
Advisory on Supreme Court Order dated March 23, 2021 regarding Income Recognition and Assets Classification (IRAC) Norms

Preamble

The honourable Supreme Court had passed following interim order on September 03, 2020 –

“the accounts which were not declared NPA till 31.08.2020 shall not be declared NPA till further orders.”

The honourable Supreme Court has passed a final order on March 23, 2021. Para 32 of the said order specifies as follows:

“In view of the above and for the reasons stated hereinabove, the present petitions seeking reliefs, namely, (i) total waiver of interest during the moratorium period; (ii) to extend the period of moratorium; (iii) to extend the period for invocation of the resolution mechanism, namely 31.12.2020 provided under the 6.8.2020 circular; (iv) that there shall be sector-wise reliefs provided by the RBI; and (v) that the Central Government/RBI must provide for some further reliefs over and above the relief packages already offered stand dismissed. Connected IAs stand disposed of.

However, it is directed that there shall not be any charge of interest on interest/compound interest/penal interest for the period during the moratorium and any amount already recovered under the same head, namely, interest on interest/penal interest/compound interest shall be refunded to the concerned borrowers and to be given credit/adjusted in the next instalment of the loan account. All these petitions are partly allowed to the aforesaid extent only and as observed for the reliefs, the petitions are dismissed. Interim relief granted earlier not to declare the accounts of respective borrowers as NPA stands vacated. However, there shall be no order as to costs.”

Applicability

The applicability of the above-mentioned final order dated March 23, 2021 would be as follows:

1. The first part of Para 32 of the Order has put an end to any further relief over and above the relief packages which are mentioned against serial numbers (i) to (v) therein. Thus, it concludes that the relief packages already declared

stands as it is without any dilution / additions / amendments thereto. This interpretation is critical due to the second part in Para 32.

2. The second part of para 32 specifies that 'there shall not be any charge of interest on interest / compound interest / penal interest for the period during the moratorium and any amount already recovered under the same head, namely, interest on interest / penal interest / compound interest shall be refunded to the concerned borrowers and to be given credit / adjusted in the next instalment in loan account.

2.1 This would nullify the interest on interest and / or compound interest and / or penal interest during the moratorium period March 01, 2020 to August 31, 2020 with respect to all borrower accounts irrespective of the exposure and thus, would imply to apply it to eligible borrower accounts wherein the ex-gratia benefit vide RBI circular No. RBI/2020-21/61 DOR.No.BP.BC.26/21.04.048/2020-21 dated October 26, 2020 on 'Scheme for grant of ex-gratia payment of difference between compound interest and simple interest for six months to borrowers in specified loan accounts (1.3.2020 to 31.8.2020) ' was not given due to restrictive eligibility criteria of Rs. 2 crores. This would require banks calculate the differential arising on account of interest on interest and / or compound interest and / or penal interest in such accounts and derecognise the same either by way of crediting to the borrower loan account or by way of refunding the same to borrower or by way of disclosing it as payable to borrower with debit of equivalent amount to respective (interest) income heads.

2.2 The calculation methodology of the portion of interest on interest and / or compound interest and / or penal interest during the moratorium period March 01, 2020 to August 31, 2020 will be as specified in RBI circular No. RBI/2020-21/61 DOR.No.BP.BC.26/21.04.048/2020-21 dated October 26, 2020 on 'Scheme for grant of ex-gratia payment of difference between compound interest and simple interest for six months to borrowers in specified loan accounts (1.3.2020 to 31.8.2020).

2.3 There is a possibility that penal interest might have been charged due to overdue instalments which relate to the period prior to March 01, 2020. However, there is no such distinction made related to such instances, thus, plain reading of the order would mean that only simple interest at applicable rate of interest to borrower account needs to be calculated for the period of moratorium availed and whatever is charged in excess of that needs to be reversed.

2.4 As there is no mention about the recovery of such concessions to be granted to borrower on lines similar to ex-gratia, the bank would be required to calculate and derecognise the interest in respective eligible accounts. Once this reversal is done, there is also a possibility of changing the status of few NPAs which might turn into Performing Assets due to the crediting of such interest portions in the respective account.

3. The second part of Para 32 specifies that 'Interim relief granted earlier not to declare the accounts as respective borrowers as NPA stands vacated', resulting in neutralising the said interim order. Thus, banks are required to follow usual asset classification norms as per the extant guidelines / directives issued by Reserve Bank of India for entire Financial Year 2020-21, without any suspension or relief of any form therefrom. This would result in an account which otherwise was required to be classified as non-performing even prior to this final order but was not marked by the bank as NPA, would now be considered as non-performing on the respective actual date of NPA.

Guidance for the Statutory Auditors:

- Asset Classification

The asset classification norms are required to be followed verbatim as per extant RBI guidelines without any dilution or dispensation of the same throughout the financial year 2020-21, unless any specific dispensation or relaxation given in RBI direction.

- Income recognition

The income recognition norms are required to be followed as specified in extant RBI guidelines without any dilution / relaxation.

As regards the Supreme Court Order dated March 23, 2021, the interest income in the form of 'interest on interest and / or compound interest and / or penal interest' w.r.t. borrower accounts during the period March 01, 2020 to August 31, 2020 [excluding the portion of ex-gratia portion as calculated vide RBI circular dated October 26, 2020 on 'Scheme for grant of ex-gratia payment of difference between compound interest and simple interest for six months to borrowers in specified loan accounts (1.3.2020 to 31.8.2020)'] will be required to be derecognised by way of debit to the respective interest (income) in Profit

and Loss Account with corresponding effect as either by crediting to the borrower loan account or by refunding to borrower or by way of disclosing it as payable to borrower.

The methodology of calculation of the 'interest on interest and / or compound interest and / or penal interest' would be same as specified in the RBI Circular No. RBI/2020-21/61 DOR.No.BP.BC.26/21.04.048/2020-21 dated October 26, 2020.