Course No. 301 ADVANCED FINANCIAL ACCOUNTING (AFAC IX)

Marks: 80 **Hours: 40**

Objective: The basic aim of this paper is to acquaint the students with advanced topics in accounting.

Course Contents:

Unit I: **Accounts of Banking Companies :**Definition and meaning of banking terms, books to be maintained; classification of Advances, preparation of profit & loss A/C and Balance sheet.

20 : 10 hrs

Unit II: Accounts of Life Insurance Companies :Definition and elements of Insurance contract, meaning of various insurance terms, types of insurance, Books, maintained under life Insurance Business, Ascertainment of profit in life Insurance Business, Preparation of Revenue Account, Balance sheet and valuation Balance sheet of life Insurance company,

20 : 10 hrs

Unit III: Accounts of General Insurance Companies : Preparation of Revenue Account and Balance Sheet of General Insurance companies.

20 : 10 hrs

Unit IV: Investment Account : Meaning, meaning of cum-dividend and ex-dividend transactions, cum-interest and ex-interest transactions, brokerage, Accounting for investment.

20 : 10 hrs

Text and Reference Books :

1. Tulsiram: Financial Accounting. Pearson Education, New Delhi.
2. Rajaseharam: Financial Accounting. Pearson Education, New Delhi.
3. Mukherji & Hanif: Financial Accounting, Tata Mc. Graw Hill, New Delhi.
4. Paul: Advanced Financial Accounting, New Central Book Agency, Hyderabad.
5. Sukla, Grewal and Gupta: Advanced Accounts, S.Chand, New Delhi.

Unit – 1: Accounts of Banking Companies

Meaning of Banking and Banking Company

As per Section 5(b) of the Banking Regulation Act, 1949, "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.

As per Section 5(d) of the Banking Regulation Act, 1949, "company" means any company as defined in Section 3 of the Companies Act, 1956 and includes a foreign company within the meaning of Section 591 of that Act.

As per Section 5(c) of the Banking Regulation Act, 1949 a "Banking Company" means any company which transacts the business of banking in India.

Business in which a banking company may engage or features of a Banking Company

Section 6 of the Banking Regulation Act, 1949 specifies the forms of business in which a banking company may engage.

These are:

Accounts

1) Borrowing, raising or taking up of money, lending or advancing of money; handling in all manners Bills of exchange/hundies/promissory notes.

2) Acting as agents for any government or local authority or any other person,

3) Managing issues of shares, stock, debentures etc. including underwriting guaranteeing,

4) Carrying on and transacting every kind of guarantee and indemnity business.

5) Managing, selling and realizing property which may come into the possession of the banking company in satisfaction of its claims.

6) Acquiring and holding and generally dealing with any property or any right, title or interest in such property which may form the security for any loans and advances.

7) Underwriting and executing trusts.

8) Establishing and supporting or aiding in the establishment and support of institutions, funds, trusts etc.

9) Acquisition, construction, maintenance and alteration of any building and works necessary for the purpose of the banking company.

10) Selling, improving, managing, developing, or otherwise dealing with property and rights of the company.

11) Acquiring and undertaking whole or any part of the business of any person or company.

12) Doing all such other things as are incidental or conductive to the promotion or advancement of the business of the banking company.

13) Any other business which the Central Government may specify.

Main Characteristics of a Bank's Book-Keeping System

The book-keeping system of a banking company is substantially different from that of a trading or manufacturing enterprise. A bank maintains a large number of accounts of various types for its customers. As a safeguard against any payment being made in the account of a customer in excess of the amount standing to his credit or a cheque of a customer being dishonoured due to a mistake in the balance in his account, it is necessary that customers' accounts should be kept up-to-date and checked regularly. In many other mercantile enterprises, books of primary entry (i.e. day books) are generally kept up-to-date while their ledgers including the general ledger and subsidiary ledgers for debtors, creditors etc. are written afterwards. However a bank cannot afford to ignore its ledgers, particularly those concerning the accounts of its customers and has to enter into the ledgers every transaction as soon as it takes place. In bank accounting, relatively less emphasis is placed on day books. There are merely treated as a means to an end-the end being to keep up-to-date detailed ledgers and to balance the trial balance everyday and to keep all control accounts in agreement with the detailed ledgers.

Presently most if not all of the Banks' accounting is done on Core Banking Solutions (CBS) wherein all accounts are maintained on huge servers with posting being effected instantly through vouchers, debit cards, internet banking etc. The main characteristics of a bank's system of book-keeping are as follows:

a) Voucher posting: Vouchers are nothing but loose leaves of journals or cash books on which transactions are recorded as they occur. Entries in the personal ledger are made directly from vouchers instead of being posted from the books of prime entry.

b) Voucher summary sheets: The vouchers entered into different personal ledgers each day are summarized on summary sheets, totals of which are posted to the control accounts in the general ledger.

c) Daily trial balance: The general ledger trial balance is extracted and agreed every-day.

d) Continuous checks: All entries in the detailed personal ledgers and summary sheets are checked by persons other than those who have made the entries. A considerable force of such check is employed, with the general result that most clerical mistakes are detected before another day begins.

e) Control Accounts: A trial balance of the detailed personal ledgers is prepared periodically, usually every two weeks, agreed with general ledger control accounts.

f) Double voucher system: Two vouchers are prepared for every transaction not involving cash-one debit voucher and another credit voucher.

Slip (or Voucher) System of Ledger Posting

The bank has to ensure that customers (depositors) ledger accounts are up-to-date so that when a cheque is presented to the bank for payment, the bank can immediately decide whether to honour or dishonour the cheque. Thus transactions in the bank are immediately recorded.

For this purpose slip system of ledger posting is adopted. Under this system entries are made in the (personal) accounts of customers in the ledger directly from various slips rather than from subsidiary books or journals and then a Day Book is written up. Subsequently, entries in the accounts of the customers are tallied with the Day Book. In this way the posting in the ledger accounts and writing of the day-book can be carried out simultaneously without any loss of time. A slip is also called voucher. In general, the types of slips used in bank book-keeping are: pay-in-slips, cheques or withdrawals forms. In these slips are filled by the customers there is much saving of time and labour of the employees of the bank.

a) Pay-in-slip: When a customer deposits money with a bank, he has to fill-up a printed pay-in-slip form and submit it to the 'receiving cashier' of the bank along with cash. The form of pay-in-slip has two parts. The left hand side portion of the pay-in-slip is called 'counterfoil'. It is returned by the receiving cashier after the received and counts the cash. The counterfoil bears signature of the receiving cashier and it is duly stamped with the rubber stamp of the bank. Pay-in-slip serves as an acknowledgement of the deposit by the customer with the bank. The remaining portion of pay-in-slip that is, its right-hand side part remains with the bank for making entry in the cash book, after which it is given to the 'personal accounts ledger keeper' for crediting the ledger account of the customer.

b) Withdrawal slip or cheque: When a customer withdraws money from the bank, he has to fill-up or write a cheque or withdrawal form and submit it to the paying cashier who makes payment, after checking the signature of the customer and adequacy of amount in his ledger account. The paying cashier credits the cash account and the ledger-keeper debits the customer's account. These days the cashier may himself debit the customer's account in the computer based ledger immediately before making the payment.

c) Dockets: sometimes the bank staffs also prepares slips for making entries in the ledger accounts for which there are no original vouchers. For example, the loan department of a bank prepares vouchers when the interest is due. This slip for voucher is knows as docket.

Need of the Slip System

The need for slip system arises due to following reasons:

1) Updated Accurate Accounts: The bank must keep its customers' accounts accurate and up-to-date because a customer may present a cheque or withdrawal slip anytime during business hours of the bank.

2) Division of Work: As the number of transactions in bank is very large, the slip system permits the distribution of work of posting simultaneously amongst the persons of the bank staff.

3) Smooth Flow of Work: The accounting work moves smoothly without any interruption.

Main advantages of the slip system are:

1. Saving of time and labour: The bank saves a lot of time and clerical labour as most of the slips are filled in by its customers.

2. No need of subsidiary books: Subsidiary books are avoided as posting is done from slips.

3. Minimum delay: Entries can be recorded with minimum delay as slips can easily pass from hand to hand among clerks concerned.

4. Division of labour: the slip system enables the division of work of posting among employees due to a large number of transactions in a bank.

5. Smooth accounting: The writing of the day book and posting of the ledger can be done simultaneously without loss of time.

6. Reliable accounting system: Slips system provides a basis for reliable accounting system as most of the slips are prepared by customers themselves. Moreover, each transaction is recorded in different books which are maintained on self balancing system.

7. Perfect basis of auditing: Individual slips (known as vouchers) are filled up by customers and becomes a proof for transaction to the satisfaction of the auditor.

8. Proper evidence: Slip duly filled by a customer provides evidence of a transaction. When needed slips preserved by the banks can be shown to the customers for their satisfaction.

Disadvantages of the slip system are:

1. Risk of loss or destruction of slips: Slips may be lost, destroyed or misappropriated as these are loose.

2. Difficulty in verification: Books cannot be verified if subsidiary books are not kept.

3. Inconvenience to customers: This system causes great inconvenience to the illiterate and semiliterate customers as slips are to be filled in (especially the amount in words and figures) with the help of other customers and arrogant bank employees.

4. Risk of manipulation and misappropriation: Dishonest employees can embezzle the money by destroying the loose and large number of slips and manipulating the amounts.

5. Expensive system: Slips system becomes difficult due to large number of daily transactions in a bank and becomes expensive to keep it date-wise record of such slips.

Books of Accounts maintained by a Banking Company

A. Principles Books of Accounts

a) The General Ledger contains accounts of all personal ledgers, the profit & loss account and different asset accounts. The accounts in the general ledger are arranged in such an order that a balance sheet can be readily prepared there from. There are certain additional accounts known as contra accounts which are a feature of bank accounting. These are kept with a view to keep control over transaction which has no direct effect on the bank's position e.g. letters of credit opened, bills received or sent for collection, guarantees given, etc.

b) Profit and Loss Ledger: Some banks keep one account for profit and loss in the General Ledger and maintain separate books for the detailed accounts. These are columnar books having separate columns for each revenue or expenses head. Other banks maintain separate books for debits and credits. These books are posted from vouchers. The total of debits and credits posted are entered into the Profit and Loss Account in the General Ledger.

B. Subsidiary Books

a) Personal Legers: Separate ledgers are maintained by a bank for different types of accounts. For example, there are separate ledgers for Current Accounts, Fixed Deposits (often further classified by length of period of deposit), Cash Certificates, Loans, Overdrafts, etc.

b) Bill Registers: Details of different types of bills are kept in separate registers which have suitable columns. For example, bills purchased, inward bills for collection, outward bills for collection etc. are entered serially on day-to-day basis in separate registers. In case of bills purchased or discounted, party-wise details are also kept in normal ledger form.

C. Other Subsidiary Registers: There are different registers for various types of transactions. Their number, volume and details will differ according to the individual needs of each bank. For example, there will be registers for:

a) Demand Drafts, Telegraphic Transfers and Mail Transfers issued on Branches and Agencies.

b) Demand Drafts, Telegraphic Transfers and Mail Transfers received from Branches and Agencies.

c) Letters of Credit.

d) Letters of Guarantee.

D. Departmental Journals: Each department of the Bank maintains a journal to note the transfer entries passed by it. These journals are memoranda books only, as all the entries made there are also made in the Day Book through Voucher Summary Sheets. Their purpose is to maintain a record of all the transfer entries originated by each department. For example, the Loans and Overdraft Section will pass transfer entries for interest charged on various accounts every month, and as all these entries will be posted in the journal of that department, the office concerned can easily find out the accounts in respect of which the interest entry has been passed.

E. Other Memorandum Books: Besides the books mentioned above, various departments of the bank have to maintain a number of memoranda books to facilitate their work.

Some of the important books are described below:

(a) Cash Department

1. Receiving Cashiers' cash book.
2. Paying Cashiers' cash book.
3. Main cash book.
4. Cash Balance book

(b) Quick Payment System: Banks introduce different systems so that their customers may receive payment of cash etc. quickly. The most prevalent system is the teller system. Under this system tellers keep cash as well as ledger cards and the specimen signature cards of each customer in respect of Current and Saving Bank Accounts.

(c) Outward Clearing:

(i) A Clearing Cheque Received Book for entering cheques received from customers for clearing.

(ii) Bank wise list of the above cheques, one copy of which is sent to the Clearing House together with the cheques.

(d) Inward Clearing: Cheques received are verified with the accompanying lists. They are then distributed to different departments and the number of cheques given to each department is noted in a Memo Book. When the cheques are passed and posted into ledgers, their number is independently agreed with the Memo Book. If any cheques are found non-payable, they are returned back to the Clearing House. The cheques themselves serve as vouchers.

(e) Loans & Overdraft Departments:

1) Registers for shares and other securities held on behalf of each customer.

2) Summary Books of Securities giving details of Government Securities, shares of individual companies etc.

3) Godown registers maintained by the godown-keeper of the bank.

4) Price register giving the wholesale price of the commodities pledged with the bank.

5) Overdraft Sanction registers.

6) Delivery Order books.

7) Drawing Power book.

8) Storage books.

(f) Deposits Department:

1) Account Opening & Closing registers.

2) For Fixed Deposits, Rate registers giving analysis of deposits according to rates.

3) Due Date Diary.

4) Specimen signature book.

(g) Establishment Department:

a) Salary and allied registers, such as attendance register, leave register, overtime register, etc.

b) Register of fixed assets, e.g. furniture and fixtures, motor cars, vehicles etc.

c) Stationery Registers.

d) Old records register.

(h) General:

a) Signature books of bank's officers.

b) Private Telegraphic Code and Cyphers.

Statistical Books: Statistical records kept by different banks are in accordance with their individual needs. For example, there may be books for recording

(i) average balance in loans and advances etc.,

(ii) Deposits received and amount paid out each month in the various departments,

(iii) Number of cheques paid,

(iv) Number of cheques, bills and other items collected.

Types of Loans and Advances provided by a bank

A Bank provides the following types of loans and advances to its customers

a) Cash Credit: It is an arrangement by which the customer is granted the right to borrow money from time to time upto a certain limit. Cash credit is usually given on hypothecation or pledge of stocks. The bank usually charges a higher banks interest on the actual amount withdrawn than that charged on loan because the bank has to keep the amount allowed as cash credit always ready under the fear that money allowed may be demanded at any time.

b) Overdraft: This facility is available to a customer who operates a current account with the bank. This facility is granted to customers who have high goodwill & name for honest dealings. In case of bank overdraft, customer is permitted to overdraw money upto a certain level. The facility of overdraft is beneficial to the customer as he has to pay interest only upon the sum overdrawn by him & not upon the maximum limit of the overdraft.

c) Loan: Loan is advance of a fixed amount to a customer to be withdrawn in lump sum by him. Interest is charged on the total amount of the loan agreed to be paid to a customer whether he uses the full amount of the loan or not. So, customers prefer to take cash credit & pay interest at a little higher rate as they find it inconvenient to use the whole amount of the loan immediately.

d) Discounting: Discounting of a bill means making the payment of the bill before the maturity date of the bill while making payment of the bill, the bank deducts discount for the unexpired period for the amount of the bill discounted.

The bank keeps the bill with it till the maturity date & gets its payment for the customer on the due date.

Non-performing Assets (NPA)

NPA indicates Non-Performing asset, it means assets of a bank which ceases to generate income for the bank. Non-performing assets means a credit facility in respect of which interest/or principal repayment instalment is in arrears for more than 90 days. A non-performing asset (NPA) shall be a loan or an advance where;

a) Interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,

b) The account remains ‘out of order’ for a period of more than 90 days, in respect of an Overdraft/Cash Credit (OD/CC),

c) The bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,

d) Interest and/or instalment of principal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricultural purposes, and

e) Any amount to be received remains overdue for a period of more than 90 days in respect of other accounts.

Categories of NPA

A. Standard assets: Standard assets are the ones in which the bank is receiving interest as well as the principal amount of the loan regularly from the customer. Here it is also very important that in this case the arrears of interest and the principal amount of loan does not exceed 90 days at the end of financial year. If asset fails to be in category of standard asset that is amount due more than 90 days then it is NPA and NPAs are further need to classify in sub categories.

Banks are required to classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

a) Sub-standard Assets

b) Doubtful Assets

c) Loss Assets

B. Sub-standard Assets: Such assets have been classified as NPA for a period not exceeding one year with effect from 31st March, 2005. The earlier period of 18 months has been reduced to 12 months. The current net worth of the borrower/guarantor or the current market value of the security charged under such cases isn’t enough to ensure recovery of the dues to the bank in full.

C. Doubtful Assets: An asset which has remained NPA for a period of one year. In term loans if the instalments of the principal have remained overdue for a period of one year should be treated as doubtful.

D. Loss Assets: Where the loss on an asset has been identified by banks/internal auditor or the RBI inspector but the amount hasn't been written off wholly/partly is known as loss asset.

Provisions required on various types of NPA

Assets	% of Provisions
Standard Assets	0.40%
Sub-standard	15%
Doubtful	
(secure) -upto 1 year	25%
–1 – 3 years	40%
More then 3 years	100%
Doubtful (unsecure)	100%
Loss Assets	100%

Non-banking assets

A banking company is not allowed to deal directly/indirectly in the purchase/sale/barter of goods except in connection with its legitimate banking business. But banks can always lead against the security of the assets. The banks may have to take possession of the asset given as security if the loanee fails to repay the loan. In that case, the asset acquired in satisfaction of the claim of the bank will be shown as an asset in the Balance Sheet under the heading 'Other Fixed Assets'. Such assets acquired should be disposed of within seven years as a banking company is not allowed to hold such assets for any period exceeding seven years from the date of their acquisition. P/L on sale of such assets is required to be shown separately in the P/L A/c of the banks.

Rebate on Bills Discounted and its Accounting Treatment

Discounting of bills means making the payment of the bill before the maturity date of the bill. While making payment of the bill, the bank deducts discount for the unexpired period for the amount of the bill discounted. Such discount is called rebate on bills discounted. It is treated as interest received in advance. In profit and loss account, closing balance of rebate on bills discounted is deducted and opening balance of rebate on bills discounted is added with the interest and discount for the year. Closing balance of rebate on bills discounted is shown as liability in balance sheet under the heading 'other liabilities'. At

the commencement of next year, a reverse entry is passed for the unexpired discount of the previous year expiring this year and treated as income.

Rebate on bills discounted is calculated with the help of following formula = (Total annual discount x no. of days after the close of the year)/365.

Accounting treatment of Rebate on Bill Discounted

a) At the end of current accounting period:

Discount on Bills A/c Dr.

To Rebate on Bills discounted A/c

b) At the beginning of next accounting period:

Rebate on Bills discounted A/c Dr.

To Discount on Bills A/c

c) Transferring balance of interest and discount to Profit and loss Account:

Discount on Bills A/c Dr.

To Profit and Loss A/c

Money at call& short notice (Schedule 7)

Money at call and Short money means a very short term loan given by banker for a period ranging from 1 day to 14 days. If the loan is given for one day, it is called 'money at call' and if the loan is given for a maximum period of 14 days and cannot be back on demand and will require at least a notice of 3 days for calling back, it is called 'money at short notice'. These items appear on the assets side of a banks balance sheet and represents temporary loans to Bill Brokers, Stock Brokers& other banks. Call money are normally unsecured in our country.

The provisions of the Banking Regulation Act relating to annual accounts and audit of a banking company are given in Section 29-34A and are as follows:

1. Preparation of Annual Accounts: On 31st March each and every banking company incorporated in India, in respect of all business transacted by it, and every banking company incorporated outside India, in respect of all business transacted through its branches in India shall prepare with reference to that year a Balance Sheet and Profit and Loss Account as on the working of the year in the Forms set out in third schedule or as near thereto as circumstances admit. Form A in third schedule is the Balance Sheet and Form B is the Profit and Loss Account. Forms A and B have been revised w.e.f 1st April, 1991. In other words the annual accounts for the year ending 31st March 1992 and onwards are to be prepared in the new formats as given in the book. The requirements of the Companies Act relating to the Balance Sheet and Statement of Profit and

Loss of a company shall, is so far as they are not inconsistent with the Banking Companies Act, apply to the Balance Sheet and Profit and Loss Account of a banking company.

2. Audit of Accounts: The Balance Sheet and the Profit and Loss Account of a banking company is required to be audited by a Chartered Accountant. The appointment of the auditor of a banking company is made as per the provisions of the Companies Act. His powers, duties and liabilities are also governed by the Companies Act, but the auditor's report on the accounts of a banking company must include certain additional particulars. Every banking company is required to take previous approval of the Reserve Bank of India before appointing or reappointing auditors. In addition, the Reserve Bank can order special audit of the banking companies Accounts if it thinks fit in the public interest of the banking company or its depositors.

3. Filing of Accounts: Three copies of the audited Balance Sheet and Profit and Loss Account together with the auditors' report shall be furnished as returns to the Reserve Bank of India within three months from the end of the accounting year to which they relate. This period of three months can be extended by the Reserve Bank for a further period upto three months. Reserve Bank is authorized to call for any further information as it may think proper from a banking company relating to the business of such company. A banking company is also required to send to the Registrar of Companies three copies of its audited Balance Sheet and Profit and Loss Account and Auditor's Report and when the Reserve Bank requires any additional information in connection with the accounts, a copy of any such additional information shall also be sent to the Registrar.

4. Publication of Accounts: The Balance Sheet, Profit and Loss Account and the Auditor's Report of every banking company shall be published in any newspaper circulating at the place where it has principal office, within six months from the end of the accounting year.

Format of Profit and Loss Account of Banking Company

Banks are required to prepare final accounts for each financial year, i.e., its books are closed each year on 31st March. But for internal purpose, banks usually close their books on 30th September. A banking company is required to prepare its Profit and Loss Account according to Form B in the Third Schedule to the Banking Regulation Act, 1949. From B is in a summary form and the details of the various items are given in the schedules. From B is given as follows:

FORM OF PROFIT AND LOSS ACCOUNT

For the year ended 31st March, (Year)

Particulars	**Schedule No.**	**Year ended on 313-(Current Year)**	**Year ended 31-3-(Previous Year)**
Income **Interest earned** **Other Income**	 **13** **14**		
Total:			
Expenditure **Interest expended** **Operating expenses** **Provisions and contingencies**	 **15** **16**		
Total:			
Profit/Loss **Net Profit/Loss (-) for the year** **Profit/Loss (-) brought forward**			
Total:			
Appropriations **Transfer to statutory reserve** **Transfer to other reserves** **Transfer to Government/Proposed dividend Balance carried over to balance sheet**			
Total:			

SCHEDULE 13 – INEREST EARNED

	Year ended on 313-(Current Year)	Year ended 31-3- (Previous Year)
Interest/discount on advances/bills Income on investments Interest on balances with Reserve Bank of India and other inter-bank funds Others		
Total:		

SCHEDULE 14 – OTHER INCOME

	Year ended on 31-3-(Current Year)	Year ended 31-3-(Previous Year)
I. Commission, exchange and brokerage II.Profit on sale of investments Less: Loss on sale of investments		

III.Profit on revaluation of investments Less: Loss on revaluation of investments IV.Profit on sale of land, buildings and other assets Less: Loss on sale of land, buildings and other assets V.Profit on exchange transactions Less: Loss on exchange transaction VI.Income earned by way of dividends etc. from subsidiaries/companies and/or joint ventures abroad/in India VII.Miscellaneous Incomes		
Total:		

SCHEDULE 15 – INTEREST EXPENDED

	Year ended on 31-3-(Current Year)	Year ended 31-3-(Previous Year)
Interest on deposits Interest on Reserve Bank of India/Inter-bank borrowings III. Others		
Total:		

SCHEDULE 16 – OPERATING EXPENSES

	Year ended on 31-3-(Current Year)	Year ended 31-3-(Previous Year)
Payments to and provisions for employees Rent, taxes and lighting Printing and stationery Advertisement and publicity Depreciation on bank's property Directors' fees, allowances and expenses Auditors' fees, allowances and expenses (including branch auditors) Law charges Postage, telegrams, telephone, etc. Repairs and maintenance Insurance Other expenditure		
Total:		

Narasimham Committee: Suggestion for Banking Sectors

1. Capital Adequacy Norms: To avoid risk, the RBI laid down capital adequacy norms in April 1992 to be complied by banks by March, 1996. All banks in India were required to achieve a risk-weighted capital adequacy ratio of 4 per cent by 31 March 1993 and of 8 per cent by 31 March, 1996. Foreign banks operating in India and Indian banks with branches abroad were to attain 8 percent by March, 1993. This has been raised to 9 per cent from March 2000 for all banks.

2. Recapitalisation: In order to enable the public sector banks to meet the prescribed capital adequacy ratio, the Government of India has been contributing to the capital of such banks. During 1993-94, the Government provided Rs.5, 700 crores towards recapitalisation of 19 nationalised banks; during 1994-95 Rs.5, 293 crores to 13 banks; Rs.850 crores to 6 banks; during 1995-96 and Rs.909 crores to 4 banks during 1996-97; and Rs.297 crores to one bank in 1999-2000.

3. Partial Privatisation of Public Sector Banks: But recapitalisation is not a permanent solution of the problem. As the Government resources are limited, banks have been allowed to mobilise equity resources from the public. First, the State Bank of India Act was amended to enable the Bank to have access to the capital market.

4. Prudential Accounting Norms: The RBI has introduced prudential accounting norms for banks since 1992-93. A credit facility is required to be treated as non-performing asset (NPA) if interest or instalment of principal are in arrears for any two quarters in the accounting year.

5. Recovery of Debts: Indian banks suffer from large debt arrears which adversely affect their current cash flow position and reduce profits. To recover bad debts, a new Act known as the "Recovery of Debts due to Banks and Financial Institutions Act, 1993" has been passed to set up Debt Recovery Tribunals. Such tribunals have been set up at major centres.

6. Freedom about Bank Branches: Banks have been given freedom to open new branches and upgrade extension counters on attaining capital adequacy norm of 8 per cent, net profits for last 3 consecutive years, NPAs of less than 15 per cent and minimum owned funds of Rs.110 crores. They are also permitted to close non-viable branches except in rural and semi-urban areas.

7. Entry of Private Sector Banks: To introduce greater competition in banking so as to improve banking services to customers, private banks have been allowed entry as per RBI guidelines. Approval has been given to a few proposals for setting up new private sector banks. Private banks have been

allowed to raise capital from institutional investors up to 20 per cent and from NRIs up to 40 per cent.

8. Department of Supervision: A Department of Supervision has been set up in the RBI with effect from 22 December 1993 to supervise the working of commercial banks. It undertakes inspection, surveillance and special investigations including those connected with frauds, and appointment of statutory auditors.

9. Board for Financial Supervision (BFS): The BFS has been set up within the RBI in November, 1994. The Board ensures implementation of regulations in the areas of credit management, asset classification, income recognition, provisioning, capital adequacy and treasury operations.

10. Disclosure on Defaulting Borrowers: To enforce payments discipline among borrowers, a scheme for disclosure of information regarding defaulting borrowers of banks with outstanding aggregating to Rs.1 crore and above as on 31 March and 30 September every year has been in operation since April, 1994.

11. Banking Ombudsman Scheme: The Banking Ombudsman Scheme has been started from June, 1995 for speedy and inexpensive settlement of customer complaints about the deficiencies in banking services. Ten Ombudsmen are functioning at important centres in the country.

12. Central Board of Bank Frauds (CBBF): The Finance Ministry has set up the CBBF in January, 1997 to advise it on the merits of the cases being pursued by the CBI against bank officials up to the level of the general manager. The Board is to scrutinize banking transactions referred to it and give its opinion within 3 months as to whether there is sufficient basis for proceeding with criminal investigations against the officials.

13. Consortium Arrangements: To encourage competition and slow-down disintermediation, lending restrictions on banks have been reduced. Large borrowers above a specified credit limit have been allowed to borrow through a consortium of scheduled commercial banks headed by a lead bank.

14. Lending Norms Liberalised: Bank lending norms have been liberalised subject to the observance of prescribed prudential norms and quarterly reporting requirements, as laid down by the RBI. They are free to decide levels of holding of individual items of inventory and receivables to be permitted to borrowers. They are also free to decide about the quantum and period of adhoc credit limits without charging additional interest.

15. Measures to Streamline Working of Banks: A number of measures have been adopted by the RBI to improve the quality of performance and

management of banks. These include: management information systems and the internal audit and control mechanisms; computerisation of banking operations; prudential norms for income recognition assets, etc.

16. Liberal Credit Control Measures: A number of steps have been taken to reduce controls and distortions in the working of banks. Statutory Liquidity Ratio (SLR) on incremental net demand and time liabilities (NDTL) has been reduced to 25 per cent. SLR on total NDTL has been brought down to 25 per cent by 1996.

17. Entry of New Private Banks: The RBI issued in January 2001 guidelines for the entry of new private sector banks other than 10 previous banks. They are:

(i) Minimum paid-up capital of Rs.200 crores to be raised to Rs.300 crores within three years of opening;

(ii) Promoters' contribution of minimum 40 per cent;

(iii) NRI contribution in primary equity 40 per cent;

(iv) No large industrial house can promote a new bank but individual companies can contribute up to 10 per cent equity;

(v) NBFCs with AAA rating and 12 per cent capital adequacy can become private sector banks;

(vi) 10 per cent capital adequacy ratio to be maintained by the new bank;

(vii) 40 per cent of net bank credit for priority sector lending, and

(viii) 25 per cent branches in rural/semi-urban areas.

18. Entry of Banks into Insurance: All banks have been allowed to enter insurance business subject to having a minimum net worth of Rs.500 crores and satisfying other criteria in regard to capital adequacy, profitability, etc.