. As the slips are mostly filled by the customers themselves, this system saves a lot of time and labour of the bank staff. The vouchers entered into different personal ledgers are summarised on summary sheets every day, totals of which are posted to the different control accounts which are maintained in the general ledger.

Double voucher system : In a bank, two vouchers are prepared for every transaction not involving cash—one debit voucher and another credit voucher. This system is called double voucher system. The vouchers are sent to different clerks who make entries in books under their charge.

Question 4

Acceptances and endorsements

(November, 2000 & November, 2003)

Answer

A bank has a more acceptable credit as compared to that of its customers. On this account, it is often called upon to accept or endorse bills on behalf of its customers. In such a case, the bank undertakes a liability towards the party which agrees to receive such a bill in payment of a debt or agreed to discount the bill after the same has been accepted by the bank. As against this liability, the bank has a corresponding claim against the customer on whose behalf it has undertaken to be a party to the bill, either as an acceptor or as an endorser. Such liabilities which are outstanding at the close of the year and the corresponding assets are disclosed as contingent liability in the financial statements. As a safeguard against the customer not being

able to meet the demand of the bank in this respect, usually the bank requires the customer to deposit a security equivalent to the amount of the bill accepted on his behalf. A record of the particulars of the bills accepted as well as of the securities collected from the customers is kept in the Bills Accepted Register. A bank may not treat this book as part of the system of its account. In such a case no further record of the transactions is kept until the bill matures for payment. If the bill, at the end of its term, has to be retired by the bank and the amount cannot be collected from the customer on demand, the bank reimburses itself by disposing of the security deposited by the customer.

Question 5

Classification of investments by a banking company.

(November, 2001 & May, 2004)

Answer

The investment portfolio of a bank would normally consist of both approved securities (predominantly government securities) and other securities (shares, debentures, bonds etc.). Banks are required to classify their entire investment portfolio into three categories : held-to-maturity, available-for-sale and held-for-maturity. Securities acquired by banks with the intention to hold them upto maturity should be classified as 'held-to-maturity'. Securities acquired by banks with the intention to trade by taking advantage of short-term price interest rate movements should be classified as held-for trading/maturity. Securities which do not fall within the above two categories should be classified as available-for-sale'.

Question 6

From the following details prepare "Acceptances, Endorsements and other Obligation A/c" as would appear in the general ledger.

On 1.4.2010 Acceptances not yet satisfied stood at ₹ 22,30,000. Out of which ₹ 20 lacs were subsequently paid off by clients and bank had to honour the rest. A scrutiny of the Acceptance Register revealed the following:

Client	Acceptances/Guarantees ₹	Remarks
A	10,00,000	Bank honoured on 10.6.2010
B	12,00,000	Party paid off on 30.9.2010
C	5,00,000	Party failed to pay and bank had to honour on 30.11.2010
D	8,00,000	Not satisfied upto 31.3.2011
E	5,00,000	-do-
F	2,70,000	-do-
Total	<u>42,70,000</u>	

(November, 1999)

Answer

Acceptances, Endorsements and other Obligation Account
(in general ledger)

		₹ '000				₹ '000
2010-11	To Constituents' liabilities for acceptances/guarantees etc. (Paid off by clients)	20,00	1.4.2010	By Balance b/d		22,30
	To Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank ₹ 22.30 lakhs less ₹ 20 lakhs)	2,30	2010-11	By Constituents' liabilities for acceptances/guarantees etc.		
				A	10,00	
				B	12,00	
				C	5,00	
10.6.2010	To Constituents' liabilities for acceptances/guarantees etc. (Honoured by bank)	10,00		D	8,00	
				E	5,00	
30.9.2010	To Constituents' liabilities for acceptances/guarantees etc. (Paid off by party)	12,00		F	<u>2,70</u>	42,70
30.11.2010	To Constituent's liabilities for acceptances/guarantees etc. (Honoured by bank on party's failure to pay)	5,00				
31.3.2011	To Balance c/d (Acceptances not yet satisfied)	15,70				
		65,00				65,00

Question 2

From the following information find out the amount of provisions required to be made in the Profit & Loss Account of a commercial bank for the year ended 31st March, 2011 :

- (i) *Packing credit outstanding from Food Processors ₹ 60 lakhs against which the bank holds securities worth ₹ 15 lakhs. 40% of the above advance is covered by ECGC. The above advance has remained doubtful for more than 3 years.*

(ii) Other advances:

(May, 2000)

Assets classification	₹ in lakhs
Standard	3,000
Sub-standard	2,200
Doubtful :	
For one year	900
For two years	600
For three years	400
For more than 3 years	300
Loss assets	600

Answer

(i)

	(₹ in lakhs)	
Amount outstanding (packing credit)	60	
Less : Realisable value of securities	<u>15</u>	
	45	
Less : ECGC cover (40%)	<u>18</u>	
Balance	<u>27</u>	
Required provision :		
Provision for unsecured portion (100%)		27.0
Provision for secured portion (100%)*		<u>15.0</u>
		<u>42.0</u>

(ii) Other advances:

(₹ in lakhs)			
Assets	Amount	% of	Provision
	₹	provision	₹
Standard	3,000	0.40	12
Sub-standard*	2,200	15	330
Doubtful* :			
For one year	900	25	225
For two years	600	40	240

For three years	400	40	160
For more than three years	300	100	300
Loss	600	100	<u>600</u>
Required provision			1,867

Note : Sub-standard and Doubtful advances have been assumed as fully secured. However, in case, the students assume that no security cover is available for these advances, provision will be made for @ 25% for sub-standard and 100% for doubtful advances.

Question 7

Bidisha Bank Ltd. had extended the following credit lines to a Small Scale Industry which had not paid any interest since March, 2005.

	Term Loan	Export Credit
Balance outstanding on 31.3.2011	₹ 70 Lacs	₹ 60. Lacs
DICGC/ECGC Cover	50%	40%
Securities held	₹ 30 Lacs	₹ 25 Lacs
Realisable value of securities	₹ 20 Lacs	₹ 15 Lacs

Compute the necessary provisions to be made for the year ended 31st March, 2011 (May, 2002)

Answer

	Term Loan	Export Credit
	₹ in Lacs	₹ in Lacs
Balance outstanding	70.00	60.00
Less : Realisable value of securities	<u>20.00</u>	<u>15.00</u>
	50.00	45.00
Less : DICGC/ECGC Cover	<u>25.00</u>	<u>18.00</u>
Net unsecured balance	<u>25.00</u>	<u>27.00</u>
Provision in respect of secured portion (100%)	20.00	15.00
Provision for unsecured portion (100%)	<u>25.00</u>	<u>27.00</u>
Provision required	<u>45.00</u>	<u>42.00</u>

Question 8

The following particulars are extracted from the (Trial Balance) Books of the M/s Commercial Bank Ltd. for the year ending 31st March, 2011:

		₹
(i)	Interest and Discounts	1,96,62,400
(ii)	Rebate on Bills Discounted (balance on 1.4.2010)	65,040
(iii)	Bills Discounted and purchased	67,45,400

It is ascertained that proportionate discount not yet earned on the Bills Discounted which will mature during 2011-2012 amounted to ₹ 92,760.

Pass the necessary Journal entries with narration adjusting the above and show:

(a) *Rebate on Bill Discounted Account; and*

(b) *Interest and Discount Account in the ledger of the Bank.*

(November, 2003)

Answer

The Commercial Bank Ltd.

Journal Entries

Date		Dr.	Cr.
2011		₹	₹
March 31	Rebate on Bills Discounted A/c Dr. To Interest and Discount A/c (Being the amount of provision for unexpired discount brought forward from the previous year credited to Interest and Discount A/c)	65,040	65,040
March 31	Interest and Discount A/c Dr. To Rebate on Bills Discounted A/c (Being provision for unexpired discount required at the end of the current year)	92,760	92,760
March 31	Interest and Discount A/c Dr. To Profit & Loss A/c (Being transfer of balance to Profit and Loss A/c)	1,96,34,680	1,96,34,680

(a) Rebate on Bills Discounted Account

2011			₹	2010			₹.
March 31	To	Interest and Discount A/c	65,040	April 1	By	Balance b/d	65,040
2011				2011			
March 31	To	Balance c/d	<u>92,760</u>	March 31	By	Interest and Discount A/c (rebate required)	<u>92,760</u>
			<u>1,57,800</u>				<u>1,57,800</u>

(b) Interest and Discount Account

2011			₹	2010			₹
March 31	To	Rebate on Bills Discounted A/c	92,760	April 1 2011	By	Rebate on Bills Discounted A/c (opening balance)	65,040
March 31	To	Profit & Loss A/c (transfer)	<u>1,96,34,680</u>	March 31	By	Cash and Sundries	<u>1,96,62,400</u>
			<u>1,97,27,440</u>				<u>1,97,27,440</u>

Question 9

Rajatapeeta Bank Ltd. had extended the following credit lines to a Small Scale Industry, which had not paid any Interest since March, 2005:

	Term Loan	Export Loan
Balance Outstanding on 31.03.2011	₹ 35 lakhs	₹ 30 lakhs
DICGC/ECGC cover	40%	50%
Securities held	₹ 15 lakhs	₹ 10 lakhs
Realisable value of Securities	₹ 10 lakhs	₹ 08 lakhs

Compute necessary provisions to be made for the year ended 31st March, 2011. (May, 2004)

Answer

	Term loan ₹ in lakhs	Export credit ₹ in lakhs
Balance outstanding on 31.3.2011	35.0	30.0
Less: Realisable value of Securities	<u>10.0</u>	<u>8.0</u>
	25.0	22.0
Less: DICGC cover @ 40%	10.0	
ECGC cover @ 50%	—	<u>11.0</u>
Unsecured balance	<u>15.0</u>	<u>11.0</u>

Required Provision:

100% for unsecured portion	15.0	11.0
100% for secured portion	<u>10.0</u>	<u>8.00</u>
Total provision required	<u>25.0</u>	<u>19.0</u>

Question 10

From the following information find out the amount of provisions to be shown in the Profit and Loss Account of a Commercial Bank:

Assets	(₹ in lakhs)
Standard	4,000
Sub-standard	2,000
Doubtful upto one year	900
Doubtful upto three years	400
Doubtful more than three years	300
Loss Assets	500

(November, 2004)

Answer

Computation of provision:

Assets	Amount (₹ in lakhs)	% of Provision	Provision (₹ in lakhs)
Standard	4,000	0.40	16
Sub-standard*	2,000	15	300
Doubtful upto one year*	900	25	225
Doubtful upto three years*	400	40	160
Doubtful more than three years*	300	100	300
Loss	500	100	<u>500</u>
			<u>1,501</u>

* Sub-standard and doubtful assets are assumed as fully secured.

Question 11

From the following information calculate the amount of Provisions and Contingencies and prepare Profit and Loss Account of Zed Bank Ltd. for the year ended 31.3.2011:

	(₹ in '000)
Interest and Discount (Includes interest accrued on investments)	8,860
Other Income	220
Interest expended	2,720
Operating expenses	2,830
Interest accrued on Investments	10

<i>Additional Information:</i>		
(a)	<i>Rebate on bills discounted to be provided for</i>	30
(b)	<i>Classification of Advances:</i>	
	(i) <i>Standard assets</i>	4,000
	(ii) <i>Sub-standard assets</i>	2,240
	(iii) <i>Doubtful assets—(fully unsecured)</i>	390
	(iv) <i>Doubtful assets – covered fully by security</i>	
	<i>Less than 1 year</i>	100
	<i>More than 1 year, but less than 3 years</i>	600
	<i>More than 3 years</i>	600
	(v) <i>Loss assets</i>	376
(c)	<i>Provide 35% of the profit towards provision for taxation.</i>	
(d)	<i>Transfer 25% of the profit to Statutory Reserve.</i>	

(May, 2005)

Answer
ZED Bank Ltd.
Profit and Loss Account for the year ended 31st March, 2011

(₹ in '000)

	<i>Particulars</i>	<i>Schedule No.</i>	<i>Year ended on 31st March, 2011</i>
I.	Income		
	Interest earned (W.N. 1)	13	8,830
	Other income	14	<u>220</u>
	Total		<u>9,050</u>
II.	Expenditure		
	Interest expended	15	2,720
	Operating expenses	16	2,830
	Provisions and contingencies (W.N. 4)		<u>2,513.95</u>
	Total		<u>8,063.95</u>
III.	Profit/Loss		
	Net profit/(loss) for the year		986.05
	Profit/(loss) brought forward		<u>Nil</u>
	Total		<u>986.05</u>

IV.	Appropriations		
	Transfer to statutory reserve @ 25%		246.51
	Balance carried to balance sheet		<u>739.54</u>
	Total		<u>986.05</u>

Working notes:**1. Schedule 13 – Interest earned**

(₹ '000s)			
(i)	Interest and discount	8,860	
	Less: Rebate on bills discounted	(30)	
	Interest accrued on investments	<u>(10)</u>	8,820
(ii)	Interest accrued on investments		<u>10</u>
			<u>8,830</u>

2. Calculation of Provisions and Contingencies

Assets	Amount	% of Provision	Provision
	(₹ in '000)		(₹ in '000)
Standard assets	4,000	0.40	16
Sub-standard assets*	2,240	15	336
Doubtful assets (unsecured)	390	100	390
Doubtful assets – covered by security			
Less than 1 year	100	25	25
More than 1 year but less than 3 years	600	40	240
More than 3 years	600	100	600
Loss assets	<u>376</u>	100	<u>376</u>
Total provision	<u>8,306</u>		<u>1,983</u>

*Note: It is assumed that sub-standard assets are fully secured.

- 3. Calculation of provision on tax** = 35% (Total income – Total expenditure)
= 35% of ₹ [(9,050 – (2,720 + 2,830 + 1,983))]
= 35% of ₹ 1,517
= ₹ 530.95

- 4. Total provisions and contingencies** = ₹ 1,983 + ₹ 530.95 = ₹ 2,513.95.

Question 12

- (a) From the following information, compute the amount of provisions to be made in the Profit and Loss Account of a Commercial bank:

	Assets	₹ in lakhs
(i)	Standard (Value of security ₹6,000 lakhs)	7,000
(ii)	Sub-standard	3,000
(iii)	Doubtful	
	(a) Doubtful for less than one year (Realisable value of security ₹ 500 lakhs)	1,000
	(b) Doubtful for more than one year, but less than 3 years (Realisable value of security ₹ 300 lakhs)	500
	(c) Doubtful for more than 3 years (No security)	300

- (b) From the following details, prepare bills for collection (Asset) Account and Bills for collection (Liability) Account:

	₹
On 1.4.2010, Bills for Collection were	51,00,000
During the year 2010-11 Bills received for Collection amounted to	75,00,000
Bill collected during the year 2010-11	98,47,000
Bill dishonoured and returned during the year	27,10,000

(May, 2006)

Answer

- (a)

Asset	Amount	% of	Provision
	₹ in lakhs	provision	₹ in lakhs
Standard	7,000	0.40	28
Sub-standard	3,000	15	450
Doubtful (less than one year)			
On secured portion	500	25	125
On unsecured portion	500	100	500
Doubtful (more than one year but less than three years)			
On secured portion	300	40	120
On unsecured portion	200	100	200
Doubtful Unsecured (more than three years)	300	100	<u>300</u>
Total provision			<u>1,723</u>

(b) Bills for collection (Asset) Account

		₹			₹
1.4.2010	To Balance b/d	51,00,000	2010-11	By Bills for collection (Liability) A/c	98,47,000
2010-11	To Bills for collection	75,00,000		By Bills for collection (Liability) A/c	27,10,000
		_____	31.3.2011	By Balance c/d	<u>43,000</u>
		<u>1,26,00,000</u>			<u>1,26,00,000</u>
1.4.2011	To Balance b/d	43,000			

Bills for collection (Liability) Account

2010-11	To Bills for collection (Asset) A/c	98,47,000	1.4.2010	By Balance b/d	51,00,000
	To Bills for collection (Asset) A/c	27,10,000	2010-11	By Bills for collection (Asset) A/c	75,00,000
31.3.2011	To Balance c/d	<u>43,000</u>			_____
		<u>1,26,00,000</u>			<u>1,26,00,000</u>
			1.4.2011	By Balance b/d	43,000

Question 13

The following is an extract from the Trial Balance of Dream Bank Ltd. as at 31st March, 2011:

Rebate on bills discounted as on 1-4-2010 68,259 (Cr.)

Discount received 1,70,156 (Cr.)

Analysis of the bills discounted reveals as follows:

Amount (₹)	Due date
2,80,000	June 1, 2011
8,72,000	June 8, 2011
5,64,000	June 21, 2011
8,12,000	July 1, 2011
6,00,000	July 5, 2011

You are required to find out the amount of discount to be credited to Profit and Loss account for the year ending 31st March, 2011 and pass Journal Entries. The rate of discount may be taken at 10% per annum. **(November, 2006)**

Answer

The amount of rebate on bills discounted as on 31st March, 2011 the period which has not been expired upto that day will be calculated as follows:

Discount on ₹ 2,80,000 for 62 days @ 10%	4,756
Discount on ₹ 8,72,000 for 69 days @ 10%	16,484
Discount on ₹ 5,64,000 for 82 days @ 10%	12,671
Discount on ₹ 8,12,000 for 92 days @ 10%	20,467
Discount on ₹ 6,00,000 for 96 days @ 10%	<u>15,781</u>
Total	<u>70,159</u>

The amount of discount to be credited to the profit and loss account will be:

	₹
Transfer from rebate on bills discounted as on 31.03.2010	68,259
Add: Discount received during the year	<u>1,70,156</u>
	2,38,415
Less: Rebate on bills discounted as on 31.03.2011 (as above)	<u>70,159</u>
	<u>1,68,256</u>

Journal Entries

		₹	₹
Rebate on bills discounted A/c	Dr.	68,259	
To Discount on bills A/c			68,259
<u>(Transfer of unexpired discount on 31.03.2010)</u>			
Discount on bills A/c	Dr.	70,159	
To Rebate on bills discounted			70,159
<u>(Unexpired discount on 31.03.2011 taken into account)</u>			
Discount on Bills A/c	Dr.	1,68,256	
To P & L A/c			1,68,256
<u>(Discount earned in the year, transferred to P&L A/c)</u>			

Question 14

From the following information of details of advances of X Bank Limited calculate the amount of provisions to be made in profit and loss account for the year ended 31.3.2011:

Asset classification	₹ in lakhs
Standard	6,000
Sub-standard	4,400
Doubtful:	
For one year	1,800
For two years	1,200
For three years	800
For more than three years	600
Loss assets	1,600

(May, 2007)

Answer**Statement showing provisions on various performing and non-performing assets**

Asset Classification	Amount	Provision	Amount of Provision
	₹ in lakhs	%	₹ in lakhs
Standard	6,000	0.40	24
Sub-standard**	4,400	15	660
Doubtful**			
One year	1,800	25	450
2 years	1,200	40	480
3 years	800	40	320
More than 3 years	600	100	600
Loss assets	1,600	100	<u>1,600</u>
			<u>4,134</u>

** Sub standard and doubtful assets have been treated as fully secured.

Question 15

The following are the figures extracted from the books of New Generation Bank Limited as on 31.3.2011:

	₹
Interest and discount received	37,05,738
Interest paid on deposits	20,37,452
Issued and subscribed capital	10,00,000
Salaries and allowances	2,00,000
Directors fee and allowances	30,000
Rent and taxes paid	90,000
Postage and telegrams	60,286
Statutory reserve fund	8,00,000
Commission, exchange and brokerage	1,90,000
Rent received	65,000
Profit on sale of investments	2,00,000
Depreciation on bank's properties	30,000
Statutory expenses	40,000
Preliminary expenses	25,000
Auditor's fee	5,000

The following further information is given:

- (i) A customer to whom a sum of ₹ 10 lakhs has been advanced has become insolvent and it is expected only 50% can be recovered from his estate.
- (ii) There were also other debts for which a provision of ₹ 1,50,000 was found necessary by the auditors.
- (iii) Rebate on bills discounted on 31.3.2010 was ₹ 12,000 and on 31.3.2011 was ₹ 16,000.
- (iv) Provide ₹ 6,50,000 for Income-tax.
- (v) The directors desire to declare 10% dividend.

Prepare the Profit and Loss account of New Generation Bank Limited for the year ended 31.3.2011 and also show, how the Profit and Loss account will appear in the Balance Sheet, if the Profit and Loss account opening balance was Nil as on 31.3.2010. **(May, 2008)**

Answer

New Generation Bank Limited

Profit and Loss Account for the year ended 31st March, 2011

		Schedule	Year ended 31.03.2011
			(₹ in '000s)
I.	Income:		
	Interest earned	13	3,701.74
	Other income	14	<u>455.00</u>
	Total		<u>4,156.74</u>
II.	Expenditure		
	Interest expended	15	2,037.45
	Operating expenses	16	480.29
	Provisions and contingencies (500 + 150 + 650)		<u>1,300.00</u>
	Total		<u>3,817.74</u>
III.	Profits/Losses		
	Net profit for the year		339.00
	Profit brought forward		<u>Nil</u>
			<u>339.00</u>
IV.	Appropriations		
	Transfer to statutory reserve (25%)		84.75
	Proposed dividend		100.00
	Balance carried over to balance sheet		<u>154.25</u>
			<u>339.00</u>
The Profit & Loss Account balance of ₹154.25 thousand will appear in the Balance Sheet under the head 'Reserves and Surplus' in Schedule 2.			
			Year ended 31.3.2011 (₹ in '000s)
Schedule 13 – Interest Earned			
I.	Interest/discount on advances/bills (Refer W.N.)		<u>3,701.74</u>
			<u>3,701.74</u>

Schedule 14 – Other Income		
I.	Commission, exchange and brokerage	190.00
II.	Profit on sale of investments	200.00
III.	Rent received	<u>65.00</u>
		<u>455.00</u>
Schedule 15 – Interest Expended		
I.	Interests paid on deposits	<u>2,037.45</u>
		<u>2,037.45</u>
Schedule 16 – Operating Expenses		
I.	Payment to and provisions for employees	200.00
II.	Rent, taxes and lighting	90.00
III.	Depreciation on bank's properties	30.00
IV.	Director's fee, allowances and expenses	30.00
V.	Auditors' fee	5.00
VI.	Law (statutory) charges	40.00
VII.	Postage and telegrams	60.29
VIII.	Preliminary expenses	<u>25.00*</u>
		<u>480.29</u>

*It is assumed that preliminary expenses have been fully written off during the year.

Working Note:

	(₹ in '000s)
Interest/discount (net of rebate on bills discounted)	3,705.74
Add: Rebate on bills discounted on 31.3.2010	12.00
Less: Rebate on bills discounted on 31.3.2011	<u>(16.00)</u>
	<u>3701.74</u>

Question 16

Following information is furnished to you by Sound Bank Ltd. for the year ended 31st March, 2011:

	(₹ in thousands)
Interest and discount - (Income)	8,860
Interest on public deposits – (Expenditure)	2,720
Operating expenses	2,662

Other incomes	250
Provisions and contingencies (it includes provision in respect of Non-performing Assets (NPAs) and tax provisions)	2,004
Rebate on bills discounted to be provided for as on 31.3.2011	30
Classification of Advances:	
Standard Assets	5,000
Sub-standard Assets	1,120
Doubtful Assets – fully unsecured	200
Doubtful assets – fully secured	
Less than 1 year	50
More than 1 year but less than 3 years	300
More than 3 years	300
Loss assets	200

You are required to prepare:

(i) Profit and Loss Account of the Bank for the year ended 31st March, 2011.

(ii) Provision in respect of advances.

(November, 2008)

Answer

Sound Bank Ltd.

Profit and Loss Account for the year ended 31st March, 2011

	Schedule No.	(₹ in thousands)
Income: Interest and Discount (8,860 – 30)	13	8,830
Other income	14	<u>250</u>
		<u>9,080</u>
Expenditure: Interest expenses	15	2,720
Operating expenses	16	2,662
Provision and Contingencies		<u>2,004</u>
		<u>7,386</u>
Net Profit/Loss for the year		<u>1,694</u>

<i>Assets</i>	<i>Value</i>	<i>% of provision</i>	<i>Provision</i>
Standard Assets	5,000	0.40	20.00
Sub-standard Assets*	1,120	15	168.00
Doubtful Assets			
100% unsecured	200	100	200.00
Secured:			
Less than 1 year	50	25	12.50
More than 1 year but less than 3 years	300	40	120.00
More than 3 years	300	100	300.00
Loss Assets	200	100	<u>200.00</u>
Total Provision			<u>1,020.50</u>

Question 13

As on 31st March 2009, Strong Bank Ltd. has a balance of ₹ 27 crores in “rebate on bills discounted” account. The bank provides you the following further information:

- (1) During the financial year ending 31st March 2010, Strong Bank Ltd. discounted bills of exchange of ₹ 4,000 crores charging interest @ 15% p.a. and the average period of discount being 146 days.
- (2) Bills of exchange of ₹ 600 crores were due for realization from the acceptors/customers after 31st March 2010, the average period outstanding after 31st March 2010, being 73 days.

You are required to pass necessary journal entries in the books of Strong Bank Ltd. for the above transactions.

(November, 2010)

Answer

In the books of Strong Bank Ltd.

Journal Entries

<i>Particulars</i>		<i>Debit (₹)</i>	<i>Credit (₹)</i>
Rebate on bills discounted A/c	Dr.	27	
To Discount on bills A/c			27

* Sub-standards assets are assumed to be fully secured.

(Being the transfer of opening balance in 'Rebate on bills discounted A/c' to 'Discount on bills A/c')			
Bills purchased and discounted A/c	Dr.	4,000	
To Discount on bills A/c			240
To Clients A/c			3,760
(Being the discounting of bills of exchange during the year)			
Discount on bills A/c	Dr.	18	
To Rebate on bills discounted A/c			18
(Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)			
Discount on bills A/c	Dr.	249	
To Profit and Loss A/c			249
(Being the amount of income for the year from discounting of bills of exchange transferred to Profit and loss A/c)			

Working Notes:

1. Discount received on the bills discounted during the year

$$₹ 4,000 \text{ crores} \times \frac{15}{100} \times \frac{146}{365} = ₹ 240 \text{ crores}$$

2. Calculation of rebate on bill discounted

$$₹ 600 \text{ crores} \times \frac{15}{100} \times \frac{73}{365} = ₹ 18 \text{ crores}$$

(It is assumed that discounting rate of 15% is used for the bill of ₹ 600 crores also)

3. Income from bills discounted transferred to Profit and Loss A/c would be calculated by preparing Discount on bills A/c

Discount on bills A/c**₹ in crores**

Date	Particulars	Amount	Date	Particulars	Amount
31 March 2010	To Rebate on bills discounted	18	1 st April, 2009	By Rebate on bills discounted	27
"	To Profit and Loss A/c (Bal.Fig.)	249	2009-10	By Bills purchased and discounted	240
		<u>267</u>			<u>267</u>

Question 14

From the following information find out the amount of provision to be shown in the Profit and Loss account of a Commercial Bank:

Assets	₹ in lakhs
Standard	4,000
Sub-standard	2,000
Doubtful upto one year	900
Doubtful more than one year but upto three years	400
Doubtful more than three years	300
Loss assets	500

Doubtful assets are considered as fully secured.

(May, 2010)

Answer**Computation of amount of provision for a Commercial Bank**

Assets	Amount ₹ in lakhs	Provision %	Provision ₹ in lakhs
Standard	4,000	0.40	16
Sub-standard	2,000	15	300
Doubtful upto one year	900	25	225
Doubtful over one year upto three years	400	40	160
Doubtful more than three years	300	100	300
Loss assets	500	100	<u>500</u>
Total provision to be made			<u>1,501</u>

Note: It is assumed that sub-standard assets are also fully secured.

Question 15

The following facts have been taken out from the records of Dee Bank Ltd. as on 31st March, 2011:

	Dr. (₹)	Cr. (₹)
Rebate on bills discounted (not due on March 31 st , 2010)		45,800
Discount received		2,02,500
Bills discounted	12,25,000	

An analysis of the bills discounted is as follows:

	Amount ₹	Due date 2009	Rate of discount
(i)	3,75,000	April 8	12%
(ii)	1,50,000	May 5	14%
(iii)	2,20,000	June 12	14%
(iv)	4,80,000	July 15	15%

You are required to:-

- Calculate rebate on bills discounted as on 31st March, 2011.
- The amount of discount to be credited to the profit and loss account.
- Show necessary journal entries in the books of Dee Bank Ltd. as on 31st March, 2011.

(November, 2009)

Answer

(i) Calculation of Rebate on bills discounted

S.No.	Amount (₹)	Due date (year 2011)	Unexpired portion from 31 st March, 2011	Rate of discount	Rebate on bills discounted (₹)
(i)	3,75,000	April 8	8 days	12%	986
(ii)	1,50,000	May 5	35 days	14%	2,014
(iii)	2,20,000	June 12	73 days	14%	6,160
(iv)	4,80,000	July 15	106 days	15%	20,910
	12,25,000				30,070

(ii) Amount of discount to be credited to the Profit and Loss Account

	₹
Transfer from Rebate on bills discounted A/c as on 31 st March, 2010	45,800
Add: Discount received during the year ended 31 st March, 2011	2,02,500
	2,48,300
Less: Rebate on bills discounted as on 31 st March, 2011	(30,070)
Discount credited to Profit and Loss Account	2,18,230

(iii)

In the books of Dee Bank Ltd.

Journal Entries

	Particulars	Dr. (₹)	Cr. (₹)
(1)	Rebate on bills discounted A/c To Discount on bills A/c (Being the transfer of opening balance of rebate on bills discounted account to discount on bills account)	Dr. 45,800	45,800
(2)	Discount on bills A/c To Rebate on bills discounted A/c (Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)	Dr. 30,070	30,070
(3)	Discount on bills A/c To Profit and Loss A/c (Being the amount of income for the year transferred from Discount on bills A/c to Profit and Loss A/c)	Dr. 2,18,230	2,18,230

Question 16

Find out the income to be recognised at Good Bank Limited for the year ended 31.3.2010 in respect of Interest on advances (₹ in lakhs) as detailed below:

	Performing Assets		N.P.A.	
	Interest earned	Interest received	Interest earned	Interest received
<i>Term loan</i>	240	160	150	10
<i>Cash credits and overdrafts</i>	1,500	1,240	300	24
<i>Bills purchased and discounted</i>	300	300	100	40

(May, 2010)

Answer

Interest on performing assets to be recognized on accrual basis, but interest on Non-performing asset should be recognized on Cash Basis.

		₹ in lakhs
Interest on Term Loan	(240 + 10)	250
Cash Credits and Over Drafts	(1500 + 24)	1,524
Bills Purchases and Discounted	(300 + 40)	<u>340</u>
Total Interest to be recognized		<u>2,114</u>

Question 17

From the following information, you are required to prepare Profit and Loss Account of Zee Bank Ltd., for the year ending 31st March, 2012 :

	₹		₹
Interest and Discount	44,00,000	Interest Expended	13,60,000
Other Income	1,25,000	Operating Expenses	13,31,000
Income on investments	5,000	Interest on balance with RBI	25,000

Additional information :

- (a) Rebate on bills discounted to be provided for ₹ 15,000
 (b) Classification of advances:

	₹
Standard Assets	25,00,000
Sub-standard Assets	5,60,000
Doubtful Assets not covered by security	2,55,000
Doubtful Assets covered by security	
For 1 year	25,000
For 2 year	50,000
For 3 year	1,00,000
For 4 year	75,000
Loss Assets	1,00,000

- (c) Make Tax Provision @ 35 %
 (d) Profit and Loss A/c (Cr.) ₹ 40,000. (November, 2009)

Answer

Form 'B'
Zee Bank Ltd.

Profit & Loss Account for the year ended 31st March, 2012

	Particulars	Schedule No.	Year ended 31 st March, 2012
I.	Income:		
	Interest Earned	13	44,30,000

II.	Other Income	14	<u>1,25,000</u>
	Total		<u>45,55,000</u>
	Expenditure		
	Interest Expended	15	13,60,000
	Operating Expense	16	13,31,000
	Provisions and Contingencies (W.N.3)		<u>10,45,813</u>
	Total		<u>37,36,813</u>
III.	Profit/Loss		
	Net profit for the year		8,18,187
	Profit brought forward		<u>40,000</u>
	Total		<u>8,58,187</u>
IV.	Appropriations:		
	Transfer to Statutory Reserve @ 25% on ₹ 8,18,187		2,04,547
	Balance carried forward to Balance Sheet		<u>6,53,640</u>
	Total		<u>8,58,187</u>

Schedule 13: Interest Earned

Particulars	₹
Interest and discount	44,00,000
Income on Investments	5,000
Interest on balance with RBI	<u>25,000</u>
Total	<u>44,30,000</u>

Working Notes:
1. Provisions for NPA

Particulars	Amount	% of Provisions	Provision
Standard Assets	25,00,000	0.40	10,000
Sub-Standard Assets*	5,60,000	15	84,000
Doubtful assets not covered by security	2,55,000	100	2,55,000
Doubtful Assets covered by security			
For 1 year	25,000	25	6,250
For 2 years	50,000	40	20,000

* It is assumed that the all sub-standard assets are fully secured.
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For 3 years	1,00,000	40	40,000
For 4 years	75,000	100	75,000
Loss Assets	1,00,000	100	<u>1,00,000</u>
			<u>5,90,250</u>

2. Calculation of Tax

Tax = 35% of [Total income – Total expenditure (excluding tax)].

Tax = 35% of [44,30,000 + 1,25,000 – (13,60,000 + 13,31,000 + 5,90,250 + 15,000)]

Tax = ₹ 4,40,563

3. Total amount of provisions and contingencies

= Provision for NPA + Provision for Tax + Rebate on bills discounted

= 5,90,250 + 4,40,563 + 15,000

= ₹ 10,45,813

Question 18

Mention the condition when a cash credit overdraft account is treated as 'out of order'.

(May, 2010)

Answer

A cash credit overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated as 'out of order' if any of the following conditions is satisfied:

- The outstanding balance remains continuously in excess of the sanctioned limit/drawing power.
- Though the outstanding balance is less than the sanctioned limit/drawing power –
 - there are no credits continuously for more than 90 days as on the date of balance sheet; or
 - credits during the aforesaid period are not enough to cover the interest debited during the same period.
- Further any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

Question 19

Given below is an extract from the trial balance of T.K. Bank Limited as on 31st December, 2009:

Particulars	Debit ₹	Credit ₹
Bills discounted	12,64,000	----
Rebate on bills discounted (1.1.2009)	----	8,340
Discount received for the year		85,912

An analysis of the bills discounted is shown below:

Amount ₹	Due date in 2010	Rate of discount (% p.a.)
1,40,000	March 6 th	5
4,36,000	March 12 th	4.5
2,82,000	March 26 th	6
4,06,000	April 6 th	4

Show the workings, how the relevant items will appear in the bank's Profit and Loss account as on 31st December, 2009 and in bank's Balance Sheet as on 31st December, 2009. **(May, 2010)**

Answer

**Profit & Loss Account (an extract)
for the period ending 31.12.2009**

	₹
Transfer from 'Rebate on bills discounted account' (01.01.2009)	8,340
Add: Discount for the year 2009	<u>85,912</u>
	94,252
Less: Rebate on bills discounted carried forward to the year 2010	<u>13,274</u>
	<u>80,978</u>

Balance Sheet (an extract) as on 31.12.2009

	₹
Other liabilities & provisions:	
Rebate on bills discounted	13,274

Working Note:

Statement of rebate on bills discounted as on 31.12.2009

Due date	Amount (₹)	No. of days after 31.12.2009	Rate of discount (%)	Discount of the unexpired period
March 6 th	1,40,000	65	5	1,247
March 12 th	4,36,000	71	4.5	3,816
March 26 th	2,82,000	85	6	3,940
April 6 th	4,06,000	96	4	<u>4,271</u>
Total rebate on bills discounted to be carried forward				<u>13,274</u>

Question 20

How will you disclose the following Ledger balances in the Final accounts of DVD bank:

	₹ in lacs
Current accounts	700
Saving accounts	500
Fixed deposits	700
Cash credits	600
Term Loans	500
Bills discounted & purchased	800

Additional information:

- (i) Included in the current accounts ledger are accounts overdrawn to the extent of ₹ 250 lacs.
 - (ii) One of the cash credit account of ₹ 10 lacs (including interest ₹ 1 lac) is doubtful.
 - (iii) 60% of term loans are secured by government guarantees, 20% of cash credits are unsecured, other portion is secured by tangible assets.
- (May, 2010)**

Answer**Relevant Schedules (forming part of the Balance sheet) of DVD Bank****Schedule 3: Deposits**

	₹ in lacs
A Demand deposits (700 — .250)	450
B Saving bank deposits	500
C Term deposits	<u>700</u>
	<u>1,650</u>

Schedule 9: Advances

	₹ in lacs
A (i) Bills discounted and purchased	800
(ii) Cash credits and overdrafts (600 + 250)	850
(iii) Term loans	<u>500</u>
	<u>2,150</u>
B. (i) Secured by tangible assets (bal. fig.)	1,730
(ii) Secured by Bank/Government guarantees (500 x 60%)	300
(iii) Unsecured (600 x 20%)	<u>120</u>
	<u>2,150</u>

Schedule 5: Other Liabilities & Provisions

	₹ in lacs
Others (Provision for doubtful debts)	10

Profit and Loss Account (an extract)

	₹ in lacs
Less: Provision for doubtful debts*	10

***Note:** It is assumed that the cash credit has been in 'doubtful' category for more than three years.

Question 21

From the following information of details of advances of Zenith Bank Ltd., calculate the amount of provisions to be made in Profit and Loss Account for the year ended on 31-3-2010:

Assets classification	(₹ in lakhs)
Standard	10,000
Sub-standard	6,400
Doubtful:	
for one year	3,200
for two years	1,800
for three years	900
for more than three years	1,100
Loss assets	3,000

(November, 2010)

Answer

Statement showing provisions on various performing and non performing assets of Zenith Bank Ltd.

Assets classification	Amount (₹ in lakhs)	Provision (%)	Amount of provision (₹ in lakhs)
Standard	10,000	0.40	40
Sub-standard	6,400	15	960
Doubtful:			
for one year	3,200	25	800
for two years	1,800	40	720

for three years	900	40	360
for more than 3 years	1,100	100	1,100
Loss assets	3,000	100	<u>3,000</u>
Total			<u>6,980</u>

Note: It is assumed that sub-standard assets and all doubtful assets are fully secured.

Question 22

A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier I and Tier II capitals. Find out the risk adjusted asset and risk weighted assets ratio.

	(₹ in crores)
Equity share capital	500.00
Statutory reserve	270.00
Capital reserve (of which ₹ 16 crores were due to revaluation of assets and the balance due to sale of capital asset)	78.00
Assets:	
Cash balance with RBI	10.00
Balance with other banks	18.00
Other investments	36.00
Loans and advances:	
(i) Guaranteed by the Government	16.50
(ii) Others	5,675.00
Premises, furniture and fixtures	78.00
Off-Balance Sheet items:	
(i) Guarantee and other obligations	800.00
(ii) Acceptances, endorsements and letter of credit	4,800.00

(November, 2010)

Answer

		₹ in crores	₹ in crores
(i)	Capital funds – Tier I		
	Equity share capital		500
	Statutory reserve		270
	Capital reserve (arising out of sale of assets) (78-16)		<u>62</u>
			832

Capital funds – Tier II		
Capital reserve (arising out of revaluation of assets)	16	
Less: Discount to the extent of 55%	<u>(8.8)</u>	<u>7.2</u>
		<u>839.2</u>

		₹ in crores	% of weight	₹ in crores
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	10	0	0
	Balance with other banks	18	20	3.60
	Other investments	36	100	36
	Loans and advances:			
	(i) Guaranteed by the government	16.5	0	0
	(ii) Others	5,675	100	5,675
	Premises, furniture and fixtures	78	100	<u>78</u>
				5,792.60
		₹ in crores	Credit conversion factor	
	Off-Balance Sheet items:			
	Guarantees and other obligations	800	100	800
	Acceptances, endorsements and letters of credit	4,800	100	<u>4,800</u>
				<u>11,392.60</u>

Risk Weighted Assets Ratio:

$$\frac{\text{Capital fund} \times 100}{\text{Risk adjusted assets}}$$

$$(839.2/11,392.60) \times 100 = 7.37\%$$

EXERCISES

1. From the following information, prepare a Balance Sheet of International Bank Ltd. as on 31st March, 2011 giving the relevant schedules and also specify at least four important Principal Accounting Policies :

	₹ in lakhs	
	Dr.	Cr.
Share Capital		198.00
19,80,000 Shares of ₹ 10 each		
Statutory Reserve		231.00
Net Profit Before Appropriation		150.00
Profit and Loss Account		412.00
Fixed Deposit Account		517.00
Savings Deposit Account		450.00
Current Accounts	28.00	520.12
Bills Payable		0.10
Cash credits	812.10	
Borrowings from other Banks		110.00
Cash in Hand	160.15	
Cash with RBI	37.88	
Cash with other Banks	155.87	
Money at Call	210.12	
Gold	55.23	
Government Securities	110.17	
Premises	155.70	
Furniture	70.12	
Term Loan	<u>792.88</u>	
	<u>2,588.22</u>	<u>2,588.22</u>

Additional Information:

Bills for collection	18,10,000
Acceptances and endorsements	14,12,000
Claims against the Bank not acknowledged as debt	55,000
Depreciation charges—Premises	1,10,000
Furniture	78,000

50% of the Term Loans are secured by Government guarantees. 10% of cash credit is unsecured. Also calculate cash reserves required and statutory liquid reserves required.

Note : Cash reserves required 3% of demand and time liabilities; liquid reserves required 30% of demand and time liabilities.

(Hints: Balance sheet total ₹ 25,88.12 lacs)

2. Following are the statements of interest on advances in respect of performing and non-performing assets of Madura Bank Ltd. Find out the income to be recognised for the year ended 31st March, 2011:

(₹ in lakhs)		
Performing Assets	Interest earned	Interest received
Cash credit and overdrafts	1,800	1,060
Term loans	480	320
Bills purchased and discounted	700	550
Non-performing Assets		
Cash credit and overdrafts	450	70
Term loan	300	40
Bills purchased and discounted	350	36

(Hints: Total income to be recognized ₹ 3,126 lakhs)