MIS Good Practices Manual For ERP System Developers

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SUBMITTED BY:
Infrastructure Professionals Enterprise Private Limited, India
In association with
Tamil Nadu Urban Infrastructure Financial Services Limited, India

† Compiled by Ramesh S Arunachalam, from various good practices resources.
Kindly Note the Following

Good practices recommend an ERP system as given in Figure 1 and this has been derived based on the various discussions. The following manual is a good practices MIS manual that has the objective of providing the domain knowledge for the ERP System developers and basically, it offers good practice suggestions for treatment of various issues while developing the ERP system.

ERP system developers may use the following as guidelines in the ERP system, with alternative options being available for flexibility. Some of the generalized good practices are captured here and these could be flexibly accommodated in the system, permitting actual choice to the system administrator at NCRPB, in the define parameters and dine values master of the ERP system.

The technical notes start with a glossary of terms and they also provide good practices suggestions with regard to accounting, financial management, financial ratios (including process of deriving them in the system) and loan portfolio management aspects – with regard to the various options and flexibility that the ERP system is to provide. These are meant primarily as a domain guide to ERP system developers.

This is a draft manual and will be revised and the final MIS good practices manual will be a supplementary resource to the SRS document.

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Account

- Formal record that represents, in words, money or other unit of measurement, certain resources, claims to such resources, transactions or other events that result in changes to those resources and claims.
- An individual form or record used to record and summarize information related to each asset, each liability, and each aspect of (Stakeholder) funds/resources.
- The form used to record additions and deductions for each individual asset, liability, capital, revenue, and expense.

Account form of balance sheet

- A balance sheet with assets on the left-hand side and liabilities and capital on the right-hand side.

Account Payable

- Amount owed to a CREDITOR for completed services or goods.
- A liability created by a purchase made on credit or for a sum of money borrowed.
- The liability that results from purchasing goods or services on credit.
- Amounts entities owe suppliers for goods and services. Listed in the current liabilities section on the statement of financial position.

Account Receivable

- Claim against a DEBTOR for an uncollected amount, generally for a sum of money lent from a completed transaction of services rendered or. (Listed in the current assets section on the statement of financial position.)

Accounts Receivable

- Money owed to Financial Intermediary (FI) like NCRPB for or loans advanced.

Accountant

- Person skilled in the recording and reporting of financial transactions.

Accounting

- Recording and reporting of financial transactions, including the origination of the transaction, its recognition, processing, and summarization in the FINANCIAL STATEMENTS.
- The process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information.

Accounting Change

- Change in (1) an accounting principle; (2) an accounting estimate; or (3) the reporting entity that necessitates DISCLOSURE and explanation in published financial reports.

Accounting Cycle

- The steps involved in the recording and summarizing processes of accounting.
- The principal accounting procedures employed to process transactions during a fiscal period.

Accounting Entry

- A record of financial transaction in the books of account like journal, ledger, cash book, etc.

Accounting Equation

- The equation that expresses the relationship between the accounting elements in a simple mathematical form: Assets = Liabilities + Net Worth

Accounts Payable Ledger

- A subsidiary ledger that lists the individual accounts of creditors. Also called the creditors' ledger.

Accounting Policies

- The principles, bases, conventions, rules and procedures adopted by management in preparing and presenting financial statements.

Accounting Period

- The period of time for which operating and financial statements are regularly prepared.
- A period that is typically one year; however, it can be any length of time for which accounting records are maintained, sometimes even a month.

Accounting Principle

- The general principles and procedures under which the accounts of an individual organisation (like NCRPB) are maintained; any one such principle or procedure. An accounting principle is an adaptation or special application of a principle necessary to meet the peculiarities of an organisation or the needs of its management. Thus, principles are required for

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2 Compiled by Ramesh S Arunachalam, from various good practices resources. The assumption here is that NCRPB will go in for a variety of products as per the Technical Assistance-which could be include even quarterly repayment loans and hence, options need to be provided in system design. These technical notes set the domain knowledge for the ERP System developers and basically offer good practice suggestions for treatment of various issues.
the computation of depreciation, the recognition of capital expenditures, income, revenue etc.

ていきます An asset account that shows the total currency (dollar or rupee or pound) amount due from borrowers.

Accounts Receivable ledger

A subsidiary ledger containing only accounts of borrowing (project) clients; also called the clients (debtors) ledger.

Accounting Year

The “Official Year” or “Year” means a year commencing on the first day of the Accounting period. In case of NCRPB, it would be April 1st year ‘Y’ to 31st March, year “Z”.

Accrual

An expense or revenue that gradually increases with the passage of time.

Accrual Basis

Method of ACCOUNTING that recognizes RECEIIVE INCOME when earned, rather than when collected. Expenses are recognized when incurred rather than when paid.

The basis of accounting that requires that revenue income is recorded when earned, no matter when cash is received, and that expenses are recorded when incurred, no matter when cash is paid.

Accrued & Due

In respect to an asset (or a liability) it means a claim which has become enforceable, and has become receivable (payable).

In respect to an income (or an expense) it means the amount earned (incurred) in an accounting period, for which a claim has become enforceable, has become receivable (payable).

Accrued Expenses

Expenses that build up or accumulate during the current period but will not be paid until the next period. Also called accrued liabilities.

Accrued Interest

The amount of interest due/earned which has not yet been realised/paid

Accrued Revenue

Revenue that has been earned in the current accounting period but will not be received until the next period. Also called accrued assets.

Accrue salaries

Salary that is unpaid at the end of an accounting period. Also called accrued wages.

Accumulated Depreciation

Total DEPRECIATION pertaining to an ASSET or group of assets from the time the assets were deployed? until the date of the FINANCIAL STATEMENT.

The total depreciation from the start of the life of a physical asset to any point in time.

This total is the CONTRA ACCOUNT to the related asset account.

Quick Ratio measures assets which can be liquidated quickly to meet current liabilities.

Acid-test ratio

The ratio of the sum of cash, receivables, and marketable securities to current liabilities.

The ratio of quick assets to current liabilities. A yardstick commonly used is a 1-to-1 ratio. It is also called quick ratio.

Active Clients (Projects)

The number of clients with loans outstanding on any given date. Active clients are usually recorded as the number of clients with loans outstanding on the date of the financial statement, usually end of fiscal year.

Active Loan Portfolio

The total amount loaned out less the total amount of repaid loans; i.e., all money (Net of NPAs) that is or owed to the institution (NCRPB) in the form of loans on the date the report is filed. Addition

A capital expenditure that literally adds on to an existing physical asset. The cost of an addition is debited to the physical asset account.

Adequate disclosure principle

States that financial statements or the explanatory notes and schedules that go with the statements must disclose all relevant data about the financial position of an entity.

Adjusting Entries

Entries made at end of an accounting period to bring balances of certain accounts up to date.

Advance

Payment made on account of, but before completion of, a contract, or before acquisition of goods or receipt of services.
### Ageing Schedule

- A schedule in which accounts receivable (loans to clients) are grouped into age categories and an estimated bad debts (provision) rate is applied to each age category.

### Aging the receivables

- A way of estimating bad debts expense when using the balance sheet approach.
- The process of analyzing the accounts receivable and classifying them according to various age groupings with the due date being the base point for determining age.

### Allowance Method

- A method of accounting for bad debts in which the amount estimated to be uncollectible is established at the end of an accounting period in an adjusting entry. Uncollectible accounts are then written off by debiting Allowance for Doubtful Accounts. The method of accounting for uncollectible receivables, by which advance provision for the uncollectibles is made.

### Analytical Procedures

- Substantive tests of financial information, which examine relationships among data as a means of obtaining evidence. Such procedures include: (1) comparison of financial information with information of comparable prior periods; (2) comparison of financial information with anticipated results (e.g., forecasts); (3) study of relationships between elements of financial information that should conform to predictable patterns based on the entity's experience; (4) comparison of financial information with industry norms (Benchmarking).

### Annual Percentage Rate (APR)

- APR includes interest, fees, commissions and the calculation method on the principal. It represents the income the Financial Intermediary (FI) should earn on the loan. It is calculated by using the internal rate of return function on a financial calculator or spreadsheet. It represents that portion of the effective interest rate to the borrower, (project).

### Amortization Schedule

- A schedule that shows precisely how a loan will be repaid. The schedule gives the required payment on each specific date and shows how much of it constitutes interest and how much constitutes repayments of principal. Also called as repayment or instalment schedule.

### Amortize

- To liquidate on an installment basis; an amortized loan is one on which the principal amount of the loan is repaid in installments during the life of the loan.
and managerially. Example is rating of NCRPB’s bond issue by CRISIL/ICRA etc.

Asset

Anything that Financial Intermediaries own. These things might be physical assets such as buildings, vehicles, equipment, and cash. Listed as a category on the statement of financial position.

Asset-Based Financing

Loans granted usually by a financial intermediary where the asset being financed constitutes the sole security given to the lender.

Asset Replacement Fund

A fund created for the purpose of replacement of an asset. The fund shall normally be equal to the amount of depreciation provided on the Fixed Assets and shall be utilised only for the purpose of replacement of those Fixed Assets or for any other purpose.

Audit

A review of (1) the operating, administrative, and financial activities of an institution for conformance with all legal and administrative requirements and conformance with the principles of economy and efficiency; or (2) selected claims, cost proposals, grants, loans, or similar agreements entered into by an institution for conformance with the principles of economy and efficiency.

Audit Engagement

Agreement between an audit firm and its client to perform an AUDIT.

Audit Sampling

Application of an AUDIT procedure to less than 100% of the items within an account BALANCE or class of transactions for the purpose of evaluating some characteristic of the balance or class.

Auditing Standards

Guidelines to which an AUDITOR adheres. Auditing standards encompass the auditor's professional qualities, as well as his or her judgment in performing an AUDIT and in preparing the AUDITORS' REPORT.

Auditor

Person who AUDITS financial accounts and records kept by others.

A person or firm an entity hires as an independent third party to review its financial information. The auditor's main purpose is to make sure the statement of earnings, statement of financial position, and statement of cash flows fairly present the Financial Intermediary’s financial condition, and that they comply with auditing standards set forth by the various regulatory frame works/Acts.

Auditors’ Opinion

A summary of the findings of a firm of certified public accountants (Chartered accountants) that audits, or examines, an Financial Intermediary’s financial statements. This report is included in the Financial Intermediary's annual report. Also called auditors' report and report of independent accountants.

Automated data processing (ADP)

The general term applied to the processing of data by mechanical or electronic equipment that operates with a minimum of manual intervention.

Auxiliary Record

A business record that is not essential but is helpful in maintaining records that are essential; an example is the petty cash payments record.

Average collection period for accounts receivable

A rough measure of the length of time accounts (delinquent or regular (oan) receivable have been outstanding. Calculated by dividing 365 days by the accounts receivable turnover.

Average outstanding Loan size

Gross Loan Portfolio / Number of Active Borrowers (Projects)

Bad Debt

A debt that is not collectible and is therefore worthless to the creditor.

All or portion of an ACCOUNT, loan, or note receivable considered to be uncollectible.

An account receivable that, for one reason or another, cannot be collected.

Balance

Sum of DEBIT entries minus the SUM of CREDIT entries in an ACCOUNT. If positive, the difference is called a DEBIT BALANCE; if negative, a CREDIT BALANCE.
The balance of an account is determined by footing (adding) the debit side, footing the credit side, and calculating the difference between the two sides.

**Balance form of account**
- A ledger account form with four amount columns that many Financial Intermediaries prefer to use because the balance is always known and it is easy to see whether the balance is a debit or a credit.
- Also called the four-column account form. The amount of difference between the debits and the credits that have been entered into an account.

**Balance Sheet**
- Financial statement presenting measures of the assets, liabilities and stakeholder's equity or net worth of institution as of a specific moment in time.
- Basic FINANCIAL STATEMENT, usually accompanied by appropriate DISCLOSURES that describe the basis of ACCOUNTING used in its preparation and presentation of a specified date the entity's ASSETS, LIABILITIES and the EQUITY of its owners. Also known as a STATEMENT OF FINANCIAL CONDITION.
- A listing of a firm's assets, liabilities, and stakeholder's equity at a specific point in time. Other terms used to describe the balance sheet are statement of financial position.

**Balance Sheet Approach**
- A method of estimating the bad debts expense under the allowance method in which the expense is based on aging the accounts receivable

**Bank**
- An organization, usually a corporation, owned by the government, or private or jointly which does most or all of the following: receives demand deposits, honours instruments drawn on them and pays interest on them; discounts notes, makes loans and investment in securities; collects checks, drafts, and notes; certifies depositor's checks; and, issues drafts and cashier's checks.

**Bank Checking Account**
- An amount of cash on deposit with a bank that the bank must pay at the written order of the depositor

**Bank Reconciliation**

**Bank Statement**
- A monthly report showing the bank's record of the checking account.

**Bankruptcy**
- A condition in which an institution does not have sufficient cash to pay its creditors.
- Legal process, governed by statute, whereby the DEBTS of an insolvent person are liquidated after being satisfied to the greatest extent possible by the DEBTOR'S ASSETS. During bankruptcy, the debtor's assets are held and managed by a court appointed TRUSTEE.

**Benchmarking**
- Peer group benchmarking puts performance measurements in context by comparing an institution (e.g., an Financial Intermediary) with similar institutions based on a common factor, such as region, size or methodology. A benchmark can also refer to the standard against which all similar institutions are compared.

**Board of Directors**
- Individuals responsible for overseeing the affairs of an entity, including the election/appointment of its officers. People elected by a Financial Intermediary’s stakeholders to oversee the activities and appoint officers and other staff.

**Book of Original entry**
- The journal is referred to as the book of original entry because it is the first place in which transactions are formally recorded.

**Book Value**
- Amount, net or CONTRA ACCOUNT balances, that an ASSET or LIABILITY shows on the BALANCE SHEET of an institution. Also known as CARRYING VALUE. Value at which an asset is acquired or liability is incurred
- The cost of an asset less the balance of any related contra asset account. For a fixed asset, it is typically the cost of the asset minus accumulated depreciation.
As entities continue to use fixed assets to generate revenue, the book values lessen, and sometimes ultimately reach zero.

**Bookkeeping**
- The recording of business data in a prescribed manner.

**Break – Even**
- This is a term used to describe a point at which revenues equal costs.

**Break-Even Analysis**
- An analytical technique for studying the relationships between fixed cost, variable cost, and profits. A breakeven chart graphically depicts the nature of breakeven analysis. The breakeven point represents the volume of business at which total costs equal total revenues (that is, profits equal zero).

**Break-even Point**
- The point in operations where total income exactly equals total fixed and variable costs; the point of zero profit or loss.

**Bridge Loan**
- Short-term loan to provide temporary financing until more permanent financing is available.

**Budget**
- Financial plan that serves as an estimate of future cost, REVENUES or both.
- A formal statement of management's financial plans for the future.

**Budgeted Balance sheet**
- A balance sheet that estimates each element of financial condition at a specified future time.

**Budgeted Income statement**
- An income statement that estimates net income for the next fiscal period, based on all income statement budgets.

**Business**
- An organization that operates with the objective of earning a profit.

**Business Entity Concept**
- The principle that states that, for accounting purposes, a business is a distinct economic entity or unit that is separate from its owner and from any other business.

**Business Plan**
- A document that describes an Financial Intermediary's current status and plans for several years into the future. It generally projects future opportunities for the organization and maps the financial, operations, marketing and organizational strategies that will enable the organization to achieve its goals.

**Business Transaction**
- The occurrence of an event or of a condition that must be recorded in the accounting records.

**Bylaws**
- Collection of formal, written rules governing the conduct of a Financial Intermediary's affairs (such as what officers it will have, what their responsibilities are, and how they are to be chosen). The owners or stakeholders approve byelaws. A set of policies that act as an entity's constitution.

**Capital**
- Broadly, all the money and other property of a corporation or other enterprise used in transacting its business/activities.

**Capital Adequacy**
- A quantitative and qualitative measure of an Financial Intermediary's level of equity/capital versus the risk it incurs. This measurement shows an institutions ability to absorb loan loss.

**Capital Expenditure**
- A cost that adds to the utility of an asset for more than one accounting period. Examples include additions, betterments, and extraordinary repairs. Capital expenditures increase either the value or the life of the asset and are debited to either the asset account or its accumulated depreciation account, depending on the type of expenditure.

**Capital Expenditures Budget**
- A budget used for long-term planning of when physical assets will need to be replaced.

**Capital Investments**
- Money used to purchase fixed assets for an institution/business, such as land, buildings, or equipments. Also, money invested in an institution/business on the understanding that it will be used to purchase permanent assets rather than to cover day-to-day operating expenses.
Good Practices MIS Technical Note For ERP System Developers

TN #1: Glossary of Financial Terms for ERP System, (A – C)
for Financial Intermediation at NCRPB

**Capital**

- The rights (equity) of the owners in an institution/business enterprise (including Financial Intermediary)

**Capital Work in Progress**

- Expenditure on capital assets which are in the process of construction or completion.

**Cash**

- In its most basic meaning, cash is currency (paper money) and coin. The definition in a business context also includes cheques, money orders, traveller’s cheques, cashier’s cheques, bank drafts, and receipts from credit card sales.
- Any medium of exchange that a bank will accept at face value.
- Currency and cheques on hand and deposits in banks. Listed in the current assets section on the statement of financial position.

**Cash Book**

- A book of original entry for cash receipts, disbursements, or both.

**Cash Basis**

- Method of bookkeeping by which REVENUES and EXPENDITURES are recorded when they are received and paid.
- A basis of accounting where revenue is recorded only when cash is received, and expenses are recorded only when cash is paid.

**Cash Budget**

- A budget that estimates the expected cash to be received and spent over a period of time.

**Cash Equivalents**

- Short-term (generally less than three months), highly liquid INVESTMENTS that are convertible to known amounts of cash.
- Highly liquid, short-term investments that can be turned to cash with little or no delay
- Instruments or investments of such high liquidity and safety that they are virtually equal to cash.

**Cash Flow**

- In investments, NET INCOME plus DEPRECIATION and other non-cash charges. In this sense, it is synonymous with CASH EARNINGS. Investors focus on cash flow from operations because of their concern with an institution’s ability to pay dividends (if required) or accumulate them (retained earnings).

**Cash Flow Financing**

- Short-term loan providing additional cash to cover cash shortfalls in anticipation of revenue, such as the payment(s) of receivables.

**Cash Flow Forecast**

- An estimate of the timing and amount of an financial intermediary’s inflows and outflows of money measured over a specific period of time - typically monthly for one to two years and then annually for an additional one to five years.

**Cash Flows**

- Net of cash receipts and cash disbursements relating to a particular activity during a specified accounting period.
- Cash receipts and cash payments from operating activities, investing activities, and financing activities.

**Cash Payments Journal**

- A special journal used for recording all disbursements of cash. Also called the cash disbursements journal.

**Cash Ratio**

- Ratio of cash and cash equivalents to current liabilities.

**Cash Receipts Journal**

- A special journal used to record all receipts of cash, regardless of the source.

**Casting**

- It means totalling of the amounts in the books of account.

**Certificate of Deposit (CD)**

- Formal instrument issued by a bank upon the deposit of funds which may not be withdrawn for a specified time period. Typically, an early withdrawal will incur a penalty.

**Charges**

- Charges or fees by the bank that are subtracted directly from the depositor’s account and appear on the bank statement. Also called bank charges.

**Chart of Accounts**

- A directory or listing of accounts in the ledger.
- A listing of all the accounts used by an enterprise or institution.
Cheques
⇒ A written order directing a bank to pay a specified sum of money to a designated person or business.

Cheque Register
⇒ A modified form of the cash payments journal used to record all transactions paid by cheque.

Cheque stub
⇒ Part of a cheque that remains in the chequebook as a permanent record of the cheque.

Cheque book
⇒ A bound book of cheques with stubs; the depositor's record of the checking account.

Classified Balance sheet
⇒ A balance sheet that divides the assets and liabilities sections into the following subsections: current assets and long-term assets, and current liabilities and long-term liabilities.

Classified Income statement
⇒ An income statement divided into several sections including: operational revenue, financing cost, operating expenses, and other income and expenses.

Closing Entries
⇒ An entry necessary to eliminate the balance of a temporary account in preparation for the following (subsequent) accounting period.

Code of Account
⇒ A unique numeric or alphanumeric identification given to each Account to facilitate classification and ease of recording.

Collateral
⇒ Assets pledged to secure the repayment of a loan.
⇒ ASSET provided to a CREDITOR as security for a loan.
⇒ Asset pledged by a borrower to secure a loan, which can be repossessed in the case of default. In a financial intermediary, like NCRPB, collateral can vary from fixed assets to guarantees from governments and others.

Combined Financial Statement
⇒ FINANCIAL STATEMENT comprising the accounts of two or more programmes/entities/schemes.

Commercialization
⇒ In a financial intermediary, commercialization refers to the move by Financial Intermediaries to provide services on a financially self-sufficient basis and under prevailing regulations and market conditions.

Commission
⇒ They are one-time charges, generally calculated as percent of the loan amount.

Comparative Financial Statement
⇒ FINANCIAL STATEMENT presentation in which the current amounts and the corresponding amounts for previous periods or dates also are shown.
⇒ A side-by-side comparison of an institution's financial statements for two or more accounting periods.

Competitive Advantage
⇒ The strategies, skills, knowledge, resources or competencies that differentiate a financial intermediary from its competitors.

Compliance Audit
⇒ Review of financial records to determine whether the entity is complying with specific procedures or rules.

Composite-rate depreciation
⇒ A method of depreciation based on the use of a single rate that applies to entire groups of assets.

Compound Interest
⇒ Interest computed on principal plus interest earned in previous periods. Compound Interest is the concept of earning interest on interest in a savings account. This occurs when the interest is left in the account form period and the bank 'capitalizes' the interest for purposes of paying interest in later periods.

Conservatism
⇒ An investment strategy aimed at long-term capital appreciation with low risk; moderate; cautious; opposite of aggressive behaviour; show possible losses but wait for actual profits. Concept that directs the least favourable effect on net income.
Consistency
ACCOUNTING postulate, which stipulates that, except as otherwise noted in the FINANCIAL STATEMENT, the same accounting policies and procedures have been followed from period to period by the organization in the preparation and presentation of its financial statements. The accounting principle that requires an institution (Financial Intermediary) to continue to use a method once chosen, rather than switch from method to method arbitrarily or for temporary advantage.

Consolidated Financial Statements
Combined FINANCIAL STATEMENTS of a parent institution and one or more of its subsidiaries as one economic unit.

Contingent Liability
Potential LIABILITY arising from a past transaction or a subsequent event.
A potential obligation that will materialize only if certain events occur in the future.

Contract
A formal written statement of the rights and obligations of each party to a transaction.

Contra Entry
An item on one side of an account which offsets fully or in part one or more items on the opposite side of the same account.

Control Account
Control account is an account in the general ledger that consists of related sub-accounts. The total of the related sub-accounts should total the balance in the related control account.

Correcting entry
An entry used to correct certain types of errors in the ledger.

Cost Accounting
Procedures used for rationally classifying, recording, and allocating current or predicted costs that relate to a certain loan product or service.

Cost of Acquisition
The cost of acquisition of a Fixed Asset comprises its purchase price and includes import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price.

Cost of Capital
The discount rate that should be used in the capital budgeting process.

Cost of Investment
The amount of expenditure incurred on or attributable to the purchase/acquisition of an investment. The cost of an investment amongst others includes acquisition charges such as brokerage, fees and duties.

Costs and consequences of delinquency
Postpones/reduces Interest Income.
Affects Cash Flow Negatively, Prevents Loan Disbursement on time and hence, impact outreach
De-capitalize the Portfolio (or revolving loan fund)
Creates a negative image
Lowers morale of staff
Creates a bad precedent for other clients who could join the bandwagon
Ultimately, affects program sustainability

Credit
Entry on the right side of a DOUBLE-ENTRY BOOKKEEPING system that represents the reduction of an ASSET or expense or the addition to a LIABILITY or REVENUE. (See DEBIT.)
The allowance of cash or services in the present, with payment expected in the future.
To credit (Cr.) an account means to enter an amount on the right, or credit, side of the account.

Credit Balance
BALANCE remaining after one of a series of bookkeeping entries. This amount represents a LIABILITY or income to the entity. (See BALANCE.)
Occurs when the amount on the credit side of an account is greater than the amount on the debit side.

Credit Loss
A loan receivable that has proven uncollectible and is written off.

Credit period
The amount of time an Financial Intermediary allows a client (project) to repay a loan.
Credit Rating
Usually used to determine an Financial Intermediary’s credit risk, a credit rating is an evaluation/opinion of an individual's or company's ability to repay obligations or its likelihood of not defaulting.

Credit Risk
Financial and moral risk that an obligation will not be paid and a loss will result.

Credit Scoring
Measures the risk associated with each credit applicant/borrower. Credit scoring is an automated system that assigns points for various credit factors, providing lenders with the ability to grade prospective clients and to calculate the risk of extending credit. In a financial intermediary, the credit scoring method is modified to take into account a borrower's experience, character (individual or institutional) and capacity to repay. The final credit score is an overall measure of the creditworthiness of the credit applicant (project or borrower).

Credit Terms
Conditions under which credit is extended by a lender to a borrower.

Creditor
Party that loans money or other ASSETS to another party. A business or person to whom a debt is owed.

Cumulative Principal Due
Cumulative Principal Due is the total principal due from a client (project) as of the current installment.

Cumulative Principal Overdue
Cumulative Principal Overdue is the difference between cumulative principal due and cumulative principal paid (for any given client/project/loan) as of the current installment.

Cumulative Principal Paid
Cumulative Principal Paid is the total principal paid by a client/project as of the current installment.

Cumulative Repayment Rate
(CRR) = Principal amount paid so far – pre-payments divided by Principal amount due so far

Current Asset
Asset that one can reasonably expect to convert into cash, sell, or consume in operations within a single operating cycle, or within a year if more than one cycle is completed each year.

Cash and assets that will be sold, used up, or turned into cash within the current accounting period, usually one year. Besides cash, usual examples are receivables.

Cash and other Financial Intermediary assets that can be readily turned into cash within one year.

Current Liabilities
Debts that are due for payment within one year. Examples are accounts payable, salaries payable, and the current portion of notes payable.

Obligations a Financial Intermediary has to others, payable within one year. Listed in the liabilities category on the statement of financial position.

Obligation whose LIQUIDATION is expected to require the use of existing resources classified as CURRENT ASSETS, or the creation of other current liabilities.

A liability that will be due within a short time (usually one year or less) and that is to be paid out of current assets or otherwise.

Debts or other obligations coming due within a year.

Current Ratio
Current assets divided by current liabilities -- a measure of liquidity. Generally, the higher the ratio, the greater the "cushion" between current obligations and a firm's (or institution's) ability to meet them. It is an indicator of a firm's (or institution's) ability to pay its short-term debts as they become due.

Current Value
(1) Value of an ASSET at the present time as compared with the asset's HISTORICAL (ACQUISITION) COST. (2) In finance, the amount determined by discounting the future revenue stream of an asset using COMPOUND INTEREST PRINCIPLES.
### Glossary of Financial Terms for ERP System

**Debenture**
- A formal document constituting acknowledgement of a debt by an entity, usually given under its common seal and normally containing provisions regarding payment of interest, repayment of principal and security, if any. It is transferable in the appropriate manner.

**Debit**
- Entry on the left side of a DOUBLE-ENTRY BOOKKEEPING system that represents the addition of an ASSET or expense or the reduction to a LIABILITY or REVENUE. (See CREDIT.). To debit (Dr.) an account means to enter an amount on the left, or debit, side of the account.

**Debit Balance**
- BALANCE remaining after one or a series of bookkeeping entries. This amount represents an ASSET or an expense of the entity. (See BALANCE.)
- Occurs when the amount(s) on the debit side of an account is greater than the amount(s) on the credit side.

**Debt**
- An amount owed for funds borrowed. The debt may be owed to an organization’s own reserves, individuals, banks, or other institutions.

**Debt Capacity**
- An assessment of a borrower’s ability (capacity) and willingness to repay a loan from anticipated future cash flow or other sources.

**Debt Service**
- Amount of payment due regularly to meet a debt agreement; usually a monthly, quarterly or annual obligation.

**Debt/Equity Ratio**
- Total debt divided by Total Equity (including reserves)

**Debtor**
- Party owing money or other ASSETS to a CREDITOR.

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**Decentralized accounting**
- A system of accounting for units in which each unit keeps its own records and prepares its own financial statements.

**Declining Balance Method of interest calculation**
- Represents interest calculated on the principal amount of the loan that is actually with the borrower during each (amortisation) period. The amount of principal outstanding reduced with principal repayments.

**Default**
- A failure to discharge a duty. The term is most often used to describe the occurrence of an event that cuts short the rights or remedies of one of the parties to an agreement or legal dispute, for example, the failure of the client to pay a loan installment, or to comply with mortgage covenants. Failure to meet any financial obligation. Default triggers a CREDITOR’S rights/remedies identified in the agreement and under the law.

**Default and Financial Intermediary**
- Default occurs when a client cannot/will not make loan repayments and the institution does not expect any further payment from the client
- Failure to make timely payment of interest or principal on a loan, or to otherwise comply with the terms/conditions of a loan.

**Deferral**
- A postponement of the recognition of an expense already paid or a revenue already received. Expenses and revenue that have been recorded in the current accounting period but are not incurred or earned until a future period.

**Deferred Charge**
- Cost incurred for subsequent periods, which are reflected as ASSETS. Another name for deferred expenses, usually applying to advance payments that cover more than a year.

**Deferred Credits**
- Another name for deferred revenue, usually applying to amounts received more than a year in advance.

**Deferred expenses**
- Advance payments for goods or services that benefit more than one accounting period.

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3 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Deferred Income
Deferred income is received but not earned until all events have occurred. Deferred income is reflected as a LIABILITY.

Deferred revenue
The advance receipt of revenue that will not be earned until a future accounting period.

Deficit
A financial shortage that occurs when LIABILITIES exceed ASSETS. A debit balance in the Retained Earnings account.

Deflation
A period when prices in general are falling and the purchasing power of the currency is increasing.

Delinquency
Delinquency is a situation that occurs when loan payments are past due and delinquent loans are loans in which any payment is past due.

Delinquency management
The outstanding portfolio or the principal amount of loan outstanding is the most important and largest asset for a Financial Intermediary as it generates Income (Interest and Fees). In other words, it is the main product demanded by clients and it is the reason for a Financial Intermediary being in existence. Hence, ensuring that this asset is safeguarded (from delinquency) is very crucial for any financial intermediary. This is because delinquency is like a ‘hidden beast’ that can eat away the portfolio (de-capitalize) of any financial intermediary and prevent it from becoming sustainable.

Delinquency Measurement
Delinquency can be measured by using two generic measures:
- Portfolio based measures (Portfolio at Risk and Arrears Rate)
- Repayment based measures (Cumulative Repayment Rate and On-Time Repayment Rate)

Deposit interest rate (Percentage)
Deposit interest rate is the rate paid by commercial or similar banks for demand, time, or savings deposits.

Deposit Slip
A form that is prepared when coin, currency, or checks are deposited in a bank account.
It indicates the depositor’s name and account number and summarizes the amount deposited. Also called deposit ticket.

Depositor
The business or person under whose name a checking account is opened.

Depreciation
Expense allowance made for wear and tear on an ASSET over its estimated useful life. (See ACCELERATED DEPRECIATION and STRAIGHT-LINE DEPRECIATION.)
An allocation process in which the cost of a long-term asset (except land) is divided over the periods in which the asset is used in the production of the business’s revenue.
The periodic cost expiration of all physical assets except land. An allowance for wear or age made to the value of a fixed asset, allocating its cost over its estimated useful life. Listed in the assets category on the statement of financial position.
Amortization of fixed assets, such as equipment, so as to allocate the cost over their (depreciable) life.

Depreciable Amount
The historical cost, or other amount substituted for historical cost of a depreciable asset in the financial statements, less the estimated residual value.

Depreciation Method
The arithmetic procedure followed in determining a provision for depreciation (an expense) and maintaining the accumulated balance.

Depreciation Rate
A percentage which when applied to the depreciable amount will yield depreciation expense for a year.

Direct expense
An expense that is associated with a specific department/unit; an expense that benefits only that department and that would not exist if the department did not exist. There may be specific expenses for planning at NCRPB.
Good Practices MIS Technical Note For ERP System Developers
TN #2: Glossary of Financial Terms for ERP System, (D – F) for Financial Intermediation at NCRPB

Direct method
⇒ A format for the statement of cash flows that discloses each major class of cash inflow and cash outflow from operating activities. It shows the amount of cash received or paid for revenues and expenses reported on the income statement. This is the method recommended by best practices.

Direct write-off method
⇒ A method of accounting for bad debts in which the expense is recorded at the time of the write-off on an account.
⇒ A method of accounting for uncollectible receivables, whereby an expense is recognized only when specific accounts are judged to be uncollectible.

Disbursement
⇒ The actual transfer of financial resources. The disbursement reflects the transfer of the loan amount from the lending institution to the borrower.

Disclaimer of Opinion
⇒ Statement by an AUDITOR indicating inability to express an opinion on the fairness of the FINANCIAL STATEMENTS provided and the reason for the inability.

Disclosure
⇒ Process of divulging accounting information so that the content of FINANCIAL STATEMENTS is understood.

Dividend
⇒ A distribution of earnings to the owners of the entity. A distribution of earnings of an Financial Intermediary to its owners (shareholders) or stakeholders.

Dividend Income
⇒ An income received from investments in shares/units.

Double declining-balance method
⇒ A depreciation method that allows greater depreciation in the early years of the life of an asset and less depreciation in later years. This is achieved by applying a constant rate to each year’s decreasing book value.

Double-entry accounting
⇒ Each business transaction affects the accounting elements in at least two ways.

Recording both effects of a transaction is called double-entry accounting. A system for recording transactions based on recording increases and decreases in accounts so that debits always equal credits.

Double-Entry Bookkeeping
⇒ Method of recording financial transactions in which each transaction is entered in two or more accounts and involves two-way, self-balancing posting. Total DEBITS must equal total CREDITS.

Drawee
⇒ The bank on which a cheque is drawn.

Drawer
⇒ The business or institution or person who writes a cheque.

Dual Effect
⇒ The principle that states that all business transactions are recorded as having at least two effects on the basic accounting elements.

Due date
⇒ The date on which a loan must be paid – this is based on the installment schedule.

Due Diligence
⇒ The process of systematically evaluating information, to identify risks and issues relating to a proposed transaction.(i.e. verify that it is what it is proposed to be).

Earned capital
⇒ Capital that arises from profitable operations of the Financial Intermediary; usually called retained earnings.

Earnings
⇒ In general, refers to an institution’s total earnings less total expenses and including interest and income tax.

Effective interest rate
⇒ Effective interest rate includes the effects of interest, fees, commissions and calculation method and other loan requirements on the total cost of the loan. It represents the total financial costs to borrower. It is calculated by using the internal rate of return function on a financial calculator.

Endorsement
⇒ A signature or stamp on the back of a cheque that transfers ownership of the cheque to the bank or another person.
Equipment
- The physical assets needed by an institution in order to operate.

Equity
- The value of assets in an organization greater than the total debt held on it. Equity investments typically take the form of an owner's share in the business, and often, a share in the return, or profits. Equity investments carry greater risk than debt, but the potential for greater return should balance the risk.
- Residual INTEREST in the ASSETS of an entity that remains after deducting its LIABILITIES. Also, the amount of an institution's total assets less total liabilities. Also, the third section of a BALANCE SHEET, the other two being assets and liabilities.
- The right or claim to the assets of an enterprise.
- The part of a business enterprise's assets that belongs to the owners or stakeholders. In other words, the amount that would remain if an institution sold all of its assets and paid off all of its liabilities. Listed as shareholders equity on the statement of financial position and on the statement of shareholders equity.

Expense
- The amount of assets consumed or services used in the process of earning revenue.
- The costs of operating a business or institution. It's effect is a reduction in owner's equity.
- Costs such as salaries, rent, office supplies and taxes. Listed in the operating expenses category on the statement of earnings.

External Audit
- A formal, independent review of an institution's financial statements, records, transactions and operations. External audits are usually performed by professional accountants in order to lend credibility to financial statements and management reports, to ensure accountability for Govt/donor funds, or to identify internal weaknesses in an organization. The external audit process is key to transparency.

Face Value
- The nominal value which appears on the face of a document recording an entitlement, generally an amount of money that has to be repaid on the maturity of a debt instrument.

Fair Market Value
- The highest price available, expressed in terms of cash, in an open and unrestricted market between informed, prudent parties acting at arm's length and under no compulsion to transact.

Fee
- A charge for services

Fees
- Fees are normally fixed amount charges, generally calculated as a percentage of the loan. Examples would be notary or legal fees. Fee amounts are normally independent of the principal amount of the loan.

Finance Company
- Company engaged in making loans to individuals or entities. Unlike a bank, most often, it need not receive deposits from the public. Investment grade NBFCs receive deposits as per approved norms.

Financial Assistance
- Economic assistance provided by (unrelated) third parties, typically government agencies. They may take the form of loans, loan
guarantees, subsidies, tax allowances, contributions, or cost-sharing arrangements.

**Financial Expense**
- All interest, fees and commissions incurred on all liabilities, including deposits clients (projects) held by the Financial Intermediary, commercial and concessional borrowings, mortgages, and other liabilities.

**Financial forecast**
- A statement indicating an enterprise’s financial plans and expectations for the future.

**Financial Incentive**
- An expression of economic benefit that motivates behavior that might otherwise not take place. A variety of financial incentives can be offered.

**Financial Position**
- Status of a firm's assets, liabilities, and equity accounts as of a certain time, as shown in its financial statement.

**Financial Revenue**
- Includes revenue generated from both the Gross Loan Portfolio and investments.

**Financial Self-Sufficiency (FSS)**
- Total operating revenues divided by total operating expenses, provisions and financial expenses, adjusted for low-interest loans and inflation. In a financial intermediary, an institution is financially self-sufficient when it has enough revenue to pay for all operational costs, loan losses, potential losses, cost of funds, inflationary effects etc

**Financial Statements**
- Presentation of financial data including BALANCE SHEET, INCOME STATEMENT, STATEMENT OF CASH FLOW AND PORTFOLIO REPORT, or any supporting statement that is intended to communicate an entity's true (Financial Intermediary’s) financial position at a point in time and its results of operations for a period then ended. Summaries of financial activities. While balance sheet and portfolio reports are stock reports (as at end of a period), the income statement and statement of cash flows are flow reports (including a period).

**Fiscal period**
- The period of time that covers a complete accounting cycle. A fiscal year is a fiscal period covering twelve months; it does not necessarily coincide with the calendar year. Period of 12 consecutive months chosen by an entity as its ACCOUNTING period which may or may not be a calendar year.
- A 12-month time period that may or may not be from January 1 to December 31 or April 1st to March 31st
- The annual accounting period adopted by an enterprise.

**Fixed Assets**
- Any tangible ASSET with a life of more than one year used in an entity's operations.
- Anything Financial Intermediaries use for delivery of financial services/products.
- Often called "Property, plant, and equipment" because that’s what fixed assets usually are. Listed after current assets in the assets category on the statement of financial position.

**Fixed costs**
- Costs that do not change as production changes; costs that occur even without any production. Can exist for financial intermediaries as well in terms of assets required for minimum scale of operation. An ERP system equipment is one such example although the actual software could be variable.
- Cost of doing business which does not change with the volume of business. Examples might be rent for business premises, insurance payments, heat and light.

**Fixed Deposit**
- Deposit for a specified period and at specified rate of interest.

**Fixed Interest Rate**
- A rate that does not fluctuate with general market conditions.

**Fixed Rate Loan**
- Loan for a fixed period of time with a fixed interest rate for the life of the loan.

**Fixed-Asset Lending/ Loan**
- Financial Intermediary product in which loans are disbursed expressly for the purpose of purchasing fixed assets.
Flat Rate Method of Interest Calculation
 우리나라

Flexible budget
 우리나라

Folio reference
 우리나라

Forecast
 우리나라

Formalized Line of Credit
 우리나라

Fraud
 우리나라

Fund
 우리나라

Funding Costs
 우리나라

Funds statement
 우리나라

Fungibility
 우리나라

Future Value
 우리나라

Flat Rate Method of Interest Calculation
 우리나라

Flexible budget
 우리나라

Folio reference
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Forecast
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Formalized Line of Credit
 우리나라

Fraud
 우리나라

Fund
 우리나라

Funding Costs
 우리나라

Funds statement
 우리나라

Fungibility
 우리나라

Future Value
 우리나라
General Expense
- Expense incurred in the general operation of a business. Expenses related to (1) running an institution’s office or (2) any other operating activities.

General Ledger
- Collection of all ASSET, LIABILITY, owners EQUITY, GRANTS, REVENUE, and expense accounts. A ledger containing the main financial statement accounts.

Going Concern
- Assumption that a Financial Intermediary can remain in operation long enough for all of its current plans to be carried out.

Going Concern concept
- The concept that assumes that a business entity has a reasonable expectation of continuing operations at a profit for an indefinite period of time.

Goodwill
- Premium paid in the acquisition of an entity over the fair value of its identifiable tangible and intangible ASSETS less LIABILITIES assumed.
- An intangible asset made up of such factors as an excellent reputation, a fine location, a superior set products, or outstanding management skills or mandate for regional planning as in case of NCRPB.

Governance
- Process by which a board of directors, through management, guides an institution in fulfilling its corporate mission and protects its assets.

Grants
- Grants are assistance in cash or kind to an enterprise for past or future compliance with certain conditions of end use.

Grace Period
- Length of time during which repayments of loan principal are excused. Usually occurs at the start of the loan period. Also called as MORATORIUM period.

Gross Block
- The total cost of acquisition/purchase of all the Fixed Assets.

Gross Loan Portfolio
- The outstanding principal balance of all of the Financial Intermediary’s outstanding loans including current, delinquent and restructured loans, but not loans that have been written off. It does not include interest receivable.

Group Lending
- Lending mechanism which allows a group of institutions or banks to lend together to the same borrower.

Guarantee
- To take responsibility for payment of a debt or performance of some obligation if the person primarily liable fails to perform.

Guaranteed Loan
- A pledge to cover the payment of debt or to perform some obligation if the person liable fails to perform. When a third party guarantees a loan, it promises to pay in the event of a default by the borrower. This is similar to State Governments guaranteeing loans taken by their agencies.

Guarantee
- Legal arrangement involving a promise by one person to perform the obligations of a second person to a third person, in the event the second person fails to perform.

Historical Cost
- Original cost of an asset to an entity.

Horizontal Analysis
- The comparison of each item in an Financial Intermediary's financial statements in the current period with the same item from a previous accounting period or periods. The percentage analysis of increases and decreases in corresponding items in comparative financial statements.

Income
- Inflow of REVENUE during a period of time. (See NET INCOME.)

Income Statement
- Summary of the effect of REVENUES and expenses over a period of time. A summary of an institution’s revenue and expenses for a specific period of time, such as a month or a year. Other terms used to describe the income statement are earnings statement, operating statement, statement of operations, and profit and loss statement.
Income and Expenditure Statement
⇒ A financial statement, often prepared by non-profit entities etc., to present their revenues and expenses for an accounting period and to show the excess of revenues over expenses (or vice-versa) for that period. It is similar to profit and loss statement and is also called revenue and expense statement.

Independent Auditors’ Report
⇒ A report accompanying financial statements, in which chartered accountants (CAs) express an opinion as to the fairness of the statements.

Indirect Labor
⇒ The cost of those employees who work in the institution, but not on the product itself.

Inflation
⇒ A period when prices in general are rising and the purchasing power of the currency is declining.

Insolvent
⇒ When an entity's LIABILITIES exceed its ASSETS.

Insurance Company
⇒ A firm licensed to sell insurance to the public.

Intangible Asset
⇒ Asset having no physical existence such as trademarks and patents.
⇒ A long-lived asset that is useful in the operations of an enterprise, is not held for sale, and is without physical qualities-goodwill/reputation/mandate etc.
⇒ Listed in the assets category (sometimes as "Investments and sundry assets") on the statement of financial position.

Interest
⇒ Payment for the use of money borrowed from a lender. The charge for credit; calculated as principal x rate x time. Interest is the amount a borrower pays in addition to the principal of a loan to compensate the lender for the use of the money. A charge for the use of money supplied by a lender.

Interest and Yield Difference
⇒ The term "interest" indicates the percent rate of return which the FI (Financial Intermediary) that issues the fixed deposit agrees to pay you each year on the principal amount of your deposit. This rate normally remains constant during the period of the fixed deposit and is indicated in the fixed deposit offer document itself. Consider a fixed deposit of Rs. 5,000 with a period of two years and an interest rate of 10 percent payable annually. The Financial Intermediary issuing this fixed deposit will pay you Rs. 500 (i.e. Rs. 5000 X 10 /100) as interest each year for two years. What, then, is “Yield”? Yield is simply the percent return that you get on an investment. In the example above, you receive Rs. 500 per year on the amount of Rs. 5,000 you invested in the fixed deposit. To calculate the yield, divide Rs. 500 by Rs. 5,000 and multiply the result by 100. Here, the yield too works out to 10 percent. Does this mean that there is no difference between yield and interest? No, there is a difference between the two only if the frequency of interest payment is different. It is here that the concept of Yield to Maturity (YTM) comes into play. YTM indicates the percent return that you can earn by holding on to your fixed deposit till the date of its maturity i.e. without withdrawing it prematurely. YTM is particularly useful when you want to make a comparison of the returns on different investment options in order to be able to decide which investment to choose. Calculation of YTM is done on the assumption that the interest amount received on the fixed deposit is reinvested at the same interest rate. This is called compounding.

Interest rate
⇒ Interest rate is the expression of interest as a percentage of the principal. Cost of using money, expressed as a rate per period of time, usually one year.

Interim Financial Statements
⇒ Financial Statements that report the operations of an entity for less than one year – say half yearly.

Interim Financing
⇒ Short-term loan to provide temporary financing until more permanent financing is available.

Intermediary
⇒ An independent third party that may act as a mediator during negotiations.

Internal Audit
⇒ AUDIT performed within an entity by its staff rather than an independent certified public accountant to test whether systems are working as originally envisaged.
**Internal Control**

- Process designed to provide reasonable assurance regarding achievement of various management objectives such as the reliability of financial reports. The procedures used within a Financial Intermediary to protect its assets.

**Internal transactions**

- Transactions, such as adjustments, that occur within an Financial Intermediary and do not affect parties outside the company. Surplus resources used to acquire financial or other assets, not in the main business of entity, to generate other income.

**Inter Unit Transactions**

- Transactions between one or more accounting units within the same organisation

**Invoice**

- A business document that contains the names and addresses of the buyer and the seller, the date and terms of the sale, a description of the goods, the price of the goods, and the mode of transportation used to ship the goods. The seller calls the invoice a sales invoice; the buyer calls it a purchase invoice. The bill provided by the seller (referred to as a sales invoice) to a purchaser (referred to as a purchase invoice) for items purchased.
Journal
- Any book containing original entries of daily financial transactions.
- A form in which transactions are recorded in chronological order (by order of date).

Journalizing
- The process of recording transactions in a journal.

Joint Venture
- Joint Venture is a contractual arrangement whereby two or more parties undertake an economic activity to share expertise in a single defined project, which is subject to joint control.

Lease
- A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period. A lease is classified as a finance lease if it transfers substantially the entire risks and rewards incident to ownership. All other leases are classified as operating leases. In a lease, asset ownership remains with lessor.

Lease Payment
- The consideration paid by the lessee to the lessor in exchange for the use of the leased equipment/property. Payments are usually made at fixed intervals.

Ledger
- Any book of accounts containing the summaries of debit and credit entries.
- A collective grouping of accounts. The group of accounts used by an enterprise.

Lending Policy
- A course of action (with specific directions) adopted by a financial institution to define principal advances/loans made to projects /clients

Lessee
- Person or entity that has the right to use property under the terms of a LEASE.

Lessor
- Owner of property, the temporary use of which is transferred to another (LESSEE) under the terms of a LEASE.

Letter of Credit
- Conditional bank commitment issued on behalf of a client (project) to pay a third party in accordance with certain terms and conditions.
- A letter of credit is a guarantee of payment by a bank (issuing institution) to a third party for a specific amount of money, if certain conditions are met.

Letter of Intent
- A document signifying genuine interest in reaching a final agreement, conditional upon the results of more detailed due diligence and negotiations.

Leverage
- Raising debt to secure funds for an organization. Often refers to financial participation by other private, public or individual sources of funds
- The use of borrowed funds to earn a greater return than the cost of the borrowed funds.
- A company's use of debt, instead of its equity, to support its assets and grow.

Liabilities
- Debts owed by the Financial Intermediary. A company's or institution's debts to a lender, a supplier of goods and services, and others. Listed as a category on the statement of financial position. DEBTS or obligations owed by one entity (DEBTOR) to another entity (CREDITOR) payable in money, goods, or services. A debt of an enterprise/institution.

Liabilities, Total Liabilities
- Total value of financial claims on a firm's assets. Equals total assets minus net worth.

Lien
- The right of a party to a contract to take possession of an asset unless payment under the contract is received in full. A lien must be registered under the respective laws in order to be valid and enforceable.

Limited Liability
- Limitation of shareholders' losses to the amount invested. Means that shareholders of a corporation are not personally liable for the debts of the institution.

Line of Credit
- Agreement that a client (project) may borrow at any time up to an established limit. An agreement negotiated between a borrower and
Liquid Asset

An asset that can be quickly converted into cash. Examples include cash and marketable securities. Cash equivalents, and marketable SECURITIES.

Liquidity

Refers to how quickly an asset can be turned into cash, used up, or expire; used in reference to assets, which are listed on the balance sheet in the order of their liquidity. The degree to which an asset can be cheaply and quickly turned into money

Loan Agreement

A written contract between a lender and a borrower that sets out the rights and obligations of each party regarding a specified loan. For example, between NCRPB and its project agencies (borrowers).

Loan Capital

Borrowed funds having a fixed interest rate.

Loan Guarantee

See Collateral.

Loan Loss Provision

A loan loss provision is the amount shown on the Income and Expenses Statement.

Loan Loss Provision Expense

A non-cash expense that is used to create or increase the Loan Loss Reserve on the balance sheet. The expense is calculated as a percentage of the value of the Gross Loan Portfolio that is at risk of default.

Loan Loss Rate

Total write-offs divided by active outstanding portfolio. The loan loss rate is an indicator to measure un-recovered loans.

Loan Loss Reserve

A loan loss reserve is an accounting entry that represents the amount of outstanding principal that is not expected to be recovered by a financial intermediary/organisation. It is recorded as a negative asset on the Balance Sheet as a reduction of the outstanding portfolio or as a liability.

See Collateral.

Loan Loss Reserve Ratio (Percentage)

Loan Loss Reserve/ Gross Loan Portfolio

Loan Products

Types of loans with particular sets of terms and conditions, and often for a particular use.

Loans that are <30 days past due

Loans with payments overdue for less than 30 days (from the scheduled repayment date). Always, the earliest unpaid installment (that is still overdue) is used for calculating the overdue age of the loan

Loans that are Above 365 days past due

Loans with payments overdue for over 365 days (from the scheduled repayment date)

Loans that are Between 181-365 days past due

Loans with payments overdue for between 181 – 365 days (from the scheduled repayment date)

Loans that are Between 31-60 days past due

Loans with payments overdue for between 30 – 60 days (from the scheduled repayment date)

Loans that are Between 61-90 days past due

Loans with payments overdue for between 61 – 90 days (from the scheduled repayment date)

Loans that are Between 91-180 days past due

Loans with payments overdue for between 91 – 180 days (from the scheduled repayment date)

Longer-Term Fixed Assets

Assets having a useful life greater than one year but the duration of the 'long term' will vary with the context in which the term is applied.
Long-Term Debt

- DEBT with a maturity of more than one year from the current date.

Long-term investment

- An investment that is not intended to be a ready source of cash in the normal operations of a business and that is listed in the “investments” section of the balance sheet. Investments that management intends to hold for more than one year.

Long-term liabilities

- Liabilities which do not mature within one year or those where the principal amount is likely to be outstanding beyond one year.
- ADB loan to be re-paid in 5 years

Loss

- Excess of EXPENDITURE over INCOME (for a period or activity)
**Management**
- Management refers to the individuals in an entity that have the authority and the responsibility to manage the entity. The positions of these individuals, and their titles, vary from one entity to another. Thus, when the context requires it, the term includes the board of directors or committees of the board, who are designated to oversee certain matters (e.g., audit committee) and senior operating staff.

**Management Accounting**
- Reporting designed to assist management in decision-making, planning, and control. Also known as Managerial Accounting.

**Margin**
- Excess of price over the unit cost – INTEREST MARGIN in case of financial intermediary.

**Market Rate**
- The rate of interest a company must pay to borrow funds currently from the market.

**Matching**
- The principle of accounting that all revenues should be matched with the expenses incurred in earning those revenues during a period of time.

**Matching Principle**
- A fundamental concept of basic accounting. In any one given accounting period, the revenue reported must be matched with the expenses it took to generate that revenue in the same time period, (or over the periods in which the benefits from that expenditure are expected to be received).
- A simple example is depreciation expense. If you buy a car that will last for many years, you don't write off the cost of that car all at once. Instead, you take depreciation deductions over the car's estimated useful life. Thus, you've "matched" the expense, or cost, of the building with the benefits it produces, over the course of the years it will be in service.
- Requires that revenue earned during an accounting period be offset by the expenses that were necessary to produce that revenue, so that the accurate net income or net loss for the period can be reported. Matching principle is very critical for fair and transparent statements.

**Maturity date**
- The date on which the principal (amount) must be repaid. Date on which a debt is due for payment.

**Maturity value**
- The principal plus the interest on an instrument like Fixed Deposit; the amount that must be paid to the payee on the maturity date of the instrument. The amount due at the maturity or due date of an FD/RD and similar instrument.

**Money Market**
- Financial market in which funds are borrowed or lent for short periods. (The money market is distinguished from the capital market, which is the market for long term funds.)

**Mortgage**
- Debt instrument by which the borrower (mortgagor) gives the lender (mortgagee) a lien on property as security for the repayment of a loan.

**Municipal fund**
- The municipal or general fund is the general operating fund of an ULB (Urban Local Body). It is used to account for all financial resources except those related to any special or trust funds.

**Narration**
- A brief description written below an Accounting Entry. It is normally written in brackets and starts with the word “Being”. It explains as to why the entry has been recorded and other related aspects of the entry.

**Net Assets**
- The excess of the book value of the assets of an accounting unit over its liabilities to outsiders.

**Net Block**
- Gross Block less Accumulated Depreciation of all the Fixed Assets of the institution.

**Net Earnings**
- A Financial Intermediary's total revenue less total expenses, showing what an Financial Intermediary earned (or if lost, called net loss) for a set period, usually one year. Listed often literally as the "bottom line" on the statement of earnings. Also called net income and net profit.

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Good Practices MIS Technical Note For ERP System Developers
TN #5: Glossary of Financial Terms for ERP System, (M – O) for Financial Intermediation at NCRPB

Net Financial Revenue Ratio (Percentage)

Net Income

Net Income (After Taxes)

Net Income (Before Taxes)

Net Income Before Donations and Taxes

Net Loan Portfolio

Net loss

Net Non-operating Income

Net Operating Income

Net profit

Net Realizable Value

Net Working Capital

Net Worth

Nominal Interest Rate

Non Current Assets

Non-Bank Financial Institution

Non-operating Expense
Number of Personnel
- The number of individuals who are actively employed by the Financial Intermediary. This includes contract employees or advisors who dedicate the majority of their time to the Financial Intermediary, even if they are not on the Financial Intermediary’s roster of employees.

Operating Expense (Total)
- The total of all expenses related to operations, such as all personnel salaries and benefits expenses, rent and utilities, transportation, office supplies, depreciation and Other Administrative Expense.

Operating Expense / Loan Portfolio (Percentage)
- Operating Expense / Period Average Gross Loan Portfolio - also called as operating cost of ratio.
- Expenses incurred in the normal operation of the – financial intermediary. Costs related to a Financial Intermediary’s operations. of earnings.

Operating Lease
- One where the risks and benefits, as well as ownership, stays with the lessor.

Operating Line of Credit
- A Financial Intermediary’s commitment to make loans to a particular borrower (project) up to a specified maximum for a specified period, usually one year.

Operating Loan
- A loan advanced under an operating line of credit.

Operating Revenue (Total)
- Includes all Financial Revenue and Other Operating Revenue.

Operational Self-Sufficiency (OSS):
- A measure of financial efficiency equal to total operating revenues divided by total operating expenses. Loan loss provisions and financial expenses. If the resulting figure is greater than 100, the organization is considered to be operationally self-sufficient.
- Operating Revenue/ (Financial Expenses + Loan Loss Provision Expense + Operating Expenses)

Opportunity Cost
- The potential benefit that is foregone from not following the best (financially optimal) alternative course of action.

Opportunity Costs
- In the context of a financial intermediary, opportunity costs include the time or anything “forgone” a borrower spends on applying and filling out the paperwork for a loan.

Outstanding Portfolio
- Outstanding Portfolio is the sum of the principal outstanding of all loans in a portfolio. It is also called as Total Outstanding Portfolio (TOP). It is the largest income-generating asset for any institution involved in financial intermediation as it is the asset on which income (interest) is earned.

Overdraft
- The amount by which a check or other payments exceeds the funds on deposits.

Overdue
- Overdue is the same as arrears or past due. When the installment amount of a loan, which is due on a specific date, is not paid on that date, the amount due but not paid becomes the overdue. Overdue becomes the principal criteria for identifying a risky loan – a loan is risky if it has overdues. This concept of “riskiness” is used for calculating measures of delinquency like portfolio at risk (PAR) and it has become part of the best practices norms in financial intermediation.
**PAR Limitations**

- **Disbursement of loans** (increases outstanding portfolio but will not have an impact on the unpaid principal balance of past due loans, especially, if the repayment schedule has not begun)
- **Rescheduling of past due loans** (reduces the unpaid principal balance of past due loans by making them current; there is no impact on outstanding portfolio)
- **Re-financing of past due loans** (reduces the unpaid principal balance of past due loans by making them current and also increases the outstanding portfolio) and
- **Loan write-offs** (reduces the unpaid principal balance of past due loans and also reduces the outstanding portfolio)

- When the outstanding portfolio increases, then the ratio appears lower and so does the risk. Likewise, when the unpaid principal balance of past due loans decreases, the ratio becomes smaller and the risk appears less. **But actually, the risk is still high.**

**Performance Standards**

- **Normative levels set for specific performance measurements, like portfolio quality or leverage. In the field of financial intermediation, there are several entities and projects attempting to set universal performance standards for Financial Intermediaries including central banks, Govts etc.**

**Period Average Assets**

- **(Beginning period Total Assets + period end Total Assets)/ 2**

**Period Average Equity**

- **(Beginning period Total Equity + period end Total Equity)/ 2**

**Period Average Gross Loan Portfolio**

- **(Beginning period Gross Loan Portfolio + period end Gross Loan Portfolio)/ 2**

**Period Average Personnel**

- **(Beginning period Personnel + period end Personnel)/ 2**

**Period End**

- The last day of any Accounting Period, e.g., quarter, half-year, year-end.

**Permanent Capital**

- Financing needed for the normal operation of an enterprise, that is long term capital and working capital.

**Personal Assets**

- Assets, the title of which are held personally rather than in the name of some other legal entity.

**Personal Guarantee**

- A legal document whereby an individual takes responsibility for payment of debt or performance of some obligation if the person/institution primarily liable fails to perform.

**Petty cash fund**

- A small amount of cash kept in the office for making small payments for items such as postage and office supplies. A special cash fund used to pay relatively small amounts.

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**Petty cash payments record**

- An auxiliary record, one that is used to record payments from the petty cash fund. At the end of the month, the record is summarized and used as a basis for a journal entry.

**Petty cash voucher**

- A voucher used when payment is made from the petty cash fund. It shows the amount of the payment, the purpose, and the account to be debited.

**Petty cashier**

- The person designated to disburse money from the petty cash fund.

**Pledged Asset**

- ASSET placed in a TRUST/pledged to a lender and used as COLLATERAL for a DEBT.

**Portfolio at risk (PAR)**

- Unpaid Principal Balance of Loans with Payments Past Due divided by Total Outstanding Portfolio (TOP).

**Portfolio at Risk > 30 days**

- The value of all loans outstanding that have one or more installments of principal past due for more than 30 days. This includes the entire unpaid principal balance, including both the past due and future installments, but not accrued interest. It does not include loans that have been restructured or rescheduled.

**Portfolio in Arrears (PIA)**

- Amount Past Due (or in Arrears or Overdue) by Total Outstanding Portfolio (TOP).

**Portfolio Past Due/Delinquent Portfolio**

- Total amount of loan payments that are due but have not yet been paid divided by active portfolio of delinquent loans.

**Posting**

- The process of transferring amounts from the journal to the ledger. The process of transferring debits and credits from a journal to the accounts.

**Posting errors**

- Errors that result from incorrect transfers from the journal to an account or from the ledger to the trial balance.

**Prepaid Expense**

- Cost incurred to acquire economically useful goods or services that are expected to be consumed in the revenue-earning process within the operating cycle.
- A purchased commodity or service that has not been consumed at the end of an accounting period.
- Another name for deferred expenses, usually applying to advance expense payments that cover a year or less.

**Prime Lending Rate**

- The interest rate that is charged by the banks to their most credit worthy customers, often set as per the Central Bank norms.

**Principal**

- In commercial law, the principal is the amount that is received, in the case of a loan, or the amount from which flows the interest. The amount of money borrowed or the amount of credit extended. Also called the face value. The obligation due under a debt instrument exclusive of interest.

**Principal Amount**

- Generally, refers to the face value of a debt.

**Principal Outstanding**

- Principal outstanding of a loan (on a given date) is the total unpaid principal balance for that loan on that date. It equals the loan disbursed minus cumulative repayments.

**Principle of Materiality**

- States that proper accounting procedures have to be strictly followed only for events and transactions that would have an effect on an enterprise’s financial statements.

**Prior Period Adjustment**

- Correction of a material error related to a prior period or periods, excluded from the determination of net income.

**Profit Center**

- Any segment of an enterprise that incurs expenses while producing revenue.

**Profitability**

- The ability of a Financial Intermediary to earn a reasonable return on the owners’ investments.
- The ability of a Financial Intermediary to earn income.
Projection

Prospective FINANCIAL STATEMENTS that include one or more hypothetical assumptions and scenarios pertaining to the future.

Promissory Note

Written promise committing the maker to pay a specified sum of money either on demand or on some future date, with or without interest.

Provision for Expense

An amount retained by way of providing for depreciation or diminution in value of assets or retained by way of providing for any known liability the amount of which cannot be determined with substantial accuracy.

Provision for Unrealised Revenue

A provision made for revenue considered doubtful of recovery.

Published Financials

Financial statements and financial information made public.

Quick Assets

Current assets that can be converted to cash right away, such as receivables and marketable securities. The sum of cash, receivables, and marketable securities.

Quick Ratio

The simple ratio of a Financial Intermediary's liquid assets to current liabilities. Such assets include cash, marketable securities, and accounts receivable.

Rate of Return

Return on invested capital (calculated as a percentage). Often an investor has, as one of their investment criteria, a minimum acceptable rate of return on an acquisition.

Ratio

A fractional relationship of one number to another. A measure of the relative size of two numbers. Usually, financial ratios are expressed as a times multiple (x) or a percentage (%). Ratios provide a quick way to compare a Financial Intermediary to its performance over time, to other Financial Intermediation, and to the industry average.

Ratio Analysis

Comparison of actual or projected data for a particular Financial Intermediary to similar data for another Financial Intermediary or industry in order to analyse trends or relationships.

Real interest rates

Real interest rates are rates that have been adjusted to compensate for the effects of inflation. That is the nominal or effective rate minus inflation. A negative real rate implies the interest charged falls below the inflation rate. A positive rate means that the rate of interest is set above the inflation rate.

Realization principle

The principle that states that revenue should be recorded when it is earned, even though cash may not be collected until later.

Receipt

A written acknowledgement of something acquired; hence, an accounting document recording the physical receipt of cash/cheques.

Receipts and Payments Statement

A financial statement prepared for an accounting period to depict the changes in the financial position and to present the cash received in and paid out in whatever form (cash, cheques, etc.) under certain headings. All non-cash related transactions are ignored while preparing this Statement.

Receivables

Accounts receivable; an amount that is owed to the enterprise, usually by one of its clients as a result of the extension of credit/loan. Amounts of money due from clients or other DEBTORS.

Reconciliation

Comparison of two numbers to demonstrate the basis for the difference between them, if any.

Recourse

In the event a person defaults on a loan, recourse is the right of an FI (Financial Intermediary) to receive payment. Recourse could give the lender the ability to take possession of the borrowers assets.
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Refinancing Agreement</strong></td>
<td>Arrangement to provide funding to replace existing financing, the most common being a refinance of a loan.</td>
</tr>
<tr>
<td><strong>Regulation and Supervision</strong></td>
<td>The creation and enforcement of a set of rules and standards for financial institutions, including Financial Intermediaries. These rules are usually set by the central bank.</td>
</tr>
<tr>
<td><strong>Reinsurance</strong></td>
<td>Process by which an insurance company obtains insurance on its insurance claims with other insurers in order to spread the risk.</td>
</tr>
<tr>
<td><strong>Remit</strong></td>
<td>Pay for purchase goods or services by cash, cheque, or electronic payment.</td>
</tr>
<tr>
<td><strong>Remittance</strong></td>
<td>A payment in cash, check or electronic transfer.</td>
</tr>
<tr>
<td><strong>Repayment Terms</strong></td>
<td>The length of time given to a borrower by a lender to repay a debt and the frequency of principal payments, which the borrower has to meet.</td>
</tr>
<tr>
<td><strong>Report of independent accountants</strong></td>
<td>A summary of the findings of a firm of independent certified auditors who audit or examine, an enterprise’s financial statements. This report is included in the enterprise annual report. Also called auditors’ report and auditors’ opinion.</td>
</tr>
<tr>
<td><strong>Reserve</strong></td>
<td>ACCOUNT used to earmark a portion of fund balance to indicate that it is not available for expenditure</td>
</tr>
<tr>
<td><strong>Restructuring</strong></td>
<td>Reorganization of capital within an entity. Restructuring may occur in the form of changing the components of CAPITAL, renegotiating the terms of DEBT (Loan) agreements, etc.</td>
</tr>
<tr>
<td><strong>Retained Earnings</strong></td>
<td>Net profits kept to accumulate after dividends are paid.</td>
</tr>
<tr>
<td><strong>Return on Equity (Percentage)</strong></td>
<td>(Net Operating Income + Taxes)/ Period Average Equity</td>
</tr>
<tr>
<td><strong>Revenue</strong></td>
<td>Income earned from carrying out the activities of financial intermediation. The amount charged to clients for services rendered – interest on loans provided etc.</td>
</tr>
<tr>
<td><strong>Reversing Entry</strong></td>
<td>An entry made at the start of a new accounting period to reverse an adjusting entry made at the end of the previous period. A reversing entry is the exact opposite of the adjusting entry. An entry that reverses a specific adjusting entry to facilitate the recording of routine transactions in the subsequent period.</td>
</tr>
<tr>
<td><strong>Revolving Credit</strong></td>
<td>Line of Credit against which funds may be borrowed at any time. Commitment Fees need to be paid to the lender for keeping resources available for use by borrower at any time.</td>
</tr>
<tr>
<td><strong>Risk</strong></td>
<td>A state in which the number of possible future events exceeds the number of events that will actually occur, and some measure of probability can be attached to them.</td>
</tr>
<tr>
<td><strong>Risk of Collection</strong></td>
<td>Chance that a borrower will not repay an obligation as promised.</td>
</tr>
</tbody>
</table>
Salaried Employees
☞ Individuals who work for a fixed amount for a definite period of time, such as a week, a month, or a year. Designated as such.

Salary
☞ A fixed amount paid to employees for a certain period of time, such as a week or a month.

Salvage Value
☞ Selling price assigned to retired FIXED ASSETS or merchandise unsaleable through usual channels. The amount that an asset is expected to be worth at the end of its productive life. Also called scrap value, trade-in value, and residual value.
☞ The value of a capital asset at end of a specified period. It is the current market price of an asset being considered for replacement in capital budgeting.

Schedule of accounts payable
☞ A listing of the balances in the accounts payable ledger.

Schedule of accounts receivable
☞ A listing of the balances in the accounts receivable ledger.

Securitization
☞ The process of pooling a group of assets, such as loans or mortgages, and selling securities backed by these assets. Securitization is one way in which the financial intermediary can access capital markets, improve liquidity and lend more money, all the while managing risk.

Security
☞ Collateral offered by a borrower to a lender to secure a loan.

Security Value
☞ The monetary value placed on security by a lender in determining the extent to which it can make loans against such security.

Seed Financing/Capital
☞ Generally, refers to the first contribution of capital toward the financing requirements of a start-up operation or equivalent

Self-sufficiency:
☞ Self-sufficiency occurs when a financial intermediary programme can cover all of its operating expenses (including loan losses and the cost of capital) entirely with internally generated sources of income.

Shareholder
☞ Owner of one or more shares of stock in a corporation.

Shareholder's Equity
☞ Represents the total assets of a corporation less liabilities.

Short-Term
☞ Current; ordinarily due within one year.

Short Term Investments
☞ Those investments which are readily realisable, and are intended to be held for not more than twelve months from the date of investment.

Sinking Fund
☞ A fund created for the repayment of a liability or for the replacement of an asset.

Solvency
☞ The ability of a Financial Intermediary to pay its debts as they come due.

Special Fund
☞ An amount set aside for a specific purpose represented by specifically earmarked assets.

Spread
☞ Difference between two prices, usually a buying and selling price. This happens with interest in the case of a financial intermediary – where there is a difference between cost of funds and cost of lending.

Statement of Cash Flows
☞ A statement of cash flows is one of the basic financial statements that is required as part of a complete set of financial statements prepared in conformity with generally accepted accounting principles. It categorizes net cash provided or used during a period as operating, investing and financing activities, and reconciles beginning and ending cash and cash equivalents.
☞ A financial statement that provides information about the cash flows from operating activities, investing activities, and financing activities.

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during an accounting period and the net increase or decrease in cash that occurred.

- A financial statement that reports the flow of cash in and out of a Financial Intermediary for a set period, usually one year. It reports the operating activities, investing activities and financing activities of the company.

**Statement of Changes in Financial Position**
- A basic financial statement devoted exclusively to reporting changes in financial position for a specified period of time.

**Statement of Earnings**
- A financial statement that reports the results of an enterprise’s business operations (revenue and expenses) for a set period, usually one year. Also called an earnings report, income statement, statement of operations, and statement of profit and loss.

**Statement of Financial Condition**
- Basic FINANCIAL STATEMENT, usually accompanied by appropriate DISCLOSURES that describe the basis of ACCOUNTING used in its preparation and presentation as of a specified date, the entity's ASSETS, LIABILITIES and the EQUITY of its owners. Also known as BALANCE SHEET.

**Statement of operations**
- A financial statement that reports the results of an institution’s operations (revenue and expenses) for a set period, usually one year. Also called an earnings report, income statement, statement of earnings, and statement of profit and loss.

**Straight-Line Depreciation**
- ACCOUNTING method that reflects an equal amount of wear and tear during each period of an ASSET'S useful life. For instance, the annual STRAIGHT-LINE DEPRECIATION of a Currency (Rupees,) 2,500 asset expected to last five years is Currency (Rupees,) 500. (See ACCELERATED DEPRECIATION.)
- A method of depreciation that provides for equal periodic charges to expense over the estimated life of an asset.

**Sub-Account**
- One or more accounts that make up the Control Account. These sub-accounts are related to the control account and provide more detail of the Control Account. The total of the related sub-accounts will equal the related Control Account.

**Subsidiary Ledgers**
- Ledgers that contain only one type of account; Accounts payable ledger.

**Subsidized Rates of Interest**
- Loan interest rates that are kept artificially low (below market rates) by the lending institution; often subsidized by donations/grants.

**Surplus**
- The excess of income over expenditure for an Accounting Period under consideration.

**Sustainability**
- An organization’s ability to cover costs. There are varying degrees of sustainability, ranging from not sustainable to financially sustainable (see Financial Self-Sufficiency and Operational Self-Sufficiency).
- Sustainability is the ability of a financial intermediary to maintain its operations and continue to provide service to its clients. A financial intermediary is sustainable when internally generated revenues are sufficient to cover all expenses over the long term.

**Tangible**
- All physical assets used by a business are tangible (capable of being touched).

**Tangible Asset**
- ASSETS having a physical existence, such as cash, land, buildings, machinery, or claims on property, investments or goods in process. (See INTANGIBLE ASSETS.)

**Taxes**
- Includes all taxes paid on net income or other measure of profits as defined by tax authorities.

**Term**
- Refers to the maturity or length of time until final repayment on a loan, etc. This is usually the duration of a loan. Loan for a specified time period.

**Term Loan**
- A secured loan made to institutions for a specific period (normally three to ten years or more). It is repaid with interest, usually with periodical payments.
Time

- The number of years, months, or days for which interest is charged. Also called the term.

Total Assets

- Includes all asset accounts net of all contra asset accounts, such as the loan loss reserve and accumulated depreciation.

Total Equity

- Total assets less total liabilities. It is also the sum of all of the equity accounts net of any equity distributions such as dividends, stock repurchases, or other cash payments made to shareholders.

Total Liabilities

- All the liability accounts representing everything that the Financial Intermediary owes to others, including all borrowings, accounts payable, other liability accounts, deposits etc.

Total Liabilities and Equity

- The sum of Total Liabilities and Total Equity

Transaction

- Any activity that changes the value of an institution’s assets, liabilities, or owner's equity.

Transformation

- In a financial intermediary, transformation refers to the process by which a non-profit organization becomes a regulated financial institution.

Trend

- A pattern in a Financial Intermediary’s performance over time.

Trial Balance

- A listing of all ledger accounts with their balances to test the equality of debits and credits; it is usually prepared at the end of each month. A summary listing of the balances and the titles of the accounts.

Unaudited Financial Statements

- FINANCIAL STATEMENTS which have not undergone a detailed AUDIT examination by an independent CHARTERED ACCOUNTANT (CA).

Uncollectible account

- Another name for bad debt.

Unearned Income

- Payments received for services which have not yet been performed.

Unearned revenue

- Another name for deferred revenue, usually applying to amounts received a year or less in advance. Revenue received in advance of its being earned.

Unencumbered

- Property free and clear of all liens (creditors’ secured claims).

Useful Life

- The period over which a depreciable asset is expected to be used by the enterprise.
Valuation

- The act or process of determining the value or price of something. (see fair market value)

Vertical analysis

- The expression of each item in a Financial Intermediary’s financial statement as a percent of a base figure, in order to see the relative importance of each item. For the balance sheet, the base is total assets; for the income statement, the base is total revenue. The percentage analysis of component parts in relation to the total of the parts in a single financial statement.

Voucher

- A method of accounting for cash payments in which all payments are authorized in advance and kept track of internally.
- A document which serves as an authorization for any financial transaction and forms the basis for recording the accounting entry for the transaction in the books of original entry, e.g., Cash Receipt Voucher, Bank Receipt Voucher, Journal Voucher, Payment Voucher, etc.

Voucher register

- The journal in which all vouchers are recorded.

Voucher

- A document that serves as evidence of authority to pay cash.

Wage

- A fixed hourly rate paid to an employee.

Weighted Average Cost of Capital (WACC)

- A weighted average of the component costs of debt, preferred shares, and common equity. Also called the composite cost of capital. This is in regular parlance. In case of a financial intermediary, it has been used to compute the weighted average cost of borrowing (Supply side).

Working Capital

- Technically, means current assets and current liabilities. The term is commonly used a synonymous with net working capital. The term often also is used to refer to all short-term funding needs for operations (excluding debt service and fixed assets). An institutions investment in current assets that are used to maintain normal business operations. Net working capital, which is the excess of current assets over current liabilities, is also interchangeable with working capital. Both reflect the resources in circulation to meet operating needs and obligations as they come due.
- Excess of CURRENT ASSETS over CURRENT LIABILITIES.
- The excess of a firm’s current assets over its current liabilities. A strong working capital means that the firm is likely to be able to carry on its current operations.

Working Capital Cash

- The cash component of working capital.

Write off

- When an investment, such as a loan, becomes seriously delinquent or in default and is determined to be uncollectible, the lender may choose to charge the outstanding investment amount as an expense or a loss.
- Charging an asset amount to expense or loss. A financial intermediary writes off loans, not expecting to collect them, while continuing to attempt collection. Loan losses or write-offs occur only as an accounting entry. They do not mean that loan recovery should not be pursued. In fact, it should be identified. They decrease the reserve and the outstanding portfolio. Loans are written off when the economic cost of recovery exceeds the amount to be recovered.

Write Off Ratio (Percentage)

- Write Offs for the 12-month period/Period Average Gross Loan Portfolio

Write Offs for the 12-month period

- Total amount of loans written off during the period. A write-off is an accounting procedure that removes the outstanding balance of the loan from the Gross Loan Portfolio and from the Loan Loss Reserve when these loans are recognized as uncollectible. When a write off happens, the net outstanding portfolio remains the same.

Written Down Value (WDV)

- In respect of a fixed asset means its cost of acquisition or substituted value less accumulated depreciation.

Written Down Value (WDV) Method

- A method under which the periodic charge for depreciation of an asset is computed by applying a fixed percentage to its historical cost or substituted amount less accumulated depreciation (net book value). This is also referred to as “Diminishing Balance Method”.

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Maintenance of Books of Accounts: Accounting is a basic management tool which, if used properly, will enable stakeholders to determine the correct financial status of the organization. Further, it points out weaknesses and indicates areas of improvement.

At NCRPB, books of account are being and need to be maintained on a daily basis, with the financial records. The Books of accounts are (and to be) maintained in a double entry system. This means that every entry will be corrected once as a debit and correspondingly as a credit. The debit and credit of each transaction completes the principles of double entry.

ERP system developers may use the following as guidelines for the accounting module in the ERP system.

What Is Debit Credit?: The three basic rules for recording transactions under the double entry system are as below:

- Personal account: Debit the receiver credit the giver
- Real account: Debit what comes in and credit what goes out
- Nominal account: Debit all expenses (and losses) and credit all incomes (and gains)

Examples of personal account, real account and nominal account are given below:

<table>
<thead>
<tr>
<th>Personal Account</th>
<th>Real Account</th>
<th>Nominal Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>Rent</td>
<td></td>
</tr>
<tr>
<td>Bank</td>
<td>Salary</td>
<td></td>
</tr>
<tr>
<td>Suppliers</td>
<td>Interest</td>
<td></td>
</tr>
<tr>
<td>Interest accrued</td>
<td>Machinery</td>
<td>Donations received</td>
</tr>
<tr>
<td>Interest prepaid</td>
<td>Building</td>
<td>Discount allowed</td>
</tr>
<tr>
<td>Interest outstanding</td>
<td>Goods purchased</td>
<td>Postage &amp; Telegram</td>
</tr>
<tr>
<td>Salary outstanding</td>
<td>Traveling expenses</td>
<td></td>
</tr>
<tr>
<td>Rent outstanding</td>
<td>Commission</td>
<td></td>
</tr>
<tr>
<td>Interest received in advance</td>
<td>Goods sold</td>
<td></td>
</tr>
</tbody>
</table>

A debit shows that: (a) Money is due to the organization; (b) The organization owns some property (cash, fixed assets, investments, stock, etc.); (c) The organization has lost money or incurred expenditure.

A credit shows that: (a) Money is due by the organization; (b) The organization has given up a certain amount of property (sale of assets, stock, etc.); (c) The organization has earned an Income or made some gains.

Box 1: Simple Rules to Follow for Accounting Transactions

1. Debit the receiver, credit the giver
2. Debit what comes in, credit what goes out
3. Debit all losses and expenses, credit all incomes and gains
   - Asset Increases – Dr
   - Asset Decreases – Cr
   - Liability Increases – Cr
   - Liability Decreases – Dr
   - Equity Increases – Cr
   - Equity Decreases – Dr
   - Expenses - Dr
   - Expenses Increases – Dr
   - Expenses Decreases – Cr
   - Revenues (Income) - Cr
   - Revenue (Income) Increases – Cr
   - Revenue (Income) Decreases – Dr

The basic rules of accounting flow from the accounting equation:

Assets = Own Funds + Liabilities

An increase in the asset, e.g., Vehicle can be brought about by: (a) Decrease in another asset, e.g., Bank Account, or; (b) Increase in liability, e.g., Loans or Payables.

An decrease in the asset, e.g., Cash may result in: (a) Increase in another asset, e.g., Medical Equipment; (b) Decrease in liability, e.g., Payment of Loans or payment of suppliers outstanding; and (c) Decrease in own funds through expenditure.

Following is the representative sample of transactions, from NCRPB, explaining the above rules and accounting entry. Some examples are given below for system developers.
### Table 2: Some Examples for System Developers

<table>
<thead>
<tr>
<th>S No</th>
<th>Transaction Description</th>
<th>Account Affected</th>
<th>Type</th>
<th>Debit/Credit</th>
<th>Account Affected</th>
<th>Type</th>
<th>Debit/Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Processing Fees from Project (Actually Received) or Agency</td>
<td>Asset, Cash</td>
<td>Inc</td>
<td>Dr</td>
<td>Income, Operational Income, Processing Fees</td>
<td>Inc</td>
<td>Cr</td>
</tr>
<tr>
<td>2</td>
<td>Processing Fees from Project (Accrued)</td>
<td>Asset, Accounts Receivable, Fees accrued</td>
<td>Inc</td>
<td>Dr</td>
<td>Income, Operational Income, Processing Fees</td>
<td>Inc</td>
<td>Cr</td>
</tr>
<tr>
<td>3</td>
<td>Accrued Processing Fees from Project (actually Received)</td>
<td>Asset, Accounts Receivable, Fees accrued</td>
<td>Dec</td>
<td>Cr</td>
<td>Asset, Cash</td>
<td>Inc</td>
<td>Dr</td>
</tr>
<tr>
<td>4</td>
<td>Loan Disbursement to clients</td>
<td>Asset, Cash</td>
<td>Dec</td>
<td>Cr</td>
<td>Asset, Loans Outstanding, Specific Project Loan Outstanding A/C</td>
<td>Inc</td>
<td>Dr</td>
</tr>
<tr>
<td>5</td>
<td>Loan Repayment by clients</td>
<td>Asset, Cash</td>
<td>Inc</td>
<td>Dr</td>
<td>Asset, Loans Outstanding, Specific Project Loan Outstanding A/C</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>6</td>
<td>Loan Prepayment by clients</td>
<td>Asset, Cash</td>
<td>Inc</td>
<td>Dr</td>
<td>Asset, Loans Outstanding, Specific Project Loan Outstanding A/C</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>7</td>
<td>Loan Prepayment by clients</td>
<td>Asset, Cash</td>
<td>Inc</td>
<td>Dr</td>
<td>Liabilities Prepaid Loans Specific Loan A/C</td>
<td>Inc</td>
<td>Cr</td>
</tr>
<tr>
<td>13</td>
<td>Interest Payment by Clients</td>
<td>Asset, Cash</td>
<td>Inc</td>
<td>Dr</td>
<td>Income, Operational Income, Interest in Project Specific Loan A/C</td>
<td>Inc</td>
<td>Cr</td>
</tr>
<tr>
<td>14</td>
<td>Interest due from client is Recognized but not paid</td>
<td>Asset, Accounts Receivable, Specific Project Interest Payable Account</td>
<td>Inc</td>
<td>Dr</td>
<td>Income, Operational Income, Interest in Project Specific Loan A/C</td>
<td>Inc</td>
<td>Cr</td>
</tr>
<tr>
<td>15</td>
<td>When Interest is actually paid</td>
<td>Asset, Cash</td>
<td>Inc</td>
<td>Dr</td>
<td>Asset, Accounts Receivable, Specific Project Interest Payable Account</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>16</td>
<td>Wholesaler Loan Repayment every quarter</td>
<td>Liability, Current Liability, Subsidized Loan, Specific Wholesaler Loan Account Payable</td>
<td>Dec</td>
<td>Dr</td>
<td>Asset, Cash</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>17</td>
<td>Wholesaler Interest Paid</td>
<td>Financial Expenses, Wholesaler Interest Expenses</td>
<td>Inc</td>
<td>Dr</td>
<td>Asset, Cash</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>18</td>
<td>Wholesaler Interest Payable on date when due, but not</td>
<td>Liabilities Accounts Payable, Wholesaler</td>
<td>Inc</td>
<td>Cr</td>
<td>Financial Expenses, Wholesaler Interest Expenses</td>
<td>Inc</td>
<td>Dr</td>
</tr>
</tbody>
</table>
### Table 2: Some Examples for System Developers

<table>
<thead>
<tr>
<th>S No</th>
<th>Transaction</th>
<th>Account Affected</th>
<th>Type</th>
<th>Debit/Credit</th>
<th>Account Affected</th>
<th>Type</th>
<th>Debit/Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>19</td>
<td>When wholesaler interest is actually paid</td>
<td>Asset, Cash</td>
<td>Dec</td>
<td>Cr</td>
<td>Liabilities Accounts Payable, Wholesaler Interest A/C</td>
<td>Dec</td>
<td>Dr</td>
</tr>
<tr>
<td>20</td>
<td>Wholesaler Fees Paid</td>
<td>Asset, Cash</td>
<td>Dec</td>
<td>Cr</td>
<td>Financial Expenses, Wholesaler Fees Expenses</td>
<td>Inc</td>
<td>Dr</td>
</tr>
<tr>
<td>22</td>
<td>Purchase of supplies by stores</td>
<td>Stock in hand, Asset Account</td>
<td>Inc</td>
<td>Dr</td>
<td>Creditors, Liability Account</td>
<td>Inc</td>
<td>Cr</td>
</tr>
<tr>
<td>23</td>
<td>Payment for Expenses</td>
<td>Expense, Expenditure Account</td>
<td>Inc</td>
<td>Dr</td>
<td>Cash/Bank, Asset Account</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>24</td>
<td>Repayment of Borrowings</td>
<td>Borrowings, Liability Account</td>
<td>Dec</td>
<td>Dr</td>
<td>Bank, Asset Account</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>25</td>
<td>Realization of Debtors</td>
<td>Bank/Cash, Asset Account</td>
<td>Inc</td>
<td>Dr</td>
<td>Receivables, Asset Account</td>
<td>Dec</td>
<td>Cr</td>
</tr>
<tr>
<td>26</td>
<td>Contribution to Pension fund</td>
<td>Pension expense, Expenditure Account</td>
<td>Inc</td>
<td>Dr</td>
<td>Pension fund, Liability Account</td>
<td>Inc</td>
<td>Cr</td>
</tr>
</tbody>
</table>

The ERP must have facility to maintain all books of account electronically and as per good practice suggestions, some of which were described above.
Accounting Conventions

Accounting conventions are the customs or traditions guiding the preparation of accounts. They are adopted to make financial statements clear and meaningful. The Accounting Conventions are as follows:

- Convention of Disclosure;
- Convention of Materiality;
- Convention of Consistency; and
- Convention of Conservatism

Convention of Disclosure: The term “disclosure” implies that there must be a sufficient revelation of information which is of material interest to owners (Govt in case of NCRPB), creditors, lenders, investors, public and other stakeholders.

The accounts and the financial statements of NCRPB should disclose full and fair information to the beneficiaries in order to enable them to form a correct opinion on the performance of such entity, which in turn would allow them to take correct decisions.

For example, the Accounting Principles that have been followed for preparation of the Financial Statements should be disclosed along with the Financial Statements for proper understanding and interpretation of the same. An example here is the extent of accrual accounting followed.

Convention of Materiality: An item should be regarded as material, if there is a sufficient reason to believe that knowledge of it would influence the decision of informed creditors, lenders, investors, public and other stakeholders.

The accounts and the financial statements should impart importance to all material information so that true and fair view of the state of affairs of NCRPB is given to its stakeholders.

Hence, keeping the convention of materiality in view, unimportant items are not disclosed separately and are merged with other items.

For example, the expenditure incurred on repairs and maintenance of a certain asset of NCRPB (like a table), which are small, may not be disclosed separately in respect of each such small item but may be grouped together and shown as a single item of expenditure.

Convention of Consistency: The convention of consistency facilitates comparison of financial performance of NCRPB from one accounting period to another.

This means that the accounting principles followed by NCRPB should be consistently applied by it over the years.

For example, it should not change its method of depreciation every year, i.e., from Straight Line Method to Written Down Value Method or vice-versa, without due reason and information disclosure.

Convention of Conservatism: As per this convention, the anticipated profits should be ignored but all anticipated losses should be provided for in the books of accounts of NCRPB.

This means that all prospective losses are taken into consideration, however, no doubtful income is taken into consideration in recording of transactions by an entity.

An instance where Convention of Conservatism is in operation is making a provision for doubtful receivable of loans or interest etc.

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Basic Accounting Concepts and General Principles

Separate Enterprise: Each FI (like NCRPB) is a separate enterprise requiring the maintenance of comprehensive accounting records and financial reporting practices to provide meaningful information to staff, officers, directors, the supervisory committee, board, and interested third parties.

Entity Concept: For accounting purposes, an "organization" is treated as a separate entity from the "owners" or "stakeholders". This concept helps in keeping private affairs of the owners and stakeholders separate from the business affairs. For example, NCRPB is a separate, independent and autonomous entity and is governed by a separate legislation and the regulations formed by it.

The various stakeholders of NCRPB, including public, Central/State Government, etc., who do not own it. Thus, a separate Balance Sheet and Income & Expenditure Statement is prepared in respect of the operations of NCRPB. This concept is applicable to all forms of organisations.

Dual Aspect or Accounting Equivalence Concept: This concept follows from the Entity Concept. All entities like NCRPB own certain assets. Such assets are acquired through contributions of those who have provided the funds for the purpose. Funds are made available either through the surpluses of the entity or loans or payables.

In a sense, such providers of funds are claimants to the assets. At any point in time, the assets will be equal to the claims. Since the claims on the assets could be those of "outsiders" (i.e. liabilities) or "owners" or "stakeholders" (i.e. capital, reserves, etc.), it results in the accounting equation:

\[
\text{Assets} = \text{Own Funds} + \text{Liabilities}
\]

Going Concern Concept: This concept assumes that an entity will continue to operate indefinitely and that it will not be liquidated in the immediate future.

Indefinite future means that the enterprise will not be wound up within the foreseeable future and therefore would be able to meet its contractual obligations and use its resources according to the plans and predetermined goals.

Each FI like NCRPB should normally maintain its accounts as a "going concern" on the basis that its operations will continue indefinitely. Therefore, assets and liabilities should represent the value to the FI as a "going concern" and should not present liquidation values.

Whenever unusual circumstances indicate a limited life for a FI, e.g., if the FI liquidates, the "going concern" concept no longer applies. As a result, a statement of realistic assets and liabilities and appropriate revenues and expenses may require adjustments. These adjustments could include:

- Re-evaluation of the loan portfolio to recognize discounts/allowances on loans,
- Evaluation of the realizable value of fixed assets in liquidation, and
- Re-evaluation of the carrying value of deferred charges and deferred credits, etc.

Monetary Basis for Accounting: State account values in terms of the Rupee amounts involved at the time transactions occur. Recording each transaction in terms of Rupee units provides the best feasible indicator of its relative impact on the overall operations of the FI. It also permits identification of the amount of assets, liabilities, equity, income, or expenses represented by the transaction.

Money Measurement Concept: Accounting is only concerned with those transactions which can be measured in terms of money. Hence transactions that cannot be expressed in terms of money are not recorded in the books of accounts. Receipt of income, payment of expenses, purchase and sale of assets, etc., are monetary transactions that are recorded in the books of accounts.

For example, the event of a computer breakdown is not recorded as it does not have a monetary value. However, the expenditure incurred for the repair of the machinery can be measured in monetary value and hence is recorded.

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Consistency in Accounting From Period To Period: NCRPB generally follows consistent accounting practices from one accounting period to the next. However, the ERP system should have provisions for automatically recording and identifying material changes in the accounting practices and disclose this on NCRPB’s financial statements, as and when they are prepared.

For example, if a FI converts to the accrual system of accounting because assets exceed Rs10 million, it should make a complete conversion at one time and report the conversion on the current period financial statements.

Accounting Period Concept: An accounting period is the interval of time at the end of which the financial statements are prepared to ascertain the financial performance of the organization. Although the “going concern” concept stresses the continuing nature of the entity, it is necessary for an organization (like NCRPB) to review how it is performing.

The preparation of financial statements at periodic intervals helps in taking timely corrective action and developing appropriate strategies. The accounting period is normally considered to be of twelve months.

Periodic Matching of Cost and Revenue Concept: To ascertain the surplus or deficit made by NCRPB during an accounting period, it is necessary that the costs incurred are matched with the revenue earned by NCRPB during that accounting period. The matching concept is a corollary drawn from the accrual concept.

To ascertain the correct surplus or deficit, it is necessary to make adjustments for all outstanding expenses, prepaid expenses, income receivable and income received in advance to correctly depict and match the income and expenditure relating to that accounting period.

Realization Concept: According to this concept, revenue should be accounted for only when it is actually realised or it has become certain that the revenue will be realised. This signifies that revenue should be recognized only when the services are rendered or the sale is effected.

However, in order to recognize revenue, actual receipt of cash is not necessary.

What is important is that the organisation should be legally entitled to receive the amount for the services rendered or the sale effected. That is, interest due at end of month, must be recognized.

Timely Recognition in Accounting Records: Record accounting transactions in a timely manner so all material information applicable to each accounting period shows in the records.

Provide for estimated losses to be sustained in the collection or conversion of loans and other assets via charges against current expenses to properly recognize the reasonable value of assets, liabilities, etc., in accounting records and financial reports.

Estimate amounts for accruing income or expenses if actual amounts are not known and cannot be determined readily. Absorb differences between the actual and estimated amounts in the operations of the subsequent accounting period.

Materiality: Recognize material facts relating to NCRPB financial activity in the accounts and report them on financial statements. GAAP provides that a statement, fact, or item is material if, giving full consideration to the surrounding circumstances as they exist at the time, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence or to “make a difference” in the judgment and conduct of a reasonable person.

The accumulation of many small items, each of which in itself would not be “material”, would be “material” if the overall effect would tend to influence the judgment and conduct of a reasonable person.

Cost Concept: A transaction is recorded in terms of the amount actually passing through the transaction, i.e., at its cost and this cost is the basis for all subsequent accounting for the asset. The cost concept does not mean that the asset will always be shown at cost.

This basically signifies that each time the financial statements are prepared; the fixed assets need not be revised and recorded at its realisable or replacement or market value. The assets recorded at cost at the time of purchase may systematically be reduced through depreciation.
Conservative Accounting: Maintain accounting records on a conservative basis. Make reasonable provisions in the accounts for potential losses on assets and for the settlement of liabilities. Do not materially overstate nor understate its assets, liabilities, revenues or expenses.

Internal Control: Adopt appropriate measures of internal control to improve the dependability of accounting records. These measures must include:

- An organization plan to provide, to the extent feasible, segregations of duties so different employees will handle the operational, custodial and accounting functions;
- A system of authorization and recording procedures adequate to provide reasonable accounting control over assets, liabilities, income and expenses;
- The employment of personnel capable of performing duties and responsibilities; and
- A supervisory committee to conduct effective and timely audits of records and accounts including verification of loan accounts, with assistance provided, where needed, by an independent auditing firm.

Complete Recording of Income and Expenses: Record income, expenses, gains, and losses in income and expense accounts and show them on the Statement of Income for the accounting period. Income and expense accounts should include actual and estimated loan and other asset losses.

Accrual Concept: Under the cash system of accounting, the revenues and expenses are recorded only if they are actually received or paid in cash, irrespective of the accounting period to which they belong.

But under the accrual concept, occurrence of claims and obligations in respect of incomes or expenditures, assets or liabilities based on happening of any event, passage of time, rendering of services, fulfillment (partially or fully) of contracts, diminution in values, etc., are recorded even though actual receipts or payments of money may not have taken place.

In respect of an accounting period, the outstanding expenses and the prepaid expenses and similarly the income receivable and the income received in advance are shown separately in the books of accounts under the accrual method.

Accounting Basis: GAAP requires the accrual basis of accounting because it provides the most complete and informative record of financial activities.

The accrual basis refers to recording liabilities and expenses when incurred, whether or not paid, and income when earned, whether or not received.

The proper accounting basis may be determined using the following guidelines:

- If assets total Rs.2 million or more at the end of the accounting period, adoption of the accrual basis is recommended;
- If the board of directors deems the accrual basis practicable, use the accrual basis;
- If following the accrual basis, FIs with less than Rs.10 million in assets may apply the cash basis to particular accounts where the results would be only insignificantly different from the accrual basis.
- For this purpose, "insignificantly" refers to differences which would not be considered important for a proper evaluation of condition or operations of the FI; and
- If adoption of the accrual basis is not required or practicable, use the modified cash basis.
- Under the modified cash basis, accounting is based upon the cash receipt and disbursement transactions except to make provision to reflect:
  - Liabilities not paid promptly when due;
  - Refunds applicable to the accounting period but not yet paid;
  - Deferred credits and charges applicable to future periods;
  - Estimated losses to be sustained on loans outstanding and other risk assets; and
  - Depreciation of fixed assets.

Accounting and Dividend Periods: Accounting periods may be monthly, quarterly, semiannually, or annually depending on the period selected by the FI to close its books.

NCRPB must close its books at least annually at the end of the fiscal year, which is April year Y to March year Y+1.
The Accounting Process and Accounting System: A Brief Description

The accounting process at NCRPB can be depicted by way of the following simple Flow Chart:

Figure 1: Accounting Process

- **Documenting the Transaction**
- **Classifying the Transactions**
- **Recording the Transactions**
- **Posting the Transaction**
- **Summarizing the Transaction**
- **Interpreting the Transaction**

The transactions are documented by preparing vouchers and issuing receipts. After classifying and recording in the cash book, journal book, petty cash book as the case may be, the transactions, are posted to the ledger and a trial balance is extracted summarizing the transactions.

The financial statements such as Receipts and Payments Account, Income and Expenditure Account and Balance Sheet are constructed to ascertain the financial health of FIs like NCRPB. The formats of these are given later and the process of obtaining them are depicted in Figure 2 given hereafter.

Figure 2: Flow Chart of Accounting System

- **Bank Account**
  - **Vouchers**
  - **Petty Cash Book**
  - **Cash Book**
  - **Journal Book**
  - **Ledger**
    - **Receipts and Payments**
    - **Trial Balance**
    - **Income and Expenditure**
    - **Balance Sheet**
    - **Submission to Stakeholders and Legal Authorities**

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13 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Good Practices MIS Technical Note For ERP System Developers

TN #12: Accounting Process and Accounting System

Accounting System

The Basic Accounting System Described: For enterprises following either the accrual basis or the modified cash basis of accounting, the majority of entries originate with the receipt or disbursement of cash.

Other entries are relatively few in number and consist generally of adjustments or transfers between accounts, establishment and maintenance of an allowance for loan losses, write offs of bad loans, and recording depreciation of tangible fixed assets.

In addition, FIs like NCRPB following the accrual basis of accounting should make entries to record accrued income and expenses.

Records of Original Entry and Record of Final Entry:

A bookkeeping system can be broken down into two distinct parts: Records of Original Entry (the Journal and Cash Record) and Records of Final Entry (the General Ledger); and

In addition, the Cash Received Voucher or its equivalent and the Journal Voucher or its equivalent serve as memorandum records of the original transactions and the sources of entries in the Journal and Cash Record.

The Records of Original Entry: The Records of Original Entry are diaries of the transactions as they occur. The Journal and Cash Record is the main record used for this purpose.

Each day's cash receipts, disbursements and other transactions are entered in the Journal and Cash Record in chronological sequence. Thus, a running history of each day's transactions are kept and may be summarized as needed.

At the end of a given period, usually the month end, the total of all transactions pertaining to each account can be obtained by totaling the debit and credit columns of the Journal and Cash Record.

The accuracy of the entries can be proved in part by balancing the debit columns against the credit columns.

The Record of Final Entry: The Record of Final Entry is the General Ledger. This record serves as a means of summarizing the entries in a form that will enable the bookkeeper to prepare reports on the results of operations to date.

Entries in the General Ledger consist of posting (simply transferring) the debits and credits (either individually or in total at the end of the month) for each account in the Journal and Cash Record to the corresponding account in the General Ledger and computing the net balance for each account. The result obtained shows the current balances of NCRPB’s accounts and the results of operations for the period.

Sometimes, when a General Ledger account summarizes a large number of transactions, it is necessary to provide detailed information about this account with a record known as a Subsidiary Ledger.

The Individual Loan Ledgers are examples of subsidiary records which show the detailed loan transactions with each project. The Loan accounts in the General Ledger reflect the total transactions with all clients (all projects at NCRPB).

These General Ledger accounts are called Control Accounts since they act as a control or check over the numerous postings to the individual or subsidiary ledgers.

Subsidiary records are balanced with related control accounts on a monthly basis and the reconcilement, or other proof of balancing, is retained.

Any accounting system should:

Be simple enough to understand, adopt and implement;
Be sufficiently informative to aid planning and budgeting; and
Have an inbuilt system for an internal check and to ensure compliance with extant laws.

The system can be manual or computerized but the essence of a good accounting system is given above.

The accounting system is one of the two core parts of an MIS/ERP system—the other is the portfolio system.
Accounting Systems and Chart of Accounts

**Accounting Systems:** Many accounting guidelines and standards govern the recording and reporting of transactions.

Transactions and accounting ledgers are part of a larger, complex system for controlling funds and reporting on their sources and uses.

In this system, accountants are responsible for showing the movement of funds throughout NCRPB.

They record how funds are received and used and what resources are used to produce or deliver services. To do this, they need a chart (or list) of accounts.

Similar to a database structure, the chart of accounts provides accountants with a structure for posting transactions to different accounts and ledgers.

It also determines what appears in the financial statements.

The chart of accounts typically designates each account by:
- An account number
- A description—for example, “Indian Bank checking account,” or “accrued salaries, NCR cell staff”
- The type of account, such as asset, liability, equity, income, or expense.
- A bank account is categorized as an asset, for example, and salaries are categorized as expenses.

A manual accounting system typically includes at least the following (Figure 1):
- Chart of accounts
- General journal
- General ledger
- Subsidiary ledgers (accounts receivable, inventory, fixed assets)
- Transaction reports
- Financial statements.

**Figure 1: A Typical Manual Accounting System**

![Diagram of a typical manual accounting system](image)

**Box 1: Key Aspects of Accounting Systems for Institutions like NCRPB**

- Cash versus accrual accounting
- Revolving Loan Fund accounting
- The chart of accounts and its structure
- General Ledger and Journal and Subsidiary Ledgers
- Transaction Reports
- Financial statements and Analytical reports

A computerized accounting system posts transaction entries directly to the general ledger. It replaces the various manual journals with a query function, producing reports as needed.

**Table 1: An Example From an FI’s Chart of Accounts**

<table>
<thead>
<tr>
<th>Account Code</th>
<th>Description</th>
<th>Type of Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>1010</td>
<td>Bank accounts</td>
<td>Current asset</td>
</tr>
<tr>
<td>1010A</td>
<td>Bank account, funded by multilateral agency like ADB</td>
<td>Current asset</td>
</tr>
<tr>
<td>1010B</td>
<td>Bank account, funded by other lenders</td>
<td>Current asset</td>
</tr>
<tr>
<td>1010Z</td>
<td>Bank accounts, general fund</td>
<td>Current asset</td>
</tr>
<tr>
<td>1910</td>
<td>Equipment account</td>
<td>Fixed asset</td>
</tr>
</tbody>
</table>

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14 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Cash versus Accrual Accounting: Accounting systems can be cash-based (accounting for income and expenses when cash changes hands), accrual-based (accounting for income and expenses when they are incurred), or modified cash systems (in which most accounting is cash-based, but selected accounts are accrual-based).

Financial intermediaries (like NCRPB) need to accrue important expenses, such as personnel benefits and interest payable on loans that may require only annual payments. Otherwise the financial statements will not accurately reflect the real flow of expenses.

Accruing interest receivable on loans to clients is a bit more complex. Accruing interest means calculating at month-end or year-end the interest owed but as yet unpaid. This unpaid interest is considered income for the period considered because that is when it was earned.

If the client makes a loan payment in the next period, some of that payment goes to pay off the accrued interest. Nonperforming loans could continue to accrue interest that will never be received, inflating reported income. So accrued interest must be aged, just as delinquent loans are; percentages of the overdue income are written off to get a more realistic estimate of the income the institution will eventually receive. Many institutions stop accruing interest income on delinquent loans after a certain number of days and NCRPB needs a policy on this. A normal recourse would be to replicate RBI’s recommendation on these aspects, which are dealt with in the financial management manual.

Chart of Accounts

Chart of accounts is thus a list of accounting heads agreed at NCRPB. Any expenditure has to be classified to the agreed head of account and not to any other head of accounts.

Both the head of accounts and the description of nature of expenditure under each head of account has to be agreed and not to be changed without proper authorization.

The design of the chart of accounts is a fundamental decision for every institution and the same is the case for NCRPB.
For example, cash, petty cash, checking account 1, and checking account 2 would all be accounts in the cash group of the assets category.

Following the four-digit account number are two two-digit groups and two single-digit groups. These groups could appear in any order and could be one digit rather than two if not much disaggregation is expected in the group. In the example the first two-digit group indicates costs by activity.

Activities are subdivided into planning, financing etc. Because not all transactions can be identified by function, two numbers are set aside—00 for balance sheet accounts, and 01 for head office activity, or overhead, not tied to a function.

Costs for staff identified with an activity would be coded to that function. Costs covering more than one function can be split proportionately among the activities, but this can add greatly to the complexity of transaction coding and should be kept to a minimum.

The second two-digit group separates income and expenses by branch office and functions as the activity/function codes do. Distributing costs by branch office (NCRPB cells) is usually easier than doing it by activity, because they generally have designated employees and fixed assets and can also have designated budgets.

The next set of digits allows the tracking of income and expenses by source. Again, 0 indicates balance sheet accounts, and 1 identifies the general treasury fund for resources not tracked by a funder. All other codes designate a specific funder.

### Table 2: Sample Chart of Account Structure

<table>
<thead>
<tr>
<th>Program (Activity/Function) Codes (DD)</th>
<th>Funder Codes (FF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>00 Balance sheet accounts</td>
<td>00 Balance sheet (assumes no separate funds)</td>
</tr>
<tr>
<td>10–19 Financing</td>
<td>20–29 Government/multilateral and bilateral (restricted)</td>
</tr>
<tr>
<td>10 Loan product 1</td>
<td>21 Asian Development Bank (ADB)</td>
</tr>
<tr>
<td>11 Loan product 2</td>
<td>12 Loan product 3</td>
</tr>
<tr>
<td>13 Loan product 3</td>
<td>22 Government of India</td>
</tr>
<tr>
<td>14–19 (open)</td>
<td>23 Government of Delhi</td>
</tr>
<tr>
<td>Planning</td>
<td>30–44 Government/multilateral and bilateral (unrestricted)</td>
</tr>
<tr>
<td>20–29 Regional Plan</td>
<td>20 Regional Plan</td>
</tr>
<tr>
<td>21 Sub-regional plan</td>
<td>21 Sub-regional plan</td>
</tr>
<tr>
<td>22 Projects</td>
<td>31 World Bank (WB)</td>
</tr>
<tr>
<td>23 90- Other</td>
<td>50–59 Private sources (restricted)</td>
</tr>
<tr>
<td>24–29 (open)</td>
<td>60–69 Private sources (unrestricted)</td>
</tr>
<tr>
<td>30–39 Training programs</td>
<td>31 Management training</td>
</tr>
<tr>
<td>32–39 (open)</td>
<td>70–99 (open)</td>
</tr>
<tr>
<td>40 Marketing assistance</td>
<td>41–99 (open)</td>
</tr>
<tr>
<td><strong>Branch Codes (EE)</strong></td>
<td></td>
</tr>
<tr>
<td>01 Head office</td>
<td></td>
</tr>
<tr>
<td>10 NCR Cell 1</td>
<td></td>
</tr>
<tr>
<td>11 NCR Cell 2</td>
<td></td>
</tr>
<tr>
<td>12 NCR Cell 3</td>
<td></td>
</tr>
<tr>
<td>13 NCR Cell 4</td>
<td></td>
</tr>
<tr>
<td>31–99 (open)</td>
<td></td>
</tr>
</tbody>
</table>

How would this structure work in practice? Here are some examples:

- If 1012 is the account for *cash in banks*, *lending*, then 1012-00-01-21 denotes money held by the head office (code 01), restricted for lending, from ADB (code 21). Since this bank account is a balance sheet account, 00 is used for the program code.
If 4120 represents *income from loan commissions*, then 4120-12-11-01 represents commission income from individual loans (program code 12) from NCR cell 2 (branch code 11), designated for the general treasury fund (funder code 01).

If 5212 represents *staff salaries*, then 5212-31-12-31 represents salaries for management training of staff (program code 31) in NCR cell 2 (branch code 11), paid for with WB funds (funder code 31).

The following guidelines should be followed while using the chart of accounts:

- Function codes, Major and Minor Head Codes would apply uniformly.
- Any requirement for an addition to functions shall be requested to a committee. Only the committee set up in this regard can add new codes under this head.
- No major code addition is likely to happen as this format is more or less the final one. In case the same is required it has to be approved by the committee only.
- Accounts can add minor heads at the state level. All additions made shall be intimated to the committee. Committee may introduce additional minor codes as mandatory at some periodicity based on the intimations received.
- The Accounts Department shall maintain a master index of all the Code of Accounts being utilised.
- Ledger Accounts corresponding to the Account Codes need to be opened only in respect of those transactions which arise. Thus all the Account Codes given here may not be used by and these are given for illustrative purposes only.

While the above is a chart of accounts structure (CoA) that can come who use in the ERP system, a very simple chart of account is given below for NCRPB; for immediate use.

<table>
<thead>
<tr>
<th>Table 3: Sample Chart of Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset Accounts</strong></td>
</tr>
<tr>
<td>1000</td>
</tr>
<tr>
<td>1000</td>
</tr>
<tr>
<td>1005</td>
</tr>
<tr>
<td>1010</td>
</tr>
<tr>
<td>1011</td>
</tr>
<tr>
<td>1012</td>
</tr>
<tr>
<td>1013</td>
</tr>
<tr>
<td>1050</td>
</tr>
<tr>
<td>1100</td>
</tr>
<tr>
<td>1200</td>
</tr>
<tr>
<td>1210</td>
</tr>
<tr>
<td>1220</td>
</tr>
<tr>
<td>1240</td>
</tr>
<tr>
<td>1300</td>
</tr>
<tr>
<td>1310</td>
</tr>
<tr>
<td>1320</td>
</tr>
<tr>
<td>1400</td>
</tr>
<tr>
<td>1410</td>
</tr>
<tr>
<td>1420</td>
</tr>
<tr>
<td>1440</td>
</tr>
<tr>
<td>1450</td>
</tr>
<tr>
<td>1459</td>
</tr>
<tr>
<td><strong>Liability Accounts</strong></td>
</tr>
<tr>
<td>2000</td>
</tr>
</tbody>
</table>
### Table 3: Sample Chart of Accounts

<table>
<thead>
<tr>
<th>Account Code</th>
<th>Account Description</th>
<th>Account Code</th>
<th>Account Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>Accounts payable, general</td>
<td>2210</td>
<td>Clients deposits (from HUDA or DDA as suggested by all team leaders) etc</td>
</tr>
<tr>
<td>2012</td>
<td>Accounts payable, employees</td>
<td>2230</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>Accounts payable, other</td>
<td>2220</td>
<td></td>
</tr>
<tr>
<td>2100</td>
<td>Interest payable</td>
<td>2300</td>
<td>Loans payable, short term</td>
</tr>
<tr>
<td>2110</td>
<td>Interest payable, loans*</td>
<td>2320</td>
<td>Loans payable, bank 1</td>
</tr>
<tr>
<td>2120</td>
<td>Interest payable, ECBs(^{15})</td>
<td>2322</td>
<td>Loans payable, bank 2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2330</td>
<td>Loans payable, other</td>
</tr>
<tr>
<td>2130</td>
<td>Interest payable, time deposits*</td>
<td>2350</td>
<td>Lease payable</td>
</tr>
<tr>
<td>2150</td>
<td>Interest payable, other*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Liability Accounts

<table>
<thead>
<tr>
<th>Account Code</th>
<th>Account Description</th>
<th>Account Code</th>
<th>Account Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2400</td>
<td>Loans payable, long term</td>
<td>2550</td>
<td>Accrued taxes*</td>
</tr>
<tr>
<td>2420</td>
<td>Loans payable, bank 1</td>
<td>2590</td>
<td>Other accrued expenses*</td>
</tr>
<tr>
<td>2422</td>
<td>Loans payable, bank 2</td>
<td>2600</td>
<td>Deferred revenue, program</td>
</tr>
<tr>
<td>2430</td>
<td>Loans payable, other</td>
<td>2610</td>
<td>Deferred interest</td>
</tr>
<tr>
<td>2450</td>
<td>Lease payable</td>
<td>2620</td>
<td>Deferred commissions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2622</td>
<td>Deferred loan service fees</td>
</tr>
<tr>
<td>2500</td>
<td>Accrued expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2510</td>
<td>Accrued salary*</td>
<td>2700</td>
<td>Deferred revenue, grants</td>
</tr>
<tr>
<td>2520</td>
<td>Accrued payroll taxes*</td>
<td>2710</td>
<td>Deferred revenue, grant 1</td>
</tr>
<tr>
<td>2530</td>
<td>Accrued benefits, insurance*</td>
<td>2712</td>
<td>Deferred revenue, grant 2</td>
</tr>
<tr>
<td>2540</td>
<td>Accrued benefits, leave*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Equity Accounts

<table>
<thead>
<tr>
<th>Account Code</th>
<th>Account Description</th>
<th>Account Code</th>
<th>Account Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>3000</td>
<td>Shareholders’ capital</td>
<td>3000</td>
<td>Fund balance</td>
</tr>
<tr>
<td>3010</td>
<td>Paid-in capital</td>
<td>3010</td>
<td>Unrestricted fund balance</td>
</tr>
<tr>
<td>3020</td>
<td>Common stock at par value</td>
<td>3020</td>
<td>Fund balance, financial intermediation</td>
</tr>
<tr>
<td>3030</td>
<td>Donated capital, current year</td>
<td>3030</td>
<td>Fund balance, planning</td>
</tr>
<tr>
<td>3040</td>
<td>Donated capital, previous years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3100</td>
<td>Gain (loss) from currency adjustments</td>
<td>3100</td>
<td>Gain (loss) from currency adjustments</td>
</tr>
<tr>
<td>3200</td>
<td>Retained earnings, current year</td>
<td>3200</td>
<td>Surplus/(deficit) of income over expenditure</td>
</tr>
<tr>
<td>3300</td>
<td>Retained earnings, previous years</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Income Accounts

<table>
<thead>
<tr>
<th>Account Code</th>
<th>Account Description</th>
<th>Account Code</th>
<th>Account Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>4000</td>
<td>Interest income</td>
<td>4200</td>
<td>Fee income</td>
</tr>
<tr>
<td>4010</td>
<td>Interest income, performing loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4020</td>
<td>Interest income, nonperforming loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4040</td>
<td>Interest income, rescheduled loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4100</td>
<td>Other loan income</td>
<td>4300</td>
<td>Bank and investment income</td>
</tr>
<tr>
<td>4120</td>
<td>Income from commissions</td>
<td>4400</td>
<td>Income from grants</td>
</tr>
<tr>
<td>4122</td>
<td>Income from loan service fees</td>
<td>4410</td>
<td>Restricted, government</td>
</tr>
<tr>
<td>4124</td>
<td>Income from closing costs</td>
<td>4420</td>
<td>Restricted, private</td>
</tr>
<tr>
<td>4130</td>
<td>Penalty income</td>
<td>4430</td>
<td>Unrestricted, government</td>
</tr>
<tr>
<td>4140</td>
<td>Income from other loan fees</td>
<td>4440</td>
<td>Unrestricted, private</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4500</td>
<td>Other income</td>
</tr>
</tbody>
</table>

\(^{15}\) HUDA, DDA etc
Good Practices MIS Technical Note For ERP System Developers
TN #13: Accounting Systems and Chart of Accounts:
Alternative Approaches

<table>
<thead>
<tr>
<th>Expense Accounts</th>
<th>4510</th>
<th>Miscellaneous income</th>
</tr>
</thead>
<tbody>
<tr>
<td>5000 Financing expenses</td>
<td>5500</td>
<td>Travel costs</td>
</tr>
<tr>
<td>5010 Interest on loans</td>
<td>5510</td>
<td>Airfare</td>
</tr>
<tr>
<td>5014 Bank commissions and fees</td>
<td>5514</td>
<td>Public ground transportation</td>
</tr>
<tr>
<td>5020 Interest on client deposits</td>
<td>5516</td>
<td>Vehicle operating expenses</td>
</tr>
<tr>
<td>5030 Other financing costs</td>
<td>5520</td>
<td>Lodging costs</td>
</tr>
<tr>
<td>5100 Loss provisions</td>
<td>5530</td>
<td>Meals and incidentals</td>
</tr>
<tr>
<td>5110 Loan loss provisions</td>
<td>5540</td>
<td>Transport of goods</td>
</tr>
<tr>
<td>5120 Interest loss provisions*</td>
<td>5542</td>
<td>Storage</td>
</tr>
<tr>
<td>5550</td>
<td>Miscellaneous travel costs</td>
<td></td>
</tr>
<tr>
<td>5200 Personnel expenses</td>
<td>5210</td>
<td>Salaries, officers</td>
</tr>
<tr>
<td>5212 Salaries, others</td>
<td>5600</td>
<td>Equipment</td>
</tr>
<tr>
<td>5214 Honoraria</td>
<td>5610</td>
<td>Equipment rental</td>
</tr>
<tr>
<td>5220 Payroll tax expense</td>
<td>5620</td>
<td>Equipment maintenance</td>
</tr>
<tr>
<td>5230 Health insurance</td>
<td>5630</td>
<td>Equipment depreciation</td>
</tr>
<tr>
<td>5232 Other insurance</td>
<td>5640</td>
<td>Vehicle depreciation</td>
</tr>
<tr>
<td>5240 Vacation</td>
<td>5700</td>
<td>Program expenses</td>
</tr>
<tr>
<td>5242 Sick leave</td>
<td>5710</td>
<td>Instructional materials and supplies</td>
</tr>
<tr>
<td>5250 Other benefits</td>
<td>5730</td>
<td>Books and publications</td>
</tr>
<tr>
<td>5300 Office expenses</td>
<td>5740</td>
<td>Technical assistance</td>
</tr>
<tr>
<td>5310 Office supplies</td>
<td>5800</td>
<td>Miscellaneous expenses</td>
</tr>
<tr>
<td>5312 Telephone and fax</td>
<td>5810</td>
<td>Entertainment</td>
</tr>
<tr>
<td>5314 Postage and delivery</td>
<td>5810</td>
<td>Entertainment</td>
</tr>
<tr>
<td>5316 Printing</td>
<td>5900</td>
<td>Nonoperating income and expenses</td>
</tr>
<tr>
<td>5322 Auditing and accounting fees</td>
<td>5910</td>
<td>Gain/(loss) on sale of investments</td>
</tr>
<tr>
<td>5330 Other office expenses</td>
<td>5920</td>
<td>Gain/(loss) on sale of assets</td>
</tr>
<tr>
<td>5332 Other</td>
<td>5930</td>
<td>Income Taxes paid (Not applicable now as NCRPB has tax exemption)</td>
</tr>
<tr>
<td>5400 Occupancy expenses</td>
<td>5940</td>
<td>Other taxes paid</td>
</tr>
<tr>
<td>5410 Rent</td>
<td>5990</td>
<td>Other</td>
</tr>
<tr>
<td>5420 Utilities</td>
<td>5430</td>
<td>Maintenance and cleaning</td>
</tr>
</tbody>
</table>
Types of Accounting

Types of Accounts: The "Asset Accounts" record what the institution owns. These include cash, loans, investments, etc. These accounts, as well as the expense accounts, normally have debit balances.

The "Liability Accounts" record what the institution owes and the "Equity Accounts" reflect the ownership interests. Together these accounts include notes payable, undivided earnings and reserves. The "Liability Accounts" and "Equity Accounts" as well as the income accounts normally have credit balances.

There are different types of accounting. Two important types are:
- Cash System
- Accrual System

Cash System

In the cash system of accounting, entries are made only when the cash is received or paid and no entry is made when the receipt or payment is due. For example, at the end of May, a salary of Rs.1,000/- becomes due but the payment is made only on 5th June.

Under the cash system no entry will be made in the books of accounts. An entry will be made in the books only on the 5th of June.

Generally under a cash system of accounting, income is recorded and accounted for when actually collected and expenses are accounted for when actually paid.

Modified Cash System

Under the modified cash system, the accounting is based on the actual receipts and disbursements of the institution except that provisions should be made to reflect:
- Liabilities which are not promptly paid when due,
- Interest refunds applicable to the accounting period but not yet paid,
- Deferred income or expenses applicable to future periods,
- Estimated losses to be sustained on loans outstanding,
- Estimated unrealized losses associated with investments, and
- Depreciation on fixed assets.

The foregoing exceptions to maintenance of accounting records on a strictly cash system are designed to recognize in the accounts certain significant financial transactions not involving the concurrent receipt or disbursement of cash and to reflect their effect in financial reports prepared from the accounts.

In unusual circumstances, there may be other significant non-cash financial transactions that should be recorded. Therefore, the above list is not all-inclusive.

Institutions for which adoption of the accrual system of accounting is not required or practicable should use the modified cash system of accounting.

Accrual System

Under the Accrual System, an entry is recorded on the basis of the amounts having become due for payment or receipt, whether or not payment is made or amounts received.

On the 31st of May the salary account will be debited for Rs.1,000/- and the salary outstanding account will be credited for Rs.1,000/-. On the 5th of June the salary outstanding account will be debited for Rs.1,000/- and the cash account will be credited for Rs.1,000/-. The accrual system of accounting refers to that method under which liabilities and expenses are recorded when incurred, whether or not paid, and income is recorded when earned, whether or not received.

It is intended that NCRPB accounting be maintained on the accrual system.
Cash Book

This book of accounts is maintained for recording cash and bank transactions. This is done in the respective columns according to the date of occurrence. The cash book reflects the actual movement of funds through cash or bank.

The balance of cash on hand and cash in the bank can thus be arrived at, on a daily basis by the institution. Standard formats can be used but it is suggested the formats be pre-printed to minimize writing to amounts. This calls for standardization of transactions.

Shall be the Book of Original Entry for recording transactions involving cash and/or bank. The Cash Book may also be referred to as the Cash and Bank Book. The Cash Book has two sides, viz., “Receipt” and “Payment”.

All collections on behalf of NCRPB shall be recorded on the “Receipt” side and all payments shall be recorded on the “Payment” side.

Separate Cash Books shall be maintained in respect of each bank account. Designated Bank Accounts may be operated for deposit of collections pertaining to various states or sources of funds.

Steps for Maintaining a Cash Book: The following steps will have to be followed in maintaining a Cash Book:

1. The closing balance of cash on hand and cash at bank shall be brought forward from the last year’s balance sheet and shown as opening balances in the cash and bank columns of the cash book.
2. The debit side (left hand side) of the Cash Book is for recording receipts either in cash or in the form of cheques /draft, etc. cash receipts should be recorded in the cash column of the receipt (debit) side and the money received in the form of cheques /drafts should be recorded in the bank column of the debit side.
3. The credit side (right hand side) of the Cash Book is for recording payments either in cash or in the form of cheques /drafts. Cash payments should be recorded in the cash column on the basis of vouchers except for those made through petty cash. Payments in the form of cheques / drafts should be recorded in the bank column.

The Cash Book should be (written) in the chronological order of payments/ receipts.

A narration (i.e., a very brief explanation) should be given below each transaction.

The Cash Book must be balanced daily and the cash on hand must tally with the book balance.

A Bank Reconciliation Statement (BRS) must be prepared so as to reconcile the balances in the various bank accounts as per the Cash Book and Bank Statement / Pass Book.

The serial number of each voucher must be written in the column provided in the Cash Book and the vouchers must be accompanied by supporting documents such as cash bill. Invoices should be filed independently in the order of occurrence.

The head of account (i.e., Salary, Travel etc) under which any transaction falls should precede the very transaction that is written in the Cash Book.

In case any amount is paid as advance for which the particulars of expenses would be received later, then the concerned party’s account should be debited and the necessary journal entries passed when the particulars are furnished.

The General Ledger Folio number i.e. the page number where the corresponding entry is made in General Ledger should be mentioned against each transaction.

Deposits and withdrawals of cash to / from the bank are written as adjusted within the Cash Book.

These are known as “contra entries” and are denoted by “C” in the Main Cash Book. Such postings are not carried to the General Ledger. The double entry system is completed within the Cash Book itself.

In the case of cash withdrawals from the Bank - Record this on the receipts side of the Cash Book in the Cash Column and on the payments side in the Bank Column.

In the case of cash deposited into the Bank - record this on the payments side of the Cash Book in the Cash Column and on the receipts side in the Bank Column.

In the case of cheques/drafts deposited into the Bank - Record this on the receipts side in the bank column on the date of deposit in the bank and not on the date of realization.

The double entry system will be completed by posting in the General Ledger.

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Accounting Records

The following books of accounts are generally accepted for an institution like NCRPB:

- Petty Cash Book (or Imprest)
- Main Cash Book with cash and bank columns (normally referred to as Cash Book/Day Book)
- General Ledger (normally referred to as Ledger)
- Loan Ledger
- Journal Register (normally referred to as Journal)
- Investment Register
- Fixed Assets Register
- Stock Register

Petty Cash Book

A Petty Cash Book is maintained in a columnar fashion. It is used for recording recurring petty transactions, and thereby lessens the burden of maintaining the Cash Book as well as posting to the General Ledger. The expenses are posted at the end of each month under their respective heads in the General Ledger.

At the end of each month when the Petty Cash Book is closed, the transfer to the General Ledger could be done in the following way:

Payments made from the Cash Book shall be acknowledged as Receipts in the Petty Cash Book. At the end of the month the various petty cash expenses are transferred to the respective accounts maintained in the General Ledger.

The difference between the receipts and the total expenses as shown in the Petty Cash Book reflects the petty cash on hand. Standard Petty Cash Book formats can be used.

This account records the authorization of a Petty Cash Fund by competent authority. The purpose of petty cash funds is for making incidental payments such as postage and other expense items of less than Rs.100/Rs.200 or as per policy of the institution from time to time.

Payments from the petty cash fund must be evidenced by receipts or signed petty cash vouchers and are not posted to the Journal and Cash Record.

Setting up Petty Cash Fund: Debit this account in the "Miscellaneous-Debit" column of the Journal and Cash Record for the gross amount withdrawn by check from the bank to establish a petty cash fund.

No subsequent debits or credits to the account are made except for the purpose of increasing or decreasing the amount of cash to be maintained in the fund. The amount set up in this fund should not exceed the maximum.

Posting to the General Ledger: Posting to this account in the General Ledger is made from the "Miscellaneous" columns of the Journal and Cash Record.

Payments for Petty Cash Fund: As payments are made out of the fund, receipts or signed petty cash vouchers should be obtained and held with the balance of the cash in the fund. Thus, the actual cash and/or receipts will always equal the total amount of the fund. No entries are made in the Journal and Cash Record for individual petty cash payments.

Recoupment: The petty cash fund is restored in full prior to the end of each accounting period, and at other times when necessary, in order that expenditures made may be recorded and that the cash in the fund will be equal to the balance in the General Ledger.

When recoupment of the fund is necessary, a Journal Voucher is prepared and a check drawn in favor of "Petty Cash". Upon cashing the check, actual cash for the total of the fund should be on hand. The receipts, which were received when disbursements were made from the fund, equaling the amount of the check is attached to the Journal Voucher or filed with other paid bills.

Entry in Journal and Cash Record: When the petty cash fund is replenished, the transaction is entered in the Journal and Cash Record by debiting all of the applicable expense accounts and crediting the Cash account (Cash-Paid Out).

Unless it is applicable, the total cost of the replenishment should not be debited to "Miscellaneous Operating Expenses".

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18 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
This entry does not affect the Petty Cash account as set up on the books.

Changes in Amount of Fund: If it is decided to reduce the amount of cash in the fund, a Cash Received Voucher is prepared.

At the end of the day when the cash received transactions are recorded in the Journal and Cash Record, the amount should be entered in the "Miscellaneous-Credit" column as received from "Petty Cash". The amount taken from the fund is deposited with other cash received that day.

Segregation of Fund: The petty cash fund must be kept physically separate and apart from all other cash.

A supervisory committee should verify the balance of the petty cash fund periodically by conducting surprise cash counts.

Illustrative Entries

• To establish the petty cash fund:

Dr.-Petty Cash Fund   Rs2500.00
Cr.-Cash              Rs2500.00

• To replenish the fund:

Dr.-Various Operating Expense Accounts   Rs1679.00
Cr.-Cash               Rs1679.00

• To reduce or eliminate the petty cash fund:

Dr.-Cash             Rs2000.00
Cr.-Petty Cash Fund   Rs2000.00

Detailed Transactions

Debit:

• With amount of cash disbursed to establish the Petty Cash Fund.

• With amount of cash disbursed to increase the Petty Cash Fund.

Credit:

• With amount of cash received (or vouchers recorded) representing a decrease in the Petty Cash Fund or creation of the Fund.

Maintaining Petty Cash under the Imprest System: Under the imprest system the petty cashier is fixed a certain limit for handling cash. The limit is fixed based on the estimated requirement for a week or fortnight.

When the petty cashier’s ‘cash in hand’ is very low, the main cashier reimburses only the total amount actually spent by the petty cashier. Let us say the petty cash limit is Rs.1,000/-.

The Petty cashier has incurred expenses of Rs.450/- under various heads of accounts. The balance cash with the petty cashier is Rs.550/-.

The petty cashier will be reimbursed Rs.450/- to ensure that the cash balance is Rs.1,000/-, the limit that has been fixed.
Good Practices MIS Technical Note For ERP System Developers
TN #17: Maintaining a General Ledger

General Ledger

This is a book of accounts in which transactions are posted from the Cash Book, Petty Cash Book and Journal Register under various account headings according to the date of occurrence e.g., Salaries, Repairs and Maintenance, Traveling and Conveyance, Rent, Loans Disbursed and Repayments Received, Interest Received, Grants received, etc.

The general ledger is a comprehensive record of individual accounts on the chart of accounts. The chart of accounts is a listing of general ledger account numbers and account names. The general ledger accounts contain entries pertaining to a specific asset, liability, equity, income, or expense. Subsidiary ledgers and account reconciliations support the general ledger.

Steps for Maintaining a General Ledger: The General Ledger is maintained to complete the system of double entry through posting. Posting is a process of transferring to the General Ledger entries passed in the Cash Book, Petty Cash Book and Journal Register.

These entries are classified in the General Ledger under different heads of account (income, expenses, assets & liabilities) chronologically. The General Ledger is maintained to record the following:

- The closing balance other than cash on hand and cash at bank are brought forward as opening balances in the ledger under the respective heads of account from the last year’s Balance Sheet.
- Entries from the Cash Book under the respective heads of account,
- Entries from the Petty Cash Book on a monthly basis under the respective heads of account.
- Entries from the Journal Register under the respective heads of account.

While posting, the following points are to be observed:

- The heads of accounts under the payment side (debit side) of the Cash Book will be posted to the debit side of the General Ledger under the respective heads of account.
- The heads of accounts under the receipts side (debit side) of the Cash Book will be posted to the credit side of the General Ledger under the respective heads of account.
- In respect of ‘contra entries’ on posting is required to be done as the double entry transaction is completed in the Cash Book itself.
- The Journal entries from the debit side are posted in the debit side of the General Ledger and credit entries are posted on the credit side of the General Ledger under the respective heads of account.
- The Cash Book folio number, Petty Cash Book folio number, Journal Register folio number e.g., the page number of any particular entry made in the Cash Book, Petty Cash Book or Journal Register should be mentioned in the General Ledger.
- The balances outstanding in the ledger account will either show a debit balance or a credit balance. These balances extracted on a specified date facilitate the drawing of a trial balance as on that specific date.

Difference between Cash Book and General Ledger: The following are some of the differences between a Cash Book and a General Ledger:

<table>
<thead>
<tr>
<th>Point of Difference</th>
<th>Cash Book</th>
<th>General Ledger</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Journal entries</strong></td>
<td>Not included</td>
<td>Included</td>
</tr>
<tr>
<td><strong>Entries recorded</strong></td>
<td>According to the date of occurrence, maintaining the various heads of accounts</td>
<td>According to head of account, chronologically in a sequential manner</td>
</tr>
<tr>
<td><strong>Opening Balances</strong></td>
<td>Opening Cash on Hand and at Bank included</td>
<td>Assets and Liabilities other than Cash on Hand or at Bank included</td>
</tr>
<tr>
<td><strong>Closing Balances</strong></td>
<td>Enables closing cash on hand and cash at bank to be arrived at</td>
<td>Enables the expenses and income under various heads of account as well as the assets and liabilities of NCRPB to be known</td>
</tr>
</tbody>
</table>

19 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
**Posting to General Ledger:** When the transactions which have been entered in the Journal and Cash Record are posted to the General Ledger accounts, the Cash account is debited with the total of the "Cash-Received" column and credited with the total of the "Cash-Paid Out" column. These totals are usually posted at the end of each month.

**Subsidiaries of the General Ledger Accounts:**
As NCRPB has investments in deposits, it is recommended that subsidiary records be maintained to clearly identify each investment transaction.

**Illustrative Entries**

- When investments are made in deposits:
  
  Dr. - Bank Deposits Rs50,000  
  Cr. - Cash Rs50,000

- When investments are withdrawn or redeemed:
  
  Dr. - Cash Rs1,000  
  Cr. - Deposits and Certificates Rs1,000

- When income earned on such deposits are automatically reinvested:
  
  Dr. - Bank Deposits Rs1,000  
  Cr. - Income from, Deposits and Certificates Rs1,000

- To record the withdrawal of deposits or certificates:
  
  Dr. - Cash Rs25,000  
  Cr. - Bank Deposits Rs25,000

**Detailed Transactions**

**Debit:**

- With deposits and investments in commercial banks, savings accounts etc.
- With income earned on deposits and investments and reinvested in banks.
  
  (Note: This entry assumes that the income is added to the deposit or investment rather than received by separate check.)

**Credit:**

- With withdrawals or redemptions of deposits.
Preservation of Financial Records\textsuperscript{20}: The financial records must be preserved and made available for verification by the Board staff, the funding agencies, the auditors and Government authorities and others.

Financial Controls: Control systems in an organization are meant to provide reasonable security to the finances and assets of the organization. Further, control systems provide checks and balances which help to keep the system in its place, to avoid frauds and misappropriation or deviations from accepted policies and procedures.

Control systems are not static as the organization operates in a dynamic environment and hence periodic review of the systems is required to maintain the vitality of the control system. The following controls are generally recommended for NCRPB.

Cash Transactions

Segregation of cashiering and accounting: It is a healthy practice to entrust these functions to two different people to avoid any collusion in committing fraud. Of course in a small organization, it may not be practical to have two persons for these functions in which case the organization has to keep a close vigil and be sensitive to its own reality.

There can easily be cases of breach of trust in any organization and hence it is neither healthy nor commendable to have total trust without adequate controls.

Segregation of cash payments into petty cash and larger payments: Both for accounting and control purposes it is wise to segregate payments into petty cash payments and larger payments. In the imprest system, there is an inbuilt limit but even otherwise it is advisable to fix limits for petty cash payments.

While petty cash can be entrusted to one person, large payments should go through the senior management through specific withdrawals from the bank.

Cheque payments versus cash payments: As far as possible make all payments for expenses through cheque except for petty cash transactions. In any case it is advisable to make all payments exceeding Rs.5,000/- by Account Payee cheque or demand draft.

Cash receipts: NCRPB management should ensure that the cash received by the organisation is promptly deposited. Its receipt should be acknowledged through pre-numbered receipts, which are properly recorded in the Cash Book. The various functions of receiving, processing and recording should be clearly segregated.

Physical verification of cash: NCRPB management should have an inbuilt system for successively higher authorities to verify the actual cash on hand with the balance shown in the book at least once a month and also on surprise visits, but definitely at the end of the financial year.

Bank Transactions

\begin{itemize}
  \item There should be a good system of preparation of Bank Reconciliation Statements and of monitoring the same.
  \item Issuing bearer cheques (i.e. uncrossed cheques) and post-dated cheques should be avoided as far as possible.
  \item Cheques for payment should be issued only when there is an adequate balance in the account since dishonoring of a cheque will attract criminal liability.
  \item All cancelled cheques should be preserved for identification and control purposes.
  \item The cheque book should always be in the safe custody of a designated authority who is accountable to the Board.
  \item A Bank account for an organization should always be opened in the name of the organization and not in the name of an individual.
  \item Cheques and drafts received by NCRPB must be promptly deposited. Their receipt should be acknowledged through pre-numbered receipts which are properly recorded in the Cash Book.
  \item The various functions of receiving, processing and recording should be clearly segregated.
  \item The bank transactions should be entered in the book from pay in slip and cheques and not from bank statements or pass book.
\end{itemize}

\textsuperscript{20} Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Maintenance of Files: A good filing system is an integral part of the accounting system of an organization. Normally the following files should be maintained at NCRPB.

- Voucher file for Cash Book
- Voucher file for Petty Cash Book
- Voucher file for Journal Register
- A separate bank file for each bank account
- Receipts file/book
- Fixed assets file/register
- Fixed deposits file
- Management reports (monthly or quarterly)
- Financial statements
- Audited accounts
- Budget file
- Separate files for Telephone bills, Electricity bills etc
- Income tax file
- Legal authorities file
- Donor files (ADB etc)
- Wholesaler files (ADB etc)

In addition to the above, NCRPB may maintain other files depending on the necessity and administrative convenience.

Documentation for Fixed Assets: Fixed Assets represent those assets of NCRPB, which are meant for use over an extended period. These are the assets held for providing services and are not held for resale in the normal course of operations.

Fixed Assets may be constructed or acquired by or may be gifted or donated either for its own use or for public benefit.

Fixed Assets can be classified into two types: (1) **Immovable** - e.g. Land, Buildings; and (2) **Movable** - e.g. Vehicles, Furniture, and Equipment

The documents relating to Fixed Assets have to be properly preserved and these are identified hereafter:

**Accounting Principles:** The following Accounting Principles shall govern the recording, accounting and treatment of transactions relating to Fixed Assets:

- All Fixed Assets shall be carried at cost less accumulated depreciation.

The cost of fixed assets shall include cost incurred/money spent in acquiring or installing or constructing fixed asset, interest on borrowings directly attributable to acquisition or construction of qualifying fixed assets up to the month of commissioning of the assets and other incidental and indirect expenses incurred up to that month.

Any addition to or improvement to the fixed asset that results in increasing the utility or economic life of the asset shall be capitalized and included in the cost of fixed asset.

Any Fixed Asset, which has been acquired free of cost or in respect of which no payment has been made, shall be recorded at nominal value of Re. 1/- or thereof.

All assets costing less than Rs.5, 000 (Rupees five thousands) shall be expensed / charged to Income & Expenditure Account in the year of purchase.

Depreciation shall be provided at full rates for assets, which are purchased by September 30th of an Accounting Year.

Depreciation shall be provided at half the rates for assets, which are acquired free of cost or in respect of which no payment has been made, shall be recorded at nominal value of Re. 1/- or thereof.

Depreciation shall be provided at full rates for assets, which are disposed after September 30th of an Accounting Year.

Depreciation shall be provided at half the rates for assets, which are disposed by September 30th of an Accounting Year.

**Accounting Treatment:** This section explains the Accounting Treatment for transactions involving fixed assets.

**Immovable Assets:** The General Guidelines to be followed for Immovable Fixed Assets are as follows:

- Conduct physical verification of the immovable assets.
- The information collated during physical verification should be cross-verified with the existing records maintained for the said fixed assets, if any.
- Only such assets, whose ownership vests with NCRPB, shall be considered for arriving at the list of assets NCRPB.
- Details of the assets, whether freehold or leasehold should be specified separately for each of the assets.
Cost of acquisition/construction.
- The cost of acquisition/construction should also include, in addition to the cost incurred in acquiring / constructing the said asset, the cost incidental to the acquisition/construction such as registration charges, stamp duty, consultancy charges (including legal charges) etc.
- In case the cost of acquisition/construction is not ascertainable, an estimate of cost that would have been incurred for the acquisition/construction should be provided.
- For assets funded out of grants, the cost of acquisition of the assets would be net of the grant proceeds utilised for the purchase of the asset
- In case an asset has been acquired/created free of cost, the asset should be recorded at a nominal value (to be decided by NCRPB).

Cost of improvement. Any cost incurred for improvement of assets, which results in increasing the life or the utility of the asset, should be considered as an improvement cost. Expenses of a normal and routine nature incurred for the repairs and maintenance of assets should not be considered as an improvement cost.

Date of Acquisition. The date of acquisition is the date on which the property was legally vested with NCRPB.
- In case of acquisition of fully constructed property, specify the estimated date of construction of the structure. Also specify the date of acquisition of the said structure by NCRPB.
- Mode of Acquisition. Specify whether the fixed assets have been purchased, constructed, transferred or gifted to the NCRPB or has been attached under any Act.
- From whom acquired. Specify the person / institution from whom the assets have been acquired.
- Reference of available title documents. It has to be ensured that all the relevant documents like title deeds, contracts, invoices etc. are available with NCRPB.
- A reference of the same has to be provided in the requisite formats. In case the original documents are not available, a duplicate set should be made.

The following should be specified in the Remarks Column:
- Source of finance for the acquisition / construction of the assets.
- Any restriction/covenants on the transfer of assets.
- Pending litigations in respect of the fixed assets
- Any unauthorized use or encroachment on the fixed assets

The Accounts Department shall provide appropriate depreciation for assets held by NCRPB to arrive at the book values of the assets. Depreciation shall be provided at the rates and calculated up to the date of opening balance sheet from the date of acquisition / installation as the case may be as per the principles laid down in the organizational charter.

In case of freehold land, the following are necessary:

a. Land (freehold)
- Original sale deeds
- Parent documents
- Sketch of the property
- Encumbrance certificates
- Legal opinion as to the title of the property
- Land tax receipts, if any
- Patta etc

In the case of leasehold land the lease agreement document should be preserved.

b. Building
Purchase of Building
- Original sale deed
- Parent documents
- Sketch of the land and building
- Encumbrance certificate
- Legal opinion as to the title of the property
- Patta etc
- Property tax and land tax receipts

Movable Assets: The General Guidelines to be followed for Movable Fixed Assets are as follows:
- Conduct physical verification of the movable assets. Allot an asset reference number to all categories of plant and machinery, vehicle, furniture, fixture and equipment (including office equipment).
The information collated during physical verification should be cross-verified with the existing records maintained for the said fixed assets, if any.

Cost of acquisition / construction is the same as discussed above

Cost of improvement. Any cost incurred for improvement of vehicles such as building of body for vehicles, etc. should be considered as an improvement cost.

Date of Acquisition. The date of acquisition is the date on which the asset was legally vested with the NCRPB.

Mode of Acquisition is the same as discussed above

From whom acquired is the same as discussed above

Reference of available title documents. It has to be ensured that all the relevant documents like title, contracts, invoices etc. are available with NCRPB. A reference of the same has to be provided as per the formats. In case the original documents are not available, a duplicate set should be made.

The following should be specified in the Remarks Column:

- Source of finance for the acquisition / construction of the assets.
- Any restriction/covenants on the transfer of assets.
- Pending litigations in respect of the fixed assets
- Any unauthorized use of the fixed assets

The documents needed are as follows:

**a. Vehicle**
- Invoice
- Proper receipt
- Registration document of the vehicles
- Road tax
- Insurance

**b. Other Assets**
- Cash bills
- Invoice
- Proper receipts
Journal Register

This is kept for passing adjustment entries, rectification entries, closing entries and for consolidation of two or more accounts. For example, adjustment entries are passed for providing depreciation and rectification of heads of expenses. Given Below is a format for a Journal Register:

Fixed Assets Register

This is maintained to reflect all the movable and immovable assets owned by NCRPB. It is required to record, account, report, control and manage the assets. It records the complete details of all assets owned by NCRPB:
- Date of purchase
- Invoice No. or Bill No.
- Name of the article
- Main Cash Book folio and General Ledger folio
- Purchase amount
- Sale amount (if sold)
- Depreciation rates
- Depreciation amount
- Assets code (e.g. every table will be numbered)

<table>
<thead>
<tr>
<th>Depreciation of Asset:</th>
<th>Register No.:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group Code :</td>
<td>Method of Depreciation:</td>
</tr>
<tr>
<td>Head of Account :</td>
<td>Maturity Period :</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Name</th>
<th>Location</th>
<th>Item Code</th>
<th>Cost/Value</th>
<th>Depreciation</th>
<th>Net book value</th>
<th>Details of Disposal (including Transfers)</th>
<th>Initials of person in charge</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Particulars of items sold / disposed of would be recorded in these columns against the corresponding ‘acquisition’ entries

The Stock Register

This is a register maintained to help keep track of the movement of stock and the balance of closing stock in terms of quantity and values on any particular date. A Stock Register should contain particulars such as date; quantity and value of issue of stock to be used etc.

<table>
<thead>
<tr>
<th>S. No</th>
<th>Date</th>
<th>Bill No.</th>
<th>Opening Balance</th>
<th>Receipts</th>
<th>Total</th>
<th>Issues</th>
<th>Closing Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

22 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Precautions for Stock Records: The following precautions should be taken while maintaining stock records:
- At the time of receipt of stock an authorized person should verify the stock with the bill to check the quantity, value, quality and such other terms and conditions prescribed at the time of purchase.
- After ensuring that the stock, received fulfills the terms and conditions of purchase, the authorized person acknowledges the receipt of goods.
- The receipt of the goods is to be recorded in the Stock Register against the respective item of stock.
- Issue of stock should be made against properly authorised requisitions.
- Any discrepancy of stock should be notified to the authorities.
- Physical certification of stock should be carried out once a year, preferable at the closing of the financial year, and a statement should be prepared to compare with the book stock.
- Discrepancies between book stock and actual stock should be immediately brought to the notice of higher authorities and necessary action taken.

Rectification of Errors: Errors could be caused due to the following:
- **Errors of Omission** – a transaction entirely omitted from record in the original books or partially omitted while posting.
- **Errors of Commission** – the posting of an amount in the wrong account or on the wrong side (i.e., expense posted on credit side) of the account.
- **Errors of Principle** – wrong classification of expenditure or receipt e.g. an asset being treated a revenue expenditure.
- **Compensatory Errors** - transactions of same amount omitted in both the income and expenditure account.

Rectification of errors is carried out by making a proper entry and not by simple deleting the wrong amount and inserting the right one. Rectification entries are passed by way of journal entries for the above errors.
The Accounting Standards\textsuperscript{23}:

General minimum compliance from the existing framework:

It is suggested that in all the case the very basis of the standards and disclosures should be:

- The basic disclosure recommended in Schedule VI of the Companies Act, 1956 and
- The Rules of the Non Banking Finance Companies as applicable in Indian scenario, issued by the Reserve Bank of India.
- A mixture of both as modified to meet the business conditions should form the basis of development of such standards.

Thus, the recommended application of the same presupposes the applicability of Accounting Standards 1-23 issued by the Institute of Chartered Accountants of India and made applicable to business entities.

Maintenance of Books:

Whether the finance activity is carried on in a formal FI structure or not, books of accounts need to be maintained separately for financing.

Basis of Preparation of Financial Statements:

- Historical Cost Convention,
- Accrual Basis,
- Going Concern and
- The normally accepted accounting principles.

Income Recognition:

All income and interest on loans to be recognized on accrual basis, except to the extent the interest income is derecognized.

Derecognition of Interest:

- On Non-performing Assets: all interest accruals should be stopped immediately, until they become a performing asset.
- All the interest so far provided and recognized in the accounts up to the date of derecognition should be reversed and not recognized as income in the accounting period in which such asset became non – performing.
- Income shall be recognised on the Non Performing Assets only when realised.

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Provision for Loan Losses:

- For the purposes of provisioning all loans should be classified into Regular and rescheduled loans.

<table>
<thead>
<tr>
<th>Classification</th>
<th>Definition</th>
<th>Provision on outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular Loans</td>
<td>Interest not paid for after it has become due</td>
<td>None</td>
</tr>
<tr>
<td>Past due Loans</td>
<td>Non repayment or in arrears for 8 weeks / 4 weeks from the due date</td>
<td>20% or as appropriate or based on financial management manual</td>
</tr>
<tr>
<td>Non Performing Assets</td>
<td>Non repayment or in arrears for 26 weeks from the due date or has been identified as loss asset</td>
<td>100% as appropriate or based on financial management manual</td>
</tr>
<tr>
<td>Loss Asset</td>
<td>Irrespective of the regularity of the loan</td>
<td>20%</td>
</tr>
</tbody>
</table>

- If any security exists or exercisable guarantee from institutions (like guarantee fund or guarantee insurance) the same should be reduced from the provision.
- Unrealisable securities should not taken into cognisance
- If there are any securities available, to that extent the provision may be reduced.
- If the security is unrealizable or not easily recoverable full provision should be made.
- However all the above provisions need not be mutually exclusive along with the specific provisions made already.

Disclosure Standards

General Compliance: These disclosures are recommended in addition to the Schedule VI of the Companies Act, 1956 requirements and the requirements of Non Banking Financial Companies Directions issued by the Reserve Bank of India.

Legal Status: The legal Status of the FI (like NCRPB) to be disclosed and laws governing that.
Good Practices MIS Technical Note For ERP System Developers
TN #21: Accounting Standards and Disclosure Policies

Note on Business Activities: An appropriate note on the activities of the FI (NCRPB), its method of lending, area of lending, the rate of interest and the method of calculation thereof etc.

The Purpose of Institution: Whether Charitable purposes, or business enterprise for profit, but owned by Charitable institution, or privately owned or Government Owned etc.

Taxability Status: Should be disclosed.

Borrowings:
✓ In the case of foreign currency loans, the currency in which it is to be repaid.
✓ Interest rate
✓ Due when and terms of loans
✓ Due within the next 12 months
✓ Any defaults, if so the arrears with interest
✓ Maturity Buckets, if falls within the accounting period.
✓ Security Provided, Nature
✓ Status of subordination and if subordinated the order of subordination.

Loans:
✓ Classification by secured and unsecured loans and Rescheduled Loans.
✓ In unsecured, or collateral free loans, Age wise outstanding and interest both at the opening and at the closing of the accounting period.
✓ Delinquency status

Deferred Revenue Expenditure: Method of deferring and amortization should be disclosed.

Auditors: The auditors of FIs should be required to follow the above standards and adequately train them in preparing the financial statements of NCRPB.
What do we mean by “Internal Controls24”? 

In general, “internal controls” refers to all the policies and procedures established and maintained by the managers of an entity to help ensure, as far as is practical, the orderly, efficient and profitable conduct of its business.

Internal controls help to promote the basic objectives of management and try to provide reasonable (but not absolute) assurance of the following:

- **Profitability or sustainability:** FIs like NCRPB must be financially and institutionally sustainable to effectively provide financial services and products to the constituents (ULB, Agencies etc) they serve.
- All the operating processes, work flows, and delivery channels are designed to provide those financial services, and to do so efficiently, according to policy, and without the loss of reputation or resources of the institution.
- **Adherence to management policies:** NCRPB management is responsible for the overall administration of the FI; the Board and regulatory authorities (Department of UD) approve policies that management implements.
  - Management’s administrative controls are internal controls designed to promote operational efficiency and encourage adherence to established management policies.
- **Safeguarding of assets:** The physical assets of an NCRPB can be accidentally destroyed, misused or stolen unless they are protected by adequate controls.
  - Non-physical assets such as loans receivable, important documents (e.g. client/project loan contracts or receipt copies), and financial records are also vulnerable.
  - Computer data, records and reports can also be destroyed or lost if care is not taken to protect them through reliable and safe backup procedures, clear assignment of duties, and controlled operating environments.
- **Prevention and detection of fraud and error:** NCRPB internal control system is important in the prevention and detection of error, fraud or other irregularities.
  - The cost of preventing a particular error, should be balanced against the likelihood of the error occurring and the amount of the error that could occur.
- **Accuracy and completeness of accounting records:** Part of the internal control system is a strong accounting system.
  - The accounting system must produce accurate and complete accounting records.
- **Timely preparation of reliable financial information:** Financial reports and information must be reliable and timely if it is to be useful for NCRPB management decision-making.
  - This is more of a function of the accounting and finance staff who use an accounting system, than the accounting system itself.
- **Discharge of statutory responsibilities:** NCRPB is accountable to external stakeholders – whether it is their Board of Directors, their Government, Central Bank regulators, or donors or lenders or public.
  - These stakeholders have both statutory and non-statutory expectations, and an internal control system can provide support and means to fulfill those.

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24 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
The Control Activities: Systems, Policies and Procedures

The two key components of the control activities are the accounting system and specific control policies and procedures.

The accounting system has to do with the collecting, recording, processing and reporting of financial transactions.

The integrity of individual transactions is critical for the reliability of the system.

Specific control procedures are the policies and procedures that guide staff to process transactions, manage assets, and conduct their work.

Control policies and procedures also enhance and strengthen the reliability of data and information in the accounting system.

The Accounting and Portfolio Tracking System

The accounting system is the process of data preparation, data entry, transaction processing and document and report generation.

The integrity of the entire system (data entry and processing), including the financial reports, will rely on the specific controls for transactions themselves, and for data entry and processing.

The overall objective is to prevent incorrect information or misstatements in the journals, records, and ultimately financial reports.

In an FI like NCRPB, the accounting system and the portfolio tracking system form the basis for financial information and management.

The two systems are inter-connected, as the portfolio tracking system is essentially the detailed subsidiary ledger of the general ledger’s control account called Client (or Project) Loans Receivable.

Control Procedures: Control procedures are the policies and procedures that management has established to achieve the entity’s specific objectives. Control procedures include things like:

- Accounting and financial policies and procedures to ensure correct and consistent treatment of transactions and operational activities
- Independent checks and review of performance
- Adequate separation of duties (Have different persons “Approve”, “Record” and “Do”)
- Proper authorization and approval of transactions and activities
- Design and use of adequate documents and records (Pre-numbered documents, multiple copies, Chart of Accounts, manuals and written procedures, etc.)
- Physical control over assets and records (In financial institutions, many records – like receipts, purchase orders, or payment vouchers – are records that have “near-cash” quality. They need to be well controlled)
- Security and controls over the application, change, continuity and backup of computer systems, databases and software

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The Context of Internal Control: The system of internal control must be under continuing supervision by management to determine that it is functioning as prescribed and is modified, as appropriate, for changes in conditions. The internal control system extends beyond those matters which relate directly to the functions of the accounting system and comprises:

- **The control environment** which means the overall attitude, awareness and actions of its directors and management regarding the internal control system and its importance at NCRPB.

- The control environment has an effect on the effectiveness of the specific control procedures and provides the background against which other controls are operated.

- A strong control environment, for example, one with tight budgetary controls and an effective internal audit function, can significantly complement specific control procedures.

- However, a strong control environment does not, by itself, ensure the effectiveness of the internal control system. Factors reflected in the control environment include:
  - The entity's organizational structure and methods of assigning authority and responsibility (including segregation of duties and supervisory functions).
  - The function of the board of directors and its committees in the case of a company or the corresponding governing body in case of any other entity.
  - Management's philosophy and operating style.
  - Management's control system including the internal audit function, personnel policies and procedures.

- **Control procedures** which mean those policies and procedures in addition to the control environment which management has established to achieve the entity's specific objectives. Specific control procedures include:
  - Reporting and reviewing reconciliations.
  - Checking the arithmetical accuracy of the records.

Checking the procedures for project approvals.
- Checking the procedures for approval of loans and advances.
- Controlling applications and environment of computer information systems, for example, by establishing controls over:
  - Changes to computer programs; and
  - Access to data files.
- Maintaining and reviewing control accounts and related subsidiary ledgers.
- Approving and controlling of documents.
- Comparing internal data with external sources of information.
- Comparing the results of physical verification of cash, fixed assets, investments and inventory with corresponding accounting records.
- Restricting direct access to assets, records and information and
- Comparing and analysing the financial results with corresponding budgeted figures.

Accounting and Internal Control Systems:
Internal controls relating to the accounting system are concerned with achieving the following objectives:

- Transactions are executed in accordance with management's general or specific authorization.
- All transactions and other events are promptly recorded in the correct amount, in the appropriate accounts and in the proper accounting period so as to permit preparation of financial statements in accordance with the applicable accounting standards, other recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets.
- Assets and records are safeguarded from unauthorized access, use or disposition.
- Recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

Objectives of Internal control: The objective of internal control is to prevent fraud or to facilitate its early detection. Internal control system in respect of project approvals, funds release, billing, collections, payables, payroll and salary related expenditures and all procurements etc. need to be reviewed and strengthened.
Some of the techniques incorporated in the internal control systems include rotation of duties, segregation of duties, introduction of checks and balances besides strengthening the internal audit system and timely follow-up action on the internal audit reports.

**NCRPB Context:** In any institution like NCRPB, the accounting system should provide internal controls for:

- Safeguarding assets of the FI (including the loan portfolio)
- Ensuring that loans, etc are promptly processed,
- Promoting the accuracy and reliability of financial data, and
- Encouraging adherence to approved policies.

Failure to do so could result in serious problems for the FI. Hence, best practices suggest that the accounting system be appropriately designed to ensure internal control of financial operations.

**System of Checks and Balances:** The system of checks and balances should be such that it ensures:

- Conformance with legal, administrative and accounting requirements,
- That funds are disbursed only for purposes for which they are legally available and administratively authorized.
- Recorded transactions need to be adequately documented so they may be traced from original documents to financial transactions in a computerized system specially prepared for the FI.
- General ledger controls need to be maintained over all assets, liabilities, funds, equities, revenues, and costs through the use of a double entry accounting system.
- General Ledger accounts will have to be grouped and subsidiary records will need to be maintained to provide the accounting detail necessary to properly record transactions and to prepare timely and meaningful financial statements and reports for all management levels and external sources.
- Other suggested internal control measures that need to be adopted by NCRPBs, include those given in the Table (next page), which are based on global best practices.

### Table 1: Best Practices Recommendations For Accounting (Internal Control) Administration In like NCRPB

<table>
<thead>
<tr>
<th>#</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Cash receipts should be promptly recorded through the use of pre numbered receipts by an individual designated to receive cash</td>
</tr>
<tr>
<td>2.</td>
<td>Pre numbered receipts must be reconciled to deposit slips by someone independent of cash receipts and accounting functions</td>
</tr>
<tr>
<td>3.</td>
<td>There must be daily posting of cash receipts to appropriate accounting records</td>
</tr>
<tr>
<td>4.</td>
<td>Disbursement of cash from cash receipts prior to their deposits must be prohibited</td>
</tr>
<tr>
<td>5.</td>
<td>Cash receipts must be deposited intact daily, if significant, or at least weekly</td>
</tr>
<tr>
<td>6.</td>
<td>Adequate physical facilities must be provided for safeguarding cash prior to deposit</td>
</tr>
<tr>
<td>7.</td>
<td>Safe combinations and keys to cash boxes or files must be restricted to an essential number of employees</td>
</tr>
</tbody>
</table>
| 8. | The following cash controls must be used:  
  - Voided copies of receipts should be retained for audit purposes  
  - Cash handling procedures must reflect proper daily check out and documentation  
  - Locked in audit copies of receipts must be used where appropriate  
  - Cashiers must be provided separate cash drawers to establish accountability  
  - Cash drawers must be locked during cashier’s absence |
| 9. | Cheques must restrictively be endorsed immediately upon receipt |
| 10. | Person receiving cash must not have authority to sign cheques and reconcile bank accounts and should not have access to accounting records other than cash receipts |
| 11. | Cash collections must be reconciled to totals of invoices, cash receipts book, deposit slips, loan register etc, especially by a person who has no access to cash |
| 12. | Cash overages and shortages must be recorded on the books by cashier and reviewed regularly by someone else |
| 13. | All journal entries and transfers must be approved by someone other than the Preparer |
### Table 1: Best Practices Recommendations For Accounting (Internal Control) Administration In like NCRPB

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>14.</td>
<td>All journal entries and transfers should be properly posted and reconciled.</td>
</tr>
<tr>
<td>15.</td>
<td>All journal entries and transfers should be properly prepared, recorded and supported.</td>
</tr>
<tr>
<td>16.</td>
<td>All bank accounts must be established in accordance with the existing legal framework.</td>
</tr>
<tr>
<td>17.</td>
<td>All inactive bank accounts should be closed promptly.</td>
</tr>
<tr>
<td>18.</td>
<td>There must be an adequate segregation of duties between employees handling cash and employees involved in record keeping.</td>
</tr>
<tr>
<td>19.</td>
<td>Employees who have no responsibilities for receipts or disbursements functions should reconcile bank accounts.</td>
</tr>
<tr>
<td>20.</td>
<td>Reconciliation procedures should include:</td>
</tr>
<tr>
<td></td>
<td>✓ Comparison of canceled cheques with the check register as to number, date, payee and amount.</td>
</tr>
<tr>
<td></td>
<td>✓ Examination of canceled cheques for authorized signature.</td>
</tr>
<tr>
<td></td>
<td>✓ Examination of canceled cheques for irregular endorsements and alterations.</td>
</tr>
<tr>
<td></td>
<td>✓ Comparison of dates and amounts of deposits as shown on the bank statements with the check register.</td>
</tr>
<tr>
<td></td>
<td>✓ Review of completed bank and fund reconciliation's by a responsible official.</td>
</tr>
<tr>
<td>21.</td>
<td>All Revolving Fund disbursements other than Petty Cash items must be made by Cheque.</td>
</tr>
<tr>
<td>22.</td>
<td>Only serially pre-numbered cheques must be used.</td>
</tr>
<tr>
<td>23.</td>
<td>The supply of unused cheques must be adequately safeguarded.</td>
</tr>
<tr>
<td>24.</td>
<td>Cheques must be under the custody of persons who do not sign cheques manually.</td>
</tr>
<tr>
<td>25.</td>
<td>Cheques must be prepared only on the strength of properly approved vouchers (or cheque requests) by persons who do not approve the vouchers (or cheque requests).</td>
</tr>
<tr>
<td>26.</td>
<td>Spoiled cheques must be mutilated to prevent reuse and kept on file for subsequent inspection.</td>
</tr>
<tr>
<td>27.</td>
<td>A copy of the cheque register or stub must be prepared simultaneously with the preparation of the cheque.</td>
</tr>
<tr>
<td>28.</td>
<td>The supporting data and approvals on the vouchers should be reviewed by the cheque signers at the time of signature.</td>
</tr>
<tr>
<td>29.</td>
<td>Notification of payment must be made on supporting data to prevent duplicate Payment.</td>
</tr>
<tr>
<td>30.</td>
<td>There must be limitations on the amounts of single signature cheques.</td>
</tr>
<tr>
<td>31.</td>
<td>The names of authorized cheque signers should be removed from the signature lists after the individuals have left the employment of the entity or have been transferred to duties incompatible with cheque signing.</td>
</tr>
<tr>
<td>32.</td>
<td>The person writing cheques should be prohibited from drawing cheques payable to:</td>
</tr>
<tr>
<td></td>
<td>✓ &quot;Cash&quot;, &quot;Bearer&quot; or similar payee which renders the cheque payable to the bearer;</td>
</tr>
<tr>
<td></td>
<td>✓ Other payee when the payee named is not intended as the party to retain funds.</td>
</tr>
<tr>
<td>33.</td>
<td>Persons authorized to sign cheques should be prohibited from:</td>
</tr>
<tr>
<td></td>
<td>✓ Having access to the petty cash.</td>
</tr>
<tr>
<td></td>
<td>✓ Preparing the bank reconciliation's.</td>
</tr>
<tr>
<td></td>
<td>✓ Recording cash transactions.</td>
</tr>
<tr>
<td></td>
<td>✓ Posting to the ledger accounts.</td>
</tr>
<tr>
<td>34.</td>
<td>The Revolving Fund cashier must be prohibited from mingling cash receipts with the Petty Cash fund.</td>
</tr>
<tr>
<td>35.</td>
<td>Unauthorized advances should be prohibited in the Revolving Fund.</td>
</tr>
<tr>
<td>36.</td>
<td>The responsibility for the Fund should not be vested in only one person.</td>
</tr>
<tr>
<td>37.</td>
<td>Reimbursements must be approved by persons other than custodians only after adequate inspection of supporting data.</td>
</tr>
<tr>
<td>38.</td>
<td>Revolving Fund claims and reconciliation's along with supporting documents should be filed separately from the other transactions.</td>
</tr>
</tbody>
</table>
### Tool for Ensuring Proper Accounting Controls In FIs

#### Table 2: Accounting (Internal Control) Questionnaire For Ensuring Proper Accounting Controls In – like NCRPB

<table>
<thead>
<tr>
<th>S No</th>
<th>Description</th>
<th>Yes</th>
<th>No</th>
<th>“NA”</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Are all cash receipts promptly recorded through the use of pre numbered receipts by an individual designated to receive cash?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Are pre numbered receipts reconciled to deposit slips by someone independent of cash receipts and accounting functions?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Is there a daily posting of cash receipts to appropriate accounting records?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Do procedures prohibit the disbursement of cash from cash receipts prior to their deposits?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>Are cash receipts deposited intact daily, if significant, or at least weekly?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Are adequate physical facilities provided for safeguarding cash prior to deposit?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Are safe combinations and keys to cash boxes or files restricted to an essential number of employees?</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>8.</td>
<td>Are the following cash controls used:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Voided copies of receipts retained for audit purposes?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Do cash handling procedures reflect proper daily check-out and documentation?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Are locked-in audit copies of receipts used where appropriate?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Are cashiers provided separate cash drawers to establish accountability?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Are cash drawers locked during cashier’s absence?</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>9.</td>
<td>Are all cheques restrictively endorsed immediately upon receipt?</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>10.</td>
<td>Is the person receiving cash without authority to sign cheques and reconcile bank accounts and without access to accounting records other than cash receipts?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>Are cash collections reconciled to totals of invoices, cash receipts book, deposit slip, loan register etc.? By a person who has no access to cash?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12.</td>
<td>Are cash overages and shortages recorded on the books by cashier and reviewed regularly by someone else?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td>Are all journal entries and transfers approved by someone other than the preparer?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14.</td>
<td>Are journal entries and transfers properly posted and reconciled</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td>Are journal entries and transfers properly prepared, recorded and supported</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td>Are all bank accounts established in accordance with the legal framework?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17.</td>
<td>Are inactive bank accounts closed promptly?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

27 Note - In the case of a "No" answer, the "Remarks" column should explain the mitigating circumstances or lack of importance of the item, and indicate whether the item is to be included for subsequent discussion. "N/A" (Not Applicable) answers should also be explained in the "Remarks" column.
### Table 2: Accounting (Internal Control) Questionnaire For Ensuring Proper Accounting Controls In – like NCRPB

<table>
<thead>
<tr>
<th>S No</th>
<th>Description</th>
<th>Yes</th>
<th>No</th>
<th>“NA”</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>18.</td>
<td>Is there an adequate segregation of duties between employees handling cash and employees involved in record keeping?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19.</td>
<td>Do employees who have no responsibilities for receipts or disbursements functions reconcile bank accounts?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20.</td>
<td>Do the reconciliation procedures include?</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Comparison of canceled cheques with the check register as to number, date, payee and amount;</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Examination of canceled cheques for authorized signature;</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Examination of canceled cheques for irregular endorsements and alterations;</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Comparison of dates and amounts of deposits as shown on the bank statements with the check register</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Review of completed bank and fund reconciliation’s by a responsible official?</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>21.</td>
<td>Are all Revolving Fund disbursements other than Petty Cash items made by cheque?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>22.</td>
<td>Are serially prenumbered cheques used?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23.</td>
<td>Is the supply of unused cheques adequately safeguarded?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>24.</td>
<td>Are cheques under the custody of persons who do not sign cheques manually?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25.</td>
<td>Are cheques prepared only on the strength of properly approved vouchers (or cheque requests) by persons who do not approve the vouchers (or cheque requests)?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>26.</td>
<td>Are spoiled cheques mutilated to prevent reuse and kept on file for subsequent inspection?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>27.</td>
<td>Is a copy of the cheque register or stub prepared simultaneously with the preparation of the cheque?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>28.</td>
<td>Are the supporting data and approvals on the vouchers reviewed by the cheque signers at the time of signature?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>29.</td>
<td>Is notification of payment made on supporting data to prevent duplicate payment?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.</td>
<td>Are there limitations on the amounts of single signature cheques (Ask and note Rupee amount)?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31.</td>
<td>Are the names of authorized cheque signers removed from the signature lists after the individuals have left the employment of the entity or have been transferred to duties incompatible with cheque signing?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>32.</td>
<td>Is the person writing cheques prohibited from drawing cheques payable to:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• “Cash”, “Bearer” or similar payee which renders the cheque payable to the bearer;</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Other payee when the payee named is not intended as the party to retain funds?</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.</td>
<td>Are persons authorized to sign cheques prohibited from:</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Having access to the petty cash</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Preparing the bank reconciliation’s</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Recording cash transactions</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Posting to the ledger accounts?</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 2: Accounting (Internal Control) Questionnaire For Ensuring Proper Accounting Controls In – like NCRPB

<table>
<thead>
<tr>
<th>S No</th>
<th>Description</th>
<th>Yes</th>
<th>No</th>
<th>“NA”</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>34.</td>
<td>Is the Revolving Fund cashier prohibited from mingling cash receipts with the Petty Cash fund?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>35.</td>
<td>Are unauthorized advances prohibited in the Revolving Fund?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>36.</td>
<td>Is responsibility for the Fund vested in only one person?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>37.</td>
<td>Are reimbursements approved by persons other than custodians upon adequate inspection of supporting data?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>38.</td>
<td>Are Revolving Fund claims and reconciliation’s along with supporting documents filed separately from the other transactions?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>39.</td>
<td>Do internal controls appear adequate for this area overall?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

ADB’s Internal Audit Guidelines

The ADB has devised guidelines and standards for monitoring its loan portfolio in organizations and for improving the quality of internal audit standards. As per section 4.2.8.8 (Internal audit) of ADB’s guidelines, the following is an extract from the INTOSAI’s Advisory Document on “Standards for Internal Controls”:

Internal control is a management tool. It is management’s responsibility to implement and monitor the specific internal controls for its operations.

Even in countries where specific controls are set out in legislation, a manager has no less a responsibility for implementing and monitoring those controls.

All managers should realize that a strong internal control structure is fundamental to their control of the organization, its purpose, operations, and resources. They should accept responsibility for it.

To design, establish, and maintain an effective internal control structure, managers should understand the objectives to be achieved.

Legislation can provide a common understanding of the internal control definition and objectives to be achieved.

It can also prescribe the policies managers are to follow to implement and monitor their internal control structures and to report on the adequacy of those structures.

Management often establishes an internal audit unit as part of its internal control structure.

While internal auditors can be a valuable resource to educate and advise on internal controls, the internal auditor should not be a substitute for a strong internal control structure.

Management can also use its internal audit unit to help monitor the effectiveness of internal controls.

The closeness of internal auditors to the day-to-day operations usually places them in a position to continually assess the adequacy and effectiveness of internal controls and the extent of compliance.

The internal auditors have a responsibility to management for reporting any inadequacies in the internal controls and any failure of employees to adhere to them and recommending areas needing improvement.

In addition, they should establish procedures for following up on previously reported internal and external audit findings to ensure that managers have adequately addressed and resolved the matters brought to their attention."

The above advice was developed for use in public sector institutions, but the key principles are equally applicable to private sector operations, except for the suggestion that legislation may be necessary to underpin the provision of internal controls. The key principles are:

It is management’s responsibility to implement and monitor the specific internal controls for its operations.

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Guidelines for the Financial Governance and Management of Investment Projects Financed by the Asian Development Bank
While internal auditors can be a valuable resource to educate and advise on internal controls, the internal auditor should not be a substitute for a strong internal control structure.

Further, management can also use its internal audit unit to help monitor the effectiveness of internal controls. The closeness of internal auditors to the day-to-day operations usually places them in a position to continually assess the adequacy and effectiveness of internal controls and the extent of compliance.

Internal audit units and operations are most likely to be found in public and private sector enterprises. The units may be centrally located with a mandate to monitor the operation and efficiency of all units throughout the area of operation of the enterprise.

Exceptions may occur in very large operational units, where subunits of an enterprise’s internal audit group may have a high degree of autonomy. It is unlikely that a nonrevenue-earning Project Implementing Unit (PIU) would have an internal audit unit specifically installed, although a central unit of a ministry or department of government may have been awarded the responsibility to review and monitor internal controls of the PIU.

ADB’s primary concern is to be assured that internal controls not only exist but also are the subjects of regular review and monitoring for efficiency and responsiveness to current operations. Therefore, if an enterprise has an efficient means of achieving this objective, the engagement of a specific internal audit unit may not be appropriate.

Where reviews and monitoring of ongoing operations of an enterprise are inefficient, ADB should discuss with senior management of the enterprise the need to introduce improvements, one of which may be the use of an internal audit operation. Such recommendations will require an expert to advise and evaluate a cost/benefit study prepared for that purpose.
**A Cycle Approach**\(^{29}\): A systematic and reliable approach for identifying points of risk within an institution is to classify operating activities and transactions into operational cycles.

Although the activities within cycles vary among different types of business entities, the major cycle categories are common to all.

**Figure 1: The Cycle Approach**

- **Revenue Cycle**: In an FI like NCRPB, the primary source of revenue is the interest and fees collected on loans made to clients.
- **Expenditure Cycle**: As in all businesses, the expenditure cycle primarily includes payment for purchases and payroll.
- **Conversion Cycle**: The risks, in asset management are often greater because the costs are higher. Controls begin with a pre-approved capital budget and criteria for the use of the assets.
- **Treasury Cycle**: The treasury cycle focuses on the management of cash within the FI, particularly through its management of liquid or near-liquid assets and liabilities.
- **Purchasing policies should outline procedures for initiating requests for goods or services, the tender or bid process, approval levels, preparing and signing cheques or issuing cash, and the receipt and storage of goods.**
- **Payroll includes the range of human resource functions of hiring, training, compensating, evaluating, and terminating as well as the disbursement functions of accounting for all payroll costs, deductions, benefits, advances, and other adjustments.**
- **Conversion Cycle**: The risks, in asset management are often greater because the costs are higher. Controls begin with a pre-approved capital budget and criteria for the use of the assets.
- **In addition, there should be policies for identification/inventory of assets, depreciation, disposition, and the procedures and recording of the disposition of assets.**
- **Treasury Cycle**: The treasury cycle focuses on the management of cash within the FI, particularly through its management of liquid or near-liquid assets and liabilities.
- **But there are a number of additional functions included in treasury, included, but not limited to, the following:**
  - Funds temporarily invested until needed for operations.
  - Asset and liability management to mitigate liquidity or interest rate risk
  - Selecting appropriate forms of financing.

To use the cycle approach to identify risks and determine the appropriate controls, apply the process and steps of the Risk Management Process:

- List the steps for each operating process
- Identify the points of risk in each process
- Prioritize and assess the risks by frequency and impact
- Design policies and procedures to mitigate risks, depending on your organizations’ aversion to risk
- Implement controls and assign responsibility
- Test effectiveness and evaluate results

\(^{29}\) Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Major Financial Statements

The four basic financial statements, which attempt to provide, in combination, an overall performance assessment of an FI's (like NCRPB) financial condition, are given in the Table below. For each statement, there is a corresponding column that lists the key strategic issues that can be discerned from a reading of the statement. While statements need to properly constructed, the timely production of such statements is also crucial, as outlined in Table below.

<table>
<thead>
<tr>
<th>Financial Statement</th>
<th>Key Strategic Issues</th>
</tr>
</thead>
</table>
| Income Statement    | • What income is being generated by NCRPB?  
|                     | • How much of this income is from operations?  
|                     | • From investments?  
|                     | • From other activities and sources?  
|                     | • What expenses are required to earn this income?  
|                     | • How much is incurred in financial expenses?  
|                     | • In operational expenses?  |
| Balance Sheet       | • What is the overall financial position of the NCRPB?  
|                     | • What assets does it own and in what categories?  
|                     | • How does it finance these assets - through liabilities (obligations to others) or other means?  |
| Cash Flow Statement | • What are NCRPB’s sources of cash?  
|                     | • How is it spending or using that cash?  |
| Portfolio Report    | • What portion of NCRPB’s portfolio is good? What portion is bad?  |

Importance of Timely and Accurate Financial Statements: Timely production of financial records is absolutely critical to the health of an institution. If financial records are not produced accurately and punctually, financial ratios become misleading and unreliable. This could lead to poor management of the organization, and ultimately result in the institution's untimely demise. Therefore, an FI should produce accurate financial reports on a regular basis. This will ensure monitoring the health of its operations periodically.

<table>
<thead>
<tr>
<th>Financial Statements</th>
<th>Type of Analysis Possible from the Statement</th>
<th>Analysis Possible and Utility to FI Manager</th>
</tr>
</thead>
</table>
| Balance Sheet        | • Liquidity  
|                     | • Efficiency  
|                     | • Asset Quality | Overall, how are NCRPB’s assets being funded and is the financing adequate?  
| Income Statement     | • Sustainability  
|                     | • Profitability  
|                     | • Efficiency | Is the FI meeting all its expenses from its income?  
| Cash Flow Statement  | • Liquidity | Is enough cash available to cover all existing cash obligations?  
| Portfolio Report     | • Asset Quality | What portion of the loan portfolio (asset) is good or bad? Do reserves and provisions exist to account for these?  |

Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Good Practices MIS Technical Note For ERP System Developers

TN #27: Trial Balance

The list of debit and credit balances prepared at any specified time from the Main Cash Book and General Ledger is called a Trial Balance. Under the double entry system, since every debit has a corresponding credit if the totals are the same, it proves that the books are arithmetically correct. A tallied Trial Balance need not be conclusive proof of accuracy, but sufficient proof of arithmetic accuracy. If the trial balance does not tally then one has to locate the error(s) committed and then make the necessary corrections or pass the necessary journal entries. Standard trial balance formats can be used.

The process of preparation of the Financial Statements shall be preceded by preparation of a Trial Balance. The Trial Balance is a list of closing balances in all the accounts in the Ledger and the Cash Books. The purpose of preparing a Trial Balance is to determine the equality of posted debits and credits, and to generate a basic summary of accounts for facilitating preparation of the Financial Statements like Income and Expenditure Statement, Balance Sheet, Statement of Cash flows and Receipts and Payments account. The Financial Statements are essentially drawn from the Trial Balance.

The following points should be noted while preparing the Trial Balance:
- The income accounts shall generally have credit balances and the expense accounts shall generally have debit balances.
- The asset accounts shall generally have debit balances and the liability accounts and the reserve funds shall generally have credit balances.

The following are the steps involved in the preparation of a Trial Balance:
- All the ledger accounts shall be closed at period end and the debit or credit balance shall be calculated.
- The debit balances shall be posted in the debit column of the Trial Balance and the credit balances in the credit column of the Trial Balance.
- The posting of Ledger Accounts in the Trial Balance shall be in the same order as shown in the Chart of Accounts.
- The Cash Books shall be closed and the balances shall be posted in the Trial Balance.
- Both the Debit Column and the Credit Column of the Trial Balance shall be totalled.

Since every debit entry has a corresponding credit entry, the sum-total of the debit balances in various account heads shall be equal to the sum-total of the credit balances in the other account heads.

A Trial balance is drawn then it would appear as provided in Table given below.

<table>
<thead>
<tr>
<th>Code No</th>
<th>Particulars</th>
<th>Debit (Rs)</th>
<th>Credit (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-02-(a)</td>
<td>YY1</td>
<td>3,00,000</td>
<td></td>
</tr>
<tr>
<td>01-03-(a)</td>
<td>YYY2</td>
<td>1,30,000</td>
<td></td>
</tr>
<tr>
<td>01-04-(a)</td>
<td>YYYY3</td>
<td>65,000</td>
<td></td>
</tr>
<tr>
<td>01-05-(a)</td>
<td>YYYY4</td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td>01-06-(a)</td>
<td>YYYY5</td>
<td>12,500</td>
<td></td>
</tr>
<tr>
<td>01-07-(a)</td>
<td>YYYY6</td>
<td>25,500</td>
<td></td>
</tr>
<tr>
<td>01-08-(a)</td>
<td>YYYY7</td>
<td>6,500</td>
<td></td>
</tr>
<tr>
<td>01-09-(a)</td>
<td>YYYY8</td>
<td>4,875</td>
<td></td>
</tr>
<tr>
<td>01-10-(a)</td>
<td>YYYY9</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>01-11-(a)</td>
<td>YYYY10</td>
<td>16,500</td>
<td></td>
</tr>
<tr>
<td>01-12-(a)</td>
<td>YYYY11</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>01-13-(a)</td>
<td>YYYY12</td>
<td>6,500</td>
<td></td>
</tr>
<tr>
<td>01-14-(a)</td>
<td>YYYY13</td>
<td>3,850</td>
<td></td>
</tr>
<tr>
<td>01-15-(a)</td>
<td>YYYY14</td>
<td>4,700</td>
<td></td>
</tr>
</tbody>
</table>

*Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.*
### Table 1: Trial Balance for the Period from 01.04.06 to 31.03.07

<table>
<thead>
<tr>
<th>Code No</th>
<th>Particulars</th>
<th>Debit (Rs)</th>
<th>Credit (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-16-(a) YYYYYYYYYYYYYYYYYYYYYY15</td>
<td>2,250</td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-17-(a) YYYYYYYYYYYYYYYYYYYYYY16</td>
<td>1,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-18-(a) YYYYYYYYYYYYYYYYYYYYYY17</td>
<td>4,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-19-(a) YYYYYYYYYYYYYYYYYYYYYY18</td>
<td>2,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-20-(a) YYYYYYYYYYYYYYYYYYYYYY19</td>
<td>2,400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-21-(a) YYYYYYYYYYYYYYYYYYYYYY20</td>
<td>16,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-22-(a) YYYYYYYYYYYYYYYYYYYYYY21</td>
<td>12,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>01-23-(a) YYYYYYYYYYYYYYYYYYYYYY22</td>
<td>17,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>02-01-(1) XX1</td>
<td></td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>02-02-(a) XXX2</td>
<td></td>
<td>11,000</td>
<td></td>
</tr>
<tr>
<td>02-03-(a) XXXX3</td>
<td></td>
<td>65,400</td>
<td></td>
</tr>
<tr>
<td>02-04-(a) XXXXX4</td>
<td></td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>02-05-(a) XXXXXX5</td>
<td></td>
<td>2,250</td>
<td></td>
</tr>
<tr>
<td>02-06-(a) XXXXXXX6</td>
<td></td>
<td>16,500</td>
<td></td>
</tr>
<tr>
<td>02-07-(a) XXXXXXXX7</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>02-08-(a) XXXXXXXXX8</td>
<td></td>
<td>4,875</td>
<td></td>
</tr>
<tr>
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<td></td>
<td>5,500</td>
<td></td>
</tr>
<tr>
<td>02-10-(a) XXXXXXXXXXXX10</td>
<td></td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>02-11-(a) XXXXXXXXXXXX11</td>
<td></td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>02-12-(a) XXXXXXXXXXXX12</td>
<td></td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>02-13-(a) XXXXXXXXXXXX13</td>
<td></td>
<td>17,000</td>
<td></td>
</tr>
<tr>
<td>02-14-(a) XXXXXXXXXXXX14</td>
<td></td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td>02-15-(a) XXXXXXXXXXXX15</td>
<td></td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td>02-16-(a) XXXXXXXXXXXX16</td>
<td></td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>02-17-(a) XXXXXXXXXXXX17</td>
<td></td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>02-18-(a) XXXXXXXXXXXX18</td>
<td></td>
<td>4,700</td>
<td></td>
</tr>
<tr>
<td>02-19-(a) XXXXXXXXXXXX19</td>
<td></td>
<td>12,500</td>
<td></td>
</tr>
<tr>
<td>02-20-(a) XXXXXXXXXXXX20</td>
<td></td>
<td>16,000</td>
<td></td>
</tr>
<tr>
<td>02-21-(a) XXXXXXXXXXXX21</td>
<td></td>
<td>130,000</td>
<td></td>
</tr>
<tr>
<td>02-22-(a) XXXXXXXXXXXX22</td>
<td></td>
<td>8,350</td>
<td></td>
</tr>
</tbody>
</table>

**Total Debit and Credit Amount**  
262,575 262,575
Balance Sheet: NCRPB is to prepare a Balance Sheet at the end of each accounting period. The Balance Sheet is a statement, which reflects the financial position of NCRPB as on a particular date. It presents the assets, liabilities and reserves of NCRPB as on a specified date.

The Balance Sheet is also drawn from the Trial Balance. Assets, liabilities and reserve heads shall be posted from the Trial Balance to the Balance Sheet as discussed above.

The details of various Balance Sheet items are given in separate schedules attached to the Balance Sheet. The contents and formats for the various schedules to the Balance Sheet are typically shown subsequent to the schedules of Income and Expenditure Statement.

While preparing the Balance Sheet and the Income and Expenditure Statement, the following shall be done:

- The balances in the asset accounts, which generally have a debit balance and are recorded on the debit side of the Trial Balance, shall be posted on the Asset side of the Balance Sheet;
- The balances in the liabilities accounts, which generally have a credit balance and are recorded on the credit side of the Trial Balance, shall be posted on the Liability side of the Balance Sheet;
- The balances in the income accounts, which generally have a credit balance and are recorded on the credit side of the Trial Balance, shall be posted on the Income side of the Income and Expenditure Statement;
- The balances in the expense accounts, which generally have a debit balance and are recorded on the debit side of the Trial Balance, shall be posted on the Expenditure side of the Income and Expenditure Statement;
- The excess of income earned by NCRPB over expenses incurred by NCRPB shall be transferred to and added to the Corpus Fund in the Balance Sheet. Likewise, excess of expenses incurred over income earned shall be transferred to and reduced from the Corpus Fund in the Balance Sheet.

No items in the trial balance are left out without carrying them either to Income and Expenditure Account or the Balance sheet.

Benefits of a Balance Sheet: The benefits of preparing a Balance Sheet are:

- Provides a record of the assets (amount owned) and Liabilities (amount owed) by NCRPB
- Allows follow up and better management on the amounts receivable and payable by NCRPB
- Allows the financial strength of NCRPB to be assessed, based on analysis of assets and liabilities;
- Allows comparability and analysis of financial position over different years.
- Without the opening balance sheet, the balance sheet at the end of the period cannot be prepared (i.e. the closing balance sheet)

Steps in Preparing the Opening Balance Sheet: The steps to be followed to prepare the Opening Balance Sheet is as follows:

- **Step # 1:** Updating of the records/creation of records for the purpose of compiling and identifying the assets and liabilities of NCRPB
- **Step # 2:** Verification of the assets and liabilities, including physical verification (in case of fixed assets), cross checking/checking with original records, loan documentation, title deeds, etc. and valuation/costing of the assets
- **Step # 3:** Compilation of the information collected in the format of the Balance Sheet to arrive at the Opening Balance Sheet
- **Step # 4:** Preparation of opening balance sheet with the required disclosures.

A Balance Sheet is a summary of the organization's uses of funds (assets) and sources of funds (liabilities and net worth) at a particular moment in time.

A balance sheet (as the title implies) always balances, in that assets are equal to the sum of liabilities plus net worth.

A sample Balance Sheet is presented (next page). A line-by-line definition of the information presented in the Balance Sheet is given in the next few pages.

---

32 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
The balance sheet uses the fundamental accounting equation

\[
\text{Assets} = \text{Liabilities} + \text{Net Worth}
\]

or

\[
\text{Assets} - \text{Liabilities} = \text{Net Worth}
\]

A sample Balance Sheet is given below. The format is a simple general format and can be adjusted as per the statutory requirements.

<table>
<thead>
<tr>
<th>Table 1: Sample Balance Sheet (Rs. In Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year Ending March</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
</tr>
<tr>
<td><strong>Cash and Deposits</strong></td>
</tr>
<tr>
<td>B1</td>
</tr>
<tr>
<td>B2</td>
</tr>
<tr>
<td><strong>B3 Total Cash and Deposits</strong></td>
</tr>
<tr>
<td><strong>Loans Outstanding</strong></td>
</tr>
<tr>
<td>B4</td>
</tr>
<tr>
<td>B5</td>
</tr>
<tr>
<td>B6</td>
</tr>
<tr>
<td>B7=B4+B5+B6 Gross Loans outstanding</td>
</tr>
<tr>
<td>B8</td>
</tr>
<tr>
<td><strong>B9=B7-B8 Net Loans Outstanding</strong></td>
</tr>
<tr>
<td><strong>Other Current Assets</strong></td>
</tr>
<tr>
<td>B10</td>
</tr>
<tr>
<td><strong>B11=B3+B9+B10 Total Current Assets</strong></td>
</tr>
<tr>
<td><strong>Long-Term Assets</strong></td>
</tr>
<tr>
<td><strong>Investments</strong></td>
</tr>
<tr>
<td>B12</td>
</tr>
<tr>
<td><strong>Property and Equipment</strong></td>
</tr>
<tr>
<td>B13</td>
</tr>
<tr>
<td>B14</td>
</tr>
<tr>
<td>B15=B13-B14 Net Property and Equipment</td>
</tr>
<tr>
<td><strong>B16=B12+B15 Total Long-Term Assets</strong></td>
</tr>
<tr>
<td><strong>B17= B11+B16 Total Assets</strong></td>
</tr>
<tr>
<td><strong>Liabilities And Net Worth</strong></td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
</tr>
<tr>
<td>B18</td>
</tr>
<tr>
<td>B19</td>
</tr>
<tr>
<td>B20= B18+B19 Total Current Liabilities</td>
</tr>
<tr>
<td><strong>Long-term Liabilities</strong></td>
</tr>
<tr>
<td>B21</td>
</tr>
</tbody>
</table>
# TN #28: Balance Sheet

## Table 1: Sample Balance Sheet (Rs. In Lakhs)

<table>
<thead>
<tr>
<th></th>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>B22 Long-term debt</td>
<td>35,000</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>B23 Deferred Revenue</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>B24= B21+B22+B23 Long-Term Liabilities</td>
<td>47,000</td>
<td>45,000</td>
<td></td>
</tr>
<tr>
<td>B25=B20+B24 Total Liabilities</td>
<td>65,000</td>
<td>57,000</td>
<td></td>
</tr>
<tr>
<td>B26 Loan Fund Capital</td>
<td>40,100</td>
<td>33,000</td>
<td></td>
</tr>
<tr>
<td>B27 Retained Net Surplus</td>
<td>200</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>B28 Current-year Net Surplus</td>
<td>1,000</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>B29=B26+B27+B28 Total Net Worth</td>
<td>41,300</td>
<td>33,200</td>
<td></td>
</tr>
<tr>
<td>B30 Total Liabilities And Net Worth</td>
<td>106,300</td>
<td>90,200</td>
<td></td>
</tr>
</tbody>
</table>

## Table 2: Balance Sheet of NCRPB as on 31st March 2008

<table>
<thead>
<tr>
<th>Balance Sheet items (Plan &amp; Non Plan)</th>
<th>FY03</th>
<th>FY04</th>
<th>FY05</th>
<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants</td>
<td>5507.81</td>
<td>8213.92</td>
<td>9171.03</td>
<td>10000.57</td>
<td>10210.34</td>
<td>15007.95</td>
</tr>
<tr>
<td>Grant from MOUD</td>
<td>5500.00</td>
<td>5200.00</td>
<td>6170.00</td>
<td>7000.00</td>
<td>7500.00</td>
<td>10000.00</td>
</tr>
<tr>
<td>Grant from Delhi</td>
<td>0.00</td>
<td>3000.00</td>
<td>3000.00</td>
<td>3000.00</td>
<td>2700.00</td>
<td>5000.00</td>
</tr>
<tr>
<td>Surplus (Non Plan)</td>
<td>7.81</td>
<td>13.92</td>
<td>1.03</td>
<td>0.57</td>
<td>10.34</td>
<td>7.95</td>
</tr>
<tr>
<td>Internal Accruals</td>
<td>5073.12</td>
<td>5200.42</td>
<td>4229.48</td>
<td>4859.99</td>
<td>6286.79</td>
<td>10771.96</td>
</tr>
<tr>
<td>Market Borrowings</td>
<td>89855.00</td>
<td>59770.00</td>
<td>38715.00</td>
<td>38715.00</td>
<td>0.00</td>
<td>20000.00</td>
</tr>
<tr>
<td>Additions during the year</td>
<td>100435.93</td>
<td>73184.34</td>
<td>52115.51</td>
<td>53757.56</td>
<td>16497.12</td>
<td>45779.92</td>
</tr>
<tr>
<td>Balance brought forward</td>
<td>87811.98</td>
<td>98367.57</td>
<td>111762.13</td>
<td>125152.64</td>
<td>140013.19</td>
<td>156510.31</td>
</tr>
<tr>
<td>Plan and Non Plan balance last year</td>
<td>87200.96</td>
<td>97768.94</td>
<td>111833.28</td>
<td>124583.79</td>
<td>140013.19</td>
<td>156510.31</td>
</tr>
<tr>
<td>Assets Fund (Office)</td>
<td>200.94</td>
<td>188.54</td>
<td>168.76</td>
<td>158.76</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project development fund</td>
<td>410.08</td>
<td>410.08</td>
<td>410.08</td>
<td>410.08</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>4093.71</td>
<td>8319.74</td>
<td>2877.53</td>
<td>4023.63</td>
<td>5988.93</td>
<td>675.88</td>
</tr>
<tr>
<td>GPF, CPF</td>
<td>81.03</td>
<td>97.14</td>
<td>116.92</td>
<td>120.94</td>
<td>119.02</td>
<td>125.88</td>
</tr>
<tr>
<td>Provision for Income Tax/TDS</td>
<td>2591.07</td>
<td>2479.28</td>
<td>101.12</td>
<td>2586.02</td>
<td>5659.84</td>
<td>0.00</td>
</tr>
<tr>
<td>Expenses Payable</td>
<td>1421.11</td>
<td>5735.89</td>
<td>2635.94</td>
<td>1234.26</td>
<td>187.41</td>
<td>522.26</td>
</tr>
<tr>
<td>Other Liabilities</td>
<td>0.50</td>
<td>7.43</td>
<td>23.55</td>
<td>82.41</td>
<td>22.66</td>
<td>27.74</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>192341.62</td>
<td>179871.65</td>
<td>166755.17</td>
<td>182751.82</td>
<td>162499.24</td>
<td>202966.11</td>
</tr>
<tr>
<td>Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets (Net)</td>
<td>207.90</td>
<td>192.70</td>
<td>170.64</td>
<td>160.01</td>
<td>138.80</td>
<td>126.57</td>
</tr>
<tr>
<td>GPF, CPF investment</td>
<td>81.10</td>
<td>90.80</td>
<td>105.81</td>
<td>114.97</td>
<td>118.10</td>
<td>124.06</td>
</tr>
<tr>
<td>Loans to States/agencies</td>
<td>87356.73</td>
<td>91293.61</td>
<td>89551.16</td>
<td>106227.35</td>
<td>127341.69</td>
<td>177116.99</td>
</tr>
<tr>
<td>Loans to Staff</td>
<td>23.64</td>
<td>23.19</td>
<td>26.68</td>
<td>18.54</td>
<td>17.39</td>
<td>15.14</td>
</tr>
<tr>
<td>Interest receivables - State/Agencies</td>
<td>4973.34</td>
<td>3575.72</td>
<td>2759.25</td>
<td>1770.32</td>
<td>1860.21</td>
<td>2517.30</td>
</tr>
<tr>
<td>Interest receivables – Investments</td>
<td>2122.47</td>
<td>1174.69</td>
<td>439.76</td>
<td>643.00</td>
<td>218.71</td>
<td>111.77</td>
</tr>
<tr>
<td>Interest receivables – Staff</td>
<td>5.82</td>
<td>8.23</td>
<td>10.82</td>
<td>8.93</td>
<td>10.75</td>
<td>12.15</td>
</tr>
<tr>
<td>Grants Receivable</td>
<td>23.43</td>
<td>3000.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>
Table 2: Balance Sheet of NCRPB as on 31st March 2008

<table>
<thead>
<tr>
<th>Balance Sheet items (Plan &amp; Non Plan)</th>
<th>FY03</th>
<th>FY04</th>
<th>FY05</th>
<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advance Tax</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>31.59</td>
<td>15.83</td>
<td>6.51</td>
<td>5.90</td>
<td>4.85</td>
<td></td>
</tr>
<tr>
<td>Bond Reserve Deposit</td>
<td>51250.00</td>
<td>26456.57</td>
<td>26802.89</td>
<td>38564.02</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Deposits</td>
<td>40353.25</td>
<td>46615.56</td>
<td>40079.66</td>
<td>30175.40</td>
<td>19500.00</td>
<td>10000.00</td>
</tr>
<tr>
<td>Savings</td>
<td>5943.93</td>
<td>10408.82</td>
<td>3018.02</td>
<td>738.05</td>
<td>5502.09</td>
<td>7293.32</td>
</tr>
<tr>
<td>Cash</td>
<td>0.01</td>
<td>0.17</td>
<td>0.31</td>
<td>0.17</td>
<td>0.03</td>
<td>0.05</td>
</tr>
<tr>
<td>Total Assets</td>
<td>192341.62</td>
<td>179871.65</td>
<td>166755.17</td>
<td>182751.82</td>
<td>162499.24</td>
<td>202966.11</td>
</tr>
</tbody>
</table>

**Assets**: Assets represent what is owned by the organization or owed to it. They are those items in which an organization has invested its funds for the purpose of generating future receipts of resources. On the balance sheet, assets are always equal to the sum of liabilities plus net worth.

**Assets may be divided into Current and Long–Term Assets.** Current assets include cash and deposits (marketable securities), accounts receivable, and inventories which in the normal course of business will be turned into cash within a year. Long-term assets represent those assets not readily redeemable as cash. Examples are land, buildings, machinery, equipment, furniture, automobiles, called fixed assets, and investments or receivables held for longer than one year.

Table 3: Asset Accounts at a Glance

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 1 – Cash And Deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash in Hand and Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Bearing Deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Cash and Deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 2 – Loans Outstanding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Past-due</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restructured</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Loans outstanding</td>
<td>(Loan Loss Reserve)</td>
<td></td>
</tr>
<tr>
<td>Net Loans Outstanding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 3 – Other Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued Interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Current Assets – Sum of Categories 1, 2 and 3</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Long-Term Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 4 – Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 5 – Property And Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At Cost</td>
<td>(Accumulated Depreciation)</td>
<td></td>
</tr>
<tr>
<td>Net Property and Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Long-Term Assets = Sum of Categories 4 and 5</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Assets = Sum of Categories 1, 2, 3, 4 and 5</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Current Assets: (a) **Cash in Hand** - all balances (cash currency) available with NCRPB in its own premises and that can be immediately summoned for use; and (b) **Cash in Bank Current Accounts** - all balances available to NCRPB on a demand basis such as funds on deposit in non-interest bearing accounts. In most cases, one combines these two accounts as Cash in Hand and Bank, in format as given below:

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B1 Cash in Hand and Bank</td>
<td>5,000</td>
<td>2,500</td>
</tr>
<tr>
<td>B2 Interest Bearing Deposits</td>
<td>8,000</td>
<td>7,000</td>
</tr>
<tr>
<td>B3 Total Cash and Deposits</td>
<td>13,000</td>
<td>9,500</td>
</tr>
</tbody>
</table>

**Interest bearing deposits** - funds on deposit with any financial institution, with a term of less than one year, which are earning interest income for NCRPB. Deposits made by NCRPB with any of the scheduled commercial banks

**Savings bank deposits** should also be included here because they earn an interest and structuring it this way would help in directly tying the investments (short-term and long-term on the balance sheet) to investment income on the income statement.

**Loans Outstanding**

- **This is the most important income-generating asset for NCRPB.** This is because, the main source of revenue comes from ‘lending’ to clients (projects). It is also called as ‘outstanding portfolio’.
- And the greater the loans provided by NCRPB, the higher is its income (all other things being equal). And the greater the loans provided, the higher the loans outstanding.
- This concept is very closely linked to the fact that the more NCRPB lends, the more it is doing its business. Hence, volume of loans outstanding (on the Balance Sheet) is an amount that analysts use to gauge the extent to which NCRPB has reached the scale (in operations) for it to be sustainable.
- **There are three sub-categories within this broad category of loans outstanding** – Namely, current loans outstanding, past due loans outstanding and re-structured loans outstanding. Each of these and other related concepts are explained with the help of the Table below

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans Outstanding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B4 Current</td>
<td>66,000</td>
<td>50,000</td>
</tr>
<tr>
<td>B5 Past-due</td>
<td>18,000</td>
<td>20,000</td>
</tr>
<tr>
<td>B6 Restructured</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>B7=B4+B5+B6 Gross Loans outstanding</td>
<td>84,000</td>
<td>70,000</td>
</tr>
<tr>
<td>B8 (Loan Loss Reserve)</td>
<td>-7,000</td>
<td>-5,000</td>
</tr>
<tr>
<td>B9=B7-B8 Net Loans Outstanding</td>
<td>77,000</td>
<td>65,000</td>
</tr>
</tbody>
</table>
**Current Loans Outstanding** - the total amount of loans outstanding at a point in time (total amount owed to an institution by its borrowers) which are *current*, i.e., with *no late payments or defaults*.

In the example above, the total value of **current loans outstanding** is 66,000. This means that for all loans, which are *current* (i.e., no over dues), the balance of the principal amount to be paid by the borrowers as on date is 66,000.

**Past-Due Loans Outstanding** - the total amount of loans outstanding which have an amount past due. In other words, this represents the outstanding balance of all overdue loans – *remember that not all of the past due outstanding is overdue but rather only a portion of it (see box below).*

For example, in the above case, let us assume that there are 16 loans with total *over dues* of Rs.3000 – i.e., *installment amounts that need to have been paid as per the scheduled date but have not been as yet.*

Apart from these overdue installments, these past due loans could also have *installments that have not become due as on date*, the total for which can be taken as Rs.15,000.

Now, the Rs.18,000 amount shown against the **past due loans outstanding** is the sum of these two figures – *overdue* (or arrears) on past due loans plus *unpaid principal balances that have not become due so far.*

This *sum* is often called the **total unpaid principal balance** on these loan accounts.

Under special circumstances, the **past due loans outstanding** could equal the *over dues*. When this happens, it would safe to assume that, loan term for all the past due loans have expired.

There is another aspect that requires clarification with regard to past due loans.

In strict accounting parlance, any loan, which has even a single (installment) payment over due for (just) a day, should be classified as a past due loan. While the actual provisioning for a past due loan would depend on the security, and/or other factors for asset classification, the fact of the matter is that once a loan installment is not paid by the end of accounts closing on the specified day, it is past due.

Thus, provisioning may have its own norms and consequently, this could vary on a case by case basis, especially based on the regulatory framework.

But, best practices recommend that, if a payment on a loan due on a certain date is not paid by that date, then that loan should be classified as a past due loan.

**Restructured Loans Outstanding** - Outstanding loans in which the original terms have been re-negotiated.

There are two cases here: loans can be either *refinanced* or *rescheduled*.

**Refinancing** a loan involves developing a new loan agreement before a previous one is completed.

**Rescheduling** a loan involves changing the payment period and/or the size of payments, on an outstanding loan.

**Restructuring** a loan is usually done so that a borrower is no longer in arrears.

Best practices suggest that such restructuring of loans is better avoided and discouraged as it results in the appearance of a “health” portfolio when in fact, restructured loans (and portfolio) indeed remain risky.

Therefore, while many FIs do not bifurcate their loans outstanding as current, past due and re-structured, best practices strongly recommend this bifurcation to ensure transparency with regard to level of risk in an FI.

As per our example, gross loans outstanding is the sum of values of rows B4 (Current Loans Outstanding), B5 (Past Due Loans Outstanding) and B6 (Re-structure)

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans Outstanding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B4</td>
<td>66,000</td>
<td>50,000</td>
</tr>
<tr>
<td>B5</td>
<td>18,000</td>
<td>20,000</td>
</tr>
<tr>
<td>B6</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>B7=B4+B5+B6</td>
<td>84,000</td>
<td>70,000</td>
</tr>
</tbody>
</table>

What are the advantages of such a bifurcation?

1. The level of risk in an FIs portfolio (i.e., its quality) can be determined very easily
2. The portfolio at risk calculation can also be done from Balance Sheet – one does not need to look at the portfolio report. The formula, in that case would be as follows:

---

33 Normally, it is end of a financial year or sometimes, even a quarter.
In fact, to offset this risk in portfolio, best practices recommend that FIs establish a loan loss reserve as outlined in the Table below (from example).

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong> (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans Outstanding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B7=B4+B5</td>
<td>Gross Loans outstanding</td>
<td>84,000</td>
</tr>
<tr>
<td>+B6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B8</td>
<td>(Loan Loss Reserve)</td>
<td>-7,000</td>
</tr>
<tr>
<td>B9=B7-B8</td>
<td>Net Loans Outstanding</td>
<td>77,000</td>
</tr>
</tbody>
</table>

**Loan Loss Reserve** - the amount set aside to cover future (likely) losses in an FI’s (NCRPB) loan portfolio.

When the Reserve is created (or adjusted), a loan loss expense (referred to as the Provision for Loan Losses) is recorded on the Income Statement as an expense. This is usually based on an aging analysis of loan accounts and allocation of risk rates (based on historical data or best practices or regulation).

The amount of loan loss expended is then recorded on the Balance Sheet as a negative asset - Loan Loss Reserve - reducing the outstanding loan balance. It usually results in a figure called as the **Net Loans Outstanding** (see above and below).

Actual loan losses, or write-offs, are reflected on the Balance Sheet only (and not on the income Statement) as a reduction of the Loan Loss reserve and the Gross Loans Outstanding.

The resultant effect is to leave the Net Portfolio on the Balance Sheet unchanged since the reserve has already been made (and expended).

If the Loan loss reserve is too low relative to the value of loans to be written off, then both the Loan Loss Reserve and the Provision for Loan Losses (on the Income Statement) first need to be increased and then the loans can be written off. (See provision for Loan Losses on the Sample Income Statement).

**Net Loans Outstanding** - is the sum of all loan balances still owed to the FI (NCRPB), that is, all loans disbursed and not yet repaid or written off, net of any loan loss reserve.

Please note that all of the loans outstanding amounts reflect only the principal due, not the interest (which is generally income statement item).

However, when interest is due but has not been received, there is a procedure by which this (due) interest is accrued and reflected on the balance sheet under accounts receivable (as accrued interest). This item is taken up below.

**Other Current Assets:** Items which do not appear above, such as accounts receivable (accrued interest, fees, etc.,) and prepaid expenses (rent, insurance, salary advances etc).

Accrued interest is one item that deserves attention from a best practices perspective. It is taken up below.

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong> (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B10</td>
<td>Accrued Interest</td>
<td>500</td>
</tr>
</tbody>
</table>

Consider an FI that uses the accrual system of accounting – many FIs are doing it today. What they do is that, when interest income becomes due (often at the same time the principal is due), they recognize this interest irrespective of whether it has been received or not.

But the interest that is due and has not been received, if it gets into the income statement, it should be accounted for in the Balance Sheet as well.

This is because when interest that is due is received, the accounting entries are:
Now that is perfectly alright.

However, when interest due is not received but recorded in the income statement, you will have the following entry:

Credit Income
Debit ???????

You cannot Debit cash because this interest has not been received.

Now go back to the fundamental accounting entity:

Assets = Liabilities + Equity

Now, when interest due is not received but it has been recorded in the income statement, this entry enters the balance sheet on the equity side through net surplus (or deficit).

And according to the fundamental accounting, there must be a balancing entry on the asset side (please note that when due is received, the corresponding entry on the asset side is Debit Cash, which goes with actual receipt of interest income).

Therefore, this balancing entry in the balance sheet (when interest is due and has not been received and is also recorded in the income statement) is called as accrued interest.

Thus, when interest is due and not received and also when it is recorded in the income statement as income, the entries are:

Credit Income
Debit Accrued Interest (asset under accounts receivable)

And when this income is realized, the corresponding entries are:

Credit Accrued Interest
Debit Cash

Therefore, as per best practices, many key issues need to be looked at by analysts that:

Is the FI following the accrual basis of accounting?
If so, are there rules for accruing items like interest? When are items accrued and are they reversed and if so, under what circumstances?
Is there an accrued interest item on the assets side of the Balance Sheet?
What proportion of the interest income is accrued (as a percentage of total interest income as well as average portfolio outstanding)?

In fact, a good look at the accrued interest will also tell the analyst, what the intended and realized yields (returns) on the portfolio are. It will also tell how much income (receipts) have been overstated on the income statement.

Summary of Current Assets: So, in summary, the current assets portion of the balance sheet is as follows.

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong> (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash and Deposits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B1 Cash in Hand and Bank</td>
<td>5,000</td>
<td>2,500</td>
</tr>
<tr>
<td>B2 Interest Bearing Deposits</td>
<td>8,000</td>
<td>7,000</td>
</tr>
<tr>
<td><strong>B3 Total Cash and Deposits</strong></td>
<td>13,000</td>
<td>9,500</td>
</tr>
<tr>
<td><strong>Loans Outstanding</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B4 Current</td>
<td>66,000</td>
<td>50,000</td>
</tr>
<tr>
<td>B5 Past-due</td>
<td>18,000</td>
<td>20,000</td>
</tr>
<tr>
<td>B6 Restructured</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>B7=B4+B5+B6 Gross Loans outstanding</td>
<td>84,000</td>
<td>70,000</td>
</tr>
<tr>
<td>B8 (Loan Loss Reserve)</td>
<td>-7,000</td>
<td>-5,000</td>
</tr>
<tr>
<td><strong>B9=B7-B8 Net Loans Outstanding</strong></td>
<td>77,000</td>
<td>65,000</td>
</tr>
<tr>
<td><strong>Other Current Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B10 Accrued Interest</td>
<td>500</td>
<td>1,000</td>
</tr>
<tr>
<td><strong>B11=B3+B9+B10 Total Current Assets</strong></td>
<td>90,500</td>
<td>75,500</td>
</tr>
</tbody>
</table>
Good Practices MIS Technical Note For ERP System Developers
TN #28: Balance Sheet

Long-Term Assets: Basically, there are two kinds of long-term assets and they are discussed below.

Long-term Investments: Investments not intended as a ready source of cash such as long term fixed deposits, stocks, bonds and promissory notes that will be held for more than one year. Some times, it may be necessary for an FI to satisfy statutory obligations by investing in long-term assets.

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-Term Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B12 Total Long-Term Investments</td>
<td>12,500</td>
<td>11,000</td>
</tr>
<tr>
<td>Property and Equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B13 At Cost</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>B14 (Accumulated Depreciation)</td>
<td>-700</td>
<td>-300</td>
</tr>
<tr>
<td>B15=B13-B14 Net Property and Equipment</td>
<td>3,300</td>
<td>3,700</td>
</tr>
<tr>
<td>B16=B12+B15 Total Long-Term Assets</td>
<td>15,800</td>
<td>14,700</td>
</tr>
</tbody>
</table>

Property and Equipment: (a) Cost - Property and equipment (fixed assets) recorded at their acquisition cost – i.e., the historical cost at which they were bought; (b) Accumulated Depreciation - This represents the sum of depreciation expenses recorded in the current and previous fiscal periods - depreciation, represents a value for the use of the fixed assets. There are several methods for calculating depreciation and prominent among these are the straight-line method and the declining balance method. (Please see additional information under Income Statement); and (c) Net Property and Equipment - The cost or recorded market value of property and equipment less accumulated depreciation.

Asset Summary: The summary of the assets side of the Balance Sheet is given below

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B1 Cash in Hand and Bank</td>
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<td>2,500</td>
</tr>
<tr>
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<td>8,000</td>
<td>7,000</td>
</tr>
<tr>
<td>B3 Total Cash and Deposits</td>
<td>13,000</td>
<td>9,500</td>
</tr>
<tr>
<td>Loans Outstanding</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B4 Current</td>
<td>66,000</td>
<td>50,000</td>
</tr>
<tr>
<td>B5 Past-due</td>
<td>18,000</td>
<td>20,000</td>
</tr>
<tr>
<td>B6 Restructured</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>B7=B4+B5+B6 Gross Loans outstanding</td>
<td>84,000</td>
<td>70,000</td>
</tr>
<tr>
<td>B8 (Loan Loss Reserve)</td>
<td>-7,000</td>
<td>-5,000</td>
</tr>
<tr>
<td>B9=B7-B8 Net Loans Outstanding</td>
<td>77,000</td>
<td>65,000</td>
</tr>
<tr>
<td>Other Current Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B10 Accrued Interest</td>
<td>500</td>
<td>1,000</td>
</tr>
<tr>
<td>B11=B3+B9+B10 Total Current Assets</td>
<td>90,500</td>
<td>75,500</td>
</tr>
<tr>
<td>Long-Term Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B12 Total Long-term Investments</td>
<td>12,500</td>
<td>11,000</td>
</tr>
<tr>
<td>Property and Equipment (Rs. In Lakhs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B13 At Cost</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>B14 (Accumulated Depreciation)</td>
<td>-700</td>
<td>-300</td>
</tr>
<tr>
<td>B15=B13-B14 Net Property and Equipment</td>
<td>3,300</td>
<td>3,700</td>
</tr>
<tr>
<td>B16=B12+B15 Total Long-Term Assets</td>
<td>15,800</td>
<td>14,700</td>
</tr>
<tr>
<td>B17= B11+B16 Total Assets</td>
<td>106,300</td>
<td>90,200</td>
</tr>
</tbody>
</table>
**Liabilities and Net Worth:** Liabilities and Net-Worth Accounts at a Glance

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities And Net Worth</td>
<td>(Rs. In Lakhs)</td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 1 – Market borrowings (commercial rate)</td>
<td>18,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Category 2 - Market borrowings (concessional rate)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Current Liabilities</strong> = Sum Of Category 1 + 2</td>
<td>18,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Long-term Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 3 - Long-term debt (commercial rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 4 - Long-term debt (concessional rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 5 - Other Liabilities like Deferred Revenue, Deferred expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Long-Term Liabilities</strong> = Sum Of Category 3+4+5</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong> = Sum Of Categories 1+2+3+4+5</td>
<td>65,000</td>
<td>57,000</td>
</tr>
<tr>
<td>Net Worth</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 6 - Loan Fund Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 7 – Retained Net Surplus/(Deficit) prior years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Category 8 - Current-year Net Surplus/(Deficit)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Net Worth</strong> = Sum Of Categories 6+7+8</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities And Net Worth</strong> = Sum Of Categories 1 TO 8</td>
<td>65,000</td>
<td>57,000</td>
</tr>
</tbody>
</table>

**Liabilities:** Liabilities represent what is owed by the organization to others either in the form of a cash commitment or as an obligation by the organization to provide goods and services in the future.

**Current Liabilities:** *(a) Short-term Borrowing* - the outstanding amounts, which the organization owes to banks or other lenders, that are due to be repaid within one year;

<table>
<thead>
<tr>
<th>Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities And Net Worth</td>
<td>(Rs. In Lakhs)</td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>B18 Market borrowings (commercial rate)</td>
<td>18,000</td>
<td>12,000</td>
</tr>
<tr>
<td>B19 Market borrowings (concessional rate)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>B20= B18+B19 Total Current Liabilities</td>
<td>18,000</td>
<td>12,000</td>
</tr>
</tbody>
</table>

**Long-Term Liabilities**

- **Long-term Debts (commercial rate)** - The outstanding amount that the organization owes to banks or other lenders for which it is paying a market rate of interest. Long-term debt is that portion which is due to be repaid in more than one year's time.

- **Long-term Debt (concessional rate)** - The outstanding amount that the organization owes to banks or other lenders for which it is paying the lender a rate of interest below the market rate.
Other Liabilities include - Restricted Deferred Revenue, which are funds received, but restricted for use in future years, are classified as a liability on the balance sheet, because they would have to be returned to the funding organizations if the specified programs were not carried out. The funds are not recorded as revenue until the service or product is delivered. When the organization receives restricted or deferred funds, it incurs an obligation (liability) to provide the services described in the grant agreement. As the organization provides the services (i.e., technical assistance or training) it incurs expenses. Deferred revenue is then reflected as grant revenue and used to cover those expenses.

Deferred Expenditure - Likewise, outstanding expenses like salaries payable, providence fund payable, insurance payable are treated as liabilities, as the organization will have to pay for such expenses in the future.

Several key issues need to be articulated here and these are outlined below:
- FIs must distinguish between long-term debt as commercial and subsidized, for this enable an analyst to understand its financial position, from a sustainability perspective. Interest rates less than the prime lending rate can be considered as subsidized and those equal to or greater than this rate (set by the RBI for different sectors) can be regarded as commercial debt.
- Disclosure of the outstanding expenses is also very crucial because it tell an analyst about the future commitments of the FI and makes the balance sheet more transparent.
- In summary, all of the above are required as part of increasing the transparency and accountability of FIs and FIs must acquire the culture to provide balance sheets in such fashion, which are based on international (global) best practices.

Net Worth

<table>
<thead>
<tr>
<th>Net Worth (Rs. In Lakhs)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>B26 Loan Fund Capital</td>
<td>40,100</td>
<td>33,000</td>
</tr>
<tr>
<td>B27 Retained Net Surplus/(Deficit) prior years</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>B28 Current-year Net Surplus/(Deficit)</td>
<td>1,000</td>
<td>200</td>
</tr>
<tr>
<td>B29=B26+B27+B28 Total Net Worth</td>
<td>41,300</td>
<td>33,200</td>
</tr>
<tr>
<td>B30 Total Liabilities And Net Worth</td>
<td>106,300</td>
<td>90,200</td>
</tr>
</tbody>
</table>

Net Worth is equal to the assets less the organization's liabilities. Net Worth is sometimes referred to as Equity, Fund Balance, or Net Assets. Unlike liabilities, the net worth of a organization does not have to be repaid. It therefore represents the value of the organization. Net worth might include capital contributions of investors or donors, retained earnings, and current year surplus.

Loan Fund Capital - represents what has been contributed over time to the organization and not spent. Sources of Loan Fund Capital include grants restricted and designated to be taken as capital, investor contributions, the proceeds of fund raising activities etc.

Net Retained Surplus / (Deficit) prior years - the amount of income (or loss) accumulated since the formation of the organization. It may also be referred to as undistributed profits or earned surplus.

Net Surplus/(Deficit) Current Year - the amount of income (or loss) generated in the current year.

Any impact of delinquency/other losses will directly affect the net worth of FI. Therefore, if de-capitalization is occurring one must look at the causes and attempt to control or mitigate or eradicate these.
Analyzing changes in the Balance Sheet Structure

<table>
<thead>
<tr>
<th>Table 4: Analyzing Changes in the Balance Sheet Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Year Ending March</strong></td>
</tr>
<tr>
<td><strong>Assets</strong></td>
</tr>
<tr>
<td><strong>Current Assets</strong></td>
</tr>
<tr>
<td>Cash and Deposits</td>
</tr>
<tr>
<td>Cash in Hand and Bank</td>
</tr>
<tr>
<td>Interest Bearing Deposits</td>
</tr>
<tr>
<td><strong>Total Cash and Deposits</strong></td>
</tr>
<tr>
<td>Loans Outstanding</td>
</tr>
<tr>
<td>Current</td>
</tr>
<tr>
<td>Past-due</td>
</tr>
<tr>
<td>Restructured</td>
</tr>
<tr>
<td>Gross Loans outstanding</td>
</tr>
<tr>
<td>(Loan Loss Reserve)</td>
</tr>
<tr>
<td><strong>Net Loans Outstanding</strong></td>
</tr>
<tr>
<td>Other Current Assets</td>
</tr>
<tr>
<td>Accrued Interest</td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
</tr>
<tr>
<td>Long-Term Assets</td>
</tr>
<tr>
<td>Investments</td>
</tr>
<tr>
<td><strong>Total Long-Term Investments</strong></td>
</tr>
<tr>
<td>Property and Equipment</td>
</tr>
<tr>
<td>At Cost</td>
</tr>
<tr>
<td>(Accumulated Depreciation)</td>
</tr>
<tr>
<td><strong>Net Property and Equipment</strong></td>
</tr>
<tr>
<td>Total Long-Term Assets</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
</tr>
</tbody>
</table>

One of the key tasks for the analyst is to isolate changes in the structure of the various asset and liability items across two years. This trend analysis is a very useful technique for understanding where the FI is today and where it is headed tomorrow. In turn, such analysis will facilitate what on-course corrections are required and also enable FI management to take suitable decisions that will enable the FI to enhance its sustainability and expand out reach.

Basically, such analysis involves calculating the proportion of asset and liability items as a measure of the total assets and liabilities respectively. This is what is presented above (for asset accounts) and next page (for liability accounts).

The 1st column gives a description of the asset/liability account, while the 2nd column represents the values for year 2007, the 3rd column values for year 2006 and the last column gives the change in values (in percentage terms). Please note that all asset accounts total 100% and so do the liability accounts.
### Table 5: Balance Sheet

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term borrowings (commercial rate)</td>
<td>16.93%</td>
<td>13.30%</td>
<td>3.63%</td>
</tr>
<tr>
<td>Short-term borrowings (concessional rate)</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total Current Liabilities</td>
<td>16.93%</td>
<td>13.30%</td>
<td>3.63%</td>
</tr>
<tr>
<td><strong>Long-term Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term debt (commercial rate)</td>
<td>11.29%</td>
<td>16.63%</td>
<td>-5.34%</td>
</tr>
<tr>
<td>Long-term debt (concessional rate)</td>
<td>32.93%</td>
<td>33.26%</td>
<td>-0.33%</td>
</tr>
<tr>
<td>Deferred Revenue/Expenditure</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td>Long-Term Liabilities</td>
<td>44.21%</td>
<td>49.89%</td>
<td>-5.67%</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>61.15%</td>
<td>63.19%</td>
<td>-2.05%</td>
</tr>
<tr>
<td><strong>Net Worth</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan Fund Capital</td>
<td>37.72%</td>
<td>36.59%</td>
<td>1.14%</td>
</tr>
<tr>
<td>Retained Net Surplus/(Deficit) prior years</td>
<td>0.19%</td>
<td>0.00%</td>
<td>0.19%</td>
</tr>
<tr>
<td>Current-year Net Surplus/(Deficit)</td>
<td>0.94%</td>
<td>0.22%</td>
<td>0.72%</td>
</tr>
<tr>
<td>Total Net Worth</td>
<td>38.85%</td>
<td>36.81%</td>
<td>2.05%</td>
</tr>
<tr>
<td><strong>Total Liabilities And Net Worth</strong></td>
<td>100.00%</td>
<td>100.00%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>
Income and Expenses Statement\textsuperscript{35}: A financial statement, often prepared by non-profit making entities like, NCRPB, etc., to present their revenues and expenses for an accounting period and to show the excess of revenues over expenses (or vice-versa) for that period. It is similar to profit and loss statement and is also called revenue and expense statement. NCRPB is to prepare an Income and Expenditure Statement for every accounting period. The Income and Expenditure Statement discloses the results of the working of NCRPB during the period covered by the statement. It shows incomes and expenditures of NCRPB for an accounting period and the excess of income over expenditure or vice-versa for that period.

Since the Financial Statements are prepared under accrual basis, the Income and Expenditure Statement shall include all the income earned during the year whether actually received or not and all the expenditure incurred whether actually paid or not. The Income and Expenditure Statement is drawn from the Trial Balance. The various heads of incomes and expenditures shall be posted from the Trial Balance to the Income and Expenditure Statement.

Any income or expenditure under a particular individual head, which is more than 1\% of the total gross income of NCRPB or Rs.1, 00,000 whichever is higher, shall be shown separately in the Schedules annexed to the Income and Expenditure Statement.

A very simple sample income statement is presented below

<table>
<thead>
<tr>
<th>Table 1: Income Statement (Rs. In Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>For Year Ending March</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Income</td>
</tr>
<tr>
<td>Operational Income</td>
</tr>
<tr>
<td>Interest Income - Current Loans</td>
</tr>
<tr>
<td>Interest Income - Pastdue Loans</td>
</tr>
<tr>
<td>Interest Income - Restructured Loans</td>
</tr>
<tr>
<td>Fees Income</td>
</tr>
<tr>
<td>Income from Penalties</td>
</tr>
<tr>
<td><strong>Total Operational Income</strong></td>
</tr>
<tr>
<td>Investment Income</td>
</tr>
<tr>
<td>Short-Term Investments</td>
</tr>
<tr>
<td>Long-Term Investments</td>
</tr>
<tr>
<td><strong>Total Investment Income</strong></td>
</tr>
<tr>
<td>Other Income</td>
</tr>
<tr>
<td>Income from Grants for operations</td>
</tr>
<tr>
<td>Income from Grants for Loan Fund Capital</td>
</tr>
<tr>
<td><strong>Grant Income</strong></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
</tr>
<tr>
<td>Expenses</td>
</tr>
<tr>
<td>Financial Expenses</td>
</tr>
<tr>
<td>Interest Expense on Borrowings 1</td>
</tr>
<tr>
<td>Interest Paid on Borrowings 2</td>
</tr>
<tr>
<td><strong>Total Financial Expenses</strong></td>
</tr>
<tr>
<td>Cash Operational Expenses</td>
</tr>
<tr>
<td>Salaries and Benefits</td>
</tr>
<tr>
<td>Administrative Charges (Rent, Electricity, Utilities, Bank, Telephone, Printing &amp; Stationary, Transportation etc)</td>
</tr>
<tr>
<td>Traveling Expense</td>
</tr>
<tr>
<td>Occupancy</td>
</tr>
</tbody>
</table>

\textsuperscript{35} Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Table 1: Income Statement (Rs. In Lakhs)

<table>
<thead>
<tr>
<th>For Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous</td>
<td>300.00</td>
<td>300.00</td>
</tr>
<tr>
<td>Total Cash Operational Expenses</td>
<td>13,900.00</td>
<td>12,800.00</td>
</tr>
<tr>
<td>Non-Cash Operational Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>400.00</td>
<td>300.00</td>
</tr>
<tr>
<td>Loan Loss Provision</td>
<td>2500.00</td>
<td>3000.00</td>
</tr>
<tr>
<td>Total Non-Cash Operational Expenses</td>
<td>2,900.00</td>
<td>3,300.00</td>
</tr>
<tr>
<td>Total Operational Expenses</td>
<td>16,800.00</td>
<td>16,100.00</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>20,500.00</td>
<td>19,600.00</td>
</tr>
<tr>
<td>Income - Expenses</td>
<td>8,100.00</td>
<td>200.00</td>
</tr>
<tr>
<td>Sustainability - Financial</td>
<td>140%</td>
<td>101%</td>
</tr>
<tr>
<td>Net Income Adjusted for Subsidies</td>
<td>1000.00</td>
<td>-750.00</td>
</tr>
</tbody>
</table>

Using the above format helps in several ways:
- One can analyses where its income is coming from and accordingly adjust its strategic direction so as to achieve long term sustainability
- Hidden costs and subsidies can be ascertained and the true financial picture of the FI can be understood
- The existence of prudential accounting norms can be ascertained (like loan loss provision) and this will enable the FI to take necessary action for safeguarding the portfolio
- The extent to which increase in operational (cash and non-cash) expenses are justified by an increase in portfolio size, quality and income can also be determined. This will help, both the FI and the wholesaler (or Donor) make better decisions aimed at enhancing the outreach and sustainability of the organization.

Income: Income for an FI like NCRPB can be received from three basic sources
- Operational Income
- Investment Income
- Other Income

<table>
<thead>
<tr>
<th>For Year Ending March</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Income - Current Loans</td>
<td>12,000.00</td>
<td>11,000.00</td>
</tr>
<tr>
<td>Interest Income - Pastdue Loans</td>
<td>3,500.00</td>
<td>1,050.00</td>
</tr>
<tr>
<td>Interest Income - Restructured Loans</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Fees Income</td>
<td>5,300.00</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Income from Penalties</td>
<td>200.00</td>
<td>300.00</td>
</tr>
<tr>
<td>Total Operational Income</td>
<td>21,000.00</td>
<td>17,350.00</td>
</tr>
<tr>
<td>Investment Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-Term Investments</td>
<td>500.00</td>
<td>1,500.00</td>
</tr>
<tr>
<td>Long-Term Investments</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Investment Income</td>
<td>500.00</td>
<td>1,500.00</td>
</tr>
<tr>
<td>Other Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from Grants for Credit Services</td>
<td>-</td>
<td>950.00</td>
</tr>
<tr>
<td>Income from Grants for Loan Fund Capital</td>
<td>7,100.00</td>
<td>-</td>
</tr>
<tr>
<td>Grant Income</td>
<td>7,100.00</td>
<td>950.00</td>
</tr>
<tr>
<td>Total Income</td>
<td>28,600.00</td>
<td>19,800.00</td>
</tr>
</tbody>
</table>
Each of these aspects are described below

Operational Income: Operational income is income that an FI like NCRPB derives from its operations of lending. This would include interest and fee income. Interest income can be further divided into interest on current, past and re-structured loans outstanding.

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Income - Current Loans</td>
<td>12,000.00</td>
<td>11,000.00</td>
</tr>
<tr>
<td>Interest Income - Pastdue Loans</td>
<td>3,500.00</td>
<td>1,050.00</td>
</tr>
<tr>
<td>Interest Income - Restructured Loans</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Fees Income</td>
<td>5,300.00</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Income from Penalties</td>
<td>200.00</td>
<td>300.00</td>
</tr>
<tr>
<td>Total Operational Income</td>
<td>21,000.00</td>
<td>17,350.00</td>
</tr>
</tbody>
</table>

Interest Income on Current, Past-Due and Re-Structured Loans - the amount collected from project/clients for borrowing money from the organization over the specified period of time.

- The interest rate is always stated as a percentage of the loan amount for a period (generally annually)
- Please note that the principal amount of the loan repaid is not included in revenue.
- It is the balance sheet accounts that are affected by the principal portion of the loan repayment, i.e., the Loan Outstanding decrease and Cash increases, until another loan is made and then the reverse is true.
- As per our example, the interest income is Rs.15,500 for year 2007 and 12050 for year 2006.

Apart from interest income, the FI can also get income from fees. Fees could be of two types - stated as a percentage of the loan amount or as a flat fee, for loans provided by the organization.

Fees are however usually stated as a percentage of the loan disbursed (or loan outstanding) and they increase the effective interest rate for the client/project. The impact of the fee however varies across loan terms, with fees having a greater impact on the effective interest rate for loans with shorter rather than longer loan terms. Sometimes, an FI charges late fees on the loans. This is the amount collected, as a penalty, from borrowers who have had loans with payments in arrears. In the present case, fees are Rs.5300 (year 2007) and Rs.5000 (year 2006) while late fees or penalties equal Rs.200 and Rs.300 for years 2007 and 2006 respectively.

Investment Income: A second income for an FI is its investments. Investments are usually excess (idle) cash invested by the FI (into fixed deposits, savings bank accounts, marketable securities etc) from its revolving loan fund.

Sometimes, due to legal restrictions, an FI could also be investing all of its deposits in the form of investments. It may not be on lending them to clients/projects again.

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-Term Investments</td>
<td>500.00</td>
<td>1,500.00</td>
</tr>
<tr>
<td>Long-Term Investments</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total Investment Income</td>
<td>500.00</td>
<td>1,500.00</td>
</tr>
<tr>
<td>Other Income</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Thus, the amount of interest earned by the organization on its investments such as term deposits, securities, treasury bills, savings bank accounts etc comprise its investment income.

There are usually two forms of investments that can be made by FIs

- Short-term investments (maturity date is less than a year)
- Long-Term Investments (maturity date is more than a year)

Grant Income is the main form of other income for institutions like NCRPB. This generally includes two types of grants:

- Grants for operations – this includes grants (or donations) provided by Governments, donors, wholesalers and others towards operational expenses.
- Grants for loan fund capital – this typically encompasses donations (or contributions) to an FIs revolving loan fund capital.

Either way, grants are better brought into the income statement and through this taken into the net worth (equity) of the balance sheet. Grants could be treated differently but it is better to recognize them and exclude them from ratio analysis.

Miscellaneous income can also be a source of other income. For example, when loans that have been written-off are collected, the cash coming in (back to the organization) is treated as miscellaneous income. This is because, the loan loss provision was treated as an expense in the first place and therefore, when the written-off loan is collected, it should be treated as an income. The key reasons for bifurcating the income in this manner (3 sources) is to see where an FI is really getting its income from - operations or investments or grants?

Financial Expenses

<table>
<thead>
<tr>
<th>Accounting Period</th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses</td>
<td>(Rs. In Lakhs)</td>
<td></td>
</tr>
<tr>
<td>Financial Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Expense on Borrowings 1</td>
<td>3,700.00</td>
<td>3,500.00</td>
</tr>
<tr>
<td>Interest Paid on Borrowings 2</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Total Financial Expenses</td>
<td>3,700.00</td>
<td>3,500.00</td>
</tr>
</tbody>
</table>
There are two kinds of financial costs for an FI.

There are:

- **Interest on Debt or borrowings** - interest paid to banks and other financial institutions for money loaned (by them) to the FI.
- **This is interest is stated as a percentage figure on an annual basis and depending on the loan term it is worked out. Different lenders usually have different methods of calculating interest – i.e., on a declining balance, flat, simple or compound basis.**
- **In most cases, financial institutions do not use the flat rate of interest. Rather, they use the declining balance interest method in conjunction with simple or compound interest**.36
- **Please note that the principal repayment of a bank loan is not included as a financial cost.**

**Interest Paid on Deposits** - interest payments earned by projects who deposit in the organization (like HUDA, DDA etc).

**Operational Expenses:** There are two kinds of operational expenses:

One that involves an outflow of cash, which are called as cash operational expenses this, includes salaries, administrative expenses, travel, occupancy and miscellaneous expenses. Please see box in the next page for definitions.

### Income Statement

<table>
<thead>
<tr>
<th>For Year Ending March</th>
<th>2007 (Rs. In Lakhs)</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Operational Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and Benefits</td>
<td>6,000.00</td>
<td>5,000.00</td>
</tr>
<tr>
<td>Administrative Charges (Rent, Electricity, Utilities, Bank, Telephone, Printing &amp; Stationary, Transportation etc)</td>
<td>2,600.00</td>
<td>2,500.00</td>
</tr>
<tr>
<td>Travelling Expense</td>
<td>2,500.00</td>
<td>2,500.00</td>
</tr>
<tr>
<td>Occupancy</td>
<td>2,500.00</td>
<td>2,500.00</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>300.00</td>
<td>300.00</td>
</tr>
<tr>
<td><strong>Total Cash Operational Expenses</strong></td>
<td><strong>13,900.00</strong></td>
<td><strong>12,800.00</strong></td>
</tr>
</tbody>
</table>

36 While banks predominantly use compound, other wholesalers and donors use simple interest.

### Box 1: Operating Cash Expenses - Some Definitions

- **Operating Expenses are related to the management of the loan fund, whether it is held as outstanding loans or investments/deposits. For a single - purpose financial institution, all costs should be included.**
- **For multi-purpose institutions, all direct costs of financial operations and an appropriate portion of the institution's overhead should be included.**
- **The latter is appropriate for NCRPB**

The main categories are:

- **Salaries and benefits** - amounts earned by staff for services rendered.
- **Administrative expenses** - costs incurred in administering the organization such as stationary, insurance, legal fees, etc.
- **Occupancy expenses** - expenses made for (1) lease of land and/or buildings for the purposes of loan fund management over a specified time period, and (2) expenses for utilities, such as electricity, water, and telephone.
- **Travel** - expenses for transportation, room and board, etc., of staff members working on behalf of the organization.
- **Other Expenses** - other expenses related to the loan fund's operations, such as training costs, loss on currency conversion, etc.

The other, which does not involve an outflow of cash, which is called as non-cash operational expenses

### Income Statement

<table>
<thead>
<tr>
<th>For Year Ending March</th>
<th>2007 (Rs. In Lakhs)</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Cash Operational Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>400.00</td>
<td>300.00</td>
</tr>
<tr>
<td>Loan Loss Provision</td>
<td>2500.00</td>
<td>3000.00</td>
</tr>
<tr>
<td><strong>Total Non-Cash Operational Expenses</strong></td>
<td><strong>2,900.00</strong></td>
<td><strong>3,300.00</strong></td>
</tr>
</tbody>
</table>

The major non-cash operational expenses for an FI are

- **Provision for Loan Losses:** This provision is based on the historical default rate, the loan loss provision is the allowance made for expected defaults on the loan fund.
The loan loss provision increases the loan loss reserve, the balance sheet account that offsets the gross portfolio outstanding. Although a loan loss provision (a non-cash expense) is treated as a direct expense when the provision is made, the loans will not yet have been written off as loan losses. Some organizations include the loan loss expense with the operating costs. It is important to separate the loan loss expense from other operating costs, as an indicator of portfolio quality.

**Depreciation Expenses:** Depreciation - is an annual, non-cash expense that is determined by estimating the useful life of each asset. Using the most common method, called straight-line depreciation, an asset with an estimated useful life of five years would have one-fifth of its purchase price reflected as an expense in each of five years. Depreciation represents a decrease in the value of property and equipment to account for that portion of their useful life that is used up during each accounting period. Land theoretically does not lose value over time and therefore is not depreciated. Legal aspects also sometimes curtail the maximum depreciation amounts based on a slab rate classification for each depreciable item such as cars, computers etc.

Summing up the operational cash expenses and non-cash operational expenses, we get the total operational expenses.

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>2007 (Rs. In Lakhs)</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Operational Expenses</td>
<td>13,900.00</td>
<td>12,800.00</td>
</tr>
<tr>
<td>Non-Cash Operational Expenses</td>
<td>2,900.00</td>
<td>3,300.00</td>
</tr>
<tr>
<td>Total Operational Expenses</td>
<td>16,800.00</td>
<td>16,100.00</td>
</tr>
</tbody>
</table>

**Summary of Income and Expenses:** And as shown below, the total income minus total expenses (i.e., financial plus operational costs) gives the net surplus (deficit), which is carried to the equity side of the Balance Sheet. This is also called as the Net profit (loss) for the organization.

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>2007 (Rs. In Lakhs)</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational Income</td>
<td>21,000.00</td>
<td>17,350.00</td>
</tr>
<tr>
<td>Investment Income</td>
<td>500.00</td>
<td>1,500.00</td>
</tr>
<tr>
<td>Other Income</td>
<td>7,100.00</td>
<td>950.00</td>
</tr>
<tr>
<td>Total Income</td>
<td>28,600.00</td>
<td>19,800.00</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Expenses</td>
<td>3,700.00</td>
<td>3,500.00</td>
</tr>
<tr>
<td>Cash Operational Expenses</td>
<td>13,900.00</td>
<td>12,800.00</td>
</tr>
<tr>
<td>Non-Cash Operational Expenses</td>
<td>2,900.00</td>
<td>3,300.00</td>
</tr>
<tr>
<td>Total Operational Expenses</td>
<td>16,800.00</td>
<td>16,100.00</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>20,500.00</td>
<td>19,600.00</td>
</tr>
<tr>
<td>Income - Expenses = Net Surplus (Deficit)</td>
<td>8,100.00</td>
<td>200.00</td>
</tr>
</tbody>
</table>
Analyzing Changes in Income Statement

One of the key tasks for the analyst is to isolate changes in the structure of the various income and expenses items across two years. This trend analysis is a very useful technique for understanding where the FI is today and where it is headed tomorrow. In turn, such analysis will facilitate what on-course corrections are required and also enable FI management to take suitable decisions that will enable the FI to enhance its sustainability and expand out reach.

Basically, such analysis involves calculating the proportion of income and expense items as a measure of the total income and expenses respectively. This is what is presented hereafter for income accounts and expense accounts.

The 1st column gives a description of the income/expense account, while the 2nd column represents the values for year 2007, the 3rd column values for year 2006 and the last column gives the change in values (in percentage terms). Please note that all income accounts total 100% and so do the expense accounts.

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>For Year Ending March</th>
<th>Year 2007</th>
<th>Year 2006</th>
<th>Change 2007-2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Income - Current Loans</td>
<td>41.96%</td>
<td>55.56%</td>
<td>-13.60%</td>
<td></td>
</tr>
<tr>
<td>Interest Income - Pastdue Loans</td>
<td>12.24%</td>
<td>5.30%</td>
<td>6.93%</td>
<td></td>
</tr>
<tr>
<td>Interest Income - Restructured Loans</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td></td>
</tr>
<tr>
<td>Fees Income</td>
<td>18.53%</td>
<td>25.25%</td>
<td>-6.72%</td>
<td></td>
</tr>
<tr>
<td>Income from Penalties</td>
<td>0.70%</td>
<td>1.52%</td>
<td>-0.82%</td>
<td></td>
</tr>
<tr>
<td>Total Operational Income</td>
<td>73.43%</td>
<td>87.63%</td>
<td>-14.20%</td>
<td></td>
</tr>
<tr>
<td>Investment Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-Term Investments</td>
<td>1.75%</td>
<td>7.58%</td>
<td>-5.83%</td>
<td></td>
</tr>
<tr>
<td>Long-Term Investments</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td></td>
</tr>
<tr>
<td>Total Investment Income</td>
<td>1.75%</td>
<td>7.58%</td>
<td>-5.83%</td>
<td></td>
</tr>
<tr>
<td>Other Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from Grants for Credit Services</td>
<td>0.00%</td>
<td>4.80%</td>
<td>-4.80%</td>
<td></td>
</tr>
<tr>
<td>Income from Grants for Loan Fund Capital</td>
<td>24.83%</td>
<td>0.00%</td>
<td>24.83%</td>
<td></td>
</tr>
<tr>
<td>Grant Income</td>
<td>24.83%</td>
<td>4.80%</td>
<td>20.03%</td>
<td></td>
</tr>
<tr>
<td>Total Income</td>
<td>100.00%</td>
<td>100.00%</td>
<td>0.00%</td>
<td></td>
</tr>
<tr>
<td>Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Expense on Borrowings</td>
<td>18.05%</td>
<td>17.86%</td>
<td>0.19%</td>
<td></td>
</tr>
<tr>
<td>Interest Paid on Project Deposits (HUDA etc)</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td></td>
</tr>
<tr>
<td>Total Financial Expenses</td>
<td>18.05%</td>
<td>17.86%</td>
<td>0.19%</td>
<td></td>
</tr>
<tr>
<td>Cash Operational Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and Benefits</td>
<td>29.27%</td>
<td>25.51%</td>
<td>3.76%</td>
<td></td>
</tr>
<tr>
<td>Administrative Charges (Rent, Electricity, Utilities, Bank, Telephone, Printing &amp; Stationary, Transportation etc)</td>
<td>12.20%</td>
<td>12.76%</td>
<td>-0.56%</td>
<td></td>
</tr>
<tr>
<td>Traveling Expense</td>
<td>12.20%</td>
<td>12.76%</td>
<td>-0.56%</td>
<td></td>
</tr>
<tr>
<td>Occupancy</td>
<td>12.20%</td>
<td>12.76%</td>
<td>-0.56%</td>
<td></td>
</tr>
</tbody>
</table>
## Income Statement

<table>
<thead>
<tr>
<th>For Year Ending March</th>
<th>Year 2007</th>
<th>Year 2006</th>
<th>Change 2007-2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous</td>
<td>1.46%</td>
<td>1.53%</td>
<td>-0.07%</td>
</tr>
<tr>
<td>Total Cash Operational Expenses</td>
<td>67.80%</td>
<td>65.31%</td>
<td>2.50%</td>
</tr>
<tr>
<td><strong>Non-Cash Operational Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>1.95%</td>
<td>1.53%</td>
<td>0.42%</td>
</tr>
<tr>
<td>Loan Loss Provision</td>
<td>12.20%</td>
<td>15.31%</td>
<td>-3.11%</td>
</tr>
<tr>
<td>Total Non-Cash Operational Expenses</td>
<td>14.15%</td>
<td>16.84%</td>
<td>-2.69%</td>
</tr>
<tr>
<td><strong>Total Operational Expenses</strong></td>
<td>81.95%</td>
<td>82.14%</td>
<td>-0.19%</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>100.00%</td>
<td>100.00%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>
Receipts and Payments

The Receipts and Payments Account shows the sources of funds and the applications of funds during the accounting reporting periods.

The Receipts and Payments Account shall be prepared from the Balance Sheet, Income and Expenditure Statement, Ledgers and Cash Book.

The following shall be noted in relation to preparation of Receipts and Payments Account:
- The receipts considered are on cash basis and does not take into account the receivables. Similarly, the payments considered are on cash basis and does not take into account the payables.
- Non-cash items like Depreciation, Miscellaneous Expenditure w/off (written off), Profit/Loss on disposal of Fixed Assets, Profit/Loss on disposal of Investments will not be considered while preparing this statement.
- If any loan is obtained by NCRPB in such a way that the disbursement of installments is directly made to the appointed project (off balance sheet for NCRPB), then the loan, though not directly received in cash by NCRPB, should be shown as 'Receipts'. Similarly, corresponding payments made to the project, though not made in cash by NCRPB, should be shown as 'Payments'.

Points of Difference between a Receipts and Payments Accounts and an Income and Expenditure Amount

<table>
<thead>
<tr>
<th>S. No</th>
<th>Points of Difference</th>
<th>Receipts and Payments Account</th>
<th>Income and Expenditure Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Opening Balance</td>
<td>Opening Cash and Bank Balance</td>
<td>No opening balance</td>
</tr>
<tr>
<td>2</td>
<td>Capital Receipts and Payments</td>
<td>Included</td>
<td>Not included</td>
</tr>
<tr>
<td>3</td>
<td>Outstanding Expenses</td>
<td>Not included</td>
<td>Included</td>
</tr>
<tr>
<td>4</td>
<td>Accrued Income</td>
<td>Not included</td>
<td>Included</td>
</tr>
<tr>
<td>5</td>
<td>Prepaid Expenses</td>
<td>Included</td>
<td>Not included</td>
</tr>
<tr>
<td>6</td>
<td>Income Received in Advance</td>
<td>Included</td>
<td>Not included</td>
</tr>
<tr>
<td>7</td>
<td>Depreciation, Provisions etc</td>
<td>Not included</td>
<td>Included</td>
</tr>
<tr>
<td>8</td>
<td>Credit Purchase and Sales</td>
<td>Not included</td>
<td>Included</td>
</tr>
<tr>
<td>9</td>
<td>Closing Balance</td>
<td>Closing Cash, Bank Balance</td>
<td>Surplus or Deficit</td>
</tr>
</tbody>
</table>

The Receipts and Payments statement is given in table below.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Opening Balances#</td>
<td>144,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cash balances including Imprest</td>
<td>1,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Balances with Banks/ Treasury</td>
<td>143,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(including balances in designated</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>bank accounts)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Table 2: Receipt and Payments Accounts for the Period from 01.04.2006 to 31.03.07

<table>
<thead>
<tr>
<th>Code No.</th>
<th>Head of Account</th>
<th>Code No.</th>
<th>Head of Account</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current Period Amount (Rs. In Lakhs)</td>
<td></td>
<td>Current Period Amount (Rs. In Lakhs)</td>
</tr>
<tr>
<td></td>
<td>Corresponding Previous Period Amount</td>
<td></td>
<td>Corresponding Previous Period Amount</td>
</tr>
<tr>
<td></td>
<td>(Rs. In Lakhs)</td>
<td></td>
<td>(Rs. In Lakhs)</td>
</tr>
<tr>
<td>1-10</td>
<td>Interest Revenue</td>
<td>2-10</td>
<td>Establishment Expenses</td>
</tr>
<tr>
<td></td>
<td>13,03,000</td>
<td></td>
<td>16,350</td>
</tr>
<tr>
<td>1-20</td>
<td>Assigned Revenues &amp; Compensations</td>
<td>2-20</td>
<td>Administrative Expenses</td>
</tr>
<tr>
<td></td>
<td>125,000</td>
<td></td>
<td>200</td>
</tr>
<tr>
<td>1-30</td>
<td>Rental income from Properties</td>
<td>2-30</td>
<td>Operations and Maintenance</td>
</tr>
<tr>
<td></td>
<td>3,000</td>
<td></td>
<td>15,100</td>
</tr>
<tr>
<td>1-40</td>
<td>GIS User Charges</td>
<td>2-40</td>
<td>Interest &amp; Finance Charges</td>
</tr>
<tr>
<td></td>
<td>55,500</td>
<td></td>
<td>15,500</td>
</tr>
<tr>
<td>1-50</td>
<td>Sale &amp; Hire Charges</td>
<td>2-50</td>
<td>Programme Expenses</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-60</td>
<td>Revenue Grants, Contributions &amp; Subsidies</td>
<td>2-60</td>
<td>Revenue Grants, Contributions &amp; Subsidies</td>
</tr>
<tr>
<td></td>
<td>45,500</td>
<td></td>
<td>17,500</td>
</tr>
<tr>
<td>1-70</td>
<td>Income from Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,290</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-71</td>
<td>Other Interest Earned</td>
<td>4-30</td>
<td>Purchase of Stores</td>
</tr>
<tr>
<td></td>
<td>1,000</td>
<td></td>
<td>5,000</td>
</tr>
<tr>
<td>1-80</td>
<td>Other Income</td>
<td></td>
<td>Other Collections on behalf of State and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Central Government</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>3-30/31</td>
<td>Loans Received</td>
<td>3-50</td>
<td>Other Payables</td>
</tr>
<tr>
<td></td>
<td>150,000</td>
<td></td>
<td>54,300</td>
</tr>
<tr>
<td>3-40</td>
<td>Deposits Received</td>
<td>3-50</td>
<td>Refunds Payable</td>
</tr>
<tr>
<td></td>
<td>43,500</td>
<td></td>
<td>10,500</td>
</tr>
<tr>
<td>3-20</td>
<td>Grants and contribution for specific</td>
<td></td>
<td>** Repayment of Loans</td>
</tr>
<tr>
<td></td>
<td>purposes</td>
<td></td>
<td>6,300</td>
</tr>
<tr>
<td>3-50</td>
<td>Sale proceeds from Assets</td>
<td></td>
<td>** Refund of Deposits</td>
</tr>
<tr>
<td></td>
<td>3,000</td>
<td></td>
<td>29,000</td>
</tr>
<tr>
<td>4-20</td>
<td>Realisation of Investment – General</td>
<td>4-10</td>
<td>Acquisition / Purchase of Fixed Assets</td>
</tr>
<tr>
<td></td>
<td>Fund</td>
<td></td>
<td>30,000</td>
</tr>
<tr>
<td>4-21</td>
<td>Realisation of Investment – Other Funds</td>
<td>4-12</td>
<td>Capital Work – in – Progress</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-41</td>
<td>Deposit works</td>
<td>3-41</td>
<td>Deposit works</td>
</tr>
<tr>
<td></td>
<td>50,000</td>
<td></td>
<td>28000</td>
</tr>
<tr>
<td></td>
<td>Revenue Collected in Advance</td>
<td>4-20</td>
<td>Investments – General Fund</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10000</td>
</tr>
<tr>
<td></td>
<td>Loans &amp; Advances to Employees (recovery)</td>
<td>4-21</td>
<td>Investments – Other Funds</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11000</td>
</tr>
<tr>
<td>4-60</td>
<td>Other Loans &amp; Advances (recovery)</td>
<td>4-60</td>
<td>Loans &amp; Advances to Employees</td>
</tr>
<tr>
<td></td>
<td>2,150</td>
<td></td>
<td>5000</td>
</tr>
<tr>
<td></td>
<td>Deposits with External Agencies</td>
<td>4-40</td>
<td>Prepaid Expenses</td>
</tr>
<tr>
<td></td>
<td>(recovery)</td>
<td></td>
<td>1800</td>
</tr>
<tr>
<td></td>
<td>Other Receipts</td>
<td>4-60</td>
<td>Other Loans &amp; Advances</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10000</td>
</tr>
<tr>
<td>3-50</td>
<td>Unclaimed salaries</td>
<td>4-60</td>
<td>Deposits with External Agencies</td>
</tr>
<tr>
<td></td>
<td>1,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-50</td>
<td>Sale proceeds of stores</td>
<td>4-60</td>
<td>Advance to contractors &amp; others</td>
</tr>
<tr>
<td></td>
<td>2,000</td>
<td></td>
<td>13000</td>
</tr>
</tbody>
</table>

** Non-Operating Receipts **

<table>
<thead>
<tr>
<th>Code No.</th>
<th>Head of Account</th>
<th>Code No.</th>
<th>Head of Account</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current Period Amount (Rs. In Lakhs)</td>
<td></td>
<td>Current Period Amount (Rs. In Lakhs)</td>
</tr>
<tr>
<td></td>
<td>Corresponding Previous Period Amount</td>
<td></td>
<td>Corresponding Previous Period Amount</td>
</tr>
<tr>
<td></td>
<td>(Rs. In Lakhs)</td>
<td></td>
<td>(Rs. In Lakhs)</td>
</tr>
<tr>
<td>3-30</td>
<td>Loans Received</td>
<td>3-50</td>
<td>Other Payables</td>
</tr>
<tr>
<td></td>
<td>150,000</td>
<td></td>
<td>54,300</td>
</tr>
<tr>
<td>3-40</td>
<td>Deposits Received</td>
<td>3-50</td>
<td>Refunds Payable</td>
</tr>
<tr>
<td></td>
<td>43,500</td>
<td></td>
<td>10,500</td>
</tr>
<tr>
<td>3-20</td>
<td>Grants and contribution for specific</td>
<td></td>
<td>** Repayment of Loans</td>
</tr>
<tr>
<td></td>
<td>purposes</td>
<td></td>
<td>6,300</td>
</tr>
<tr>
<td>3-50</td>
<td>Sale proceeds from Assets</td>
<td></td>
<td>** Refund of Deposits</td>
</tr>
<tr>
<td></td>
<td>3,000</td>
<td></td>
<td>29,000</td>
</tr>
<tr>
<td>4-20</td>
<td>Realisation of Investment – General</td>
<td>4-10</td>
<td>Acquisition / Purchase of Fixed Assets</td>
</tr>
<tr>
<td></td>
<td>Fund</td>
<td></td>
<td>30,000</td>
</tr>
<tr>
<td>4-21</td>
<td>Realisation of Investment – Other Funds</td>
<td>4-12</td>
<td>Capital Work – in – Progress</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-41</td>
<td>Deposit works</td>
<td>3-41</td>
<td>Deposit works</td>
</tr>
<tr>
<td></td>
<td>50,000</td>
<td></td>
<td>28000</td>
</tr>
<tr>
<td></td>
<td>Revenue Collected in Advance</td>
<td>4-20</td>
<td>Investments – General Fund</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10000</td>
</tr>
<tr>
<td></td>
<td>Loans &amp; Advances to Employees (recovery)</td>
<td>4-21</td>
<td>Investments – Other Funds</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11000</td>
</tr>
<tr>
<td>4-60</td>
<td>Other Loans &amp; Advances (recovery)</td>
<td>4-60</td>
<td>Loans &amp; Advances to Employees</td>
</tr>
<tr>
<td></td>
<td>2,150</td>
<td></td>
<td>5000</td>
</tr>
<tr>
<td></td>
<td>Deposits with External Agencies</td>
<td>4-40</td>
<td>Prepaid Expenses</td>
</tr>
<tr>
<td></td>
<td>(recovery)</td>
<td></td>
<td>1800</td>
</tr>
<tr>
<td></td>
<td>Other Receipts</td>
<td>4-60</td>
<td>Other Loans &amp; Advances</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10000</td>
</tr>
<tr>
<td>3-50</td>
<td>Unclaimed salaries</td>
<td>4-60</td>
<td>Deposits with External Agencies</td>
</tr>
<tr>
<td></td>
<td>1,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-50</td>
<td>Sale proceeds of stores</td>
<td>4-60</td>
<td>Advance to contractors &amp; others</td>
</tr>
<tr>
<td></td>
<td>2,000</td>
<td></td>
<td>13000</td>
</tr>
</tbody>
</table>

** Non-Operating Payments **

<table>
<thead>
<tr>
<th>Code No.</th>
<th>Head of Account</th>
<th>Code No.</th>
<th>Head of Account</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Current Period Amount (Rs. In Lakhs)</td>
<td></td>
<td>Current Period Amount (Rs. In Lakhs)</td>
</tr>
<tr>
<td></td>
<td>Corresponding Previous Period Amount</td>
<td></td>
<td>Corresponding Previous Period Amount</td>
</tr>
<tr>
<td></td>
<td>(Rs. In Lakhs)</td>
<td></td>
<td>(Rs. In Lakhs)</td>
</tr>
<tr>
<td>3-30</td>
<td>Loans Received</td>
<td>3-50</td>
<td>Other Payables</td>
</tr>
<tr>
<td></td>
<td>150,000</td>
<td></td>
<td>54,300</td>
</tr>
<tr>
<td>3-40</td>
<td>Deposits Received</td>
<td>3-50</td>
<td>Refunds Payable</td>
</tr>
<tr>
<td></td>
<td>43,500</td>
<td></td>
<td>10,500</td>
</tr>
<tr>
<td>3-20</td>
<td>Grants and contribution for specific</td>
<td></td>
<td>** Repayment of Loans</td>
</tr>
<tr>
<td></td>
<td>purposes</td>
<td></td>
<td>6,300</td>
</tr>
<tr>
<td>3-50</td>
<td>Sale proceeds from Assets</td>
<td></td>
<td>** Refund of Deposits</td>
</tr>
<tr>
<td></td>
<td>3,000</td>
<td></td>
<td>29,000</td>
</tr>
<tr>
<td>4-20</td>
<td>Realisation of Investment – General</td>
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<td>Acquisition / Purchase of Fixed Assets</td>
</tr>
<tr>
<td></td>
<td>Fund</td>
<td></td>
<td>30,000</td>
</tr>
<tr>
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<td>Realisation of Investment – Other Funds</td>
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<td>Capital Work – in – Progress</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-41</td>
<td>Deposit works</td>
<td>3-41</td>
<td>Deposit works</td>
</tr>
<tr>
<td></td>
<td>50,000</td>
<td></td>
<td>28000</td>
</tr>
<tr>
<td></td>
<td>Revenue Collected in Advance</td>
<td>4-20</td>
<td>Investments – General Fund</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10000</td>
</tr>
<tr>
<td></td>
<td>Loans &amp; Advances to Employees (recovery)</td>
<td>4-21</td>
<td>Investments – Other Funds</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11000</td>
</tr>
<tr>
<td>4-60</td>
<td>Other Loans &amp; Advances (recovery)</td>
<td>4-60</td>
<td>Loans &amp; Advances to Employees</td>
</tr>
<tr>
<td></td>
<td>2,150</td>
<td></td>
<td>5000</td>
</tr>
<tr>
<td></td>
<td>Deposits with External Agencies</td>
<td>4-40</td>
<td>Prepaid Expenses</td>
</tr>
<tr>
<td></td>
<td>(recovery)</td>
<td></td>
<td>1800</td>
</tr>
<tr>
<td></td>
<td>Other Receipts</td>
<td>4-60</td>
<td>Other Loans &amp; Advances</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10000</td>
</tr>
<tr>
<td>3-50</td>
<td>Unclaimed salaries</td>
<td>4-60</td>
<td>Deposits with External Agencies</td>
</tr>
<tr>
<td></td>
<td>1,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3-50</td>
<td>Sale proceeds of stores</td>
<td>4-60</td>
<td>Advance to contractors &amp; others</td>
</tr>
<tr>
<td></td>
<td>2,000</td>
<td></td>
<td>13000</td>
</tr>
</tbody>
</table>
Table 2: Receipt and Payments Accounts for the Period from 01.04.2006 to 31.03.07

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>3-50</td>
<td>Recovery from service providers</td>
<td>2,000</td>
<td></td>
<td>4-80</td>
<td>Loan issue expense deferred</td>
<td>3000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4-60</td>
<td>Employee provident fund Loan</td>
<td>2500</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Closing Balances #</td>
<td>16,59,390</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Cash balances including Imprest</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Balances with Banks/Treasury</td>
<td>16,58,390</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(including balances in designated bank accounts)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grand Total</td>
<td>19,63,440</td>
<td></td>
<td></td>
<td>Grand Total</td>
<td>19,63,440</td>
<td></td>
</tr>
</tbody>
</table>

Cash Flow Statement

The purpose of the statement of cash flows is to highlight the major activities that directly and indirectly impact flow of cash and hence, the overall cash balance. There is a very good reason to focus on cash – without sufficient cash at the right times, an FI may not be able to serve clients, pay salaries, service debts. Such a situation may lead the FI into bankruptcy. Therefore, the statement of cash flows answers questions that cannot be answered by the income statement, balance sheet or the Portfolio report.

For example, the statement of cash flows can be used to answer questions like the following:

- Where did FI AAA get the cash to pay a dividend in a year in which, according to its income statement, it lost money?
- How was FI CCC able to invest in its RLF despite a loss on its investment in a recent branch asset?
- Where did FI DDD get money to expand its operations in a year in which its net income was only small and it did not raise any new debt?

To answer such questions, familiarity with the statement of cash flows is required. The statement of cash flows is a valuable analytical tool for managers as well as for investors and creditors, although managers tend to be more concerned with prospective statements of cash flows that are prepared as part of the budgeting process.

The statement of cash flows can also be used to focus on crucial aspects such as the following:

- Is the organization generating sufficient positive cash flows from its ongoing operations to remain viable?
- Will it be able to meet its financial obligations to creditors, including clients?
- Will it be able to pay its customers, their interest on borrowings (private placement of bonds)?
- Why is there a difference between net income and net cash flow for the year?
- To what extent will NCRPB have to borrow money in order to make the necessary disbursements and/or investments?
- In what other ways were significant amounts of cash raised?
- Is NCRPB reinvesting excess cash in productive assets or is it using excess cash to drive debts?
- To what extent are the NCRPB investments being financed by internally generated cash and to what extent by borrowing or other external sources?
- For the cash obtained externally, what proportion was from debt and what kind?
- Is NCRPB having to borrow cash in order to maintain its cash payments?

Although the cash flow statement cannot provide complete answers to all of these questions, it can at

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Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
least suggest answers and highlight areas where it would be desirable to gather more information before deciding on alternative courses of action. In other words, cash flow statements help improve the process of cash flow management in FIs like NCRPB.

**Cash Flow Management:** Cash is critical to NCRPB’s survival and effective cash flow management is one of the most important tasks for FI managers. Without sufficient (liquid) cash, loans cannot be disbursed, employees cannot be paid, and debts cannot be settled.

The liquidity of the institution is the degree to which cash will be available in the time frame and amounts required for program and operational needs. The most common measure of liquidity adequacy (which can be applied to the historical balance sheet) is the "current ratio" of the organization.

\[
\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}
\]

- The current ratio is a measure of the degree to which anticipated sources of cash will be able to cover projected cash disbursements in the coming year/period.
- It is important to keep in mind that the current ratio reflects only balance sheet items - in other words, projected expenses (salaries, rent, travel, etc.) are not reflected in the liquidity adequacy of the current ratio, nor are projected loan disbursements.
- Also, the time frame of the current ratio is simply the coming twelve months; the measure offers no information about whether cash sources will be sufficient to cover uses at various times during the course of the year.

To develop a through projection of anticipated cash sources and uses, it is necessary to create a detailed cash flow projection. The projected cash flow adapts the format of the income statement to include additional sources and uses of funds. It can also start from the opening cash balance and go on to project the actual cash flow during a year.

When we start with income, the cash flow statement called is a fund flow statement. And when we start with cash, the cash flow statement is called a cash flow statement. We will look at the former in the following discussion but we will use the terminology cash flow statement to refer to both of these above statements.

**Cash Flow Statement Starting With Income:**
Starting with the overall surplus from the income statement (that is, total income minus total expenses), one adds back those expense items that do not entail an outlay of cash, such as depreciation, loan loss provision etc.

Then other sources and uses of cash that are not reflected on the income statement are factored. These other sources and uses are the net changes in assets and liabilities (See table below).

**Table 1: Classification of Sources and Uses of Cash**

<table>
<thead>
<tr>
<th>Sources (i.e., credits)</th>
<th>Uses (i.e., debits)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income</td>
<td>Always</td>
</tr>
<tr>
<td>Net loss</td>
<td>Always</td>
</tr>
<tr>
<td>Changes in non cash assets</td>
<td>Decreases</td>
</tr>
<tr>
<td>Changes in liabilities</td>
<td>Increases Decreases</td>
</tr>
<tr>
<td>Changes in capital stock accounts</td>
<td>Increases Decreases</td>
</tr>
<tr>
<td>Dividends paid to stockholders</td>
<td>Always</td>
</tr>
<tr>
<td>Total sources</td>
<td>Total uses</td>
</tr>
<tr>
<td>Total sources – Total uses = Net cash flow</td>
<td></td>
</tr>
</tbody>
</table>

*Contra asset accounts, such as the Accumulated Depreciation and Amortization account, follow the rules for liabilities.

Holding other factors constant, an increase in total assets will mean a decrease in (or a use of) cash. This is because cash has been used to purchase a new asset. On the other hand, a decrease in another asset means an increase in cash, as funds have been received from the liquidation of the asset. Conversely, an increase in liabilities will mean an increase in (or a source of) cash, because funds have been acquired by borrowing. Therefore, when examining the changes in the cash position of an institution, in addition to the income statement one needs to look at the increases and decreases in assets and liabilities from one balance sheet to the next.

By projecting anticipated cash receipts and disbursements on a monthly basis, NCRPB,
management will be able to evaluate whether cash receipts are likely to be sufficient to cover cash needs. If necessary, proactive steps can be taken well in advance to increase receipts or decrease disbursements, so that ongoing operations are not suddenly and unexpectedly held up due to liquidity problems.

The Basic Approach to a Statement of Cash Flows: For the statement of cash flows to be useful to its managers and others, it is important that NCRPB employs a common definition of cash. It is also important that the statement be constructed using consistent guidelines in identifying activities that are sources of cash and uses of cash.

The proper definition of cash and the guidelines to use in identifying sources and uses of cash are discussed in this section.

Definition of Cash: In preparing a statement of cash flows, the term cash is broadly defined to include both cash and cash equivalents.

Cash equivalents consist of short-term, highly liquid investments such as fixed deposits, treasury bills, commercial paper and money market funds. Such investments are made solely for the purpose of generating a return on funds that are temporarily idle.

Instead of simply holding cash, FIs invest their excess cash reserves in these types of interest-bearing assets that can be easily converted into cash. These short-term, liquid assets are usually included in marketable securities on the balance sheet.

What Is A Cash Flow Statement?: Imagine that you have a checking account in which amounts over some minimum balance, say Rs.1,000/- are automatically invested in highly liquid, interest-bearing securities. Instead of your account representing just cash, it constitutes the sum of cash and cash equivalents. In your checkbook register you record all deposits and other increases in the account (debits), and you also record all checks written and other withdrawals from the account (credits). Now assume that at the end of each year, you wishes to prepare a summary of the various uses you made of the cash in the account. For example, the sources categories might be wages, investment earnings, and gifts, and the uses categories might be housing costs, other living expenses, recreation/entertainment, health related, taxes, and major purchases (such as a new television set or a car).

You could first classify each entry in your checkbook register according to one of these categories, and then add the amounts of all of the items in each category and report the totals of the various categories. The end result could reasonably be called a personal cash flow statement.

In substance, the cash flow statement for any entity like NCRPB is analogous in that it summarizes a myriad of specific cash transactions into a few categories. However, the information for the statement of cash flows, apart from being taken directly from the Cash and Cash equivalent accounts, can also be derived from the income statement and balance sheet data.

Exhibit 7 describes the derivation of the cash flow statement from the balance sheet and relates it to the income statement.

Organization of the Statement of Cash Flows: To make it easier to compare statements of cash flows as well as construct them, a statement of cash flows be divided into three sections - operating activities, investing activities, and financing activities. The Box below provides guidelines for classifying transactions as operating, investing and financing activities for FIs like NCRPB.
Box 1: Guidelines for Classifying Transactions as Operating, Investing and Financing Activities for FIs

**Operating Activities**
- Net income
- Changes in current assets
- Changes in non-current assets that affect net income (e.g., depreciation)
- Changes in current liabilities (except for debts to lenders and dividends payable, if there is equity)
- Changes in non-current liabilities that affect net income

**Investing Activities**
- Changes in non-current assets that are not included in net income

**Financing Activities**
- Changes in the current liabilities that are debts to lenders rather than obligations to suppliers, employees, or the government
- Changes in non-current liabilities that are not included in net income
- Changes in capital stock account
- Dividends

Basic Steps to Preparing the Statement of Cash Flows: The statement of cash flows can be prepared as per the following steps listed given in table below:

<table>
<thead>
<tr>
<th>S No</th>
<th>Description</th>
<th>Add or Deduct</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Net income</td>
<td>Rs. XXX</td>
</tr>
<tr>
<td>2</td>
<td>Adjustments needed to convert net income to a cash basis:</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Depreciation, depletion, and amortization charges</td>
<td>+</td>
</tr>
<tr>
<td>3</td>
<td>Add (deduct) changes in current asset accounts affecting Revenue or expenses*:</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Increase in the account</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Decrease in the account</td>
<td>+</td>
</tr>
<tr>
<td>4</td>
<td>Add (deduct) changes in current liability accounts affecting Revenue or expense**:</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Increase in the account</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Decrease in the account</td>
<td>+</td>
</tr>
<tr>
<td>5</td>
<td>Add (deduct) gains or losses on sales of assets:</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Gain on sales of assets</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Loss on sales of assets</td>
<td>+</td>
</tr>
<tr>
<td>6</td>
<td>Add (deduct) changes in the Deferred Income Taxes account:</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Increase in the account</td>
<td>+</td>
</tr>
<tr>
<td></td>
<td>Decrease in the account</td>
<td>+</td>
</tr>
<tr>
<td>7</td>
<td>Net cash</td>
<td>Rs XXX</td>
</tr>
</tbody>
</table>

* Examples include accounts receivable, accrued receivables, inventory, and prepaid expenses.
** Examples include accounts payable, accrued liabilities, and taxes payable.
Adapting the above generic method, we can prepare the statement of cash flows for FIs in the following manner, as given in Table below:

### Table 3: Cash Flow Statement For FI like NCRPB

<table>
<thead>
<tr>
<th>Surplus (Deficit) of Total Revenue Over Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plus Non-cash Operating Items</td>
</tr>
<tr>
<td>• + Depreciation</td>
</tr>
<tr>
<td>• + Loan Loss Provision</td>
</tr>
<tr>
<td>• + Other ( )</td>
</tr>
<tr>
<td>Plus Other Sources of Cash</td>
</tr>
<tr>
<td>• + Loan Repayments Collected</td>
</tr>
<tr>
<td>• + Infusions of Borrowed Funds</td>
</tr>
<tr>
<td>• + Sale of Fixed Assets</td>
</tr>
<tr>
<td>• + Decrease in Investments</td>
</tr>
<tr>
<td>• + Decrease in Other Assets</td>
</tr>
<tr>
<td>• + Increase in Client Deposits Held (HUDA/DDA etc)</td>
</tr>
<tr>
<td>• + Increase in Other Liabilities</td>
</tr>
<tr>
<td>Minus Other Uses of Cash</td>
</tr>
<tr>
<td>• - Loans Disbursed</td>
</tr>
<tr>
<td>• - Repayments of Borrowed Funds</td>
</tr>
<tr>
<td>• - Purchase of Fixed Assets</td>
</tr>
<tr>
<td>• - Increase of investments</td>
</tr>
<tr>
<td>• - Increase in Other Assets</td>
</tr>
<tr>
<td>• - Decrease in Client Deposits Held (HUDA/DDA etc)</td>
</tr>
<tr>
<td>• - Decrease in Other Liabilities</td>
</tr>
<tr>
<td>Net Cash Flow</td>
</tr>
</tbody>
</table>

#### Box 2: How Does Delinquency Affect the Cash Flow Statement?
- It postpones the availability of cash due to delayed repayments
- It delays the disbursement of loans as enough cash may not be available
- Therefore, delinquency upsets both the inflows (sources) and outflows (use) and could really throw financial operations out of gear
- That is why the on-time repayment rate is regarded as the most crucial for FIs like NCRPB as it is a measure of the extent to which clients pay on-time (as per the scheduled date)
- If the on-time repayment rate is below 90% percent, as per best practices norms, the FI does have a serious problem and will need use other ways (like short-term borrowings) to systematize its cash flow management

While the above showed the derivation of the cash flow statement from the income, the cash flow statement can also be constructed using cash and cash accounts. Normally, this route is followed when making financial projections whereby the cash flow, income statement and balance sheet are sequentially constructed.

**Interpretation of the Statement of Cash Flows:**
When interpreting a statement of cash flows, it is particularly important to scrutinize the net cash provided by operating activities. This figure provides a measure of how successful the FI is in generating cash on a continuing basis.

A negative cash flow from operations would usually be a sign of fundamental difficulties. A positive cash flow from operations is necessary to avoid liquidating assets or borrowing money just to sustain day-to-day operations. The purpose of analyzing cash flow statements is not solely to understand what has happened in the past. In addition, this analysis serves as a means of projecting what cash flows may look like in the future. A projected cash flow statement is therefore an essential device for future planning, especially with regard to the amount, timing, and character of new financing.
These projections are important both to management in anticipating future cash needs and to prospective lenders for appraising a FI’s ability to repay debt on the proposed terms.

To summarise, the statement of cash flows is one of the major financial statements prepared by organizations. As it attempts to explain how cash was generated and how it was used during a period, it is widely used as a tool for assessing the financial health of organizations like NCRPB.

Cash Flow statement is prepared in order to have information about the cash flows of an enterprise like NCRPB. It is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents and the needs of the enterprise to utilise those cash flows.

A Cash Flow Statement, when used in conjunction with the other Financial Statements, provides information that enables users to evaluate the changes in assets and liabilities, its financial status, and the actual performance in terms of cash inflows and outflows. This statement provides relevant information about cash receipts and cash payments during the reporting period and supplements the Statement of Financial Condition and the Statement of Income. At NCRPB management’s option, prepare the Statement of Cash Flows at least annually under the accrual basis of accounting. Management may prepare the statement more frequently. The Statement of Cash Flows, when used with the related disclosures and other financial statements, should help to assess:

- NCRPB management’s ability to generate positive future cash flows;
- Management’s ability to meet its obligations, pay interest, and determine its need for external financing;
- Reasons for differences between net income and associated cash receipts and cash payments; and
- Effects on NCRPB’s position of both its cash and non-cash investing and financing transactions during the reporting period.

A simple Cash Flow Statement is given in Table below.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Current Year (Rs. In Lakhs)</th>
<th>Previous Year (Rs. In Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Cash flows from operating activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross surplus/ (deficit) over expenditure</td>
<td>13,96,348</td>
<td></td>
</tr>
<tr>
<td>Adjustments for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>18,875</td>
<td></td>
</tr>
<tr>
<td>Interest &amp; finance expenses</td>
<td>15,500</td>
<td></td>
</tr>
<tr>
<td>Provision for doubtful debts</td>
<td>23,000</td>
<td></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit on disposal of assets</td>
<td>(1,000)</td>
<td></td>
</tr>
<tr>
<td>Interest income</td>
<td>(1,822)</td>
<td></td>
</tr>
<tr>
<td>Investment income</td>
<td>(1,500)</td>
<td></td>
</tr>
<tr>
<td>Adjusted income over expenditure before effecting changes in current assets and current liabilities and extra ordinary items.</td>
<td>14,49,401</td>
<td></td>
</tr>
<tr>
<td>Changes in current assets and current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Increase) / decrease in Sundry debtors</td>
<td>(27,246)</td>
<td></td>
</tr>
<tr>
<td>(Increase) / decrease in Stock in hand</td>
<td>7,200</td>
<td></td>
</tr>
<tr>
<td>(Increase) / decrease in prepaid expenses</td>
<td>(1,800)</td>
<td></td>
</tr>
<tr>
<td>(Increase) / decrease in other current assets</td>
<td>850</td>
<td></td>
</tr>
<tr>
<td>(Decrease) / increase in Deposits received</td>
<td>11,500</td>
<td></td>
</tr>
<tr>
<td>(Decrease) / increase in other current Liabilities</td>
<td>29,500</td>
<td></td>
</tr>
<tr>
<td>(Decrease) / increase in provisions</td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td>Extra ordinary items (Specify)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 4: Statement of Cash Flow for the year ended 31st March, 2007

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Current Year (Rs. In Lakhs)</th>
<th>Previous Year (Rs. In Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net cash generated from/ (used in) operating activities (a)</strong></td>
<td>14,64,405</td>
<td></td>
</tr>
<tr>
<td><strong>b. Cash flows from investing activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Purchase) of fixed assets 1</td>
<td>(55,500)</td>
<td></td>
</tr>
<tr>
<td>(Purchase) of other assets 2</td>
<td>(17,500)</td>
<td></td>
</tr>
<tr>
<td>(Increase) / Decrease in Special funds/grants</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Decrease) / Increase in Earmarked funds</td>
<td>18,785</td>
<td></td>
</tr>
<tr>
<td>(Purchase) of Investments</td>
<td>(21,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Add:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from disposal of assets</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>Proceeds from disposal of investments</td>
<td>6,500</td>
<td></td>
</tr>
<tr>
<td>Interest income received</td>
<td>1,550</td>
<td></td>
</tr>
<tr>
<td>Recovery of Loan</td>
<td>1,950</td>
<td></td>
</tr>
<tr>
<td>Loan advanced to employee</td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td>Loan advanced to others</td>
<td>(10,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Net cash generated from/ (used in) investing activities (b)</strong></td>
<td>(77,215)</td>
<td></td>
</tr>
<tr>
<td><strong>c. Cash flows from financing activities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Add:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans from banks/others received</td>
<td>150,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan repaid</td>
<td>(6,300)</td>
<td></td>
</tr>
<tr>
<td>Finance expenses</td>
<td>(15,500)</td>
<td></td>
</tr>
<tr>
<td><strong>Net cash generated from (used in) financing activities (c)</strong></td>
<td>128,200</td>
<td></td>
</tr>
<tr>
<td><strong>Net increase/ (decrease) in cash and cash equivalents (a + b + c)</strong></td>
<td>15,15,390</td>
<td></td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at beginning of Period</strong></td>
<td>144,000</td>
<td></td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at end of Period</strong></td>
<td>16,59,390</td>
<td></td>
</tr>
<tr>
<td><strong>Cash and Cash equivalents at the end of the year comprises of the following account balances at the end of the year:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Balances</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Bank Balances</td>
<td>16,58,390</td>
<td></td>
</tr>
<tr>
<td>Nationalized banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balances with operationalised FIs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balances with other banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>16,59,390</td>
<td></td>
</tr>
</tbody>
</table>
Table 1: Sample Portfolio Report

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>P1</td>
<td>Total value of loans disbursed during period</td>
<td>160,000</td>
<td>130,000</td>
<td>30,000</td>
<td>23.08%</td>
<td>Increase</td>
</tr>
<tr>
<td>P2</td>
<td>Total number of loans disbursed during period</td>
<td>1,600</td>
<td>1,300</td>
<td>300</td>
<td>23.08%</td>
<td>Increase</td>
</tr>
<tr>
<td>P3</td>
<td>Number of loans outstanding (End of period)</td>
<td>1,800</td>
<td>1,550</td>
<td>250</td>
<td>16.13%</td>
<td>Increase</td>
</tr>
<tr>
<td>P4</td>
<td>Value of loans outstanding (End of period)</td>
<td>84,000</td>
<td>70,000</td>
<td>14,000</td>
<td>20.00%</td>
<td>Increase</td>
</tr>
<tr>
<td>P5</td>
<td>Average outstanding balance of loans</td>
<td>75,000</td>
<td>61,000</td>
<td>14,000</td>
<td>22.95%</td>
<td>Increase</td>
</tr>
<tr>
<td>P6</td>
<td>Value of payments arrears (End of period)</td>
<td>5,000</td>
<td>9,000</td>
<td>-4,000</td>
<td>-44.44%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P7</td>
<td>Value of outstanding balance of loans in arrears (End of period)</td>
<td>18,000</td>
<td>20,000</td>
<td>-2,000</td>
<td>-10.00%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P8</td>
<td>Value of loans written off during period</td>
<td>500</td>
<td>700</td>
<td>-200</td>
<td>-28.57%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P9</td>
<td>Average initial loan size</td>
<td>100</td>
<td>100</td>
<td>No Change</td>
<td>No Change</td>
<td>No Change</td>
</tr>
<tr>
<td>P10</td>
<td>Average loan term (months)</td>
<td>12</td>
<td>12</td>
<td>No Change</td>
<td>No Change</td>
<td>No Change</td>
</tr>
<tr>
<td>P11</td>
<td>Average number of loans officers during period (Loan Department Staff)</td>
<td>6</td>
<td>6</td>
<td>No Change</td>
<td>No Change</td>
<td>No Change</td>
</tr>
<tr>
<td>P12</td>
<td>Value of Re-Scheduled Loans Outstanding</td>
<td>0</td>
<td>0</td>
<td>No Change</td>
<td>No Change</td>
<td>No Change</td>
</tr>
<tr>
<td>P13</td>
<td>Value of Re-Financed Loans Outstanding</td>
<td>0</td>
<td>0</td>
<td>No Change</td>
<td>No Change</td>
<td>No Change</td>
</tr>
<tr>
<td>P14</td>
<td>Value of Loan Outstanding for which Repayment is yet to Begin</td>
<td>0</td>
<td>0</td>
<td>No Change</td>
<td>No Change</td>
<td>No Change</td>
</tr>
</tbody>
</table>

Table 2: Aging Analysis Of All Outstanding Loans For Year Ending 31st March 2007

<table>
<thead>
<tr>
<th>S No</th>
<th>Type of Loans</th>
<th>Outstanding Number of Loans</th>
<th>Value of Loans</th>
<th>Percentage of Total Loans Outstanding</th>
<th>Portfolio at Risk (PAR)</th>
<th>Provision Rate</th>
<th>Provision Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>P15</td>
<td>Current Loans</td>
<td>1,440</td>
<td>66,000</td>
<td>78.57%</td>
<td>0.00%</td>
<td>0%</td>
<td>0</td>
</tr>
<tr>
<td>P16</td>
<td>Less than 30 Days past due</td>
<td>200</td>
<td>8,750</td>
<td>10.42%</td>
<td>10.42%</td>
<td>10%</td>
<td>875</td>
</tr>
<tr>
<td>P17</td>
<td>Between 31- 60 Days past due</td>
<td>75</td>
<td>5,000</td>
<td>5.95%</td>
<td>5.95%</td>
<td>50%</td>
<td>2500</td>
</tr>
<tr>
<td>P18</td>
<td>Between 61- 90 Days past due</td>
<td>60</td>
<td>2,500</td>
<td>2.98%</td>
<td>2.98%</td>
<td>75%</td>
<td>1875</td>
</tr>
<tr>
<td>P19</td>
<td>&gt; 90 Days</td>
<td>25</td>
<td>1,750</td>
<td>2.08%</td>
<td>2.08%</td>
<td>100%</td>
<td>1750</td>
</tr>
<tr>
<td>P20</td>
<td>Total</td>
<td>1,800</td>
<td>84,000</td>
<td>100.00%</td>
<td>21.43%</td>
<td>Na</td>
<td>7,000</td>
</tr>
</tbody>
</table>

Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
### Explanation of Various Items:

While reading the portfolio report, for rows 1 to 14 and all columns, the following guidelines should be very useful:

- **General Basic Data and Information**

  - Column I gives the row identification number,
  - Column II is the description of the item,
  - Columns III and IV provide the amounts for the respective item for two consecutive years (in this case 2007 and 2006),
  - Column V represents the absolute (amount) change in the values of the respective items across two years.
  - Column VI gives the percentage change for the respective items across two years.
  - Column VII provides a trend of whether the specific item is increasing or decreasing.

| **1. Total Value of Loans Disbursed during the Period** | Refers to the total value (in currency) of loans disbursed in a specific time period. (Please see Column II, Row P1). |
| **2. Total Number of Loans Disbursed during the Period** | Refers to the total number of loans disbursed in a specific time period. (Please see Column II, Row P2). As per example above |
| **3. Average Outstanding Balance of Loans** | Refers to the average value (in currency) of loans outstanding over a period. |
| **4. Number of Loans Outstanding (end of period)** | Refers to the number of loans which still have an amount due on them. Loans, which have been repaid in full, are not considered in this number. (Please see Column II, Row P3). |
| **5. Value of Loans Outstanding (end of period)** | Refers to the current value (in currency) of loans still not paid at a specific date. Differs from the "Total Value of Loans Made in the Period" in that "Total Loans Outstanding" does not consider the amount that was disbursed, just the amount that is currently owed to the organization. |
| **6. Average Outstanding Balance of Loans** | Refers to the average value (in currency) of loans outstanding over a period. |

While reading the portfolio report, for rows 1 to 14 and all columns, the following guidelines should be very useful:

- Column I gives the row identification number,
- Column II is the description of the item,
- Columns III and IV provide the amounts for the respective item for two consecutive years (in this case 2007 and 2006),
- Column V represents the absolute (amount) change in the values of the respective items across two years.
- Column VI gives the percentage change for the respective items across two years.
- Column VII provides a trend of whether the specific item is increasing or decreasing.

---

40 One will always have to specify "to" and "from" dates for the portfolio report.
41 The most recent year is always given before the earlier year. Therefore, COLUMN III has values for year 2007 and COLUMN IV has values for year 2006. This is a general best practices report format but users can change this, if there is a good reason to do so.
42 Amount due here would include over due plus future due.
For example, to determine the Average Outstanding Balance for a 12-month period using monthly intervals, the outstanding balance at the end of each month would be added together and the total figure divided by 13.

As per our example, for year 2007, the average outstanding balance of loans (as the approximate formula) is \((\frac{84,000 + 70,000}{2}) = 77,000\). The accurate formula of taking the month end balances and dividing by 13 gives the 75,000 listed in the report (Row P5 and Column III).

Therefore, while for cursory analysis, one may use the approximate formula of opening balance plus closing balance and dividing this by 2, it is imperative that from a best practices perspective, the accurate formula of adding all month end balances with the opening balance and dividing by 13 is followed.

- **Value of Payments in Arrears (end of period)** - Refers to the value (in currency) of payments in arrears – payments that have been due and not paid. This figure includes principal only that has become due but has not been received as of the end of the period. (Please see Column II, Row P6)

  Likewise, for year ending 31st March 2007, the value of payments in arrears is 5,000 (Column III) and for year ending 31st March 2006, it is 9,000 (Column IV). In other words, value of payments in arrears has gone down by 4,000 (Column V) in year ending March 2007 as compared to year ending March 2006. This represents a percentage decrease of 44.4% (Column VI). The trend of this change is a decreasing one (Column VII).

- **Value of Outstanding Balance of Loans in Arrears (end of period)** - Refers to the total value (in currency) of loans that have one or more payments in arrears. Includes principal amount only, but covers the total loan amount outstanding, not just the amount of principal that has fallen due and not been received. Also referred to as "Portfolio at Risk" (when this is divided by the Outstanding Portfolio). (Please see Column II, Row P7)

  Likewise, for year ending 31st March 2007, the value of Outstanding Balance of Loans in Arrears is 18,000 (Column III) and for year ending 31st March 2006, it is 20,000 (Column IV).

  In other words, value of Outstanding Balance of Loans in Arrears has gone down by 2,000 (Column V) in year ending March 2007 as compared to year ending March 2006. This represents a percentage decrease of 10% (Column VI). The trend of this change is a decreasing one (Column VII).

- **Value of Loans Written Off During the Period** - Refers to the value (in currency) of loans that have been determined as non-recoverable and have been written off the Balance Sheet. (Please see Column II, Row P8)

  Likewise, for year ending 31st March 2007, the Value of loans written off during period is 500 (Column III) and for year ending 31st March 2006, it is 700 (Column IV). In other words, value of Outstanding Balance of Loans in Arrears has gone down by 200 (Column V) in year ending March 2007 as compared to year ending March 2006. This represents a percentage decrease of 28.57% (Column VI). The trend of this change is a decreasing one (Column VII).

Writing off loans is always a difficult decision and it must be carefully taken. Please refer to the note on Delinquency Management and portfolio quality for comprehensive best practices guidelines in this regard. Nonetheless, some crucial (technical) aspects are given below:

- When a loan is written off, the Outstanding Loan Balance and the Loan Loss Reserve are reduced by the value of loans written off.
- Once a loan is written off, it is no longer recorded as an asset (i.e. an amount due to the organization).
- Writing off loans too rapidly can make an organization’s loan portfolio look much healthier than it may be, as the Portfolio at Risk appears small.
- By the same token, past due loans, which should be written off but are still included in an organization’s outstanding loan figure overstate the size of the organization’s healthy portfolio and consequently distort the financial picture.

- **Average Initial Loan Size** - Refers to the average size of loans at the time of disbursement. (Please see Column II, Row P9)
This would normally be determined in the following manner:

<table>
<thead>
<tr>
<th>Value of Loans Disbursed</th>
<th>Number of Loans Disbursed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Cumulative till date)</td>
<td>(Cumulative till date)</td>
</tr>
</tbody>
</table>

Using the above formula, we get the average loan sizes for years ending March 2007 as 100 (1,60,000/1,600) and March 2006 as 100 (1,30,000/1,300).

It can be seen that the average loan size has stayed the same across the two-year period, April 2005 – March 2007.

- **Average Loan Term** - Refers to the amount of time that loans, on average, are outstanding. (Please see Column II, Row P10)
- It can be seen that the average loan term (12 months) has stayed the same across the two-year period, April 2005 – March 2007.
- **Average Number of Loan Officers during Period** - refers to the number of employees of the organization who deal directly with projects in disbursing loans and collecting loan payments. The average (rather than the absolute number) is taken because there could be a turn over of the employees. (Please see Column II, Row P11).

It can be seen that the average number of loan officers (6) has stayed the same across the two-year period, April 2005 – March 2007.

Apart from the above, best practices recommendations suggest that the following additional information should be a part of Portfolio Report in order to ensure greater transparency and accuracy in the risk estimates:

- **Value of Re-Scheduled Loans outstanding** - Refers to the value of loans that have been re-scheduled – all outstanding loans, whose terms have been changed but no new amounts have been given (additionally).
- **Value of Re-Financed Loans outstanding** - Refers to the value of loans that have been re-financed – all outstanding loans, whose terms have been changed and also new amounts have been given additionally.

**Value of Loans outstanding for which repayment is yet to begin** - Refers to the value of loans outstanding for which the repayment schedule is yet begin. These could include loans that have a longer moratorium period as well as loans that have been recently disbursed. (Please see Column II, Row P14).

- The reason for obtaining this information is that, inclusion of such loans (outstanding) in the total outstanding portfolio will cause the risk to be understated when the portfolio at risk is calculated.
- Therefore, to present the true picture of the risk, it is important to calculate an adjusted portfolio at risk and for this purpose, one requires this additional (but easily available) information.
- This is due to the fact that for such loans, repayment behavior is not observable (as it has not yet started) and therefore, it is only fair and accurate that these amounts (if known) be deducted from the outstanding portfolio.
- Of course, these amounts would have to be automatically included in the total outstanding portfolio, once the repayment schedule begins.

In the present case, in either of the two years, there no such loans (outstanding), for which the repayment schedule is yet to begin.

While reading the portfolio report, for rows 15 to 20 and all columns, Aging Analysis of All Outstanding Loans for Year Ending 31st March 2007, the following guidelines should be very useful:

- Column I gives the row identification number,
- Column II is the description of the type of loans classified as current and various days past due.
- Column III provides the number of such loans in the various categories, as mentioned above. This should equal the figure given in row P3, Column III.
- Column IV gives the value of unpaid principal balance (or loan outstanding) for the respective category of loans (both current and

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43 One will always have to specify “to” and “from” dates for the portfolio report.
44 The categorization of the past due loans has been kept simple for illustrative purposes. The best practices recommendations for categorization of past due loans have however been provided as a box item also.
past due by different days). This total should equal the amount given in row P4, Column III.

- Column V shows the percentage of loans outstanding in each of the categories (as a proportion of the total loans outstanding). The total here should equal 100%.
- Column VI highlights the Portfolio at risk for loans in each of the categories.
- Column VII gives the risk factor in terms of the percentage of the loan outstanding, that will (perhaps) not be recovered. This is available for each of the categories of loans (current and past due loans by different days)
- Column VIII provides the amount at risk for the different types of loans, taking into account the loan outstanding and the risk factor.

**Number of Current Loans** - Refers to the number of loans at the end of the period that have no payments that are due but have not been received. In other words, all loans in which the borrowers have no over dues would be listed here (Please see Column II, Row P15).

**Number of Loans in Arrears** - Refers to the number of loans at the end of the period that have one or more payments which have become due but have not been received. In other words, all loans that have an arrears (or over dues) will be listed here.

For example, Column II, Row P16 gives the number of loans (with installments) that are over due for less than 30 days (from the due date).

Likewise, Column II, Row P17 gives the number of loans (with installments) that are over due for between 31 – 60 days (from the due date).

Similarly, Column II, Row P18 gives the number of loans (with installments) that are over due for between 61 – 90 days (from the due date).

Likewise, Column II, Row P19 gives the number of loans (with installments) that are over due for greater than 90 days (from the due date).

Lastly, Column II, Row P20 gives the total outstanding value of all loans (current and those past due) and this should equal the total value given in P4 Column III.

Two aspects with regard to classifying loans (as past due) need to be mentioned before we progress further.

First, specifically, organizations must have rules that determine at what point a loan becomes in arrears or past due.

Best practices suggest that, if any installment of a loan is not paid on the due date, the day immediately after the due date, the loan should called as in arrears. For example, let us say that 100 units of currency is due on March 30th for a loan. If no payment is received towards this installment of 100 units of currency by the due date (i.e., 30th March), then on 31st March, this loan should be called as a delinquent loan or loan in arrears or past due loan. Best practices also strongly recommend that FIs like NCRPB should not compromise on this aspect, under any circumstances.

Second is the aspect of how to determine the correct age of a past due loan with regard to different categories like ‘less than 30 days past due’, ‘31–60 days past due’, ‘61–90 days past due’ and ‘greater than 90 days past due’.

While doing this classification, best practices recommend that the age of a loan is always based on the 1st installment that became overdue (and has not been paid). In other words, if a client has not paid 6 installments (on a quarterly repayment interval schedule) till date, then this loan would be classified in the category – “=180 days past due”. This is because the 1st installment is more than 6 months overdue.

Please note that under no circumstances should installments that were overdue and had been paid back (fully) be considered in determining the age. The key aspect is that only installments that are still overdue should be considered. As the portfolio report is a stock report (as on date report), all loans with installments overdue as on the date of the portfolio report should be classified in different age categories, keeping in mind the age of the 1st installment (for every loan) that became overdue and is still in arrears.

**Loan Loss Reserve** - Refers to the amount of reserve made to cover loan losses. In the Portfolio Aging Report, the Loan Loss Reserve is calculated as a percentage of the Outstanding Balance of Loans in Arrears, based on the estimated risk (probability) of not receiving the full amount of the loan.

For example, loans which have payments 30 days past due may have a 10% risk of default (payment will never be received and loan will need to be written off).
Loans 90 days past due may have a 75% risk of default. The percentage risk of default is multiplied by the Outstanding Balance of Loans with Payments in Arrears to determine the Loan Loss Reserve in currency. The total value (in currency) of Loan Loss Reserve is then divided by the value of Loans Outstanding (in currency) to determine the Loan Loss Reserve Rate (in percentage).

Comparative Analysis of Key Portfolio Indicators

The Table below provides illustrative calculation of the various key ratios mentioned above in the Portfolio report. As best practices recommend a trend analysis, as evident from the Table (below), values of various ratios across years 2007 and 2006 are compared and also, the trends have been identified.

Without question, regular computation of such ratios and comparison of these over periods of time should help an FI like NCRPB to better understand the quality of its portfolio - an aspect that is very crucial to managing the lending function.

### Table 3: Key Ratios from the Portfolio Report

<table>
<thead>
<tr>
<th>S No</th>
<th>Name of the Ratio</th>
<th>Value in % for 2007</th>
<th>Value in % for 2006</th>
<th>Change</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>P21</td>
<td>PAR</td>
<td>21.43%</td>
<td>28.57%</td>
<td>-7.14%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P22</td>
<td>PAR adjusted for re-scheduling</td>
<td>21.43%</td>
<td>28.57%</td>
<td>-7.14%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P23</td>
<td>PAR adjusted for re-scheduling and re-financing</td>
<td>21.43%</td>
<td>28.57%</td>
<td>-7.14%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P24</td>
<td>PAR adjusted for write-offs</td>
<td>21.89%</td>
<td>29.28%</td>
<td>-7.39%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P25</td>
<td>PAR adjusted for fresh loan disbursements</td>
<td>21.43%</td>
<td>28.57%</td>
<td>-7.14%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P26</td>
<td>RE-scheduling ratio</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>No Change</td>
</tr>
<tr>
<td>P27</td>
<td>RE-scheduling and re-finance ratio</td>
<td>0.00%</td>
<td>0.00%</td>
<td>0.00%</td>
<td>No Change</td>
</tr>
<tr>
<td>P28</td>
<td>Write-off ratio</td>
<td>0.67%</td>
<td>1.15%</td>
<td>-0.48%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P29</td>
<td>Portfolio in arrears</td>
<td>5.95%</td>
<td>12.86%</td>
<td>-6.90%</td>
<td>Decrease</td>
</tr>
<tr>
<td>P30</td>
<td>Loan loss reserve ratio (base year 2000 = 5%)</td>
<td>8.33%</td>
<td>5.00%</td>
<td>3.33%</td>
<td>Increase</td>
</tr>
</tbody>
</table>
Tracking System (MIS) 45: Another critical control procedure is to ensure that the loan portfolio outstanding as reported in the Portfolio Tracking System (or MIS) agrees to the Loans Receivable account in NCRPB’s accounting general ledger. This reconciliation should be done monthly. Manual tracking systems or accounting systems make this very challenging, but all the more necessary.

Document Controls: Managing documents involves more than the production and printing of duplicate or triplicate copies, or ensuring they are serially pre-numbered. It also includes the proper storage, recording, issuance and tracking those documents. Normally, this is done in a Document Control Register. Staff who need to use and withdraw a receipt book for example, are required to sign them out. When they are completely filled, staff will return the receipt book with book copies intact. Receipts that are spoiled or voided remain in the book. Receipts will be spot checked and verified and then stored in safe place. These documents are generally stored and locked in a special place, since they represent the means for cash (e.g. receipts) and can be misused.

Audit and Paper Trail: The “audit trail” represents the linking of source documents to journals, to summaries, and to monthly or cumulative financial information. For example, a receipt is issued to a client for a loan payment and should be recorded in either a collection sheet or a cash register. This entry includes the date of the receipt, the receipt number, the client name, the total amount, and the amounts allocated to principal and interest. Receipts are summarized on the collection sheet on a daily or weekly basis, and the summarized total is then posted to the general ledger at the end of the month. The general ledger posting will make reference to the date and the number of the collection sheet.

A “paper trail” refers to the system of documentation that supports accounting transactions, entries and reports.

For example, source documents like invoices, payment schedules or receipts support the accounting transaction voucher. They need to be filed sequentially by month in order to be available for internal or external audits. The “paper trail” also includes the systematic filing and printing of all computer-generated reports. For example, it includes the printing of weekly or monthly transactions journal, the monthly general ledger, or the monthly financial statements.

It also includes the systematic printing and filing of all Loan Tracking System reports. Auditors and managers do not rely on screen data to analyze FI performance, or to audit financial reports, but on hard copy documents and reports.

Loan Portfolio Information: It is important to distinguish three separate FI systems that affect the loan portfolio. In practice, there may be some overlap, but in theory they perform separate functions and they need to be in congruence:

Loan Administration: The loan administration system is not an information system, but rather it is the set of policies and procedures that govern the loan operations, including:

✓ Loan marketing - eligible clients and types of business
✓ Loan analysis (repayment capacity)
✓ Loan terms and conditions
✓ Loan approval process
✓ Collateral and/or guarantors
✓ Loan documentation and disbursement
✓ Loan supervision and collection
✓ Follow-up loans
✓ Collection policies for delinquent loans
✓ Rescheduling for delinquent loans
✓ Provision for loan impairments
✓ Write-off of bad loans
✓ Reporting procedures

Loan Tracking: The purpose of the loan tracking system is information about individual loans, including:

❖ Identity of the client/project
❖ Credit history
❖ Amount disbursed
❖ Loan terms: interest rate, fees, maturity, etc.
❖ Repayment schedule: dates and amounts
❖ Amount and timing of payments received
❖ Amount and aging of delinquency
❖ Outstanding principal balance

The system should contain this information for both current loans and past due loans. Reports

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45 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
generated from loan tracking systems are a critical part of NCRPB portfolio management. Loan tracking systems should also be able to provide this information in a usable form on loans that have been paid off or written off.

The credibility of the loan tracking system is crucial. If the staff does not expect accuracy, people tend to let down their guard. Situations that ought to cause alarm are ignored with the assumption they represent errors or glitches in the system rather than actual problems with portfolio quality. Where people think there are MIS problems, fraud is more tempting because it is less likely to be detected promptly.

**Accounting for the Loan Portfolio:** Two balance sheet accounts are very important account balances in FIs like NCRPB - the loan portfolio account and the loan loss provision account (called the Impairment Loss Allowance in International Accounting Standards).

The portfolio typically accounts for most of the assets of the institution, and the potential for misstatement is great. Even without incidences of fraud, most FI failures stem from deterioration in the quality of the loan portfolio.

The risk of not collecting on some of the portfolio is accounted through the contra account, often called the loan loss provision on the balance sheet. The accounting system can receive information about individual loan transactions, but its purpose is to generate aggregate information that feeds into the financial statements.

Ideally, the loan tracking and accounting system should be seamlessly integrated (refer to Figure 1). In practice, this is often not the case. Many FIs use a standard accounting system that can be adjusted to fit their needs, but often need to design their own loan tracking system.

Loan disbursement and payment transactions are captured by both systems. But the two systems may capture the loan data at different times and from different sources, resulting in discrepancies between the two systems. Hence, what is required is an integrated system that automatically transfers the loan data from the portfolio tracker to the accounting part.

### Table 1: Areas of Risk in Loan Information

<table>
<thead>
<tr>
<th>Area</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accuracy</strong></td>
<td>Does the system correctly reflect loans disbursed, payments received, and current repayment status of outstanding loans?</td>
</tr>
<tr>
<td><strong>Security</strong></td>
<td>Is the system physically secure? Is there access control? Who can enter, change, or read data?</td>
</tr>
<tr>
<td><strong>Effectiveness</strong></td>
<td>Are reports prepared in a timely manner? Is the information used?</td>
</tr>
<tr>
<td><strong>Reconciliation Items</strong></td>
<td>If there is a discrepancy with the accounting records, is it due to a fundamental inconsistency between the two systems?</td>
</tr>
<tr>
<td><strong>Misrepresenting the Loan Payoff</strong></td>
<td>Does the project have the ability to repay, or is the payoff a substitution of one type of account for another? Examples: Refinancing - using a new loan to pay the old. Payment by cheque – usually post-dated and not honoured. Payoff with collateral - often of insufficient value.</td>
</tr>
<tr>
<td><strong>Rescheduling</strong></td>
<td>Are rescheduled loans tracked separately? If not, the old bad loan disappears, replaced by a new loan contract that appears to be current.</td>
</tr>
<tr>
<td><strong>Following Established Procedures</strong></td>
<td>Do the loan officers and the credit committees follow the FI loan administration policies? Is there sufficient staff training and supervision?</td>
</tr>
<tr>
<td><strong>Segmentation</strong></td>
<td>Does the system permit segmentation, especially of delinquent loans? Examples: segment by region, branch, loan officer, loan type, etc.</td>
</tr>
<tr>
<td><strong>Loan Write-offs</strong></td>
<td>Is the policy for writing off unrecoverable balances consistently applied?</td>
</tr>
<tr>
<td><strong>Provision Expense for Loan Impairment</strong></td>
<td>Is the current method for calculating the provision expense for loan impairment reasonable in light of historical loss experience and the current delinquency situation?</td>
</tr>
</tbody>
</table>
Figure 1: Financial Management Information Systems

Accounting System

- Chart of Accounts
- Transaction Entry
- General Journal
- General Ledger
- Financial Statements
- Reports
- Financial Management
  - Financial Statement Analysis
  - Financial Ratio Analysis
  - Cash Flow Analysis
  - Portfolio Analysis
  - Asset/Liability Management

Client/Project Portfolio System

- Client/Project Account Transactions
- Installment Schedule
- C1
- Transactions Record (Ledger Loan)
- C2
- Individual Loan Status
- Portfolio Status:
  - Loan Status
  - Aging of Arrears
  - Late Loans
- Reports
- Financial Management
- Transactions, Controls, and Recommendations
Accounting Standards: Accounting standards have been laid down by the Institute of Chartered Accountants of India with the following objectives:

- To provide better understanding of the financial statements;
- To improve the quality of presentation of the financial statements;
- To facilitate a meaningful comparison of financial statements;
- To prepare financial statements in conformity with such laws to ensure consistency in the presentation of the financial statements.

It is a healthy practice to adhere to the accounting standards that are laid down by the professional bodies from time to time. Maintenance of proper financial records and documents on a daily basis is basic for a good accounting system. Any transaction must be supported by certain valid documents e.g., vouchers, receipts, etc. These are known as supporting documents and they are an integral part of any accounting system. This is discussed in detail below.

Proforma Invoice, Invoice, Cash Bill: This is merely a quotation giving the estimated cost of the goods or services. This is not a supporting document and it has to be followed by an invoice. Where a good policy for procurement of goods and services exists, a quotation is asked for and the cost estimate is provided by the supplier in a Proforma Invoice. A good procurement policy should aim at obtaining the best goods or services at the most competitive and economic cost for the requirement purpose. An organization invites quotations, bids or cost estimates and the suppliers provide such estimates through Proforma Invoices.

<table>
<thead>
<tr>
<th>S.No</th>
<th>Particulars</th>
<th>Quantity</th>
<th>Price</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tables</td>
<td>10</td>
<td>2,000.00</td>
<td>20,000.00</td>
</tr>
<tr>
<td>2</td>
<td>Chairs</td>
<td>30</td>
<td>500.00</td>
<td>15,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>35,000.00</strong></td>
<td></td>
</tr>
</tbody>
</table>

(Rupees Thirty Five Thousand Only)

Authorised Signatory

Invoice: This is a credit bill i.e., a bill for goods and/or services provided where the payment is yet to be made. This by itself is not a supporting document for payment. It has to be supported by a receipt acknowledging the payment towards the invoice. A proper invoice should contain complete particulars i.e., name of the organization, serial number, date, description of goods and/or services provided. It should be signed. See below a sample of an invoice.

<table>
<thead>
<tr>
<th>S. No</th>
<th>Particulars</th>
<th>Quantity</th>
<th>Price</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Motor Cycles</td>
<td>2</td>
<td>50,000.00</td>
<td>1,00,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>1,00,000.00</strong></td>
</tr>
</tbody>
</table>

(Rupees One Lakh Only)

Terms and Conditions: Payments should be made within 15 days

Authorised Signatory

Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Cash Bill: This is a simple bill given by the recipient to the organization in acknowledgment of the receipt of money. This by itself is a supporting document for any payment but only if it is printed with the following details: name of the organization, serial number, date, and description of the goods or services. See below a sample of a cash bill.

<table>
<thead>
<tr>
<th>S. No</th>
<th>Particulars</th>
<th>Quantity</th>
<th>Price</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tables</td>
<td>10</td>
<td>2,000.00</td>
<td>20,000.00</td>
</tr>
<tr>
<td>2</td>
<td>Chairs</td>
<td>30</td>
<td>500.00</td>
<td>15,000.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td>35,000.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(Rupees Thirty five thousand Only)</td>
</tr>
</tbody>
</table>

Authorised Signatory

Vouchers: A voucher is the basic document used to support the authenticity of a transaction entered in the books of accounts. All the details shown in the following format must be included and supporting evidence be provided e.g., a cash bill.

<table>
<thead>
<tr>
<th>Voucher No:</th>
<th>72</th>
<th>Date :</th>
<th>01</th>
<th>04</th>
<th>2003</th>
<th>Rs.100,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit</td>
<td>Vehicles</td>
<td>A/c Code</td>
<td>Project/Fund Code</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paid to Mr./Mrs/Messrs.</td>
<td>Kohinoor Motors</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A sum of Rupees</td>
<td>One Lakh Only</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>By cash/cheque/draft No.</td>
<td>56789 dated 1st April 1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Drawn on</td>
<td>State Bank of India</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Being</td>
<td>Purchase of two motorbikes for the two Program Officers of the programme (Invoice &amp; Stamped receipt annexed)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepared by</td>
<td>(Accountant)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Approved by</td>
<td>(Authorised Person)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payee’s Signature</td>
<td>(Affix Revenue Stamp)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Vouchers can be of different colours for bank and cash transactions which may be useful when making a Bank Reconciliation.

Third Party Vouchers versus Self-Vouchers: Third party vouchers are vouchers with supporting documents acknowledging the receipt of payment from the organization e.g. cash bill for, petrol etc. Self-vouchers are vouchers with no supporting documents for which payment is attested by the person who has incurred the expenditure e.g. conveyance.

Wherever it is not possible or practical to obtain third party vouchers, self-vouchers may be used. In all other cases third party vouchers should be used. Vouchers are classified as Cash, Petty Cash, Bank and Journal. They should be independently filed in the order of occurrence and duly numbered.
The following points are to be observed with regard to vouchers of all types:

- Any payment within suitable limits should be approved by a duly authorised person and under no circumstances should vouchers be authorised by the person preparing the voucher.
- In a case where a cash bill or cash receipt is given, the same shall be attached to the voucher and there is no need for the payee’s signature or for a revenue stamp on the voucher.
- For payment of Rs.500/- and above, a revenue stamp of appropriate value Rs.1/- must be affixed and the payee of the person authorised by the payee, should sign and in the case of a third person, write his/her address.
- Where expenditure cannot be supported by external documentary evidence, a detailed statement of account for the expenditure incurred by the payee, duly signed by the payee, should be attached with the voucher or be written on it. This is to be signed after affixing a revenue stamp of appropriate value (Rs.1/-) if the payment is Rs.500/- and above.
- The head of account under which the transaction falls must be clearly written.
- Payment should not be released either in cash or by cheque unless the voucher, supported with proper evidence, is produced and is complete in all aspects.

**Cash and Bank Vouchers:** Cash and Bank vouchers are basic documents for recording entries on the payments side in the cash column and in the bank column of the cash book. Such vouchers should be filed separately.

**Petty Cash Vouchers:** Petty cash vouchers are basic documents for recording entries on the payments side in the Petty Cash Book in respect of small recurring transactions. Below is a format for Petty Cash Voucher.

| Table 5: Name and Address of the Organization Petty Cash Voucher |
|------------------|-----------------|-----------------|-----------------|
| PC Voucher       | 25              | Date:           | 20 04 2003      | Rs. 1,525.00    |
| Debit            | Printing and Stationery | A/c Code | Fund / Project code | ILO |
| Paid to Mr./ Mrs./ Messrs | Ramesh Stationery Mart |
| a sum of Rupees  | One Thousand Five Hundred and Twenty Five Only |
| Being            | Purchase of fifteen packets of plain typing sheets, brown paper, 25 |
| Prepared by      | (Accounts Officer) |
| Approved by      | (Authorized Person) |
| (Affix Revenue Stamp) | CEO/Project Manager |
| Payee’s Signature | (Affix Revenue Stamp) |

**Journal Vouchers:** Journal vouchers are supporting documents for non-cash transactions such as recording adjustment entries, rectification entries and closing entries and to enter provisions like loan loss provision depreciation etc in the Journal Register. In the case of a staff salary and advance, which has to be adjusted against the next month’s salary, the following journal voucher should be prepared:

| Table 6: Name and Address of the Organization Journal Voucher |
|------------------|-----------------|-----------------|-----------------|
| Journal Voucher No: | 004 | Fund / Project Code | ILO | Date: | 30 04 2003 |
| Particulars | LF | Debit Amount | Credit Amount |
| Salary Account DR. | 08 | 1,000 00 | | |
| To Staff Advance Account | 15 | | 1,000 00 |
| (Being amount given to Mr. Ramesh as advance adjusted against the salary) | | |
| Totals | | 1,000 00 | 1,000 00 |

(Rupees One Thousand Only)

Prepared by (Accounts Officer) Approved by (Authorized Person) CEO/Project Manager.
Receipts: A receipt is an acknowledgment of money received by the organisation towards capital and income (revenue) such as donations, advance recovered and loans received. Receipts can be classified into two types.
1. **Capital receipts** e.g. corpus donations, loans received, money from sale of fixed assets etc.,
2. **Revenue receipts** e.g. payments which are not corpus donations, revenue from loans, bank interest, repayments and the like.

Given below are formats for a receipt:

<table>
<thead>
<tr>
<th>Table 7: Name And Address Of The Organisation Receipt</th>
</tr>
</thead>
<tbody>
<tr>
<td>S.L. No</td>
</tr>
<tr>
<td>---------</td>
</tr>
<tr>
<td>72</td>
</tr>
<tr>
<td>Received with thanks from</td>
</tr>
<tr>
<td>a sum of Rupees</td>
</tr>
<tr>
<td>by cash / cheque / draft No.</td>
</tr>
<tr>
<td>drawn on</td>
</tr>
<tr>
<td>being</td>
</tr>
<tr>
<td>Fund / Project Code</td>
</tr>
<tr>
<td>(Cheques subject to realization)</td>
</tr>
</tbody>
</table>

**Procedure for Issuing Receipts:** The following points should be noted with regard to issuing receipts:
- Receipts should be serially (pre) numbered.
- A duplicate copy of the receipt should be retained on record.
- The addresses should be mentioned in full in the receipt book.
- Each receipt should be signed by a duly authorized person.

**Debit Note and Credit Note:** A debit note or a credit note is made out in order to adjust a difference that may arise in a particular transaction which is issued by one party to another. When a debit note or a credit note is issued no cash transaction takes place. The note acts as a voucher which shows the necessary amendments which need to be made in the appropriate books of accounts.

For example, if the Institution has returned damaged bundles of stationery worth Rs.400/-, the Institution will issue a debit note and the stationery mart will issue a credit note. A debit or a credit note is attached to a journal voucher to pass the adjustment entries.
Policies and Procedures for FIs Like NCRPB:
Clear and comprehensive policies and procedures are an integral part of preventive control of risks in an FI.

<table>
<thead>
<tr>
<th>Policies</th>
<th>Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policies are the written guidelines that indicate the direction of the operations. Credit policies will include guidelines on eligibility of clients, description of products offered, etc.</td>
<td>Procedures are the written instructions that tell how to implement and follow the policies.</td>
</tr>
</tbody>
</table>

In order to be effective, policies and procedures must be:

- **Written** – oral instructions are seldom consistent and easily misunderstood
- **Simple/Clear** – keep straight and to the point; use diagrams to show the flow of operations
- **Available** – ensure that each staff has the policies applicable to their position
- **Understood** – provide training for all staff
- **Relevant** – if a policy has been changed, be sure it is communicated and training provided
- **Implemented** – expect all staff to follow the policies and procedures as stated

Policies and procedures need to be written for every area of operations. In an FI like NCRPB, control systems for cash, reports, and loans are of primary importance.

**Accounting Controls:** The integrity of the FI's financial reports will depend on the strength and integrity of the accounting system – whether manual or computerized. The system must operate and process transactions correctly. Individual transactions must be entered into the system correctly. The following diagram illustrates the flow of transactions through the accounting and portfolio tracking system. The two systems are connected and it is critical that transactions are entered correctly and treated correctly in both systems. The reports produced by both systems must also be reconciled at the end of each month.

**Characteristics of Transactions:** In order to produce reliable financial statements and reports, accounting transactions must have the following characteristics. These are core elements of basic accounting and information controls.

Controls for validity, completeness, and valuation are best maintained by independent checks and segregation of duties within the accounting function. This ensures that each person performs only certain functions within the system and that each person’s work is checked by another.

- **Transactions shall be valid.** The system must not permit the inclusion of fictitious or nonexistent transactions in journals or other records.
  - All pre-printed forms shall be pre-numbered and kept under the control of the Head Accountant
  - All transactions entered in the journals must be recorded in numerical order
  - All transactions must be fully substantiated by supporting source documents
  - Any changes made to entries must be made by first reversing the incorrect entry and then entering the new one. Entries that have already been posted should not be altered.

- **Transactions shall be properly authorized.** Upon approval of the annual budget, the Manager or appropriate authority alone authorizes expenditures. These shall remain within budget by classified categories unless approvals are received for any changes. Supporting documentation and vouchers for transactions that have been paid, shall be stamped "Paid" and dated. FI’s assets can be wasted or destroyed by approval of incorrect or fraudulent transactions.

- **Transaction records shall be complete.** The system must prevent the omission of transactions from the records. All pre-numbered forms must be accounted for in numerical order, including forms that have been mutilated or otherwise voided due to error.

- **Transactions shall be properly valued.** Expense reports, invoices, receipts and other transactions shall be checked for accuracy and initialed by someone other than the person preparing the payment documentation. Values should be checked for consistency throughout the recording process.

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Good Practices MIS Technical Note For ERP System Developers
TN #35: Policies and Procedures for FIs Like NCRPB

- **Transactions shall be properly classified.** The transactions must be entered into the journals with the proper account categories according to the chart of accounts.
- **Transactions shall be recorded at the proper time.**
  - Recording transactions before or after they occur will increase the likelihood of error.
  - All transactions occurring in any given month must be recorded in the books during that month preferably as and when they occur on a daily basis.
  - Proper month-end cut-off procedures shall be maintained to ensure consistent reporting from month-to-month.
- **Transactions shall be properly posted to the general ledger (master files) and correctly summarized and aggregated.** Whether the accounting system is manual or automated, adequate controls must be in place to make sure that classification, posting and summarization is correct.
- **All transactions must be supported by adequate and appropriate documents that justify and support the payment.**

**Voucher preparation:** Every time a transaction occurs, it must be documented on an accounting voucher or other internal source document. Preparing a voucher will record the transaction consistent with the accounting treatment. Every organization has specific ways of preparing vouchers.

The most important point to remember is that vouchers result in a paper trail for each transaction. In a computerized system, this is the basic document used for data entry. In a manual system, this is also the initial source document.

Vouchers are supported by invoices and cheque stubs or cash requests and generally include the following:
- Number and nature of voucher
- Name of department
- Date prepared
- Account name and number
- Amount of money
- Source and description of the transaction
- Authorized signature(s) of person reviewing the documentation, and also authorized signature of person approving the transaction
- Attachment of original invoices and cash requests

- **Proof of delivery or completion of services rendered**

**Segregation of Duties:** The segregation of duties in the internal control system generally refers to the practice that no one person approves, handles and records financial transactions. If anyone is responsible for all three activities, the opportunity for error, abuse or fraud is created. An Officer, who processes a loan, disburses the loan in cash, and records the loan ledger card may falsify transactions or documents or be tempted to take some of the cash. Segregating the duties between different staff helps to avoid problems.

However, it is also more costly to involve more people to processes, and does not prevent collusion of staff in misappropriation (staff work together to falsify records or take away cash).

If at all possible, three separate people should be assigned to the three activities of: (a) Approve; (b) Record; and (c) Do

**Limits of Authority:** Limits are often used to set parameters for approvals, expenditures, and other ordinary business processes. Budgets are one of the most common types of limits used in business operations. Another operational limit is to put a cap on the amount of cash allowed in a branch at any point in time. Beyond the cap, the Branch should make a bank deposit.

**Dual Controls:** Dual controls act as a backstop to decision making or approvals by having at least one other employee check or approve a transaction. Cheques should always be signed at least by two or more approved employees. Some FIs use a Credit Committee to approve loans, thereby spreading the responsibility and authority of those approvals over several individuals. The PSMG is such a committee.

**Independent Checks and Verification:** Independent review and checks are a common internal control feature in financial operations generally, and are used for transactions, reconciliations, approvals and reports. It is a way of not only segregating duties, but an extra “pair of eyes” to ensure that bank reconciliations are done properly, financial reports are supported by reconciliation schedules that agree to the report, and that accounting reports agree to MIS loan tracking reports and the like.
Procedures for Cash Receipts: The proper management of cash is very important for a FI like NCRPB for the following reasons:

- There could be a number of transactions of cash receipts and cash disbursements.
- The chance of fraud being committed regarding cash is high and strict controls are therefore required. Properly maintained cash books help to achieve this.
- Timely payments to creditors increase the reputation of the organization.
- Timely payments from projects improve the financial position.
- Good systems foster trust, limit opportunities for abuse, and protect staff who follow procedures as outlined.

Cash Receipts

Loan repayments: In many cases, loan payments are made directly into a bank account. In other cases, payments are made by DD.

Therefore, all collection procedures should include the following elements:

- Issue pre-printed repayment schedules to each project client with the loan proceeds. Include bank account numbers, if paid to a bank.
- Issue pre-numbered receipts to borrowers for bank deposit slips or cash funds received.
- List all collections, and compare with accounting and MIS transaction journals.
- Each individual receipt is recorded in two places: the individual client (project) ledger and the cash receipts journal.
- Reconcile the total receipts for each day with the daily bank deposit slip (the institution’s deposit, not the client’s).
What are Non Performing Assets

An asset, including a leased asset, becomes non performing when it ceases to generate income for the Financial intermediary.

A non performing asset (NPA) is a loan or an advance where;
- Interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,
- The account remains ‘out of order’ (as defined below), in respect of an overdraft/cash credit (od/cc),
- The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitisation transaction undertaken.

Financial intermediaries should, classify an account as NPA only if the interest charged during any quarter is not serviced fully within 90 days from the due date (as per policy)

What is ‘Out of Order’?

An account should be treated as ‘out of order’ if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as ‘out of order’.

What is ‘Overdue’?

Any amount due to the Financial intermediary under any credit facility is ‘overdue’ if it is not paid on the due date fixed by the Financial intermediary.

What is Asset Classification

Categories of NPAs

Financial intermediaries are required to classify nonperforming assets further into the following three categories based on the period for which the asset has remained nonperforming and the realisability of the dues:
- Substandard Assets
- Doubtful Assets
- Loss Assets

Substandard Assets: A substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. In such cases, the current net worth of the borrower/ guarantor or the current market value of the security charged is not enough to ensure recovery of the dues to Financial intermediaries in full. 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 Financial intermediaries will sustain some loss, if deficiencies are not corrected.

Doubtful Assets: An asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the 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.

Loss Assets: A loss asset is one where loss has been identified by the Financial intermediary or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as an asset is not warranted although there may be some salvage or recovery value.

Guidelines for Classification of Assets

Broadly speaking, classification of assets into above categories should be done taking into account the degree of well-defined credit weaknesses and the extent of dependence on collateral security for realisation of dues.

Financial intermediaries should establish appropriate internal systems to eliminate the tendency to delay or postpone the identification of NPAs, especially in respect of high value

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accounts. Financial intermediaries may fix a minimum cut off point to decide what would constitute a high value account depending upon their respective business levels.

The cut off point should be valid for the entire accounting year. Responsibility and validation levels for ensuring proper asset classification may be fixed by Financial intermediaries. The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines.

**Availability of Security/Net Worth of Borrower/Guarantor:** The availability of security or net worth of borrower/ guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise, except to the extent provided in the note of (Accounts where there is erosion in the value of security/frauds committed by borrowers’) as income recognition is based on record of recovery.

**Accounts with Temporary Deficiencies:** The classification of an asset as NPA should be based on the record of recovery. Financial intermediary should not classify an advance account as NPA merely due to the existence of some deficiencies which are temporary in nature such as non-availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements and non-renewal of the limits on the due date, etc. In the matter of classification of accounts with such deficiencies Financial intermediaries may follow the following guidelines:

- Financial intermediaries should ensure that drawings in the working capital accounts are covered by the adequacy of current assets, since current assets are first appropriated in times of distress. Drawing power is required to be arrived at based on the stock statement which is current. However, considering the difficulties of large borrowers, stock statements relied upon by Financial intermediaries for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months, would be deemed as irregular.

A working capital borrowal account will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days even though the unit may be working or the borrower’s financial position is satisfactory.

- Regular and ad hoc credit limits need to be reviewed/ regularised not later than three months from the due date/date of ad hoc sanction. In case of constraints such as non-availability of financial statements and other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is already on and would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the regular/ ad hoc credit limits have not been reviewed/ renewed within 180 days from the due date/ date of ad hoc sanction will be treated as NPA.

**Upgradation of loan Accounts Classified as NPAs:** If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as nonperforming and may be classified as ‘standard’ accounts. With regard to upgradation of a restructured/ rescheduled account which is classified as NPA contents the topic of ‘Restructuring/Rescheduling of Loans’ and ‘Revised Guidelines on Corporate Debt Restructuring (CDR) Mechanism’ will be applicable.

**Accounts Regularised near about the Balance Sheet Date:** The asset classification of borrowal accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as a NPA. In other genuine cases, Financial intermediaries must furnish satisfactory evidence to the Statutory Auditors/Inspecting Officers about the manner of regularisation of the account to eliminate doubts on their performing status.
Asset Classification to be borrower-wise and not facility-wise:

- It is difficult to envisage a situation when only one facility to a borrower/one investment in any of the securities issued by the borrower becomes a problem credit/investment and not others. Therefore, all the facilities granted by a Financial intermediary to a borrower and investment in all the securities issued by the borrower will have to be treated as NPA/NPI and not the particular facility/investment or part thereof which has become irregular.

- If the debits arising out of invoked guarantees are parked in a separate account, the balance outstanding in that account also should be treated as a part of the borrower’s principal operating account for the purpose of application of prudential norms on income recognition, asset classification and provisioning.

Advances under consortium arrangements:
Asset classification of accounts under consortium should be based on the record of recovery of the individual member Financial intermediaries and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one Financial intermediary and/or where the Financial intermediary receiving remittances is not parting with the share of other member Financial intermediaries, the account will be treated as not serviced in the books of the other member Financial intermediaries and therefore, be treated as NPA. Financial intermediaries participating in the consortium should, therefore, arrange to get their share of recovery transferred from the lead Financial intermediary or get an express consent from the lead Financial intermediary for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

Accounts where there is erosion in the value of security/frauds committed by borrowers: In respect of accounts where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and existence of other factors such as frauds committed by borrowers it will not be prudent that such accounts should go through various stages of asset classification. In cases of such serious credit impairment the asset should be straightaway classified as doubtful or loss asset as appropriate.

- Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the Financial intermediary or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

- If the realisable value of the security, as assessed by the Financial intermediary/approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the Financial intermediary.

Loans with moratorium for payment of interest:
The period of loan for 1st installment is 10 years with moratorium of 2 years for payment of principal. Prepayment shall not be accepted during the moratorium period of the Project.

Government Guaranteed Advances: The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income. The requirement of invocation of guarantee has been delinked for deciding the asset classification and provisioning requirements in respect of State Government guaranteed exposures. State Government guaranteed advances and investments in State Government guaranteed securities would attract asset classification and provisioning norms if interest and/or principal or any other amount due to the Financial intermediary remains overdue for more than 90 days.

Restructuring/Rescheduling of Loans: The stages, at which the restructuring/
rescheduling/renegotiation of the terms of loan agreement could take place in three stages

a) In each of the three stages, the rescheduling, etc., of principal and/or of interest could take place, with or without sacrifice, as part of the restructuring package evolved.

**Treatment of restructured standard accounts:**

- A rescheduling of the instalments of principal alone, at any of the aforesaid first two stages would not cause a standard asset to be classified in the sub standard category provided the loan/credit facility is fully secured.

- A rescheduling of interest element at any of the foregoing first two stages would not cause an asset to be downgraded to sub standard category subject to the condition that the amount of sacrifice, if any, in the element of interest, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

b) In case there is a sacrifice involved in the amount of interest in present value terms, as at (a) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved.

c) In case there is a sacrifice involved in the amount of interest in present value terms, as at (b) above, the amount of sacrifice should either be written off or provision made to the extent of the sacrifice involved. Even in cases where the sacrifice is by way of write off of the past interest dues, the asset should continue to be treated as substandard.

**Upgradation of restructured accounts:** The substandard accounts which have been subjected to restructuring etc., whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after the specified period i.e., a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, could also be reversed after the one year period. During this one year period, the substandard asset will not deteriorate in its classification if satisfactory performance of the account is demonstrated during the period. In case, however, the satisfactory performance during the one year period is not evidenced, the asset classification of the restructured account would be governed as per the applicable prudential norms with reference to the pre-restructuring payment schedule.

**General**

1. The instructions contained in above would be applicable to all type of credit facilities provided they are fully covered by tangible securities.
2. While assessing the extent of security cover available to the credit facilities, which are being restructured/ rescheduled, collateral security would also be reckoned, provided such collateral is a tangible
security properly charged to the Financial intermediary and is not in the intangible form like guarantee etc.

3. Financial intermediaries cannot reschedule/restructure/renegotiate borrowal accounts with retrospective effect. The asset classification status as on the date of approval of the restructured package by the competent authority (NCRPB Board) would be relevant to decide the asset classification status of the account after restructuring/rescheduling/renegotiation. In case there is undue delay in sanctioning a restructuring package and in the meantime the asset classification status of the account undergoes deterioration, it would attract supervisory intervention.

4. Financial intermediaries are not expected to repeatedly reschedule/restructure the amounts due to them unless there are very strong and valid reasons which warrant such repeated restructuring/rescheduling. Restructuring in all cases should be based on viability parameters. Any restructuring done without looking into cash flows of the borrower would invite supervisory concerns.

5. The special asset classification status in terms of above shall be available only when the account is restructured for the first time, as already prescribed for restructuring under CDR mechanism, vide in the note of Asset Classification of repeatedly/restructured accounts.

6. Normally restructuring cannot take place unless alteration/changes in the original loan agreement are made with the formal consent/application of the debtor. However, the process of restructuring can be initiated by the financial intermediary in deserving cases subject to customer agreeing to the terms and conditions.

7. As regards the regulatory treatment of ‘funded interest’ recognised as income and ‘conversion into equity, debentures or any other instrument’ Financial intermediaries should adopt the following: **Funded Interest**: Income recognition in respect of the NPAs, regardless of whether these are or are not subjected to restructuring/rescheduling/renegotiation of terms of the loan agreement, should be done strictly on cash basis, only on realisation and not if the amount of interest overdue has been funded. If, however, the amount of funded interest is recognised as income, a provision for an equal amount should also be made simultaneously. In other words, any funding of interest in respect of NPAs, if recognised as income, should be fully provided for.

**Conversion into equity, debentures or any other instrument**: The amount outstanding converted into other instruments would normally comprise principal and the interest components. If the amount of interest dues is converted into equity or any other instrument, and income is recognised in consequence, full provision should be made for the amount of income so recognised to offset the effect of such income recognition. Such provision would be in addition to the amount of provision that may be necessary for the depreciation in the value of the equity or other instruments, as per the investment valuation norms. However, if the conversion of interest is into equity which is quoted, interest income can be recognised at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity. Such equity must thereafter be classified in the “available for sale” category and valued at lower of cost or market value. In case of conversion of principal and/or interest in respect of NPAs into debentures, such debentures should be treated as NPA, ab initio, in the same asset classification as was applicable to loan just before conversion and provision made as per norms. This norm would also apply to zero coupon bonds or other instruments which seek to defer the liability of the issuer. On such debentures, income should be recognised only on realisation basis. The income in respect of unrealised interest which is converted into debentures or any other fixed maturity instrument should be recognised only on redemption of such instrument. Subject to the above, the equity shares or other instruments arising from conversion of the principal amount of loan would also be subject to the usual prudential valuation norms as applicable to such instruments.

8. Reversal of provision made for NPA is permitted when the account becomes a standard asset. The provision made in a
restructured/rescheduled account towards interest sacrifice, may be reversed on satisfactory completion of all repayment obligations and the outstanding in the account is fully repaid. Financial intermediaries should not re-compute the extent of sacrifice each year and make adjustments in the provisions made towards interest sacrifice.

These restructured/rescheduled accounts would continue to age and migrate to the next asset classification status in the normal course. Financial intermediaries should ensure that the amount of sacrifice, if any, in the element of interest both in term loans or working capital facilities, measured in present value terms, is either written off or provision is made to the extent of the sacrifice involved. For the purpose, the future interest due as per the original loan agreement in respect of an account should be discounted to the present value at a rate appropriate to the risk category of the borrower (i.e., current PLR + the appropriate credit risk premium for the borrower-category) and compared with the present value of the dues expected to be received under the restructuring package, discounted on the same basis.

These restructured/rescheduled accounts, whether in respect of principal instalment or interest amount, by whatever modality, would be eligible to be upgraded to the standard category only after a period of one year after the date when first payment of interest or of principal, whichever is earlier, falls due under the revised terms, subject to satisfactory performance during the period. The amount of provision made earlier, net of the amount provided for the sacrifice in the interest amount in present value terms as aforesaid, could also be reversed after the one year period.

9. Disclosures in the Notes on Account to the Balance Sheet pertaining to restructured/rescheduled accounts apply to all accounts restructured/rescheduled during the year. While Financial intermediaries should ensure that they comply with the minimum disclosures prescribed, they may make more disclosures than the minimum prescribed.

**Box 1: Computation of NPA levels**

FIs should deduct the following items from the Gross Advances and Gross NPAs to arrive at the Net advances and Net NPAs respectively:

a) Balance in Interest Suspense Account
b) DICGC/ECGC claims received and held, pending adjustment
c) Part payment received and kept in suspense account
d) Total provisions held (excluding amount of technical write off and provision on standard assets)

For the purpose, the amount of gross advances should exclude the amount of Technical Write off but would include all outstanding loans and advances; including the advances for which refinance has been availed but excluding the amount of rediscounted bills. The level of gross and net NPAs will be arrived at in percentage terms by dividing the amount of gross and net NPAs by gross and net advances, computed as above, respectively.
Income Recognition Policy

- The policy of income recognition has to be objective and based on the record of recovery. Internationally income from non-performing assets (NPA) is not recognised on accrual basis but is booked as income only when it is actually received. Therefore, the financial intermediaries (FIs) (Banks, Financial Institutions, Funds) should not charge and take to income account interest on any NPA.
- However, interest on advances against term deposits, NSCs, IVPs, KVPs and Life policies may be taken to income account on the due date, provided adequate margin is available in the accounts.
- Fees and commissions earned by the financial intermediaries (FIs) (Banks, Financial Institutions, Funds) as a result of renegotiations or rescheduling of outstanding debts should be recognised on an accrual basis over the period of time covered by the renegotiated or rescheduled extension of credit.
- If Government guaranteed advances become NPA, the interest on such advances should not be taken to income account unless the interest has been realised.

Reversal of income

- If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.
- In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

Leased Assets: The finance charge component of finance income (as defined in ‘AS 19 Leases’ issued by the Council of the Institute of Chartered Accountants of India (ICAI)) on the leased asset which has accrued and was credited to income account before the asset became nonperforming, and remaining unrealised, should be reversed or provided for in the current accounting period.

Appropriation of Recovery in NPAs

- Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.
- In the absence of a clear agreement between the financial intermediary (FI) (Bank, Financial Institution, Fund) and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), financial intermediaries (FIs) (Banks, Financial Institutions, Funds) should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

Interest Application

There is no objection to the financial intermediaries (FIs) (Banks, Financial Institutions, Funds) using their own discretion in debiting interest to an NPA account taking the same to Interest Suspense Account or maintaining only a record of such interest in proforma accounts.

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This group of ratios are very crucial for MIS because the “portfolio”\(^{50}\) is the primary income generating asset of a revolving loan fund or financial intermediary (FI). The risk that some of the loans may not earn revenue or be paid back (at all) is very real and must be anticipated. Hence, management of this risk is crucial because it impacts the very viability of the entire financing operation. The Central Bank has also started recommending the use of early warning indicators such as PAR and On-Time Repayment Rate.

Therefore, timely and periodic monitoring of select asset quality ratios should enable FIs to detect delinquency at the early stage and nip it in the bud, which, in the long-term, could help in preventing serious loan losses. Failure to do this could perhaps de-capitalise the revolving loan fund of the FI and put the entire operations in jeopardy and therefore, it is recommended that some of the critical asset quality ratios are. The key asset quality ratios that could be monitored\(^{51}\) as part of the MIS are:

- **Portfolio at Risk/Aged Portfolio at Risk** (Pessimistic Measure of Delinquency)
- **Arrears Rate**\(^{52}\) (Optimistic Measure of Delinquency)
- **Loan Loss Provision Ratio**
- **Loan Loss Ratio**

<table>
<thead>
<tr>
<th>Statements/Reports / Records</th>
<th>Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portfolio Report with Ageing Analysis</td>
<td>Yes, this alone is required and sufficient. But, the ageing of loans must be done in an accurate manner. Ageing of portfolio is currently not measured.</td>
</tr>
<tr>
<td>Balance Sheet</td>
<td>Could be used if appropriately structured, especially to include information on past due and restructured loans as well as earlier period loan loss reserves etc</td>
</tr>
<tr>
<td>Income Statement</td>
<td>Some information is useful, especially with regard to loan loss provisions</td>
</tr>
<tr>
<td>Loan Ledger (Individual Project)</td>
<td>Yes, required and very important</td>
</tr>
</tbody>
</table>

Apart from the above asset quality ratios, the traditionally used Repayment Rates (On-Time Repayment Rate and Cumulative Repayment Rate) could also be used, despite them not being genuine measures of portfolio quality.

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\(^{51}\) These are generally calculated for Principal Amounts but the most of the same concepts can be applied for interest payments as well.

\(^{52}\) This is not a healthy indicator but is often required for statutory reporting.
**What is Portfolio at Risk?**

Portfolio at Risk (also called as “PAR”) is a percentage (%). It is one of the most important measures of asset quality that FIs (Financial Intermediary or Institution) need to calculate. It is a recommended ratio as per good practices for financial intermediation in India and globally, especially for revolving loan funds (RLFs). It represents the “proportion of an FI’s total gross outstanding loan portfolio that is at default risk.” It can be a useful indicator for NCRPB revolving loan fund (RLF) management.

**Why Portfolio at Risk (PAR)?**

Good practices suggest that traditional measures of delinquency have perhaps not provided early warning signals to the possibility of delinquency in the portfolio. Often times, as has been witnessed globally, because of fairly flexible definitions of ‘past dues’ and also ‘liberal asset classification norms’, many financial intermediaries and institutions have maintained delinquent assets as normal assets and attended to them as such (perhaps in a laissez faire manner). The impact of such a strategy has been felt globally across the financial services sector and there is now widespread recognition to have early warning of delinquency, so that it can be nipped in the bud. This is where the Portfolio at Risk (PAR) measure somewhat overcomes the limitations of traditional delinquency measures such as arrears rate or repayment rates – both of which tend to measure what amount is overdue rather than what amount is at risk. Please see Annex to this technical note.

**What does PAR measure?**

On the contrary, PAR attempts to measure the default risk in an RLF’s (NCRPB’s) portfolio by using past as well as future data. Its estimation is based on the key question that, if all delinquent borrowers (read as projects) of NCRPB were to completely default, then how much (money) would NCRPB stand to lose?

From this perspective, Portfolio at Risk (PAR) provides a pessimistic estimate of the default risk in NCRPB’s portfolio. This is quite a useful ratio and is used as a standard for determining delinquency and provisioning levels – which is perhaps seen as the most crucial aspect in management of financial intermediaries or RLFs, especially in the wake of the global financial crisis. This indicator should be available automatically from the ERP system and can be captured without any extra effort and difficulty from the basic ERP system.

**What is the formula for Portfolio at Risk (PAR)?**

<table>
<thead>
<tr>
<th><strong>Sum of Unpaid Principal Balance of All Loans with Payments Past Due (1 to 365 Days and more)</strong></th>
<th><strong>Total Gross Outstanding Loan Portfolio (Sum of Principal Outstanding of All Loans)</strong></th>
</tr>
</thead>
</table>

PAR focuses on principal (outstanding) rather than interest because that is the primary income generating asset for an institution like NCRPB. In other words, if the principal is not paid back by the borrowers, then, the RLF or FI will be decapitalised and would have no real funds to deploy as principal outstanding – the primary income generating asset.

**What are desirable standards for PAR, from a good practices perspective?**

Generally speaking, sustainable institutions have a PAR <= 2-5%. However, apart from absolute % values, two other factors are important while using PAR: a) trends, in terms of decreasing/increasing values as compared to the last (reference) period; and b) aged values of PAR.

**How to interpret PAR, from an MIS perspective?**

1. A decreasing Portfolio at Risk (PAR) is positive. However, this trend can be misleading because a lower ratio can be obtained by decreasing the numerator and/or increasing the denominator. In other words, sudden and large disbursement’s of loans could mask the actual default risk.
2. Also, if the loan portfolio is fast expanding in terms of loan disbursement’s, the same limitation applies. And when the repayment period for these loans are yet to begin, the problem is exacerbated.
3. Likewise, re-scheduling, refinancing and loan write-offs can portray a lower PAR ratio, while the (default) risk may still be high.
4. Similarly, a higher value of PAR at higher age classifications of an overdue loan is negative as compared to higher value of PAR at lower age classifications, as it means that larger number of loans are at greater risk.

**From the perspective of an MIS, how to calculate PAR?**

From the perspective of an MIS, the key inputs, processes, outputs and associated remarks for calculating PAR is given in figure hereafter.
Good Practices MIS Technical Note For ERP System Developers

TN #38: Good Practices Asset Quality Ratios - What is Portfolio at Risk? What are its advantages? How to use it?

1. From the FI’s (NCRPB’s) total loan portfolio, determine all loans that are outstanding.
2. For every loan that is outstanding, create a loan repayment schedule incorporating the actual repayments.
3. Determine if loan is delinquent and age it for past due.
4. Delinquency and ageing analysis for all loans that are outstanding for the FI (NCRPB) as on date.
5. Classify loans as per age and summarise in ageing table as current or past due loans of different ages.
6. Calculate PAR as per formula.
   - Sum of Unpaid Principal Balance of All Loans with Payments Past Due (1 to 365 Days and more)
   - Total Gross Outstanding Loan Portfolio (Sum of Principal Outstanding of All Loans)
7. Calculate aged PAR as per classification given in step 5.
8. Interpret PAR as per guidelines.

Input
- Individual Loan Ledgers
- Loan repayment transactions and credit policy

Process
- Step 1: From the FI’s (NCRPB’s) total loan portfolio, determine all loans that are outstanding.
- Step 2: For every loan that is outstanding, create a loan repayment schedule incorporating the actual repayments.
- Step 3: Determine if loan is delinquent and age it for past due.
- Step 4: Delinquency and ageing analysis for all loans that are outstanding for the FI (NCRPB) as on date.
- Step 5: Classify loans as per age and summarise in ageing table as current or past due loans of different ages.
- Step 6: Calculate PAR as per formula.
  - Sum of Unpaid Principal Balance of All Loans with Payments Past Due (1 to 365 Days and more)
  - Total Gross Outstanding Loan Portfolio (Sum of Principal Outstanding of All Loans)
- Step 7: Calculate aged PAR as per classification given in step 5.
- Step 8: Interpret PAR as per guidelines.

Outputs
- List of all outstanding loans
- Installment Schedule for each loan and all loans, with repayment data incorporated
- Ageing Report of a Loan and its classification as past due
- Ageing Report for all outstanding loans and their classification as past due, current etc.
- Ageing table with categories of current and past due loans of different ages and Portfolio Report
- Value of Portfolio at Risk (PAR)
- Value of aged PAR
- Values of PAR and Aged PAR and interpretation

Remarks
- All loans with any amount – fines, penal interest, interest, principal > 0 should be included. A loan is outstanding if any of the above is > 0.
- Make sure repayment appropriation is as per best practices – fines or penal interest first, interest next, and principal last – in that order. Also, it should be as per NCRPB’s credit policy/terms as at time of loan disbursement to client.
- The correct method of ageing should be used. Age of a past due loan is date of taking ageing report minus date at which earliest unpaid overdue (principal or interest) exists. Installment schedule should have fixed amounts due and dates due.
- It may be better to state this in terms of number of payments / installments skipped rather than days past due. However, legal requirements may require that this be done in terms of day, month, quarter, year etc. So, flexibility must be available on this aspect.
- Need to adjust total gross outstanding loan portfolio for loans for which repayments have not begun as also Re - scheduled, Re-financed, and Written-off loans.
- It may be better to state this in terms of number of payments / installments skipped rather than days past due. However, legal requirements may require that this be done in terms of day, month, quarter, year etc. So, flexibility must be available on this aspect.

Interpretation for absolute values and trends in PAR, Aged PAR and action required and implications.
Some key aspects that need to be understood and remembered by application developers are given below:

**First,** a loan is outstanding if and only if either principal or interest or penal interest or penalties are due from the borrowers (projects). Thus, a loan is outstanding when Principal or Interest or Penal Interest due is greater than ‘0’. Hence, the key rule for calculating the PAR indicator is to select all loans with Principal, Interest, Penal Interest > 0

**Second,** the application developer must use the correct sequence of repayment appropriation and in common financial parlance, any repayment has to be counted first towards penal interest, then interest overdue, then interest (if it is due then or proportionate interest as on that date), then principle overdue, then principle. The MIS must ensure that the above good practices sequence of repayment appropriation is followed. This should be an automatic (non-alterable) feature. Only then, would the system be able to get the correct set of loans. A word of caution is very necessary here.

**Third,** for every loan that is outstanding, to create the loan repayment schedule incorporating repayments, one will have to look at – a) the terms and conditions agreed at the time of disbursement for the loan type, which will be available as per NCRPB’s credit policy; and b) the actual transactions of repayments and ensure that they have been appropriated as per accepted norms. Thus, it is imperative that the following data with regard to each loan is available: a) Loan Amount Disbursed; b) Loan Term (Number of Installments); c) Repayment Frequency and Installment Method; d) Interest Rates – Annualized; e) Method of Interest Calculation etc; f) Sequence of Appropriation of Repayments – Penal Interest and Interest First and Principal Last (which is preferable); g) Grace or Moratorium Period etc; h) Any other terms and conditions that are relevant; and i) All transaction amounts and dates with appropriation as per standard good practices rules

**What events/activities affect (distort) PAR?**

<table>
<thead>
<tr>
<th>Events/Activities that affect PAR</th>
<th>Impact on Numerator</th>
<th>Impact on Denominator</th>
<th>Impact on PAR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rescheduling</strong></td>
<td>Decreases Numerator</td>
<td>None</td>
<td>Reduces the whole PAR Ratio, while default risk still exists</td>
</tr>
<tr>
<td><strong>Refinancing</strong> (overdue amounts are rescheduled and fresh amounts are given to same borrower)</td>
<td>Decreases Numerator</td>
<td>Increases denominator</td>
<td>Reduces the whole PAR Ratio, while default risk still exists</td>
</tr>
<tr>
<td><strong>Write-offs</strong></td>
<td>Decreases Numerator</td>
<td>Decreases Denominator</td>
<td>Reduces the whole PAR Ratio, while default risk still exists</td>
</tr>
<tr>
<td><strong>Fresh Loan Disbursements for which repayments are yet to begin</strong> (including those with a grace/moratorium period)</td>
<td>None</td>
<td>Increases Denominator</td>
<td>Reduces the whole PAR Ratio, while default risk still exists</td>
</tr>
<tr>
<td><strong>Incorrect ageing of past dues, based on the installment /other methods of ageing.</strong> The correct method of ageing is defined in the flow chart.</td>
<td>None</td>
<td>None</td>
<td>Distorts the age of past dues (over dues) and affects provisioning, reserve and sustainability</td>
</tr>
<tr>
<td><strong>Sequence of payments, Principal first and interest next</strong></td>
<td>Decreases numerator</td>
<td>None</td>
<td>Reduces the whole PAR Ratio, while default risk still exists. Distorts the age of past dues (over dues) and affects provisioning, reserve and sustainability and through reduction of interest payments (yield)</td>
</tr>
</tbody>
</table>
What is Arrears Rate (AR)?

**Arrears Rate (also called as Portfolio in Arrears) is a percentage (%)**. It represents the “proportion of an FI’s total gross outstanding loan portfolio that is over due or in arrears and hence, at risk”. It is a widely used measure of asset quality by FIs but not necessarily the most accurate one.

What is the formula for Arrears Rate (AR)?

\[
\text{Arrears Rate} = \frac{\text{Sum of Past Due (Over Due or Arrear) Amounts (1 to 365 Days and more) for all overdue loans}}{\text{Total Gross Outstanding Loan Portfolio (Sum of Principal Outstanding of All Loans)}}
\]

It estimates default risk in a portfolio by taking into account the actual past dues in a portfolio – i.e., how much of the total outstanding portfolio is over due or in arrears. At best, at any point in time the arrears rate provides information on the amounts that are overdue and could be lost if the delinquent borrowers do not settle the over dues. In many ways, Arrears Rate is an optimistic estimate of the default risk and it states the position of today and assumes that tomorrow would be the same.

What are the limitations of Arrears Rate?

Arrears Rate’s major generic limitation stems from the fact that it assumes that the world of tomorrow will be the same as today – i.e., at the maximum, the over dues (or arrears) that exist today will manifest themselves tomorrow and hence, measuring actual over dues provides an estimate of the default risk in a portfolio.
Good Practices MIS Technical Note For ERP System Developers

TN #38: Good Practices Asset Quality Ratios - What is Portfolio at Risk? 
What are its advantages? How to use it?

1. From the FI’s (NCRPB’s) total loan portfolio, determine all loans that are outstanding
2. For every loan that is outstanding, create a loan repayment schedule incorporating the actual repayments
3. Determine if loan is delinquent and age it for past dues
4. Delinquency and ageing analysis for all loans that are outstanding for the FI (NCRPB) as on date
5. Classify loans as per age and summarise in ageing table as current or past due loans of different ages and Portfolio Report
6. Calculate AR as per formula
   - Sum of Overdue Amounts of All Loans with Payments Past Due (1 to 365 Days and more)
   - Total Gross Outstanding Loan Portfolio (Sum of Principal Outstanding of All Loans)
7. Calculate aged AR as per classification given in step 5...
8. Interpret AR as per guidelines

Remarks:
- All loans with any amount – fines, penal interest, interest, principal - >0 should be included. A loan is outstanding if any of the above is > 0
- Make sure repayment appropriation is as per best practices – fines or penal interest first, interest next, and principal last- in that order. Also, it should be as per NCRPB’s credit policy/terms as at time of loan disbursement to client
- The correct method of ageing should be used. Age of a past due loan is date of taking ageing report minus date at which earliest unpaid overdue (principal or interest) exists. Installment schedule should have fixed amounts due and dates due.
- It may be better to state this in terms of number of payments / installments skipped rather than days past due. However, legal requirements may require that this be done in terms of day, month, quarter, year etc. So, flexibility must be available on this aspect
- Need to adjust total gross outstanding loan portfolio for loans for which repayments have not begun as also Re-scheduled, Re-financed, and Written-off loans.
- It may be better to state this in terms of number of payments / installments skipped rather than days past due. However, legal requirements may require that this be done in terms of days past due. So, flexibility must be available on this aspect

Values of AR and Aged AR and interpretation

Interpretation for absolute values and trends in AR, Aged AR and action required and implications.

Input
- Individual Loan Ledgers
- Loan repayment transactions and credit policy
- Installment schedules with repayment data incorporated and rules for calculating age of loan

Process
- List of all outstanding loans
- Installment Schedule for each loan and all loans with repayment data incorporated
- Ageing Report of a Loan and its classification as past due
- Ageing report for all outstanding loans and their classification as past due, current etc.
- Ageing table with categories of current and past due loans of different ages and Portfolio Report

Outputs
- All loans with any amount – fines, penal interest, interest, principal - >0 should be included. A loan is outstanding if any of the above is > 0
- Make sure repayment appropriation is as per best practices – fines or penal interest first, interest next, and principal last- in that order. Also, it should be as per NCRPB’s credit policy/terms as at time of loan disbursement to client
- The correct method of ageing should be used. Age of a past due loan is date of taking ageing report minus date at which earliest unpaid overdue (principal or interest) exists. Installment schedule should have fixed amounts due and dates due.
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Values of AR and Aged AR

Interpretation for absolute values and trends in AR, Aged AR and action required and implications.

Step 1:
From the FI’s (NCRPB’s) total loan portfolio, determine all loans that are outstanding

Step 2:
For every loan that is outstanding, create a loan repayment schedule incorporating the actual repayments

Step 3:
Determine if loan is delinquent and age it for past dues

Step 4:
Delinquency and ageing analysis for all loans that are outstanding for the FI (NCRPB) as on date

Step 5:
Classify loans as per age and summarise in ageing table as current or past due loans of different ages and Portfolio Report

Step 6:
Calculate AR as per formula
   - Sum of Overdue Amounts of All Loans with Payments Past Due (1 to 365 Days and more)
   - Total Gross Outstanding Loan Portfolio (Sum of Principal Outstanding of All Loans)

Step 7:
Calculate aged AR as per classification given in step 5...

Step 8:
Interpret AR as per guidelines

Values of AR and Aged AR and interpretation

Interpretation for absolute values and trends in AR, Aged AR and action required and implications.
What is the Loan Loss Ratio? … and How to use it?

What is Loan Loss Ratio?

Loan Loss Reserve Ratio (also called as “LLR” Ratio) is a percentage (%). It reflects accumulated provision expenses (minus write-offs) and gives an indication of management’s expectation of future loan losses. Generally speaking, it is a rough indicator of the overall quality of the portfolio and it represents the “loan loss reserve amounts maintained by an FI to offset the default risk in its total (outstanding) loan portfolio”.

What is the formula for the Loan Loss Ratio?

\[
\text{Loan Loss Ratio} = \frac{\text{Principal Amount Written Off During Period}}{\text{Average Outstanding Loan Portfolio}}
\]

What can be said with regard to trends for LLR?

A decreasing Loan Loss Reserve Ratio (LLR) is positive. However, this trend can be misleading because a lower ratio can be obtained by decreasing the numerator and/or increasing the denominator. In other words, sudden and large disbursements of loans could mask the actual default risk. Also, in an FI that is fast expanding in terms of loan disbursements, the same limitation applies. And when the repayment period for these loans are yet to begin, the problem is exacerbated. Likewise, re-scheduling, refinancing and loan write-offs can portray a lower LLR ratio, while the (default) risk may still be high.

How to calculate the LLR Ratio?

**Step 1**
From the FI’s total loan portfolio, determine **all loans that are outstanding** - A loan is outstanding if and only if either principal or interest or penalties are due from the client. Thus, a loan is outstanding when Principal or Interest or Penalties due is greater than ‘0’.

**Step 2**
For every loan that is outstanding, create a loan repayment schedule, identify whether the loan is delinquent and age the loan in days with regard to past dues.

To create the loan repayment schedule, one will have to look at the terms and conditions agreed at the time of disbursement for the loan type, which will be available in the credit policy. Thus, it is imperative that the following data with regard to each loan is available:

1. Loan Amount Disbursed
2. Loan Term (Number of Installments)
3. Repayment Frequency and Installment Method
4. Interest Rates – Annualized, Method of Interest Calculation etc
5. Sequence of Appropriation of Repayments – Penalties and Interest First and Principal Last (which is preferable)
6. Grace or Moratorium Period etc
7. Any other terms and conditions that are relevant

**Step 3**
Do the same for all loans that are outstanding for the FI at the point of time when the ratio is being calculated.

**Step 4**
Aggregate loan repayments schedules for all loans and summarize these (either in the form of a simple ageing table report or comprehensive portfolio report). These should contain the following information for the various types of loans as shown in Box below.

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53 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Good Practices MIS Technical Note For ERP System Developers

TN #39: Financial Indicators, Asset Quality

What is Loan Loss Ratio? … and How to use it?

### Step 5

Probability assignment of likely losses (called as provisioning %), based on the age category of a past due loan, could be based on FI/Industry historical data and/or best practices.

### Step 6

Using either of these reports, sum the loan loss provision amounts (which equals unpaid principal balance for a past due loan category x probabilistic provision %) for all categories of past due loans. This gives the Total Loan Loss Provision Amount for the period (usually a year).

### Step 7

Then do the following mathematical calculation to get the Total Loan Loss Reserve, as on date:

\[
\text{Total Loan Loss Reserve (as on date)} = \text{Existing Loan Loss Reserve (from Balance Sheet)} - \text{Opening Balance} + \text{Total Loan Loss Provision Expense for Period (Calculated in Step 6 as given in box below)} - \text{Loan Write-offs} - \text{Closing Balance}
\]

### Step 8

Then, divide the above arrived at Total Loan Loss Reserve by the Total Gross Outstanding Portfolio (as on date) to get the Loan Loss Reserve Ratio.

<table>
<thead>
<tr>
<th>Category of Loans</th>
<th>Number of Loans</th>
<th>Amount Past Due or Over Due</th>
<th>Unpaid Principal Balance</th>
<th>Proportion (%)</th>
<th>Provision Rate</th>
<th>Provision Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans &lt; 90 Days Past Due</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans Between 91-180 Days Past Due</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans Between 181-365 Days Past Due</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans &gt; 365 Days Past Due</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

What minimum records are required for calculating PAR?

- **Loan ledger** with disbursement date, installment schedule and repayment data on each individual loan backed-up by a comprehensive credit policy outlining various terms and conditions.

- **Aggregation of the loan ledger data with regard to delinquent and current loans** – either a simple ageing table or comprehensive portfolio report. The formats for these reports should follow best practices structure so that institutions can be compared and contrasted on various aspects related to the Loan Loss Reserve Ratio in terms of its appropriateness and other factors.

Calculating the reserve ratio requires the presence of an effective MIS, especially for large FIs - manually doing the ageing analysis required for calculating the reserve ratio could well turn out very tedious. And of course, if the incorrect method of ageing (like the installment method) is used, then provisioning and reserve requirements could be very different from what is actually required. Again, the MIS should take care of this aspect and ensure that the correct method of ageing is used for calculating the age of past due loans. Give NCRPB specific.
### What events/activities affect (distort) the LLR Ratio?

<table>
<thead>
<tr>
<th>Events/Activities that affect the LLR Ratio</th>
<th>Impact on Numerator</th>
<th>Impact on Denominator</th>
<th>Impact on PAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rescheduling</td>
<td>Decreases Numerator</td>
<td>None</td>
<td>Reduces the loan loss reserve and LLR ratio, while default risk still exists</td>
</tr>
<tr>
<td>Refinancing (overdue amounts are rescheduled and fresh amounts are given to same client)</td>
<td>Decreases Numerator</td>
<td>Increases Denominator</td>
<td>Reduces the loan loss reserve and LLR ratio, while default risk still exists</td>
</tr>
<tr>
<td>Write-offs</td>
<td>Decreases Numerator</td>
<td>Decreases Denominator</td>
<td>Reduces the loan loss reserve and LLR ratio, while default risk still exists</td>
</tr>
<tr>
<td>Fresh Loan Disbursements for which repayments are yet to begin (including those with a grace/moratorium period)</td>
<td>None</td>
<td>Increases Denominator</td>
<td>Reduces the loan loss reserve and LLR ratio, while default risk still exists</td>
</tr>
<tr>
<td>Incorrect ageing of past dues, based on the installment /other methods of ageing</td>
<td>None</td>
<td>None</td>
<td>Distorts the age of past dues (over dues) and affects provisioning, reserve and sustainability</td>
</tr>
<tr>
<td>Sequence of payments, Principal first and interest next</td>
<td>Decreases numerator</td>
<td>None</td>
<td>Distorts the amount and age of past dues (over dues) and affects provisioning, reserve and sustainability and through reduction of interest payments (yield)</td>
</tr>
</tbody>
</table>

Reduces the loan loss reserve and LLR ratio, while default risk still exists

Reduces the loan loss reserve and LLR ratio, while default risk still exists

Distorts the age of past dues (over dues) and affects provisioning, reserve and sustainability

Distorts the amount and age of past dues (over dues) and affects provisioning, reserve and sustainability and through reduction of interest payments (yield)

Reduces the loan loss reserve and LLR ratio, while default risk still exists
Good Practices MIS Technical Note For ERP System Developers

TN #39: Financial Indicators, Asset Quality

What is Loan Loss Ratio? ... and How to use it?

System Calculating for Loan Loss Ratio (LLR)

Input

Individual Loan Ledger

Process

Step 1: From the FI’s (NCRPB’s) total loan portfolio, determine all loans that have been Written-off during year

Step 2: Sum the loan write-off amounts for Written-off loans. This gives the Total Loan Loss write-off Amount for the period (usually a year)

Step 3: From the loan ledger + portfolio report, calculate the average outstanding portfolio during the period (for instance, a year) using the outlined procedure:

Step 4: Calculate Loan loss ratio as per formula

\[
\text{Loan Loss Ratio} = \frac{\text{Total Loan Written-off amounts during period}}{\text{Average Gross Outstanding Loan Portfolio}}
\]

Outputs

List of all Written-off loans

Total Value of loan amounts Written-off during period (year)

Average Outstanding Portfolio

Value of Loan Loss Ratio and its interpretation

Loan loss write-offs must reduce the Loan Loss Reserve

Remarks

Compare with financial statements to make sure that write-offs have been properly reported.

Compare with financial statements to make sure that write-offs have been properly reported and are consistent with financial statement data.

Using a monthly/quarterly basis for output may be more appropriate.

Input

Individual Loan Ledger

Individual Loan Ledger and Write-off Report

Loan Ledger, Loan Disbursement Report and Portfolio Report

Value of Outputs from Step 2+3
What is Cumulative Repayment Rate?

**Cumulative Repayment Rate** helps get a sense of a repayment performance over a long period of time. Ceterus paribus, institutions that have a good track record of repayment over a large number of years, have certainly demonstrated a consistency in their ability to manage their portfolio effectively. It is a simple percentage (%)

What minimum records are required for calculating the Cumulative Repayment Rate?

Loan ledger with disbursement, schedule and repayment data on each individual loan backed-up a comprehensive credit policy outlining various terms and conditions. **Aggregation of the loan ledger data with regard to delinquent and current loans** – either a simple ageing table or comprehensive portfolio report. Key **financial statements** like the Balance Sheet and Income Statement, appropriately constructed

What aspects affect Cumulative Repayment Rates?

The sequence of allocating client repayments – interest first versus principal first – has an impact on repayment rates. It is suggested that client repayments should be allocated in the following sequence - first to interest overdue, then to interest due, then to principal overdue and finally to principal due. When aggregating repayments from various clients, prepayments of some clients could smoothen the non-repayment by other clients. Hence, prepayments should always be subtracted while calculating repayments rates

What can be said with regard to trends for Cumulative Repayment Rate?

- An increasing Cumulative repayment Rate is positive.

How to calculate Cumulative Repayment Rate?

**Step 1** Create a loan repayment schedule, identify whether the loan is delinquent and age the loan in days with regard to past dues

**Step 2** Aggregate loan repayments schedules for all loans and summarize these in the form of a simple table

**Step 3** Sum the total principal amounts paid so far by clients

**Step 4** Sum the prepayments, if any made by them so far. Prepayment would have occurred if the total amount paid by the client exceeds the amount due from the client

**Step 5** Sum the total amounts due from the client till date (today or date of aggregation etc)

**Step 6** Then do the following calculation to get the Cumulative Repayment Rate

\[
\frac{\text{Total amount paid so far by Clients} - \text{Prepayment } \times 100}{\text{Total amount due from Clients till date}}
\]

What is the formula for Cumulative Repayment Rate?

\[
\text{Cumulative Repayment Rate} = \frac{\text{Total amount paid so far by Clients} - \text{Prepayment } \times 100}{\text{Total amount due from Clients till date}}
\]

What does Cumulative Repayment Rate measure?

- Provides a sense of the overall delinquency in the FI, especially over the years
- From a historical perspective, cumulative repayment rates are also required as they provide an overall measure of what proportion of the amount due till date, has been paid by clients
- In other words, it gives an overall estimate of the amounts past due for the program through the years.
- It is particularly useful when assessing the performance of an FI over a long period of time.

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54 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
Good Practices MIS Technical Note For ERP System Developers
TN #40: Financial Indicators, Asset Quality
What is Cumulative Repayment Rate? … and How to use it?

System Calculating for Cumulative Repayment Rate (CRR)

**Input**
- Individual Loan Ledgers
- Loan repayment transactions and credit policy
- Installment schedules with repayment data incorporated and rules for calculating age of loan
- Same input as in step 3 for all loans

**Process**
- **Step 1:** From the FI's (NCRPB's) total loan portfolio, determine all loans that have been disbursed
- **Step 2:** For every loan, create a loan repayment schedule
- **Step 3:** Determine if loan is delinquent and age it for past dues
- **Step 4:** Do the same for all loans disbursed for the FI (NCRPB) as on date
- **Step 5:** Sum the total amounts due from the client till date (today or date of aggregation etc) as per installment schedule
- **Step 6:** Sum the prepayments, if any made by so far clients.
- **Step 7:** Sum the total amounts paid by the client till date (today or date of aggregation etc)
- **Step 8:** Then do the following calculation to get the Cumulative Repayment Rate
  - Total amounts paid so far by Clients – Prepayments x 100
  - Total amounts due from Clients till date

**Outputs**
- List of all Disbursed loans
- Installment Schedule for each loan and all loans
- Ageing Report of Loan
- Ageing report for all past due disbursed loans
- Total amount due for all disbursed loans
- Total Prepayments by Clients and aggregated
- Total amount paid for all disbursed loans
- Value of Cumulative Repayment Rate and its interpretation

**Remarks**
- Randomly check for consistency with cash/disbursement records
- Make sure client repayment appropriation is as per best practices – fines first, interest next, and principal last– in that order. Also, it should be as per credit policy/terms as at time of loan disbursement to client
- The correct method of ageing should be used. Age of a past due loan is date of ageing report minus date at which earliest unpaid overdue (principal or interest) exists. Installment schedule should have fixed amounts due and dates due.
- Make sure that installment schedules remain same as at time of loan disbursement and is also consistent with credit policy
- The correct method of ageing should be used. Age of a past due loan is date of ageing report minus date at which earliest unpaid overdue (principal or interest) exists. Installment schedule should have fixed amounts due and dates due.
- Make sure that installment schedules remain same as at time of loan disbursement and is also consistent with credit policy
- Prepayment would have occurred if the total amount paid by the client exceeds the amount due from the client. Sequence of appropriation is critical.
- Key is to ensure installment schedule stays stable, client repayment appropriation is correct and prepayments are properly adjusted. Consistency of installment schedule with loan terms and conditions from credit policy must also be ensured.
What is On-time Repayment Rate? … and How to use it?

**On-time Repayment Rate (OTRR)**

<table>
<thead>
<tr>
<th>Formula</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Amounts paid as per schedule by Clients – Prepayments x 100</td>
<td>Total Amounts Due from Clients till date as per schedule</td>
</tr>
</tbody>
</table>

What does On-time Repayment Rate measure?

**On-time repayment** is a measure of credit discipline and it helps in cash flow management. The better the on-time repayment rate, the lower the postponement of interest income, the greater the efficiency of portfolio rotation and other aspects, ceterus paribus. It is a simple percentage (%).

What minimum records are required for calculating the On-time Repayment Rate?

**Loan ledger** with disbursement, schedule and repayment data on each individual loan backed-up a comprehensive credit policy outlining various terms and conditions. **Aggregation of the loan ledger data with regard to delinquent and current loans** – either a simple ageing table or comprehensive portfolio report. **Key financial statements** like the Balance Sheet and Income Statement, appropriately constructed.

What aspects affect On-Time Repayment Rates?

The sequence of allocating client repayments – interest first versus principal first – has an impact on repayment rates. It is suggested that client repayments should be allocated in the following sequence - first to interest overdue, then to interest due, then to principal overdue and finally to principal due. When aggregating repayments from various clients, prepayments of some clients could smoothen then on-repayment by other clients. Hence, prepayments should always be subtracted while calculating repayments rates. As evident from the repayment formulas given earlier, a decrease in arrears, caused by collection of over dues, will not affect the on-time repayment rate. This is because the on-time repayment is primarily concerned with how much borrowers repay as per their (original) schedule.

Put differently, improvement in delinquency (that has already occurred) will impact current and cumulative repayments rates because in the formulas for calculating these repayment rates, there is a provision to factor in the arrears (overdue payments) coming in. Such a provision does not exist as far as On-Time Repayment Rate is concerned.

How to calculate On-time Repayment Rate?

**Step 1** Create a loan repayment schedule, identify whether the loan is delinquent and age the loan in days with regard to past dues

**Step 2** Aggregate loan repayments schedules for all loans and summarize these in the form of a simple table

**Step 3** Sum the total principal amounts paid as per schedule till date by clients

**Step 4** Sum the prepayments, if any made by them so far. Prepayment would have occurred if the total amount paid by the client exceeds the amount due from the client

**Step 5** Sum the total amounts due from the client till date (today or reference date)

**Step 6** Then do the following calculation to get the On-Time Repayment Rate

\[
\text{On-Time Repayment Rate} = \left( \frac{\text{Total Amounts paid as per schedule by Clients – Prepayments} \times 100}{\text{Total Amounts Due from Clients till date}} \right)
\]

**What is the utility of On-Time Repayment Rates?**

- Discerns (consistently) good borrowers from delinquent and default borrowers
- Help in Cash flow projections
Good Practices MIS Technical Note For ERP System Developers
TN #41: Financial Indicators, Asset Quality
What is On-time Repayment Rate? ... and How to use it?

System Calculating for On-Time Repayment Rate (OTRR)

**Input**
- Individual Loan Ledgers
- Loan repayment transactions and credit policy
  - Installment schedules with repayment data incorporated and rules for calculating age of loan
  - Same input as in step 3 for all loans

**Process**
- **Step 1:** From the FI’s (NCRPB’s) total loan portfolio, determine all loans that have been disbursed
- **Step 2:** For every loan, create a loan repayment schedule
  - Installment Schedule for each loan and all loans
  - Ageing Report of Loan
  - Total amount due for all disbursed loans
  - Total Prepayments by Clients and aggregated

**Outputs**
- **Step 3:** Determine if loan is delinquent and age it for past dues
  - Ageing report for all past due disbursed loans
  - Value of On-time Repayment Rate and its interpretation

**Remarks**
- Randomly check for consistency with cash/disbursement records
- Make sure client repayment appropriation is as per best practices -- fines first, interest next, and principal last-- in that order. Also, it should be as per credit policy/terms as at time of loan disbursement to client
- The correct method of ageing should be used. Age of a past due loan is date of ageing report minus date at which earliest unpaid overdue (principal or interest) exists. Installment schedule should have fixed amounts due and dates due.
- Make sure that installment schedules remain same as at time of loan disbursement and is also consistent with credit policy
- Make sure schedule does not change and late payments must be excluded. Sequence of appropriation is critical.
- Key is to ensure installment schedule stays stable, client repayment appropriation is correct and prepayments are properly adjusted. Consistency of installment schedule with loan terms and conditions from credit policy must also be ensured.

**Value of On-time Repayment Rate and its interpretation**
- Total on-time amount paid for all disbursed loans as per schedule
  - Total Prepayments by Clients and aggregated
  - Total amount due for all disbursed loans
  - Total amount paid by the client exceeds the amount due from the client. Sequence of appropriation is critical.

**Step 4:** Do the same for all loans disbursed for the Financial Intermediation (FI) at NCRPB as on date

**Step 5:** Sum the total amounts due from the client till date (today or date of aggregation etc) as per installment schedule

**Step 6:** Sum the prepayments, if any made by them so far. Prepayment would have occurred if the total amount paid by the client exceeds the amount due from the client

**Step 7:** Sum the total (on-time) amounts paid as per schedule by the clients till date (today or date of aggregation etc)

**Step 8:** Then do the following calculation to get the On-Time Repayment Rate

\[
\text{On-Time Repayment Rate} = \frac{\text{Total Amounts paid as per schedule by Clients} - \text{Prepayments} \times 100}{\text{Total Amounts Due from Clients till date}}
\]
What is Operating Cost Ratio?… and How to use it?

What is Operating Cost Ratio?

Operating Cost Ratio is a percentage (%). This ratio is perhaps the best indicator of the overall efficiency of a Financing Institution (FI) like NCRPB. For this reason, the ratio is also commonly referred to as the efficiency ratio: it measures the institutional cost of delivering loan services. The lower the Operating Cost Ratio, the higher the efficiency of the lending institution. It is affected by increasing or decreasing operational costs relative to the average loan portfolio outstanding.

What is the formula for Operating Cost Ratio?

\[
\text{Operating Cost Ratio} = \frac{\text{Operating Costs during period}}{\text{Average Outstanding Loan Portfolio}}
\]

What does Operating Cost Ratio measure?

It is the key measure of the efficiency of the lending operations at NCRPB.

If the performing assets are primarily loans funds, this ratio shows how much the institution must spend on all operating costs (salaries, rent, office, vehicles, etc.) to keep a unit of money loaned out for one year’s time.

If an institution selects an efficient methodology and employs a highly productive staff, the operating cost ratio will drop, resulting in a more sustainable institution. In an organization, a downward trend in this ratio, highlights the increasing efficiency.

What are records required for calculating the Operating Cost Ratio?

- **Loan ledger** with disbursement, schedule and repayment data on each individual loan backed-up a comprehensive credit policy outlining various terms and conditions.
- Aggregation of the loan ledger data with regard to delinquent and current loans – either a simple ageing table or comprehensive portfolio report.
- **Key financial statements** like the Balance Sheet and Income Statement, appropriately constructed.

What can be said with regard to trends for Operating Cost Ratio?

- A decreasing Operating Cost Ratio is positive.
- However, this trend can be misleading because a lower ratio can be obtained by decreasing the numerator and/or increasing the denominator.
- In other words, sudden and large disbursements of loans could mask the actual efficiency.
- Also, in an FI that is fast expanding in terms of loan disbursements, the same limitation applies. And when the repayment period for these loans are yet to begin, the problem is exacerbated.

How to calculate Operating Cost Ratio?

**Step # 1:** From the income statement, sum all expenses related to the financial operations of NCRPB. These typically would include:
- Salaries and Allowance
- Administrative Expenses
- Travel
- Depreciation etc
- Other expenses.

**Interest, provision and extraordinary expenses should not be included.**

**Step # 2:** From the loan ledgers, calculate the average outstanding portfolio during the period (for instance, a year) using the following procedure:
- Divide the period (year) into appropriate sub-periods – for example, a year could be divided into 12 sub-periods of a month each (see Table next page)
- Take the actual loans outstanding at the beginning of the period (say April 1st, 2008)
- Add to this the sum of loans outstanding at the end of each sub-period (i.e., month)
- Then compute Average Loan Outstanding as follows:
  \[
  \text{Average Loan Outstanding} = \frac{B + E_1 + E_2 + E_3 + \ldots + E_{12}}{13}
  \]

**Step # 3:** Divide Operating Costs during period by Average Loans Outstanding to get the Operating Cost Ratio.

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55 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
### What is Operating Cost Ratio? … and How to use it?

#### Process For Computing Average Loan Outstanding on Monthly Basis

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1st, 2008</td>
<td>Actual Loan Outstanding at Beginning of Period</td>
<td>B1</td>
</tr>
<tr>
<td>April 30th, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 1</td>
<td>E 1</td>
</tr>
<tr>
<td>May 31st, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 2</td>
<td>E 2</td>
</tr>
<tr>
<td>June 30th, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 3</td>
<td>E 3</td>
</tr>
<tr>
<td>July 31st, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 4</td>
<td>E 4</td>
</tr>
<tr>
<td>August 31st, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 5</td>
<td>E 5</td>
</tr>
<tr>
<td>September 30th, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 6</td>
<td>E 6</td>
</tr>
<tr>
<td>October 31st, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 7</td>
<td>E 7</td>
</tr>
<tr>
<td>November 30th, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 8</td>
<td>E 8</td>
</tr>
<tr>
<td>December 31st, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period 9</td>
<td>E 9</td>
</tr>
<tr>
<td>January 31st, 2009</td>
<td>Actual Loan Outstanding at End of Sub-Period 10</td>
<td>E 10</td>
</tr>
<tr>
<td>February 28th, 2009</td>
<td>Actual Loan Outstanding at End of Sub-Period 11</td>
<td>E 11</td>
</tr>
<tr>
<td>March 31st, 2009</td>
<td>Actual Loan Outstanding at End of Sub-Period 12</td>
<td>E 12</td>
</tr>
<tr>
<td></td>
<td>13 Data Points Actual Loan Outstanding amounts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Calculating Average Average Loan Outstanding</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sum of B + E 1 + E 2 + ... E12</td>
<td></td>
</tr>
</tbody>
</table>

If there is good reason to feel that this could be done on a quarterly basis, the above can be done using a quarterly interval and the formula would be Sum of $B + Q1 + Q2 + Q3 + Q4$ over 5.

#### Process For Computing Average Loan Outstanding on Quarterly Basis

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1st, 2008</td>
<td>Actual Loan Outstanding at Beginning of Period</td>
<td>B1</td>
</tr>
<tr>
<td>June 30th, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period Q1</td>
<td>Q1</td>
</tr>
<tr>
<td>September 30th, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period Q2</td>
<td>Q2</td>
</tr>
<tr>
<td>December 31st, 2008</td>
<td>Actual Loan Outstanding at End of Sub-Period Q3</td>
<td>Q3</td>
</tr>
<tr>
<td>March 31st, 2009</td>
<td>Actual Loan Outstanding at End of Sub-Period Q4</td>
<td>Q4</td>
</tr>
<tr>
<td></td>
<td>4 Data Points Actual Loan Outstanding amounts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Calculating Average Average Loan Outstanding</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sum of B1 + Q1 + Q2 + Q3 + Q4</td>
<td></td>
</tr>
</tbody>
</table>

If there is good reason to feel that this could be done on a quarterly basis, the above can be done using a quarterly interval and the formula would be Sum of $B + Q1 + Q2 + Q3 + Q4$ over 5.
What is Operating Cost Ratio? … and How to use it?

**Operating Cost Ratio**

**Input**
- Income/Expenditure Statement

**Process**
- **Step 1:** From the income statement, sum all expenses related to the operations
- **Step 2:** From the loan ledger + portfolio report, calculate the average outstanding portfolio during the period (for instance, a year) using the outlined procedure:

**Output**
- Operating Expenses
- Average Outstanding Portfolio

**Remarks**
- Operating Cost Ratio and Interpretation
- Trend is critical apart from absolute values. Absolute values also need to be as per life cycle stage – it will be higher for nascent operations.

- Please try and get subsidised expenses. Unreported expenses must also be taken into account.
What is Total Cost Ratio? Total Cost Ratio is a percentage (%). Like the operating cost ratio, this ratio is an indicator of the overall efficiency of a lending institution. The lower the total Cost Ratio, the higher the efficiency. However, because costs of funds and loan loss provision are included here, greater care must be exercised while interpreting the ratio.

What is the formula for Total Cost Ratio?

\[
\text{Total Cost Ratio} = \frac{\text{Operating Costs during period} + \text{Cost of Funds} + \text{Loan Loss Provision} + \text{other (incentive) provisions}}{\text{Average Outstanding Loan Portfolio}}
\]

What does Total Cost Ratio measure? Only Loan?

If the performing assets are primarily loans funds, this ratio shows how much the institution must spend on all costs (salaries, rent, office, vehicles, sourcing capital and making provisions etc.) to keep a unit of money loaned out for one year’s time.

If an institution selects an efficient lending methodology, employs highly productive staff and uses technology, the total cost ratio will drop, resulting in a more sustainable institution. In an organization, a downward trend in this ratio, highlights the increasing efficiency of the organization. But, again because the cost of funds and loan loss provision are included, a decreasing ratio may not necessarily be good (or positive) because the numerator can be decreased by accessing subsidized funds as well as having lower provisions than mandated by the portfolio quality.

What minimum records are required for calculating the Ratio?

- Loan ledger with disbursement, schedule and repayment data on each individual project loan backed-up a comprehensive credit policy outlining various terms and conditions
- Aggregation of the loan ledger data with regard to delinquent and current loans - either a simple ageing table or comprehensive portfolio report

Key financial statements like the Balance Sheet and Income Statement, appropriately constructed

What events/activities affect (distort) the Total Cost Ratio?

Portfolio size, loan size, incentives etc have an impact on this ratio. Portfolio size matters and while NCRPB can become more efficient by growing, beyond a point, the importance of economics of scale diminishes rapidly and other factors become crucial.

Loan size certainly has a much stronger impact on efficiency.

Also, the operating expenses of NCRPB with more widely dispersed projects would be higher. Hence, NCRPB would tend to have higher total cost ratio under such circumstances.

Standardization of financing operations including use of technology and automation of workflow should help in a reduced total cost ratio.

This ratio is also affected by unreported and/or hidden subsidies. Organizations providing financing and other services like planning can allocate costs in such a way that their credit operations look more efficient than they really are. When NCRPB allocates costs to other units or does not carry them on the books at all, for instance when donors meet certain costs like cost of TA, paying for consultants – this ratio is affected.

Finally, because the cost of funds and loan loss provision are included, a decreasing ratio may not necessarily be good (or positive) because the numerator can be decreased by accessing subsidized funds as well as having lower provisions than mandated by the portfolio quality.

What can be said with regard to trends for Total Cost Ratio?

A decreasing Total Cost Ratio is positive but sufficient attention must be given to the cost of funds aspects and also loan loss provision created.

How to calculate Total Cost Ratio?

Step # 1: From the income statement, sum all expenses related to the operations of the NCRPB including cost of funds and loan loss provisions. These typically include:
What is Total Cost Ratio? … and How to use it?

<table>
<thead>
<tr>
<th>S No</th>
<th>Various Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Operational Costs</td>
</tr>
<tr>
<td></td>
<td>Salaries and Allowance</td>
</tr>
<tr>
<td></td>
<td>Administrative Expenses</td>
</tr>
<tr>
<td></td>
<td>Occupancy Expenses</td>
</tr>
<tr>
<td></td>
<td>Travel</td>
</tr>
<tr>
<td></td>
<td>Depreciation etc</td>
</tr>
<tr>
<td>2</td>
<td>Cost of Project Funds</td>
</tr>
<tr>
<td>3</td>
<td>Loan Loss Provisions</td>
</tr>
<tr>
<td>1+2+3</td>
<td>Total Costs</td>
</tr>
</tbody>
</table>

**Step # 2:** From the portfolio report, calculate the average outstanding portfolio during the period (for instance, a year) using the following procedure:

1. Divide the period (year) into appropriate sub-periods – for example, a year could be divided into 12 sub-periods of a month each (see Table next page)
2. Take actual loans outstanding at the beginning of the period (say 1st April, 2008)
3. Add to this the sum of loans outstanding at the end of each sub-period (i.e., month)
4. Then compute Average Loan Outstanding as follows
5. Average Loan Outstanding (During Period) = \( \frac{B + E1 + E2 + E3 + \ldots + E12}{13} \)

**Step # 3:** Divide Total Costs during period by Average Loans Outstanding to get the Total Cost Ratio

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### Process For Computing Average Loan Outstanding on Monthly Basis

<table>
<thead>
<tr>
<th>Date</th>
<th>Actual Loan Outstanding</th>
</tr>
</thead>
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<td>E2</td>
</tr>
<tr>
<td>June 30th, 2008</td>
<td>E3</td>
</tr>
<tr>
<td>July 31st, 2008</td>
<td>E4</td>
</tr>
<tr>
<td>August 31st, 2008</td>
<td>E5</td>
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<tr>
<td>September 30th, 2008</td>
<td>E6</td>
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<tr>
<td>October 31st, 2008</td>
<td>E7</td>
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<tr>
<td>November 30th, 2008</td>
<td>E8</td>
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<tr>
<td>December 31st, 2008</td>
<td>E9</td>
</tr>
<tr>
<td>January 31st, 2009</td>
<td>E10</td>
</tr>
<tr>
<td>February 28th, 2009</td>
<td>E11</td>
</tr>
<tr>
<td>March 31st, 2009</td>
<td>E12</td>
</tr>
</tbody>
</table>

13 Data Points

Calculating Average

\[ \text{Average Loan Outstanding} = \frac{B + E1 + E2 + \ldots + E12}{13} \]

If there is good reason to feel that this could be done on a quarterly basis, the above can be done using a quarterly interval and the formula would be \( \frac{B + Q1 + Q2 + Q3 + Q4}{5} \)

### Process For Computing Average Loan Outstanding on Quarterly Basis

<table>
<thead>
<tr>
<th>Date</th>
<th>Actual Loan Outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1st, 2008</td>
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</tr>
<tr>
<td>June 30th, 2008</td>
<td>Q1</td>
</tr>
<tr>
<td>September 30th, 2008</td>
<td>Q2</td>
</tr>
<tr>
<td>December 31st, 2008</td>
<td>Q3</td>
</tr>
<tr>
<td>March 31st, 2009</td>
<td>Q4</td>
</tr>
</tbody>
</table>

Calculating Average

\[ \text{Average Loan Outstanding} = \frac{B1 + Q1 + Q2 + Q3 + Q4}{5} \]

If there is good reason to feel that this could be done on a quarterly basis, the above can be done using a quarterly interval and the formula would be \( \frac{B + Q1 + Q2 + Q3 + Q4}{5} \)
Total Cost Ratio

**Input**
- Income/Expenditure Statement

**Process**
- **Step 1:** From the income statement, sum all expenses of Financial Intermediation at NCRPB including cost of funds and loan loss provisions.
- **Step 2:** From the loan ledger + portfolio report, calculate the average outstanding portfolio during the period (for instance, a year) using the outlined procedure:
- **Step 3:** Divide Total Costs during period by Average Loans Outstanding to get the Total Cost Ratio

**Output**
- All Expenses = Operating Expenses + Financial Expenses + Loan Loss Provision

**Remarks**
- Please try and get subsidised and all expenses adjust for same. All type of expenses must be taken into account.
- Using a monthly/quarterly basis for output may be more appropriate.
- Trend is critical apart from absolute values. Absolute values also need to be as per life cycle stage – it will be higher for nascent operations.

Using data from Step # 1 and 2

**Interpretation**

**Total Cost Ratio**
What is Financial Self-Sufficiency? What does it measure?

Financial Self-Sufficiency is an important measure of sustainability of the lending operations. Looking at the ratio as a self-sufficiency figure allows determination of the extent to which operations are becoming (increasingly) self-sustaining. Financial self-sufficiency indicates whether or not enough revenue has been earned to cover both direct costs, including financing costs, provisions for loan losses, and operating expenses, and indirect costs, including the adjusted cost of capital.

The adjusted cost of capital is considered to be the cost of maintaining the value of the equity relative to inflation (or the market rate of equity) and the cost of accessing commercial rate liabilities rather than concessional loans.

Unless 100% Financial Self-Sufficiency is reached, the long-term provision of financial services will ultimately be undermined by the impact of inflation and the continued necessity to rely on subsidized funds.

What minimum records are required for calculating the Ratio?

Loan ledger with disbursement, schedule and repayment data on each individual loan backed up a comprehensive credit policy outlining various terms and conditions. Aggregation of the loan ledger data with regard to delinquent and current loans – either a simple ageing table or comprehensive portfolio report.

Key financial statements like the Balance Sheet and Income Statement, appropriately constructed and adjusted for loan losses, depreciation, accrued interest, inflation impact, subsidies etc. Please refer hereafter for calculating adjusted cost of capital ratio and relevant notes for making all relevant adjustments to financial statements.

Cost of Capital Adjustment

NCRPB funds its loans with donated funds (Grant) from government and thus to continue funding its loan portfolio, it would need to generate enough revenue to increase its equity to keep pace with inflation.

If the NCRPB was to operate with borrowed funds, the financing costs in the income statements would capture the costs of debt and not the cost of inflation, because inflation only affects equity and not liabilities.

Liabilities are priced by the lender to NCRPB to cover the cost of inflation, because the borrower—in this case, the NCRPB—repays the loan in the future with inflated currency.

If it turns out that the rate of inflation is greater that the rate interest on the loan, the lender loses money, not NCRPB.

Furthermore, NCRPB may also access concessional funding (quasi-equity) at below-market rates. Due consideration must be given to this subsidy and an additional cost of funds has to be included, based on NCRPB accessing commercial loans.

The formula for the adjusted cost of capital is at follows:

Cost of capital = [(Inflation rate X (Average equity - Average fixed assets)] + [(average funding liabilities X market rate of debt) – actual financing costs]

The first half of the formula in red quantifies the impact of on equity. Some analysts and NCRPB may wish use a market rate of equity rather than inflation, on the fact that if the NCRPB was to have equity investors they would demand a return greater than the case of inflation.

How to calculate Financial Self-Sufficiency?

Step # 1: From the adjusted income statement, sum up all operating income. This would include:

- Interest on Current and Past Due Loans +
- Interest on Restructured loans +
- Interest on Investment +
- Loan Fees and Service Charges +
- Late Fees on Loans = Total Operating Income

GRANT INCOME SHOULD NOT BE INCLUDED

Step # 2: From the adjusted income statement sum all expenses for the year related to the financing. These typically would include:
What is Financial Self-Sufficiency? … and How to use it?

1. Operating Expenses
2. Loan Loss Provisions
3. Financing Costs
4. Total Direct Expenses

Add to the total expenses above the adjusted cost of capital (see hereafter)

**Step # 3:** Divide Total Operating Income by Total Expenses to get Financial Self-Sufficiency ratio. Total Expenses is sum of Total Direct expenses (Operating Expenses + Loan Loss Provision + Financing Costs) + Cost of Capital Adjusted.

**What events/activities affect (distort) the Ratio?**

This ratio is also affected by unaccounted, unreported and/or hidden subsidies with regard to operations. Sometimes, organizations providing financing as well as other services like planning can allocate costs in such a way that their credit operations look more sustainable than they really are

- When NCRPB allocates costs to subsidiaries or does not carry them on the books at all, for instance when governments or donors meet certain costs, such as paying for consultants – this ratio is affected
- Fixed assets are subtracted based on assumption that property and buildings generally enhance their value relative to inflation.
- The second half of formula (blue in previous page) quantifies the cost of the NCRPB if it were to less commercial debt rather than concessional debt.
- If adjusted financial statements are used, adjusted cost of capital is not required to calculate the financial self-sufficiency.
- Once the adjusted cost of capital is determined, the financial self-sufficiency ratio can be calculated as given above
Financial Self-Sufficiency

**Input**
- Income/Expenditure Statement

**Process**
1. **Step 1**: From the *adjusted income statement*, sum up all operating incomes.
2. **Step 2**: From the *adjusted income statement* sum all expenses (operational + LLP + Financial Expenses)
3. **Step 3**: Calculate adjusted cost of capital as per formula:
   \[
   \text{Adjusted Cost of Capital} = (\text{Inflation rate} \times (\text{Average equity} - \text{Average fixed assets})) + (\text{average funding liabilities} \times \text{market rate of debt}) - \text{actual financing costs}
   \]
4. **Step 4**: Calculate Grant Total Expenses as per formula:
   \[
   \text{Grand Total Expenses} = \text{Total Expenses} + \text{Adjusted cost of capital}
   \]

**Output**
- Total Operating Income
- Total Expenses = Operating Expenses + Financial Expenses + Loan Loss Provision

**Remarks**
- Exclude Donations and Grants
- Include unreported and all subsidies
- Use Inflation Rate in RBI Website and calculate averages using application interval

**Input**
- Income/Expenditure Statement

**Process**
- Total Operating Income

**Output**
- Financial Self-Sufficiency ratio

**Remarks**
- Please note that wrong provisioning can undermine ratio

**Financial Self-Sufficiency and Interpretation**
- Grand Total Expenses = Total Expenses + Adjusted cost of capital
- Financial Self-Sufficiency ratio = Total Operating Income / Grand Total Expenses

**Input**
- Income Statement and Balance Sheet

**Process**
- Adjusted Cost of Capital

**Output**
- Financial Self-Sufficiency ratio

**Remarks**
- Use Inflation Rate in RBI Website and calculate averages using application interval

**Input**
- Using data from Step # 2 and 3

**Process**
- Using data from Step # 1 and 4

**Output**
- Financial Self-Sufficiency ratio

**Remarks**
- Please note that wrong provisioning can undermine ratio
**What is Subsidy Dependence Index?**

**SDI** is a number a very important measure of self-sufficiency that is getting to be widely used is the subsidy dependence index (SDI). Developed by Jacob Yaron as part of his seminal work on Rural Financial Institutions, the SDI is a unique measure because it takes into account the implicit and explicit subsidies received by an institution while calculating self-sufficiency.

To be financially viable, an NCRPB cannot rely on govt grants to subsidize its operations. If an organization is not financially self-sufficient, the subsidy dependence index can be calculated to determine the rate at which the NCRPB’s interest rate needs to be increased to cover the same level of costs with the same revenue base (loan portfolio), without subsidies. Thus, the SDI represents the % increase in on-lending rate required (for an NCRPB) to completely eliminate all subsidies and operate in a sustainable manner.

It is different from the adjusted financial self-sufficiency ratio in that it uses the market rate rather than inflation to make the various adjustments to subsidies. The subsidy dependence index makes explicit the subsidy needed to keep the institution afloat, much of which is not reflected in conventional accounting reporting.

**What is the formula for SDI?**

\[
\frac{A (M-C) + E \times M + K - P}{LP \times I} = 0
\]

- **A** – Total Borrowings
- **M** – Market Rate of Interest
- **C** – Concessional Rate of Interest
- **E** – Equity Capital
- **P** – Profit
- **K** – Total Grants for the Year
- **LP** – Loan Portfolio Outstanding
- **I** – On-lending Interest Rate

**What does it measure?**

- It is an important measure of sustainability of the lending operations

---

**The SDI measures the degree to which an NCRPB relies on subsidies for its continued operations.**

Looking at the SDI as a self-sufficiency figure allows determination of the extent to which operations are subsidized and also where these subsidies exist.

The SDI also offers prescriptions on what to do to eliminate these subsidies and become fully sustainable.

In terms of interpretation (please refer to box next page), an SDI of 0 implies a fully sustainable NCRPB. Intuitively it makes sense because, this happens when an NCRPB can cover its subsidies on borrowed funds, the opportunity cost of its equity capital and all other subsidies from its profit.

A negative SDI suggests that an NCRPB has reached full or complete sustainability – it is sustainable and also generating a surplus.

Likewise, a positive SDI (say for example 100) indicates that the NCRPB is long ways from sustainability and needs to increase its on-lending rate by 100% (i.e., double it) to be sustainable with the same costs and level of operations.

According to the SDI, several factors are critical for reducing or eliminating subsidy dependence: adequate on-lending rates, high rates of collection, control of operational costs and optimization of portfolio rotation.

Capital will be reduced by losses (unless additional grants can be raised to cover operating shortfalls). This means that there will be a smaller amount of funds to loan to borrowers, (which could lead to closing the NCRPB once the funds run out).

**Numerator of SDI**

\[
A (M-C) + E \times M + K - P = 0
\]

\[
P = A (M-C) + E \times M + K
\]

Profit = Subsidy on borrowings + Opportunity cost of capital + All other subsidies then SDI = 0

Profit > Subsidy on borrowings + Opportunity cost of capital + All other subsidies then SDI < 0

Profit < Subsidy on borrowings + Opportunity cost of capital + All other subsidies then SDI > 0

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58 Compiled by Ramesh S Arunachalam, from various good practices resources. They are gratefully acknowledged and the SRS document will have a complete list of references including those previously authored by Ramesh S Arunachalam.
What minimum records are required for calculating the Ratio?

- Loan ledger with disbursement, schedule and repayment data on each individual loan backed-up a comprehensive credit policy outlining various terms and conditions.
- Aggregation of the loan ledger data with regard to delinquent and current loans – either a simple ageing table or comprehensive portfolio report.
- Key unadjusted financial statements like the Balance Sheet and Income Statement, appropriately constructed.
- Unadjusted financial statements are required to get an accurate picture of all types of subsidies received by the institution. Thus, the subsidy dependence index is calculated ONLY by using an NCRPB’s unadjusted financial statements to determine the true value of the subsidies

How to calculate SDI?

**Step # 1:** From the unadjusted financial statements and other sources of data and records, calculate the subsidies on borrowings (which is borrowings into the interest rate differential between market rates of interest and actual concessional rate). Do this for each source of borrowings. Please note that to get as accurate figures as possible, one will have to use the actual borrowings ledger and repayment schedule

**Step # 2:** Then calculate the opportunity cost of equity capital by multiplying total equity with the market rate used above

**Step # 3:** Then identify and place a value on all other subsidies including in kind subsidies. Please refer to best practices resources for various kinds subsidies and methods of allocating costs to them

**Step # 4:** Sum up the subsidy on borrowings, opportunity cost of equity capital and other subsidies. This gives the total subsidies for the NCRPB. From this, subtract the NCRPB’s profits to get the numerator of the SDI

**Step # 5:** Then calculate the average annual income by multiplying the average gross loan portfolio outstanding (use formula below to calculate this) by the on-lending effective interest rate. The actual income received during the period could also be used – this is the denominator of the SDI

**Step # 6:** Divide Subsidies – Profits by the Average Annual Income

**Step # 7:** This gives the value of SDI

What events/activities affect (distort) the Ratio?

This ratio is also affected by unaccounted, unreported and/or hidden subsidies with regard to operations

Organizations providing finance as well as other services can allocate costs in such a way that their finance operations look more sustainable than they really are – for example when NCRPB do not carry them on the books at all, such as when donors meet certain costs, like paying for consultants

**Formula for calculating Average Loan Outstanding**

From the portfolio report, calculate the average outstanding portfolio during the period (for instance, a year) using the following procedure:

- Divide the period (year) into appropriate sub-periods – for example, a year could be divided into 12 sub-periods of a month each
- Take the actual loans outstanding at the beginning of the period (say April 1<sup>st</sup>, 2001)
- Add to this the sum of loans outstanding at the end of each sub-period (i.e., month)
- Then compute Average Loan Outstanding as follows

\[
\text{Average Loan Outstanding (During Period)} = \frac{B + E1 + E2 + E3 + \ldots + E12}{13}
\]
Subsidy Dependence Index

**What is Subsidy Dependence Index? … and How to use it?**

**Input**
- All Financial Statements, RBI Site
- RBI Website and Balance Sheet
- Income Statement and Balance Sheet
- All outputs from Steps above (1-3)

**Process**
- **Step 1:** From the unadjusted financial statements and other sources of data and records, calculate the subsidies on borrowings as per formula \((A \times (M - C))\)
- **Step 2:** Then calculate the opportunity cost of equity capital by multiplying total equity with the market rate used above using formula \((E \times M)\)
- **Step 3:** Then identify and place a value on all other subsidies including in kind/other subsidies \((K)\)
- **Step 4:** Sum up the subsidy on borrowings, opportunity cost of equity capital and other subsidies.
- **Step 5:** From this, subtract the Financial Intermediations (FIs) at NCRPB’s profits to get the numerator of the SDI \((A \times (M - C)) + E \times M + K - P = 0\)
- **Step 6:** Then calculate the average annual income by multiplying the average gross loan portfolio outstanding by Portfolio Yield (Divide Interest and Fee Income during period by Average Loans Outstanding)
- **Step 7:** Divide Subsidies – Profits by the Average Annual Income

**Output**
- Subsidy on borrowings
- Opportunity Cost of Equity Capital
- All other Subsidies
- Total Subsidies - Profits
- Average Annual Income
- Subsidy Dependence Index Ratio (SDI) and Interpretation

**Remarks**
- Using benchmark prime lending wholesale rate as market rate
- Include donated equity as well
- This is critical and all unreported subsidies must be included
- Use effective Yield rather than Effective Interest Rate (EIR)

**Interpretation**
- SDI > 0 – Not Sufficiency
- SDI = 0 – Sufficiency
- SDI < 0 – Fully Sufficiency
What is Portfolio Yield?

Portfolio yield is a percentage (%). It shows the average gross returns as a proportion of the portfolio outstanding. Generally speaking, Portfolio Yield is the initial indicator of an institution’s ability to generate revenue with which to cover its financial and operating expenses.

What is the formula for Portfolio Yield?

<table>
<thead>
<tr>
<th>Interest and Fee Income during period</th>
<th>Average Outstanding Loan Portfolio</th>
</tr>
</thead>
</table>

Portfolio Yield measures how much the NCRPB actually received in interest payments from its clients during the period.

It also provides insight into portfolio quality if NCRPB uses cash accounting – here, the Portfolio Yield will not include the accrued (interest and fee) income that delinquent loans should have generated, but did not.

For Portfolio Yield to be meaningful, it must be understood in the context of the prevailing interest rate environment that NCRPB operates in.

What minimum records are required for calculating the Ratio?

Loan ledger with disbursement, schedule and repayment data on each project loan backed-up a comprehensive credit policy outlining various terms and conditions.

Aggregation of the loan ledger data with regard to delinquent and current loans – either a simple ageing table or comprehensive portfolio report

Key financial statements like the Balance Sheet and Income Statement, appropriately constructed along with complete details of finances including sources, repayment schedule and terms and all other related information

What can be said with regard to trends for PAR?

- An increasing Portfolio Yield is positive

How to calculate Portfolio Yield?

Step #1: Portfolio Yield is calculated by dividing total interest and fee income (in other words all income generated by the loan portfolio) by the average gross outstanding portfolio.

Step #2: From the income statement (adjusted or unadjusted), sum all interest and fee income received by the NCRPB. These typically would include:

- Interest on Current and Past Due Loans
- Interest on Restructured loans
- Loan Fees and Service Charges
- Late Fees on Loans

In Total Income, GRANT INCOME SHOULD NOT BE INCLUDED

Step #3: From the portfolio report, calculate the average outstanding portfolio during the period (for instance, a year) using the following procedure:

```
Average Loan Outstanding
(During Period) = \frac{B + Q1 + Q2 + Q3 + \ldots + Q12}{13}
```

Step #4: Divide Interest and Fee Income during period by Average Loans Outstanding to get the Yield on Portfolio

What events/activities affect (distort) the Ratio?

- The Ratio is affected by growth in portfolio
- If NCRPB is using accrual basis of accounting, the interest revenue due but not received must be subtracted from the numerator
- Portfolio yield is very sensitive to the sequence of payments that NCRPB uses with regard to repayments from projects.

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For example, an institution that uses the sequence of principal first and interest last would have a lower yield than an institution that uses the conventional sequence of “Interest First and Principal Last”.

Correct order of appropriating repayments would be:

Portfolio Yield is an easy way to calculate the actual effective interest rate charged by an institution. It works through the many strategies used to package on-lending rates such as flat rates, up front fees, discounts from disbursed amount, incentives etc. Thus, portfolio yield shows how much, on average, NCRPB receives in interest payments on its loans.

Likewise, it is a good indicator of delinquency as even if PAR is low, if the actual yield is lower than expected yield, then there is delinquency.

Reasons for Lower than Expected Yield
Some of the major reasons for lower than expected yield are:
- Large loan disbursements towards end of financial year, which tend to distort average loan outstanding and yield
- Loan terms which impact effective interest rate and yield
- Principal first paid vs Interest first paid concept
- Delinquency, re-scheduling, write-offs etc that shroud a serious delinquency problem
- A small proportion of total assets as loans outstanding

### Portfolio Yield

**Input**
- Income/Expenditure Statement
- Loan Ledger, Loan Disbursement Report, Portfolio Report

**Process**
- **Step 1:** From the income statement (adjusted or unadjusted), sum all interest and fee income received by the FI (NCRPB)
- **Step 2:** From the portfolio report, calculate the average outstanding portfolio during the period (for instance, a year) using the outlined procedure
- **Step 3:** Divide interest and fee income during period by average loans outstanding to get the yield on portfolio

**Output**
- Total Operating Income
- Average Outstanding Portfolio
- Yield on Portfolio and Interpretation

**Remarks**
- Exclude Grants/donations in income
- Using monthly or Quarterly basis will give more accurate loan outstanding figure
- Compare yield with Effective Interest Rate (EIR) and see how different they are?
What is Return on Assets?

Return on Assets Ratio is a percentage (%). The return on assets (ROA) ratio measures the net income earned on its assets by NCRPB. Simply put, it measures how well the institution uses all its assets.

What is the formula for Return on Assets?

\[
\frac{\text{Net Income (Excluding Donations)}}{\text{Average Total Assets}}
\]

Return on Assets (RoA) is an overall measure of profitability that reflects both the profit margin and the efficiency of the institution. For calculating the return on assets, average total assets are used rather than performing assets, because the entire organization is being measured on its total financial performance, including decisions made to purchase fixed assets or invest in land and buildings (in other words, using funds that could be used for other revenue-generating investments) or invest in securities.

Analysis of this ratio will improve the ability of NCRPB to determine the revenue impact of policy changes, improved delinquency management, or the addition of products - as Average Total Assets as opposed to Average Performing Assets (which is most often the Average Loans Outstanding) is used.

What minimum records are required for calculating the Ratio?

Supporting statements like the Portfolio Report and Loan Ledgers of loans to NCRPB funded projects (clients). Key financial statements like Balance Sheet and Income Statement, appropriately constructed – unadjusted as well as adjusted along with complete details of finances including sources, repayment schedule and terms and all other related information.

What can be said with regard to trends RoA

- An increasing Return on Assets Ratio is positive

Average Total Assets or Average Performing Assets: Which to use, when and why?

1. Average Total Assets is the appropriate measurement where all of the assets of the institution are used (either directly or indirectly) for the purpose of supporting its financial services.
2. This would include the fixed assets of the institution, such as land and buildings.
3. These assets are included in the denominator since they have been acquired solely to support the financing operations, and capital outlays made to purchase them could have been used to finance other performing assets of the institution.
4. In the case of an institution, which only operates a financing program, it would be appropriate to use this measurement.
5. Average Performing Assets, on the other hand, is a more relevant denominator for multi-purpose institutions, where only part of the assets, are used to support the financing operations.
6. Average total assets is calculated by summing total assets as per the Balance Sheet at the end of each month and dividing by the number of months.
7. Clearly, for NCRPB, which is a planning and financing institution, the use of average total assets is more appropriate.
8. In such a case, many of the assets of the institution (again, such as land and buildings) are being applied exclusively to support the financing program - rather they are being used to support planning and financing.
9. In this case, it is correct to use the total of all of the assets as a basis of analysis and, therefore, using Average Total Assets as the denominator is more appropriate.
10. If rather than NCRPB, the return achieved by the financing program of NCRPB is sought, average performing assets must be used as outlined in note # 9.
11. The average is calculated by totaling those assets at the end of each month and dividing by the number of months.

How to calculate Return On Assets?

Step # 1: Use the formula given earlier to calculate return on assets- net income (excluding any donations) by average total assets during the period.

Step # 2: Return on Assets can be calculated in two ways – 1) using unadjusted financial statements; and 2) using adjusted financial statements.

Step # 3: In either case, from the (unadjusted or adjusted) income statement, take the net income (excluding grants) – this is the numerator.

Step # 4: Likewise, from the (unadjusted or adjusted) balance sheet, calculate the average total assets using...
the formula given in the next page – this is the denominator

**Step # 5:** Divide net income by average total assets to get the return on assets ratio

**Step # 6:** When unadjusted statements are used, we call it the unadjusted return on assets ratio

**Step # 7:** Similarly, when adjusted financial statements are used, we call it the adjusted return on assets ratio

**Formula for Calculating Average Total Assets**

From the Balance Sheet, calculate the average assets during the period (for instance, a year) using the following procedure:

- Divide the period (year) into appropriate sub-periods – for example, a year could be divided into 12 sub-periods of a month each (see formula below)
- Take the actual total assets at the beginning of the period (say April 1st, 2001)
- Add to this the sum of total assets at the end of each sub-period (i.e., month)

Then compute **Average Total Assets as follows**

Average Total Assets (During Period) = \( \frac{B + E_1 + E_2 + E_3 + \ldots + E_{12}}{13} \)

**What events/activities affect (distort) the Ratio?**

- Factors that affect the return on assets ratio are varying loan terms, interest rates and fees, and changes in the status of delinquent payments.
- The split between interest and fee income also affects this ratio if loan terms loan amounts change.
- Return on Assets is a fairly straightforward measure. However, as in the case of return on equity, a correct assessment of return on assets depends on the analysis of the components that determines net income, primarily portfolio yield, cost of funds and operational efficiency.
- Supervised FIs, which can more easily access commercial funding sources, are more highly leveraged and therefore manage to earn good return on equity despite a relatively low return on assets.

**When to Use Return on Assets?**

1. **Return on assets (ROA)** reflects how much has been earned on the investment of all the financial resources committed to the NCRPB.
2. Thus, the ROA measure is appropriate if one considers the investment in the NCRPB to include current liabilities, and owners’ equity, which are the total sources of funds invested in the assets.
3. It is useful measure if one wants to evaluate how well NCRPB has used its funds (short-term creditors, long-term creditors, bondholders, and shareholders).
Return on Assets

**Input**
- Income Statement and Loan Disbursement Report
- Balance Sheet and Loan Portfolio Report

**Process**
1. **Step 1:** In either case, from the unadjusted income statement, take the net income (excluding grants) – this is the numerator.
2. **Step 2:** From the unadjusted balance sheet or portfolio report, calculate the average total assets using the formula given.
3. **Step 3:** Using formula to get Return on Assets
   - Interest and Fee Income during period
   - Average Total Assets

**Output**
- Net Income
- Average Total Assets

**Remarks**
- Exclude donations/grants
- Using monthly or Quarterly basis will give more accurate loan outstanding figure
- Look to compare this with Return on Average Performing Assets and see any differences

**Output Values from above Steps (1 and 2)**
What is Return on Performing Assets?

Return on Performing Assets Ratio is a percentage (%). The return on performing assets (ROPA) ratio measures the net income earned on the performing assets of an NCRPB.

Please note that while Cash, Interest Bearing Deposits, Gross Loans Outstanding, and Long-term Investments can be considered as performing assets, while evaluating lending operations, it is better to use gross loan portfolio outstanding as the primary performing asset. This is because for NCRPB, it is the largest income generating asset.

What is the formula for Return on Performing Assets?

\[
\text{Net Income (Excluding Donations & grants)} \\
\hline
\text{Average Performing Assets (or Average Loans Outstanding)}
\]

What does it measure?

When performing assets includes just the outstanding portfolio, the return on performing assets ratio indicates the productivity of the lending activities only.

It measures the average net income received for every unit of currency (rupee) outstanding.

While the return on performing assets might indicate an adequate return, if only 50 percent of the assets are represented by outstanding loans, the organization may not be forming as well as the return on performing assets ratio would indicate.

What minimum records are required for calculating the Ratio?

Key financial statements like Balance Sheet and Income Statement, appropriately constructed – unadjusted as well as adjusted.

Supporting statements like the Portfolio Report and Loan Ledgers.

What can be said with regard to trends?

✓ An increasing Return on Performing Assets Ratio is positive.

What events/activities affect (distort) the Return on Performing Assets Ratio?

- Factors which affect the Return on Performing Assets ratio include changes in non-performing loans, the amount of idle funds, changes in average loan terms, and changes in interest rate and fee levels.
- The split between interest income and fee income can also affect this ratio if loan terms change.
- A fee structure that is more dependent on fees and commissions will be more sensitive to changes in loan term than a fee structure that is based on an interest rate.
- As the loan term changes, the frequency of any up-front fees also changes. If the loan term increases, the loan fund will turn over more slowly and the institution will charge commission less frequently, thus reducing income. In contrast, if the loan term decreases, borrowers will pay commission more frequently and the institution’s income will increase.
- Due to this interrelationship between fee structure, loan term and income, the Return on Performing Assets ratio is an important indicator to analyze when changes in pricing and/or loan terms are implemented.
- Analysis of this ratio will improve the ability of NCRPB to determine the impact of policy changes, or the addition of new products.

How to calculate Return On Performing Assets?

Step # 1: Use the formula given earlier to calculate return on performing assets: net income (excluding any donations) by average performing assets during the period.

Step # 2: Return on Performing Assets can be calculated in two ways – 1) using unadjusted financial statements; and 2) using adjusted financial statements.

Step # 3: In either case, from the (unadjusted or adjusted) income statement, take the net income (excluding grants) – this is the numerator.

Step # 4: Likewise, from the (unadjusted or adjusted) balance sheet or portfolio report, calculate the average performing assets using the formula given in the next page – this is the denominator.
**Step # 5:** Divide net income by average performing assets to get the return on performing assets ratio

**Step # 6:** When unadjusted statements are used, we call it the unadjusted return on performing assets ratio

**Step # 7:** Similarly, when adjusted financial statements are used, we call it the adjusted return on performing assets ratio

**Formula for Calculating Average Performing Assets**

From the Balance Sheet or Portfolio Report, calculate the average performing assets during the period (for instance, a year) using the following procedure:

1. Divide the period (year) into appropriate sub-periods – for example, a year could be divided into 12 sub-periods of a month each (see formula hereafter)
2. Take the actual performing assets (gross loan portfolio outstanding in this case as per our definition here) at the beginning of the period (say April 1st, 2001)
3. Add to this the sum of performing assets at the end of each sub-period (i.e., month)
4. Then compute Average Performing Assets as follows

\[
\text{Average Performing Assets (During Period)} = \frac{B + E_1 + E_2 + E_3 + \ldots + E_{12}}{13}
\]
What is Return on Performing Assets? … and How to use it?

### Step 1:
In either case, from the unadjusted income statement, take the net income (excluding grants) — this is the numerator.

### Step 2:
From the unadjusted balance sheet or portfolio report, calculate the average loan outstanding using the formula given below — this is the denominator.

### Step 3:
Using formula to get Return on Performing Assets: Interest and Fee Income during period.

- **Average Performing Assets (Average Loan Outstanding)**

Output Values from above Steps (1 and 2):

- **Net Income**
  - Exclude donations/grants

Output:

- **Average Performing Assets**
  - AveragePerforming Assets Using monthly or Quarterly basis will give more accurate loan outstanding figure.

Remarks:

- **Return On Performing Assets Ratio and Interpretation**
  - Look to compare this with Return on Average Performing Assets and see any differences