

Presentation of NPA provision in the balance sheet of an NBFC

A. Facts of the case

1. A non-banking financial company (NBFC) is duly registered with the Reserve Bank of India (RBI) and involved in hire purchase/leasing business. During inspection under section 45N of the RBI Act, 1934, the RBI inspecting officer made the following comment in the inspection report :

“The provisions for NPAs were netted from the respective assets which is a violation of paragraph 9 of the Pruden-

that the provision for NPAs should be shown separately on the ‘Liabilities’ side of the balance sheet under ‘Provisions’ and not as a deduction from sundry debtors/advances etc.

4. The querist has submitted that the RBI directions require that the NBFC has to disclose distinctly the provision made in the books relating to NPAs by stating the value of hire purchase debtors at gross amount and provision thereagainst separately as a distinct item and only showing

Schedule VI, Part I specifically provides that provision for doubtful debts should be reduced from the gross amount of debtors and advances. Any violation in preparation of the balance sheet and profit and loss account as per the formats prescribed under the Companies Act, 1956, is punishable with imprisonment upto six months or a fine upto Rs.10,000/- or both. As per the querist, other NBFCs are also following the same practice of disclosure in their audited financial statements as has been done by the company.

6. The querist has also stated that in the case of banks, the RBI guidelines allow advances to be shown at net figure (advances less provisions for NPAs) and the amount of provision for NPAs etc., is shown in the notes to accounts only.

7. The querist has informed that the matter was discussed with the RBI officials of the Regional Office. Their point of view was that directions to NBFCs have been issued under the RBI Act and, therefore, irrespective of the provisions contained in the Companies Act, 1956, these are binding on the NBFCs. Their contention was that the way the provision for NPAs has been shown in the balance sheet by the company, it amounts to showing ‘net’ figures in the balance sheet and, therefore, the company has not complied with the NBFC Prudential Norms (Reserve Bank) Directions, 1998.

The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to query sent by a member. This is being published for the information of readers.

tial Norms Directions. This was pointed out in the last inspection also. The irregularity still persists.”

2. The querist has stated that the disclosure requirements in the balance sheet are prescribed in paragraph 9(1) of the NBFC Prudential Norms (Reserve Bank) Directions, 1998, which are as under:

“Every NBFC shall separately disclose in its balance sheet the provisions made as per paragraph 8 above without netting them from the income or against the value of assets.”

As per sub-paragraph 2 of paragraph 9 of the Prudential Norms, “the provisions shall be distinctly indicated under separate heads of account”.

3. The querist has informed that the RBI’s interpretation of this direction is

net amount of hire purchase debtors without showing the provision is not allowed. The querist has also submitted that the company has complied with the said directions since it has duly disclosed the provision for doubtful debts and loans and advances in the Schedules annexed to and forming part of the balance sheet. The process of netting, in the view of the querist, will normally mean showing net figure of debtors/advances and this has not been done by the company.

5. The querist has stated that the balance sheet and profit and loss account of a company are required to be prepared in accordance with Schedule VI, Parts I and II as provided under section 211 of the Companies Act, 1956.

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Committee

B. Query

8. In view of the above facts, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (a) What is the true and correct interpretation of RBI Directions relating to disclosure of provisions made for NPAs in the balance sheet? Is there any contravention of the norms in case the company shows provision for NPAs by way of reduction from sundry debtors/loans and advances?
- (b) Will there be contravention of Schedule VI, Part I, prescribed under the Companies Act, 1956, in case provision for NPAs is not shown as a deduction from sundry debtors/loans and advances but shown on liabilities side of the balance sheet?
- (c) Can the company prepare two balance sheets - one as per the RBI requirements (showing provision for sundry debtors/loans and advances on the liabilities side) and another in compliance with Part I of Schedule VI to the Companies Act, 1956, showing it as deduction from gross amount of sundry debtors/loans and advances with suitable disclosure giving reasons for preparing two balance sheets?

C. Points considered by the Committee

9. The Committee notes that Chapter III - B of the Reserve Bank of India Act, 1934, lays down the 'Provisions Relating to Non-Banking Institutions Receiving Deposits and Financial Institutions', under section 45JA of which the RBI is empowered to issue directions. The Committee further notes that Non-Banking Financial Companies Prudential Norms (Reserve Bank) Directions, 1998, have been issued by the RBI in exercise of the powers conferred under the aforesaid section. The Committee also notes that section 45Q of the Reserve Bank of India Act, 1934, provides that "The provisions of this Chapter shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law". Since the Directions are issued by the RBI under the aforesaid Chapter, the same override the requirements of Schedule VI to the Companies Act, 1956.

10. The Committee is of the view that the NPA provisions shown by way of deduction from the relevant asset amounts to netting from the value of assets as only the net amount of the asset is shown in the outer column. The Committee is, accordingly, of the view that the aforesaid presentation is not in accordance

with the requirements of paragraph 9(1) of the NBFC Prudential Norms (Reserve Bank) Directions, 1998. The NPA provisions, therefore, should be presented on the 'Liabilities' side of the balance sheet, under the head 'Provisions'.

11. The Committee is of the view that it is not proper to prepare and present two balance sheets - one as per the Companies Act, 1956, and the other as per the Prudential Norms, since the latter has the overriding effect as explained in paragraph 9 above.

D. Opinion

12. On the basis of the above, the opinion of the Committee on issues raised by the querist in paragraph 8 is as below:

- (a) True and correct interpretation of RBI Directions is explained in paragraph 10 above. There is a contravention of the said Directions in case a company shows provisions for NPAs by way of a reduction from sundry debtors/loans and advances.
- (b) No, there will not be contravention of Schedule VI to the Companies Act, 1956, because of overriding effect of the said Directions over Schedule VI to the Companies Act, 1956.
- (c) No, the company cannot prepare two balance sheets as suggested by the querist in paragraph 8(c) above.

Notes:

1. *The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.*
2. *The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in twenty four volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.*